Are financial cooperatives crowded out by commercial banks in the process of financial sector development?

Vanroose Annabel*[1,2], Anaïs Périlleux*[2,3], and Bert D'espallier[4,2]

[1]Vrije Universiteit Brussel (VUB) – Pleinlaan 2 1050 Brussel, Belgique
[2]Centre for European Research in Microfinance (Cermi) – Universite Libre de Bruxelles 1050 Brussels, Belgique
[3]Université Catholique de Louvain (UCL) – Place de l'Université 1 Louvain-la-Neuve, Belgique
[4]Hogeschool Brussel (HUB) – Warmoesberg 26 100 Brussels, Belgique

Résumé

The idea that everyone has to have access to affordable and adapted financial services is widely supported by international development organizations like the World Bank and the United Nations (Cull et al., 2013). Therefore financial sector development is seen off crucial importance. While private commercial banks tend to be the main players in the developed world, in the developing world, there exist still an important number of different types of formal and informal financial institutions (CGAP, 2011). Among them, financial cooperatives are one of the earliest and most widespread forms of alternative financial institutions across the world (Hollis and Sweetman, 1998; Fonteyne, 2007). Typically they are created to fill a gap left by commercial banks that find it too risky to lend to poor or rural people. Consequently, they serve financially excluded people and create access to finance for an important number of people. Actually, it is estimated that financial cooperatives serve more than 81 million people in developing countries (WOCCU, 2012).
However, one can wonder what happens when the commercial banking sector develops. On the one hand, one could expect that the sectors are complementary. The two types of institutions serve other people and synergies between the two sectors make them develop simultaneously. However, one could also be arguing that the two sectors are competing. Once commercial banks develop, they become interested in the market served by cooperatives and take over their clients. In this argumentation one could speculate whether financial cooperatives just are a step in financial sector development: they open up the market and then the commercial banks take over crowding them out.

The question of how these two sectors interact is key since cooperatives also play a social role. Indeed, financial cooperatives are alternative financial institutions pushed by self-help dynamism where values of, democracy, equity and solidarity are a common base (Guinnane, 1994; Branch and Baker, 2000; Armendáriz et Morduch, 2010). They often work for the mutual interest of their members and additionally support the local development of their area. Furthermore, the recent financial crisis questioned the commercial models and has demonstrated the importance to preserve institutional diversity (Hesse and Cihák, 2007;

*Intervenant

Groeneveld and de Vries, 2009; Ayadi et al., 2010). Therefore alternative financial institutions are put in the spotlight and the interaction between the two sectors becomes a crucial one.

This paper looks at the relationship between the development of commercial and cooperative financial sector in the developing countries, where the level of financial development is still low. Using the World Council of Credit of Unions (WOCCU)[1], we assess the relationship for a panel of 66 countries over the years 1990 until 2011. In the best of our knowledge this is the first paper that addresses this issue empirically.

Our results hint towards the existence of competition between the two sectors. This is, where the development of the commercial banking sector is low there is a higher development of the cooperative sector. This demonstrates the positive role that cooperatives play in overcoming banking market failure. In countries where the commercial sector less developed, people associate in cooperatives that play a vital role in creating access to finance. However, in the process of financial development they encounter a risk of being crowded out by commercial banks. Additionally, the results suggest that financial cooperatives benefit from some bank' activity in the sense that the existence of banks provides them with an infrastructure to secure their savings. Indeed, we find a positive relationship between banking development and the average level of savings cooperatives gather. It could also be that through financial sector development the overall savings culture of the country is positively stimulated, creating a positive spillover effect.

The paper is organized as follows. Section 2 presents the literature on financial cooperatives and explores the possible relationship between the commercial banking sector and the cooperative one. In section 3, the data and methodology are presented. Section 4 presents and discusses the empirical results. Section 5 concludes and proposes a number of policy-oriented recommendations.

Indicative bibliography

Andersen, T., & Malchow-Moller, N. (2006). Strategic Interaction in Undeveloped Credit Markets. Journal of Development Economics, 80, 275-298.

Armendáriz, B., & Morduch, J. (2010). The Economics of Microfinance. MIT Press.

Assefa, E., Hermes, N., & Meesters, A. (2013). Competition and the performance of microfinance institutions. Applied Financial Economics, 23(9), 767–803.

Banerjee, A., Besley, T., & Guinnane, T. (1994). Thy Neighbor's Keeper the Design of a Credit Cooperative with Theory and Test. Quarterly Journal of Economics, 109(2), 491-515.

Branch, B., & Grace, D. (2008). Credit Union Regulation and Supervision. World Council of Credit Union - Technical Guide.

Branch B., & Baker, C. (2000). Overcoming Credit Union Governance Problems. In Westley G., & Branch, B. (ed.). Safe Money: Building Effective Credit Union in Latin America. Washington, Inter American Development Bank, 203-226.

Beck, T., Demirg'uc-Kunt, A., & Maksimovic, V. (2004). Bank Competition and Access to Finance: International Evidence. Journal of Money, Credit and Banking, 36(3), 627-648.

Burgess, R. & Pande, R. (2005). Do Rural Banks Matter? Evidence from the Indian Social Banking Experiment. American Economic Review, 95, 780-795.

Caudill, S., Gropper, D., & Hartarska, V. (2009). Which Microfinance Institutions Are Becoming More Cost-Effective With Time? Evidence from a Mixture Model. Journal of Money, Credit, and Banking, 41(4), 651-672.

Cuevas, C.E., & Fischer, K.P. (2006). Cooperative Financial Institutions – Issues in Governance, Regulation, and Supervision. World Bank-WP, No 82. Washington DC.

Fonteyne, W. (2007). Cooperatives Banks in Europe – Policy Issues. International Monetary Fund – Working Paper 07/159.

Groeneveld, H., & de Vries, B. (2009). European Co-operative Banks: First Lessons of the Subprime Crisis. Rabobank-WP.

Guinnane, T. (2001). Cooperatives as Information Machines: German Rural Credit Cooperatives, 1883-1914. Journal of Economic History, 61(02), 366-389.

Guinnane, T. (2002). Delegated Monitors, Large and Small: Germany's Banking System, 1800-1914. Journal of Economic Literature, 40(1), 73-124.

Guinnane, T. (2003). A Friend and Advisor: External Auditing and Confidence in Germany's Credit Cooperatives, 1889-1914. Business History Review, 77(2), 235-264.

Guinnane T. (2011). The early German credit cooperatives and microfinance organizations today: Similarities and differences. In Armendáriz B, Labie M (eds), The Handbook of Microfinance. Scientific Press: London; pp. 77–100.

Hansmann, H. (1996). The ownership of enterprise. The Belknap Press of Harvard University, Cambridge, Massachusetts.

Hartarska, V. ; Nadolnyak, D., & Shen, X. (2012). Efficiency in Microfinance Cooperatives. Iberoamerican Journal of Development Studies, 1(2), 52-75.

Hellwig, M. (2009). Systemic Risk in the Financial Sector: An Analysis of the Subprime-Mortgage Financial Crisis. De Economist, 157, 129–207.

Hermes, N., Lensink, R., & Meesters, A. (2009). Financial Development and the Efficiency of Microfinance Institutions. Groningen University-WP, Groningen.

Hesse, H., & Cihák, M. (2007). Cooperative Banks and Financial Stability. International Monetary Fund (IMF)–WP, N○07/2

Hirschland, M., Jazayeri, A., & Lee, N. (2008). Reaching the Hard to Reach: Comparative Study of Member-Owned Financial Institutions in Remote Rural Areas. Coady International Institute, Canada.

Hollis, A., & Sweetman, A. (1998). Microcredit: What Can We Learn from the Past? World Development, 26(10), 1875-1891.

Kalmi, P. (2007). The Disappearance of Cooperatives from Economics Textbooks. Cambridge Journal of Economics, 31, 625–647.

Kotz, H., & Nagel, J. (2002). Les banques du secteur coopératif allemand sont-elles construites sur un avantage comparatif déclinant ? Revue d'économie financière, 67, 57-72.

Masson, P.R., Bayoumi, T., & Samiei, H. (1998). International evidence on the determinants of private savings. The World Bank Economic Review, 12, 483–501.

Mersland, R. (2011). The Governance of Non-Profit Microfinance Institutions - Lessons from History. Journal of Management and Governance, 15(3), 327–348.

Michie, J., Llewellyn, D.T., Anderson, D., Eyre, N., Hunt, P., Mills, C., & Palmer, J. (2009).

Converting failed financial institutions into mutual organisations. The Oxford Centre for Mutual & Employee-owned Business. University of Oxford, 40p.

Ouédraogo, A., & Gentil, D. (2008). La Microfinance en Afrique de l'Ouest, Histoire et innovations, Confédération des Institutions Financières. Editions Karthala, Ouagadougou.

Prinz, M. (2002). German Rural Cooperatives, Friedrich-Wilhelm Raiffeisen and the Organization of Trust 1850 – 1914. University of Bielefeld, paper delivered to the XIII IEHA Congress Buenos Aires.

Rogaly, (1998). Combating Financial Exclusion Through Co-operatives: Is There a Role for External Assistance? Journal of International Development, 10, 823-836.

Sahoo, P., & Dash, R.K. (2013). Financial sector development and domestic savings in South Asia. Economic Modelling, 33, 388–397

Sodokin, K., & Donou-Adonsou, C. (2010). Banks, Microfinance Institutions and Economic Growth in the West African Economic and Monetary Union. African Development Review, 22(4), 495-510.

Stiglitz, J., & Weiss, A. (1981). Credit Rationing in Markets with Imperfect Information. The American Economic Review, 71(3), 393-410.

Sukadi Mata, R. (2012). Microfinance and Remittances. Reflets et perspectives de la vie économique, 51(3), 115-127.

Vanroose, A., & D'Espallier, B. (2013). Do microfinance institutions accomplish their mission? Evidence from the relationship between traditional financial sector development and microfinance institutions' outreach and performance. Applied Economics, 45, 1965–1982.

Westley, G., & Shaffer, S. (1997). Credit Union and Performance in Latin America. Reach Department of Federal Reserve Bank of Philadelphia-WP, No. 98, Philadelphia.

WOCCU (2009). Statistical Rapport 2009, World Council of Credit Unions, Madison, Wisconsin.

WOCCU (2012). Statistical Rapport 2012, World Council of Credit Unions, Madison, Wisconsin.

http://www.woccu.org/about (Consulted October, 2014).

Mots-Clés: cooperatives, financial sector development, market failure, commercial banks