Non-Listed Banking Models

VRL KnowledgeBank

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SCOPE

The banking community is currently the subject of a level of public vitriol that was unimaginable only a few years ago. Against this background and with several financial players' status changed to that of semi-nationalised entities, the public at large is questioning the role of the banking industry and many of its operating practices, (not least the issue of executive rewards).

As the banking sector seeks to recover from the fall out from subprime and restore the trust and credibility of key stakeholders – real lessons in vision and a broad range of best practice can be gained from studying the new and established players in Non-Listed Banking Models.

This report concerns itself with the provision of 'retail banking services' through institutions owned by members, communities (on and off-line) or municipalities. The institutions examined include building societies, co-operative banks, credit unions, various types of community banks and social networking sites. The business models and basis of ownership vary, but a strong common ethos exists linking the differing institutions directly to their constituencies. And there is increasing evidence that the members and constituents of these types of institutions are placing an increasing value on their distinctive brand values.

PART 1: INTRODUCTION

This report considers the areas in which these types of institutions have found particular success, often to the standard of international best practice. It also looks at issues and areas of contention related to their respective business models and situations. Many of the organisations considered by this report have historic origins that still influence some aspect of the way in which they do business, and this factor is also taken into account. The Overview introduces the respective business models and issues that surround them, for example, the issue of demutualisation that has concerned the sector for much of the last three decades.

PART 2: BUILDING SOCIETIES

This section reflects a UK building society movement that has been hit hard by demutualisation over the last 20 years, but has now entered a period of renewed growth and greater appreciation for the mutual ethic. This positive trading climate is further enhanced by a supportive legislature, and strong support from the Building Societies Association. The case studies of the Nationwide building societies offer insights into many areas of best practice. These include the primacy of membership, member rewards, co-operation between mutuals and leading-edge approaches to staff engagement and culture. At the time of writing the UK building society movement seems to have coped more successfully with the credit crunch and recession than the 'mainstream' banking community.

The Australian mutual sector is supported by both a trade association (Abacus – Australian Mutuals) and major service providers. This does much to ensure that the sector benefits from strong guidance, a co-ordinated voice and the ready availability of processing support with significant economies of scale. Heritage Building Society is among those that have been moved to estimate the 'additional member value' in dollars of its preferential mutual pricing strategy. Since 1999, it has also offered communities a package of support that allows them relatively low-cost access to the creation of their own local banking operation. Newcastle Building Society stands out for the awards that it has received for many aspects of its products and services. It has also made a contribution in excess of A$100 million to local causes in just the last two years.

PART 3: COMMUNITY BANKS

The business model that delivers this type of banking can vary significantly by market, and origins. In the US, the majority of such banks are member-driven mutuals, and operate as members of the organisation, America's Community Bankers. The German Sparkassen model is account-able to community stakeholders, and is organised at national level through the Deutscher Sparkassenund Giroverband (the German Savings Bank Association, or DSGV). These local 'savings banks' have long since matured as full retail banking operations, but have retained their local catchments and orientation. The model supported and promoted by Bendigo Bank in Australia is based on a joint venture with the community through a specially-constructed corporate vehicle. Across all models, the underlying principle of community stakeholding and influence is the common factor.

The US sector has enjoyed a period of stability, albeit with continuing consolidation, and the development of the mutual holding company has provided a vehicle through which resources could be raised to support further investment. However, issues have surrounded both the German and Australian experience. Examples of innovation by the Sparkassen incorporate best practice in many areas of the branch network. The development of the Bendigo-sponsored community banks has been progressing, although it is only in recent years that it has begun to earn industry wide recognition.

PART 4: CO-OPERATIVE BANKS

The co-operative banking sector shares strong common principles rooted in the mid-19th century. The European Association of Co-operative Banks (EACB) represents nearly 4.600 member institutions to the European Union from its Brussels-based offices. The case studies included in this section of the report are distinctive and contrasting. Rabobank in The Netherlands is the central banking organisation for 188 local co-operative banks located across the country. The strong agricultural history and associations are reflected in the commercial activities through which it leverages this experience and its resources in other countries. The Co-operative Bank in the UK enjoys direct lineage from the origins of the movement and was formed in 1872 to support the retailing arm and associated production activities. It operates as a domestic bank but also offers a showcase of best practice in the application of ethics and concern for the environment within financial services.

PART 5: CREDIT UNIONS

While the players in this sector are diverse in both size and nature, they are linked by strong principles. Credit Union Australia is the largest union in Australia, with assets of over A$2 billion and approaching 400,000 members. Members and Education Credit Union (mecu), also from Australia, was formed from a merger of 23 smaller organisations in 2003, and exemplifies growth through merger. It has also entered into a covenant with the State of Victoria's environmental authorities as part of its major commitment to environmental sustainability under a United Nations programme.

The US credit union sector dates from 1909 and now includes around 8,500 organisations with a member base of 87 million people and assets of over US$700 billion. As the report shows, the credit unions of Australia and the US are also beneficiaries of strong representative bodies and competent service providers able to offer otherwise unrealisable economies of operational scale. Cuscal and Indue operate within the Australian market to provide a wide range of payment systems access, credit risk management, operational support and other management services. In the US, similar organisations include Credit Union Service Corporation (CUSC), CO-OP Financial Services and Payment Systems for Credit Unions (PSCU).

The major issue facing the credit unions of the US is the defence of their tax-exempt status. The mutual community banks are particularly vocal in their call for a 'level playing field'. The issue is exacerbated by two facets of the credit union community. In the first instance, the leading organisations are viewed as complex, bank-like structures, operating branch networks and offering a full range of retail financial services. The other issue that adds to the concerns of the protagonists is the ability and tendency of credit unions to widen their formal catchment periodically in order to acquire business from new sources. All of these attributes are displayed by the US-based Delta Community Credit Union, which is discussed within this section of the report.

PART 6: SOCIAL NETWORKING AND BANKING – AN INNOVATION?

'Peer-to-peer', 'person-to-person', lending is a means by which borrowers and lenders can transact directly without traditional financial intermediaries such as banks. P2P lending has two basic models – the 'online marketplace' model and the 'friends and family' model. The model was the subject of much media commentary through 2007 and renewed discussion since the incredibly successful use of online fund raising by President Obama during his Presidential campaign.

The philosophical roots of P2P lending lie in traditional peer lending circles in which community members pool their savings and lend them out to one another. In developed markets the credit union is the most prevalent example of this model.

The key difference between credit unions and P2P lending is that credit unions are financial intermediaries. Investors purchase deposits and CDs and the credit union loans these funds to borrowers. In P2P lending, on the other hand, investors loan funds directly to borrowers. P2P lending platforms are essentially bond markets for individuals - allowing individual borrowers to issue their own personal bonds and allowing individual investors to purchase them. Prior to the advent of P2P lending, individual borrowers and lenders had little opportunity to transact directly.

P2P lending is thus something of a contradiction. On one hand it is rooted in borrowing and lending among members of close-knit local communities in which the knowledge gained through relationships is the cornerstone of lending decisions. On the other hand it is an open bond market and embraces the transactional lending model and automated credit evaluation processes characteristic of mainstream banks.

On the Internet dispersed individuals are able to interact freely. Popular social networking sites such as MySpace and Facebook allow individuals to gather in online communities to keep up existing relationships or to form and build new ones. The personal and social interaction that was once only possible in local communities is now available to anyone with an Internet connection. Online P2P lending marketplaces incorporate these social media tools. Users can post personal profiles, photographs, and video clips, form user groups based on shared affinities, build up networks of friends, and interact on discussion forums. The promise of P2P lending is to leverage the online social networking tools to make relationship lending possible on a mass scale.

Whether P2P represents a true banking innovation, or simply the on-line version of an existing model is a much debated point. While the threat of P2P lending has been over-stated (comparisons with file sharing are somewhat far-fetched) the practices and customs associated with P2P lending offer real lessons to main stream banks in terms of future trends in customer behaviour.

CONCLUSION

This report has taken a snapshot of the state of the mutuals, community banks and peer to peer sites in major markets across the world.

It has found much to applaud in the management and principles of the business models. An aggregation of best practice, drawn only from the case studies within this report, would provide an industry-leading model through which to offer retail financial services in the 21st century. While animosity towards the sector may well continue in some markets, a key insight from this report is that there is also much to learn from the innovatory work of mutuals and community banks. The distinctive positioning of these types of institutions is increasingly appreciated and valued by their members and constituents.

The findings of this report illustrate the extent to which these types of organisations enrich the retail financial services sector by offering a real alternative to clients across all the major segments.