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

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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;
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


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

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