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FINANCIAL DEREGULATION AND ECONOMIC DISTRESS: IS THERE A FUTURE FOR FINANCIAL CO-OPERATIVES?[1]

Yiorgos Alexopoulos and Silvio Goglio[2]

Abstract

The last years have witnessed a wide reshaping of the banking scene. According to researchers and authorities, the aftermath of these developments include an increased risk of demarketing of the conventional banking system towards certain customer segmentations and marginal areas and activities. Recently the banking scene has deteriorated, especially at the local level, as the financial crisis increased the scarcity of readily available, sufficient and reliable services. Behind the current crisis seems to be the influential corporate governance of dominant financial institutions, which introduced innovative products that resulted in less transparency and created uncertainty and a lack of trust toward and within the financial system.

The present paper argues that this new reality can be thought of as giving new opportunities for financial co-operatives to increase their importance among the market and areas that they historically serve. The paper bases its analysis on the development pattern of the financial co-operatives of Italy and Greece and outlines the critical path that the financial co-operatives should follow in order to provide efficient (and crucial for local development banking) services and products. It is argued that these changes can be exploited only if the financial co-operatives would be able to transform without losing their basic values. Further, this route goes through the development of new strategies and in certain cases of the modernization of their services. The authors also stress and define the risk of failing that might hinder the co-operative movement, as the huge potential of co-operative endeavors are rarely "translated" to gains automatically.

Keywords: Credit cooperatives, local banks, Greece and Italian financial co-operatives, financial systems, financial crisis

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1. The banking scene before and after the crisis in the European context

The financial system around the globe has undergone radical changes in the last two decades. If we confine our analysis to the banking sector, which still is its backbone, changes have been in size, in manner of operation and in organisational structure. The leading forces for these can be traced among the rapid progress in information and communication technology, financial innovation, deregulation and decrease of the role of the States, growing international openness, and changes in demand for banking and financial services which have all led to stronger competition and prompted a far-reaching process of concentration among banking institutions and a rationalization of their productive structures.

The long trend of mergers and acquisitions (M&A), which has involved every type and dimension of banking, has led to an increase in the average size of banks, more complex and structured forms of group organisation, and a diversification of customer relation policies and methods. M&As can be considered, first of all, as reaction to changes in market structure: for big banks a possible solution to needs of re-positioning; for smaller banks to needs of scale economies and preventive defence against takeovers (Belaisch et al., 2001; ECB, 2000 and 2001).

On the other hand, the new banks originated by M&A may suffer scale diseconomies towards smaller customers, lenders and borrowers, more dependent on personal relationships: SMEs, families, unskilled workers, unemployed, women, young people, elders (Berger et al. 2001; Leyshon and Thrift, 1993 and 1995).

Since mainstream banking institutions either are lacking the spatial configuration to serve local markets or withdrawing from local markets, as a result of a reengineering process that their cost-rationalization strategies compel (restructuring for profit), the risk of a de-marketing of their retail branches from some sectors of the population and from peripheral areas and activities becomes evident. These strategies included: a) minimum loan sizes; b) tiered interest rated giving very low interest on savings/deposit accounts with low balances; c) account maintenance charges on low balance deposit accounts; and d) use of credit scoring systems leading to outright refusal to grant loans or to open some types of accounts.

Even when operative at local level, mainstream banks are most likely to apply more secure loan policies based on standardized credit, screening and monitoring and focus on market segments that offer them advanced opportunities for profits under a "less-risky" lending policy. Cost-considerations again prevent them from "investing" in relationship-based transactions, necessary to address informational opaque borrowers. Relationship lending might be considered as contrary to their standardized credit policies, which are based on easily observed, verifiable and transmittable data, i.e. pure transactions lending. Thus, because of physical or "informational" distance, mainstream banks are not efficient in generating borrower specific information, which, in addition, due to its "soft" characteristics, may be difficult to transmit through the communicating channels of large institutions. Many potential borrowers are so dismissed because they do not have credit records, enough collateral and are asking for not profitable small loans.

The European integration has played a significant role in this restructuring process, and it is not likely to change substantially the segmentation of the banking market and its different levels of competition. As a consequence the distribution of its benefit will be uneven. Its impact will differ, according to banks size: lesser for the larger ones, since they are long exposed to international competition, substantial for the middle ones, which will be exposed to an increased competition, and even more significant, at least initially, for the local ones (European Central Bank, 2001).

The financial market crisis, that broke out in the summer of 2007 and grew worse after September 2008, can not be separated from the afore said structural change, since it is also a consequence of the bad governance of the change, or of the inability, and in some cases even unwillingness, to institute new forms of governance, fitted to the new context. In broad terms, we may find the origin of the crisis in the global trade and financial unbalances; the past USA monetary policy and the following excess of liquidity; the increased investors' attitude towards risk; the bulging expectations on real estate and stocks values, and the following speculative bubbles (Targetti and Fracasso, 2008).

If we restrain to the financial sector, the crisis seems to be articulated around a number of financial innovations and reckless behaviours aimed to give the credit system more elasticity, to the detriment of transparency: securitisation of loans, financial disintermediation, structuring of credit claims, risk reduction of financial institutions, bank loans granted incautiously, low information on debtors' conditions, huge increase of out of budget activities by banks, reckless behaviour and conflict of interests by rating agencies, emergence of many financial operators not liable to control by authorities. All these innovations and misbehaviours have ingenerated growing uncertainty that has damaged trust for and within the banking system[3], increasing the cost of capital and depressing economy (GFSR, 2007; BEBdI, 2008).

Four aspects should be stressed:

1. the development of "innovative" complicated products has nothing to do with the usual and simple banking behaviour;
2. the crisis has showed the limits of the dominating theory of complete markets and perfect information that foresees an effective "self-regulation" capacity of the financial system, which led to the retreat of the state and the regulation authorities. It is significant that the most authoritative analyses conducted to date highlight the central role of governance arrangements and risk management systems for the stability of individual institutions and the financial system as a whole. The reforms that legislators and authorities are called upon to carry out, at various supranational and national levels, have to be based on "common rules" and a greater role for "organisational and corporate governance" variables (Ferri, 2008);
3. even after the channelling of billions of euros in the banking circuit, the problem still remains, as it seems that the money has difficulties in reaching the real economy. Banks still are rationing credit, in particular to SMEs, because of their opacity and lack of collaterals, but also because of banks incapacity to evaluate projects and screen firms;
4. mainstream banks do not seem to have learned from the crisis: banks budgets are still opaque and highly risky behaviour has restarted, as it is shown by the prompt revival in 2009 of junk bonds, hedge funds, and futures.

[3] How can a bank that does not know the volume of the consequences within its own organisation, trust the interbank market?

2. Co-operative banking in Europe: recent trends

Co-operative banks are a key component of the co-operative movement in the credit sector, which originated in Europe in the nineteenth century as a response to the problems that small urban and rural businesses had in obtaining credit. From the very first credit unions promoted by Schulze-Delitzsch and Raiffeisen, they adopted an organisational model based on democratic governance and mutualism. In time, this model evolved and differentiated into a multiplicity of institutions with characteristics reflecting the needs of co-operative members on the one hand and the specificities of national legislative frameworks on the other.

Today, the co-operative credit sector in Europe embraces systems that are not entirely uniform in terms of legal set-up, size and organisation. Some systems are strongly integrated. This is the case in Germany, where the *Volksbanken* and *Raiffeisenbanken* are joined in a single trade association and have common central structures (DZ Bank), and in the Netherlands, whose co-operative banks are gathered together in the Rabobank group, one of the country's largest banking groups. Other systems are more highly diversified, as in France, whose co-operative system includes three of the country's five largest banking groups (*Crédit Agricole*, *Caisse d'Épargne* and *Crédit Mutuel*) plus the *Banques Populaires* group consisting of a federal bank and 20 regional banks with more than 3,000 branches.

Co-operative banks' ability to adapt and to grow in highly diverse economic and institutional environments has made them a substantial part of the banking industry in many European countries. Overall, the co-operative banking sector in the European Union counts more than 4,000 local and regional banks, 62,000 branches and 49 million members, with a significant incidence in their national markets. Although comparing international data involves some difficulty, we can put co-operative banks' market shares in terms of number of branches at about 60 per cent in France, 50 per cent in Austria, 40 per cent in Germany and the Netherlands, and 10 per cent in Spain and Portugal. In Italy, the figure is 39 per cent for the entire co-operative banking sector (EACB, 2008).

In the other European countries, co-operative banks have developed mainly in a context, including the legal and institutional framework, in which central organisations play a driving role. In Italy, by contrast, the movement has been marked by greater differentiation between mutual banks (*Banche di Credito Cooperativo*) and popular banks (*Banche Popolari*), with less integration and autonomous paths of development being preferred. The first segment of the co-operative banking sector has consolidated its position in its chosen markets, focusing on internal growth and successfully enacting the role of local bank with close connections with the fabric of small and medium-sized enterprises. The largest *Banche Popolari*, on the other hand, have concentrated on external growth, carrying out broad merger programmes, both within their category and outside, by acquiring former savings banks, local banks set up in the form of public limited companies, and specialized banks. This has led to the formation of medium and large-sized groups that operate beyond regional borders. In some cases growth has led to changes in ownership structure – and greater market openness – as well as entry into new lines of business (Padoa-Schioppa, 1997)[4].

[4] Both growth paths have greatly reinforced the category of co-operative banks as a whole. In the last decade, despite a reduction from 56 to 38 in the number of independent *Banche Popolari* and groups headed by *Banche Popolari*, their market share in Italy has risen from 16.8 to 21.1 per cent of total bank assets, from 15.9 to 21.6 per cent of lending to residents and from 21.1 to 27.3 per cent of branches. There has been a parallel sharpening of differences within the category. In 1998 the five largest groups headed by *Banche Popolari* ran an average of 526 branches, while

Finally, in Greece, although the sector presented a surprisingly dynamic development in the '90, is still found in a transitional period. In the nine year period (1998-2007) total membership and co-op capital were tripled, assets, loans and deposits were ten times bigger and equity capital, pre tax profits and the number of employees grew by an annual rate of almost 40,0 per cent. It is important to note that while until 2002 the absolute figure of loans was steadily above that of deposits, the last five years the relevant increase of deposits was higher, even marginally, than that of loans. These changes are on the one hand indicative of the importance co-operative banks attribute to financing local enterprises and on the other indicate that with time they seem to strengthen the links among local population, a fact that results to more local money being channelled to cover local needs (Alexopoulos and Davis, 2008).[5]

Each model has its strengths and weaknesses. Close coordination at central level can help overcome constraints and inefficiencies due to the small size of individual co-operative banks. On the other hand, in banking as in other industries, entrepreneurial autonomy fosters competition, the quest for innovative solutions, and the ability to adapt to the needs of local economies.

In a rapidly evolving sector, the co-operative banks, for their part, have proved extremely dynamic while evolving in a variety of directions, depending on their different initial situations and the opportunities offered by their local economies.

There is evidence, however, that the financial co-operative sector has undergone radical changes during the last decade. According to the relevant data of the European Co-operative Banking Association (Table 1) although the number of local banks decreased from 4,567 to 4,162 (i.e. almost 9%) this evolution did not deteriorate their local presence nor their penetration to the market. More specifically, during the same period, the number of banking outlets has increased by 7.5%, which is consistent to the co-operative banks orientation to retain strong links and strengthen their proximity advantages within local areas. This seems to be appreciate by local societies as during the reference period membership has increased by 11% and total clients by more than 25%. This development, of course, strengthened co-operative bank assets by more than 37%, added some 38% more deposits which led to a 45% more financing to local economies. These simple figures are indicative of a financial sector that gains importance within the European banking market system.

Banche Popolari not belonging to groups had 16 each; today those figures are respectively 1,340 and 23. The average value of the top five groups' total assets was ten times that of the other *Banche Popolari*, a ratio that is now close to 25:1. Of the 16 banking groups headed by *Banche Popolari*, two are among the top five in Italy in terms of total assets and eight are listed on the stock exchange or have at least one listed member. Cf. Tarantola, 2009.

[5] According to the last available data of 31.12.2007, in total, Greek Co-operative Banks employ 1086 persons in 157 branches in order to serve 187,347 members. Their membership holds some 2.61 billion euros in deposits and received from their banks 2.54 billion euros in loans. With total assets of 3.29 billion euros, one sixth of which is own (equity) capital, their gross profits were nearly 131.31 million euros and their net pre-tax profits were 56.07 million euros. It should be mentioned that in 2007 its market share stood at the levels of 1% (0.8% of assets, 0.9% of deposits and 1.0% of loans of the total).

Table 1 - Main figures of European co-operative banks - EU-25 (2004 & 2007) (financial data in million euros)

	2004	*2007*	*% of change*
Local Banks	4567	4162	-8,9
Banking outlets	58437	62829	7,5
Members	44500827	49347932	10,9
Clients	125700769	158750433	26,3
Assets	3742789	5150218	37,6
Deposits	1943795	2689309	38,4
Loans	1888905	2741158	45,1

EACB, annual reports, own calculations

3. Where does this growing demand for co-operative financial services stem from?

The previous section has offered strong evidence for a successful co-operative banking paradigm in Europe[6]. Moreover, before the current crisis a number of papers highlighted the importance of co-operative banks for financial stability in the regions they serve, suggesting that co-operative banks have generally lower incentives to take on risks and, thus, they tend to adopt less risky strategies (Groeneveld and de Vries, 2009; Hesse and Cihak, 2007; Fonteyne, 2007). In addition, they conclude that co-operative banks seem to be more stable, due to the much lower volatility of the co-operative banks' returns, which more than offsets their relatively lower profitability. The reason behind the observed lower variability of returns can be found in the fact that co-operative banks in normal times pass on most of their returns to customers, but are able to recoup that surplus in weaker periods. To some extent, this result can also reflect the mutual support mechanisms that many co-operative banks have created.

This last remark is focusing on the special features of the co-operative organisation model. Historically, the small size of co-operative banks has been balanced by their network organisation and the formation of higher order organs. Their structure as networks of banks and not as bank networks made possible the expression of the advantages deriving from small size. In addition, mutual help and solidarity among the autonomous co-operative banks has lessened the negative impacts of small size (Wyman, 2008).

The crisis started to shed light to issues that are strongly attached to the philosophy of the financial co-operatives, in terms of everyday business. Thus, scholars stress that co-operative banks defend consumer interests and their presence and mode of operation maximise consumer surplus (Fonteyne, 2007; Ferri, 2008). They focus on their ability to offer simple and transparent products, fair priced, better designed to meet local needs, in a manner that ensures that risks are well understood and communicated. Moreover they indicate the ways in which credit co-operatives – compared to commercial banks – may be helpful at a time of credit crunch:

- they may be less inclined to ration credit to customers;

[6] On the competitiveness of CCB in Italy see: Cannari and Signorini, 1997; Clemente, 2001; Di Salvo, Guidi and Mazzilis, 2004; Pagano and Panunzi, 1997.

- they may be less prone to raise the loan rate during a time of financial stress;
- thanks to better capitalization and more prudent lending, credit co-operatives may be less likely to be distressed themselves and, therefore, may be more able to continue assisting their customers in a time of financial stress.

All of the three potential effects of the credit co-operatives stem from their governance, business model and specialization, which heavily rely on relationship-based retail banking[7].

Research shows that in Italy Credit Co-operative Banks (*Banche di Credito Co-operativo*) and *Banche Popolari* have exhibited a greater tendency than other institutes to perform the role of local banks in industrial districts, as well as in non-district areas (Conti and Ferri, 1997). If one adds the fact that in most cases the economics of the small business is indistinct from the domestic economy of the entrepreneur, then the fruits of the mutually beneficial co-operation (between the member and his/her co-operative bank) diffuse towards the household and affect its prosperity. Hence, the positive effect of the operation of the co-operative institution is not merely restrained at the entrepreneurial sphere. It reaches and concerns almost spontaneously more dimensions of a communitarian and/or holistic approach of the relevant context of analysis (Alexopoulos, 2006).

4. New opportunities for co-op banks

Does this new banking environment give new opportunities for co-op banking growth? In general the answer is positive. Increase in levels of concentration and banking market quotas, new expansive strategies and processes of rationalization aimed to strengthen competition leave uncovered financial areas, that may became prey of local non institutional and uncontrolled lenders. Research (Berger et al., 2001; Ahrendsen et al., 1999) shows that M&A involving big banks lead to loan reduction to SMEs; the opposite happens if M&A are among small banks. Thus M&A have important side effects, among which to open new spaces and opportunities for new entries or small banks already present on the market, as a consequence of major banks re-positioning. Historically financial co-ops expand in banking markets that are socially and/or spatially segmented. Recent research shows that in USA the increase concentration in retail banks lead to an increase in co-operative credit. The mix of community bonds, shared responsibility and the capacity to mobilize local savings allow not only to reduce information asymmetry and solve scale diseconomies due to small loans, but to re-establish and strengthen trust towards banking system.

Both structural changes and financial crisis have created a context where, at least at the local level, the model of financial intermediation that credit co-operatives follow is encouraged to flourish: there are certain sections of the population that face increased difficulties to gain access to the financial system, while some peripheral communities and sectors are confronted with a more-restricted set of options. Such a context is indicative of the role that credit co-operatives can play in "plugging the gap between local need and the mainstream services". But the real questions are: how can this be achieved, how can co-op banks capitalise their competitive advantages and which are their competitive advantages?

[7] On relationship banking see: Berger and Udell, 1990; Di Salvo, Lopez and Pezzotta, 2004; Harhoff and Körtring, 1998; Petersen and Rajan, 1994.

In our opinion Credit Co-operative Banks should stress to become true local banks, meaning by this not only a proximity bank and/or a relational bank, but a financial institution rooted in the territory, with intensive relationship with the territory, able to support local economic activities evaluated inside a pattern of development. For this purpose, the bank's decisional bodies must be "in the territory", i.e. have both a good knowledge of the socio-economic reality (strengths, weaknesses and possible paths) and privileged relationships with local economic categories. To set an example, a normal relational bank would grant credit to a small entrepreneur on the basis of long time knowledge of trust in repayments, also with few collaterals (on the basis of moral collaterals). A true local bank would also extend credit in more cases if it could be able to understand the potentialities of the investment, in general and specifically for the territory. In this sense, the local bank could be regarded also as an agent of social change and development (Goglio, 2009).

The new context places indeed imperative challenges to financial co-operatives, forcing to a deep thinking on their general and local strategies, on their daily activity, both with members and customers, on their loyalty to constitutive social principles. Thus the questions are if they do possess the characteristics to play a new and efficient role in local banking market, if they can translate their constitutive features in a modern and competitive banking setting, and how. In other words, given the necessary restructuring that also these financial institutions must undergo to give adequate answers to their local customers' needs, one must inquire how long they may go on to benefit from their competitive position on the territory, due to lesser information costs in screening and monitoring loans, and easier, at least in theory, enforcing of repayments.

5. Definition of problems

The main challenges, hastened by the crisis, that co-operative banks have to face have three related roots:

1. increase in competition. With time, experts anticipate competition at the level of retail banking, i.e. the level that traditionally financial co-operatives serve, will increase. This not only from Commercial Banks, trying to recover on the field of relational finance, but also among Co-operative Banks themselves[8];
2. local identity. Although no one can deny that it is in that very local identity where the strength of credit co-operatives stems from, it should be stressed that in certain cases it encompasses some sources of danger;
3. growth and M&A. The most potential weaknesses of Co-operative Banks stem from their scale diseconomies. Apart from the pyramidal form of the organisational structure of credit co-operatives that acts as a cushion for such difficulties, European credit co-operatives have opted for a more radical reaction during the last decade, i.e. that of mergers, which were in the forefront in terms of numbers within the European banking system. These decisions epitomise what is known as "consolidating" or "defensive" mergers, aiming at cutting costs and possibly also at diversifying risks. Notwithstanding the synergies that these mergers definitely create, they also alter some fundamental characteristics of the grass-root initiative (Bonaccorsi di Patti and Gobbi, 2001; Di Salvo, Guidi and Mazzilis, 2002; Di Salvo, La Torre and Maggiolini, 1998).

[8] Commercial Banks have received a bulk of money from States-EU-US government: are they allowed now to say that co-op banks are operating under a favourable tax status?

From these three general sources of problems stem the following, intertwined, challenges.

5.1. Difficulties in diversifying loan portfolios especially in a time of crisis

An important source of difficulty refers to a credit co-operative's inability to diversify loan *portfolio*, in case local productive activities are relatively homogeneous or sector dependent (Barham et al., 1996). In this case, negative shocks, e.g. a decline in output prices, can lead to widespread loan default, deposit-runs and the loss of financial viability unless external insurance of some form is available. The territorial concentration of the loans *portfolio* in a strongly specialized area may in fact exacerbate the impact on the local financial system of idiosyncratic shocks, turning banking localism from an element of stabilization into a factor amplifying crises in the district economy, and neutralizing the possible advantages that the local bank may derive from local system externalities (closer relations with firms, informational advantages, accurate selection of debtors, peer monitoring and extra-economic sanctions on insolvent debtors). These factors may explain the tendency of local banks to reduce their functionality to Italian industrial districts over time, and to thin out their presence, unless they have particularly close relations with firms (Baffigi, Pagnini and Quintiliani, 2000).

On the other side, one should not neglect the existence of a mechanism whereby the banking system transmits and amplifies the economic effects of a geographically localized shock (regional credit channel). "When the local economy is hit by a crisis, banks react to the worsening of the financial position of their creditors and to the deterioration of their own balances by adopting more restrictive credit policies. This endogenous reaction tends to amplify and prolong the effects of the initial shock". The effects are tendentially more intense in provinces where the banking system is more closed: "The existence itself of a local credit channel seems to depend on the territorial segmentation of the banking markets. When the geographical diversification of banks is limited, the impact on their balances of local economic conditions is stronger. By contrast, banks operating in several territorial areas are better able to off-set their difficulties in the crisis zone with the better results obtained in their other operational zones" (Beretta, Omiccioli and Torrini, 2000, p. 283; Baffigi, Pagnini and Quintiliani, 2000; Pagano, 2000).

Along the same lines there appears to be a "need for the provision of special advices for entrepreneurs that operate in areas hit by the crisis". This stresses the fact that in most cases personal knowledge and peer monitoring is not sufficient. Establishing and maintaining a long-term relation between a bank and an enterprise is not easy, even for a co-operative local bank with a particularly large share of local credit market. The bank needs a clear vision of strengths and opportunities of the territory, i.e. a development vision and consulting capacity. It should improve its capacity to act as an agent of social change and development. The dialectic procedure inherent in such a social process, which is evidently present in the long history of financial co-operatives, has proved, that the scale diseconomies problems that arise in the implementation of this territorial approach should be addressed and solved within the apex institutions. The "modernisation of the financial co-operatives' pyramidal structure" should also refer to the development of appropriate services that could result to a meaningful and effective intervention at the local level.

Moreover, these apex institutions may supply first level banks with low risk channels of investment for the surplus of savings, additional funds, insurance, supervision and regulation, counselling and training, endorsement and sponsorship. In order to have these functions performed efficiently, the distinct (two or three in some countries) levels of co-operative banks must be able to collaborate in a modern way: the lower ones giving the right territorial information and problems, and implementing the proposed solutions. In other words the pyramidal organisation must be able to conjugate the pros of both dimensions, to capitalize at the central level on the inside information and monitoring from the decentralized network, coherently with a shared social philosophy. Evidently, all this requires the modernization of the CCBs and their government and governance.

5.2. Need of more sophisticated management and resulting agency problems [9]

While in the past financial co-operatives, following an old pattern, were run under relatively simple administrative practices that simple management schemes could handle easily, with growth, the need to employ sophisticated professional management in order to deal with the more complex financial situations becomes inevitable (Huppi and Feder, 1989; Poyo et al., 1993). A quite simple example of the complexity in transactions that growth may cause can be offered if one argues that deposit mobilization may generate important constraints with regard to liquidity management because of the uncertainty introduced by the unknown demand for cash of passbook depositors. Another one is the need to supply more sophisticated advice to entrepreneurs, which was elaborated above.

On the other hand the qualitative and quantitative reinforcing of management may lead to the separation of ownership and control and intensify agency problems (Emmons and Schmid, 1999 a and b; Leggett and Strand, 2002). The risk is either a misappropriation of co-operative funds on behalf of the management for its own use, or a corporate philosophy substantially different from members' needs and will. Statistical evidence suggests that as financial co-operatives add membership groups and members, benefits are transferred from members to management. Management is able to channel residual earnings away from members – in the form of higher net interest margins – toward itself – in higher salaries and operating expenses. This last remark leads to a well known debate among co-operative theorists and practitioners, which refers to the governance mechanisms and representation of membership to the Board of Directors, aspects that are commented in the following points.

5.3. Board of Directors: political aspirations, personal improvement, collusion

As co-operative banks grow in dimension, the issue of the motivation of the members of the boards of directors becomes more relevant. What are the motives that induce a person to embark on this role, given that s/he cannot expect substantial direct economic profit from it? Working to create positive externalities for the community is not necessarily at odds with the pursuit of one's own broader interest. The directors may have a particular personal interest in the availability of the public good in question (i.e. an efficient local bank), and may hence be willing to contribute more of their capabilities in order to achieve the result. However, it may happen that some directors have no particular interest in the availability of the public good. In these circumstances, s/he may act purely out of altruism, or s/he will seek to acquire specific credits within the community – social status, for example, in order to promote her/his political career or to be appointed to some more lucrative post (perhaps, but

[9] For general references on agency problems with coops management see: Borzaga and Depedri, 2008; Chaves and Sajardo-Moreno, 2004; Davis, 2001; Freeman, 1984; Frey and Osterloh, 1999; Tirole, 2001.

not necessarily in the co-operative network). All these chances are related to the dimension and power both of the specific CCB and the co-operative network.

The principal/agent problem forcefully arises. As they perform their role in the board, directors have their own interests which may turn collective action away from its initial goals, giving rise to less efficient solutions. The problem is even more serious when the role of director is performed by influential individuals without a direct interest in the availability of the local public good. In these cases it is more likely for such an individual to pursue his/her election to the board and to see it as a means towards ultimate goals not necessarily beneficial to the local society or even illegal. In general, the greater the member of the board direct interest in the availability of the public good (i.e. the greater his/her individual demand), the less likely will it be that his/her initiative is instrumental to other ends (Goglio, 1999).

On these issues research is really poor and needed. However, in the Greek case, the almost complete defamation of the agricultural co-operatives during the 80s, which was mainly due to the intense state intervention and the consequent linkages of the co-operative leaders with political centres and power that led many co-operatives to bankruptcy (Papageorgiou, 2004) led to the foundation of credit co-operatives on a pure entrepreneurial, yet co-operative, financial services perspective (Alexopoulos, 2006). An interesting lesson was drawn from their successful initiative to the benefit of the entire Greek co-operative movement, i.e. that co-operatives should not be considered as the vehicle for exercising state social policy or a means for local or wider political power, but as private enterprises aiming at the improvement of the economic and social conditions of their members on the basis of their joint ownership and action.

5.4. Problems of governance

The increased number of membership may, also, add difficulties in adequate internal control as it promotes free riding by members (Ouattara et al., 1999; Ferguson and McKillop, 1997). Members feel disempowered as the institution adds new members, which in turn creates difficulties in making existing members to exercise their ownership rights and responsibilities in overseeing management. According to a number of recent surveys, member participation rates in board elections decline as credit co-operatives become larger. In any case, the absence of members from the general meeting deprives them the possibility of coming across the reasoning accompanying the operation of the co-operative bank. As a result, it can be said that they judge the performance of the bank mainly through their transactions with the co-operative bank, having no idea about the reasons that shape the character of transactions and the consequences of the policy followed (Alexopoulos, 2006).

In many cases the negative replies of members in relevant surveys refer, also, to ineffective general meeting. Such a reply is usually connected with the large numbers participating in the general meetings that render them ineffective and with the long distances that make access difficult. This recent M&A activity in the area of financial co-operatives is definitely strengthening the validity and importance of this last remark. Moreover, the distance from the seat of the credit co-operative, where the general meeting is normally held, acts as a barrier to participation. Some members give, also, as a reason of non-participation to the general meeting their insufficient knowledge of the subjects discussed, or even allege that the board of directors formulates the policy of the credit co-operative without taking into account the needs of the members. The result of these problems is, again, that members choose to exercise control and to influence the co-operative bank's operation through transactions and through the direct local contacts with members of the board of directors. Moreover, they measure the credibility of the board of directors by taking into account the position of its members to local society. But, however effective these ways of participation in the running of their co-operative may be considered, it is clear that members attempt to influence the results of the policies applied and not the processes that produced these policies and, subsequently, results. Thus, co-operatives should rather adopt rules for effective functioning of their highest organ, without falsifying their democratic character, such as distance voting and bylaw clauses on the possibility of holding meetings in separate locations[10].

5.5. Weakened bonds

When membership and assets grow beyond small numbers the importance of local knowledge and enforcement might decrease. The common bond looses its tight influence in maintaining a moral obligation of members to the co-operative. It can not be neglected that both the past success and the present revival of co-operative credit rest on the commitment to the communitarian principle: in other words, on the implementation of a different approach to financial intermediation. Therefore it is necessary to work either to restore or to strengthen the bond among co-operative values, members' participation and business, bond often ravaged by the market, as last financial vicissitudes have shown. In an era in which marketing departments of multinational banking institutions struggle to develop strategies in order to make their customers "feel" that they are part of their philosophy, to keep them "involved" and to "listen" to what they have to say of their performance, it is definitely a luxury for financial co-operatives to loose the close links with their membership[11]. This could also be regarded as an effective answer to the problems that derive from the "reduced local enforcement and peer monitoring capacity" within the financial co-operative that is most likely to arise when the – increased – membership retains loose links with its financial institution. Indeed, one may easily conclude that if the financial co-operative fails to develop a sound business record along with a meaningful local intervention capacity, the "moral obligation" among membership "to repay" should be expected to fade away. Although an urban setting is increasing the relevant difficulties that have to be addressed, it should be noted that in our point of view, regardless of the spatial setting within it is rooted, a financial co-operative should be aware that the increasing of membership can also lead to situations which threaten its institutional and/or operative equilibrium, an issue that is further elaborated below.

5.6. Conflict of interests and/or operational objectives

Conflicts between the interests of member-depositors and member-borrowers augment in a large-member financial co-operative (Smith et al, 1981; Smith, 1984;

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[10] For general considerations on co-operatives see Osterberg and Nilsson, 2009; Hariyoga, 2004; Caswell, 1987. For the debate on the governance of italian CCB see: Di Salvo and Schena, 1998; Panetta, 2005; Pittaluga, 1998; Santella, 2001.

[11] It took 10 years of continuous decline in membership for Rabobank-Netherlands to re-consider the fact that it was its co-operative status that contributed to its success and needed to be revitalized. Thus, in late-90s Rabobank launched a strategy of maintaining closer links with its members, which, in 2000 alone, resulted in 210,000 new members joining the group and added 892 mil. euros to its equity. This result confirmed its leadership's confidence that their co-operative background not only should not be regarded as a barrier for modern organisational forms but it constitutes an asset, a major competitive advantage that these initiatives enjoy in order to cope with the difficulties that the contemporary financial context poses.

Patin and McNiel, 1991a and b). Accommodating each group's interests influences heavily the operational character of the financial intermediary, which in turn leads to policy-problems that might be more adequate to be dealt by an experienced management. Moreover, the insufficient development of adequate participatory and monitoring procedures at the local level could lead to the "inability of a large co-operative to detect the socio-economic needs of members-customers (and the community's) and provide solutions".
In the turbulent banking scene that the crisis has created it should be expected that there would be an increased pressure towards the strengthening of equity and profits. But while for commercial banks these could be regarded as important indicators that characterise sound institutions, it is well known that their importance is rather reduced under a co-operative point of view. Further, if financial co-operatives fail to pronounce and defend efficiently their different banking philosophy, such a "commercial" approach on behalf of e.g. the regulation authorities, may lead to an "imbalance between the firm's profits and the members' surplus". In other words, if financial co-operatives are trapped in a conventional banking assessment procedure and, consequently, mode of development and operation, the "harmonisation of the firm's growth and local interest might prove to be difficult" to the detriment of course of local potential and capacity.

Sharing membership in a credit co-operative is not related only to the better knowledge of participants' behaviour. It is related to an entirely different approach in financial intermediation through which the demand side of the market configures essential features of the supply side. Although monetary benefits are usually appreciated by members (i.e. the ones that accrue from high deposit interest rates and low interest loans) both members and credit co-operatives should agree that this is not the distinctive feature for the local economy. On the contrary, it should be clear that they do not need to trade off the qualitatively different banking approach against an aggressive price policy in order to be competitive. They have to be aware of the fact that, in the long run, this may hinder their development and deprive members and local society of the essential characteristics of their performance, which places the satisfaction of human and local needs at the centre of their operational objectives.

6. Discussion and conclusions

The paper has tried to illustrate the driving forces behind the current developments in the modern banking system. In this new context there appear to be both a need and an open space within market segments and localities for the active participation of co-operative banks in order to facilitate macro and micro dimensions of the development process. Moreover it is argued that the critical side-effects on financial co-operatives were the outcome of the re-engineering within the sector before the recent financial crisis, with the latter intensifying some but, more importantly, rather creating more favourable conditions for their further expansion. Although there are a few papers in press that strengthen the hypothesis that the trend is positive for co-operative banks in Europe, compared to commercial banks, field researchers should have to wait for more recent financial data in order to describe the aftermaths of the crisis on the co-operative banking sector.

As it is, more or less, obvious that states and banking authorities are rather heading to a re-regulation of the banking system, the paper has tried to present and stress the importance of some interesting dimensions of the distinctive characteristics of financial co-operatives which are considered as critical for their development. Thus, it should be mentioned that the future steps of co-operative financial intermediaries are in need of a regulation authority that will respect and treat with caution their different organisational and operating model. However, in order to appeal to such a treatment credit co-operatives should keep in mind that local societies do not run a co-operative institution for the sake of it: members seek for quality in services and products and support only sound institutions. Above all, it should be understood that these ventures need leaders from a committed local society and competent co-operative management that would reactivate the participatory procedures in order to challenge the difficulties in a highly competitive modern banking scene and facilitate a sustainable local development procedure.

If financial co-ops do not want to intensify moral hazard problems that, as argued earlier, will definitely arise with growth, they should urge the formation of adequate and high standard internal auditing procedures. It is obvious that the benefits of having strong financial co-ops with adequate organisational features, such as mutual guarantee funds and monitoring procedures, spread to the society as a whole, because in the absence of the above mentioned features the taxpayers would have to face higher-risk and potential costs. Thus, a combination of ownership form, common bond requirements, supervision and monitoring restrict risk-taking for financial co-operatives. It is in the density and quality of the different formal and informal characteristics of the mutual institutions were success lays.

Credit co-operatives are social and economic organisations. In their dual capacity they have historically managed to help local societies that saw in the co-operative form the means to serve their needs. Much of the literature on financial co-operatives was tempted to admit that financial co-operatives seem to be "appropriate technology" for relatively backward economies. Furthermore, it was often argued that these initiatives should become less important in the process of economic development as individuals' market opportunities expand. Thus, one should expect financial co-operatives to fade away or disappear altogether as economic development proceeds. The very late developments lead to the suggestion that the co-operative form of organisation, not only did not disappear with economic development in industrialized countries but, proving its flexibility, is considered to be among the fastest growing groups of financial institutions in some advanced nations today. Their long history has proved that they are in the position to adapt to any conditions, innovate and re-define the local potential.

However, what should be kept in mind is that the historical and cultural variety found throughout the areas of the world means that no simple or linear development path can be prescribed for all credit co-operative endeavours; their development in reality varies under the influence of historically specific and contemporary economic and social conditions. In the same time, it should also be kept in mind that co-operative credit is a flexible mechanism, not necessarily associated to simple or backward social and economic systems: its organisation can and should evolve in coherence with the development of the territories where it operates. In the same way the national institutional and legal framework should evolve: in particular it should help the evolution of CCBs in a not strictly business-like way, acknowledging the different approach to perform banking activities by coop banks, and placing bonds and incentives consequently.

The most original feature of co-operatives is to provide for the material needs of their members as well as to respond to their fundamental aspiration for greater dignity in their lives. Dignity, however, should not be limiting its importance at the individual level but at the level of collective action as well. In other words, in an era when competition has blurred the lines between a pure commercial and a co-op enterprise, credit co-operatives face a major challenge: to re-establish the - lost in a market logic approach - link between co-operative values, members active participation and commercial strategy and practice.

Hence, if co-operative banks can succeed in addressing the above mentioned problems, without loosing their financial stability and operational character, they could proceed to substantial innovative initiatives that will permit them to become agents of local development, providing that they will have a) a well chosen, well prepared and competent Board of Director and management, with deep and solid co-operative training and knowledge, and b) a committed membership, which means that they have to work more on retaining close everyday links to a membership that increases in numbers and demand.

Current trends in local development theories and programmes call for interventions that seek to mobilize endogenous resources, support active participation and collective action, emphasise on empowerment in order to enhance capabilities of local people. These are considered as the prerequisites that foster the "involvement" of local actors, "unlock" local potential and act toward the implementation of a sustainable development process.

But if these are the prerequisites for development to be sustained at the local level, then it seems that the co-operative institution, and even more the co-operative institution which is active in the critical sector of credit, could "fit efficiently" in such a multifaceted process. Thus, the real potential of these membership based organisations can be implemented if they manage to turn to agents of social change and development.

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