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Miscellanea

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Towards a new business model of cooperative banks

Abstract

The purpose of this work is to characterise the cooperative bank sector's strengths, weaknesses, chances and threats identified by its representatives in Poland, as well as to determine desirable changes in the organisation and functioning of cooperative banks. In analytical terms, the assessments and conclusions were based on presentations and panel discussions of participants of the Forum of Cooperative Bank Leaders, which was held in Warsaw on 17–18 September 2019. It was concluded on the basis of the analysis that although cooperative banks are aware of their weaknesses and strengths as well as they see chances and threats for their operations, they clearly lack consensus on the shape and joint actions in the scope of the development of a new business model. The greatest expectations of these banks are connected with the development of electronic economy and digitisation, which requires considerable financial outlays and organisational effort. The key problem is the insufficient level of integration and cooperation within associations functioning and among them, as well as lack of willingness – even reluctance – of many banks to change the existing model. Greater integration of all entities in the cooperative bank sector is the necessary condition for the improvement of banks' operations and their further development.

Key words: cooperative bank, business model, bank sector

JEL: G21, G28, O16

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Introduction

On 17–18 September 2019, the 13th Forum of Cooperative Bank Leaders, dedicated to key problems of the cooperative banking sector in Poland, was held in Warsaw¹. This year, the forum focused on modernisation challenges faced by cooperative banking in the times of consolidation on the market of financial services. The cooperative bank sector is an important element of the national financial system. It results from the tradition-based role played in local communities by cooperative banks being the main partner of agriculture and territorial self-government units². Despite the significant extension of the range of bank services technological progress, fulfilment of regulation requirements and, at the same time, faster pace of growth in assets for 10 years in comparison with the entire banking sector, cooperative banks have not managed to increase their share in the market (their share in assets of the banking sector is between 7 and 8%). Over the past years, the conditions in which cooperative banks have functioned, i.e. their environment and the institutional model of the sector, have been changing, whereas their business model has undergone insignificant modifications and adjustments. The assets and financial position of many banks have deteriorated, banks have started to depart from conducting business pursuant to the cooperative idea and lost their long-term clients. The issue of the business model change has been the subject of discussions for more than a decade³. And although the diagnosis of the cooperative bank sector is well known in the business environment and the expectations are identified, the pace and effects of operationalisation and implementation of the business activity model are unsatisfactory. Furthermore, not all key problems have been solved and, along with changes in the business environment, new problems are emerging.

The purpose of this work is to characterise the cooperative bank sector's strengths, weaknesses, chances and threats on the basis of the analysis of presentations and statements made by participants of the Forum of Cooperative Bank Leaders, as well as to determine desirable changes in the organisation and functioning of

¹ The Forum of Cooperative Bank Leaders is organised by the Polish Bank Association in cooperation with banks associating cooperative banks (Bank Polskiej Spółdzielczości S.A. in Warsaw and SGB-Bank S.A. in Poznań) and with the National Association of Cooperative Banks. Every year, the conference is attended by 350–400 people – mainly representatives of cooperative banks and associating banks, as well as representatives of supervisory, financial and banking infrastructure institutions, academic circles and government and self-government administration.

² The cooperative banking tradition in Poland reaches back over one hundred and fifty years. Cooperative banks have experience in financial services for local communities and in developing social (self-help) ties. The traditional area of the cooperative bank sector's interest is agriculture and rural areas, micro-enterprises, as well as cooperation with territorial self-government units. See: J. Szambelańczyk, *Banki spółdzielcze w Polsce w procesach zmian systemowych*, Wydawnictwo Akademii Ekonomicznej w Poznaniu, Poznań 2006.

³ J. Szambelańczyk, *Czy bankom spółdzielczym grozi „bankrupsion”*, „Głos Banków Spółdzielczych”, 2019, nr 1, pp. 21–28.

cooperative banks. The analysed presentations and panel discussions of the Forum's participants concerned⁴:

- the current financial, organisational and regulatory situation of the cooperative banking sector,
- chances and threats in the era of digitalisation, open banking and clients' mobility, with special attention to cyber threats,
- institutional and business changes in the sector,
- the progress of works on the implementation of organisational and technical solutions,
- development possibilities,
- legislative changes having impact on cooperative banks' operations,
- increasing competition from other entities on the market of financial services.

1. Economic situation of the cooperative bank sector in Poland as at 31 August 2019

At the end of August 2019 in Poland there were 543 cooperative banks and two associating banks: Bank Polskiej Spółdzielczości S.A. in Warsaw (BPS SA) and SGB-Bank S.A. in Poznań. BPS SA associated 323 cooperative banks conducting operations mainly in the eastern and southern part of Poland, whereas SGB-Bank S.A. associated 195 cooperative banks conducting operations mainly in the northern and western part of Poland. The territorial distribution of cooperative banks forming part of the above mentioned associations causes that in some locations they compete with each other. Both associations had institutional protection schemes (IPS): BPS Association Protection Scheme and SGB Cooperative Protection Scheme⁵, covering 95.4% of cooperative banks conducting operations. In addition to associations and IPS, there were 25 cooperative banks, including 15 cooperative banks with own funds of the value of at least EUR 5 million, entitling them to conduct independent operations, without the regulatory obligation to participate in an association⁶.

⁴ Information and programme of the Forum of Cooperative Bank Leaders 2019 and speakers' presentations are available at the following website <https://konferencje.alebank.pl/konferencje/forum-liderow-bankow-spoldzielczych-2019/>.

⁵ The cooperative Institutional Protection Scheme, within which cooperative banks may associate, was introduced by the amendment to the Act on the functioning of cooperative banks in June 2015 in the course of the implementation of the EU provisions (Capital Requirements Regulation). It is created by cooperative banks and associating banks on the basis of agreements made between them, determining mechanisms of liquidity assistance and solvency of the scheme's participants, risk control mechanisms within the scheme and values of parameters conditioning the participation in the scheme. Participants guarantee each other's obligations establishing the assistance fund which may be used for granting financial assistance in the case of solvency problems and for preventing bankruptcy of any of the participants. The scheme ensures additional mechanisms of the risk management and internal control.

⁶ At the end of March 2019, 181 cooperative banks had own funds exceeding the equivalent of EUR 5 million, and only 3 cooperative banks had own funds below EUR 1 million.

At the end of August 2019, cooperative banks (without associating banks) had share of 7.16% in the assets of the banking sector in Poland, 4.4% in the net financial result and 6.04% in equity. At the same time, they had the largest network of bank outlets (more than 28% of all outlets) and employed more than 30 thousand people, which constituted 19.1% of all people employed in the banking system (Table 1). The cooperative bank sector traditionally has the majority share in granting credits to farmers (approx. 58%) and it is the undisputed leader as a business partner of territorial self-government units (it has 29% share in deposits and 11.25% in crediting government and self-government institutions).

Table 1. Indicators characterising the cooperative bank sector in Poland at the end of August 2019

Indicator	Value
Share in assets of the banking sector	7.16%
Share in the net financial result of the banking sector	4.4%
Share in assets of the banking sector own capital	6.04%
Share of the banking sector in deposits from the non-financial sector	9.65%
Share of the banking sector in receivables from the non-financial sector	5.8%
Share of the banking sector in deposits from government and self-government institutions, including:	8.19%
– from self-government units	29%
Share of the banking sector in government and self-government institutions' receivables	11.25%
- in self-government units' receivables	15%
Share in loans for farmers	58.4%
Share in the number of the banking sector's outlets	28.5%
Share in the number of employees of the banking sector	19.1%
Capital ratio	17.9%
Tier I ratio	17.1%
Assets/the employed	PLN 4,720,585
Share of receivables at risk in receivables from the non-financial sector	8.38%
Coverage ratio of receivables at risk in receivables from the non-financial sector	46.1%
Loan-to-deposit ratio of the non-financial sector	58.1%

Source: compilation based on figures of the cooperative bank sector available on the website of the Polish Financial Supervision Authority: *Dane miesięczne sektora bankowego – sierpień 2019 r.*, https://www.knf.gov.pl/publikacje_i_opracowania

Financial data document relatively small, but stable share of cooperative banks in the banking sector, systematic growth in own funds and loans for non-financial entities, mainly individual entrepreneurs and farmers⁷. The significant growth in share took place in the case of loans for the self-government sector. A negative phenomena is that receivables at risk increases faster than in the total banking sector, although along therewith the cover of loans at risk with write-offs increases.

The selected performance indicators for the cooperative bank sector, except interest margin, have been lower for many years than the average for the entire banking sector (Table 2).

Table 2. Selected performance indicators for the cooperative bank sector as at 31 December 2018

Indicator	Cooperative bank sector	Banking sector
ROE	5.1%	6.9%
ROA	0.47%	0.73%
C/I	69.8%	58.8%
Interest margin	2.8%	2.51%
Interest income to income on banking activities	77.4%	71.6%
Non-interest income to banking operations' income	22.6%	28.4%
Total capital ratio	17.7%	18.3%
Tier I Capital ratio	16.8%	16.3%
Indicator of loans at risk of the non-financial sector	9%	6.9%

Source: *Raport o stabilności systemu finansowego, czerwiec 2019*, NBP, Departament Stabilności Finansowej, Warszawa 2019, <https://www.nbp.pl/systemfinansowy/rsf062019.pdf>, p. 84–86.

Average solvency and liquidity ratios for the cooperative bank sector meet supervisory norms⁸. And although the values of performance indicators do not correspond to the cooperative bankers' ambitions, they are accepted thereby due to the positive trend of changes in unfavourable disproportions. The main concern

⁷ Pursuant to data of the Polish Financial Supervision Authority, loans for individual entrepreneurs and for individual farmers (including the so-called preferential loans) constitute 15% and 28% of the value of the cooperative banks' loan portfolio respectively.

⁸ In the case of the total solvency ratio, the ratio of 528 cooperative banks was above 13.5% (level in 2019), whereas liquidity norms were met by all cooperative banks (the Liquidity Coverage Ratio is well above 100%, and in many banks above 200%).

is the share of the interest income in the income on banking activities significantly higher as compared to the average for the entire sector, which indicates a significant sensitivity of cooperative banks to the interest rate changes⁹.

The general economic situation of the entire cooperative bank sector was assessed as stable, both by cooperative banks' representatives and by supervisory authorities. Nevertheless, the assessment of the sector carried out by the supervisor pursuant to the BION (supervisory review and assessment) methodology¹⁰ at the level of 2.61 is significantly below the supervisor's expectations¹¹. All the more so as the cooperative sector is characterised by a great diversity of banks in terms of the operation scope, organisation, asset resources and capital. The diversity also concerns the assessment of individual cooperative banks' situation. There are banks in a very good economic situation, but also banks facing problems, which require assistance and support from the association or IPS. The regulatory authority drew attention to the associating banks' worsening situation which, due to financial (deposit and capital) relationships, may have negative consequences for the cooperative banks' operations.

2. Cooperative banks strengths and weaknesses

During the two-day debate, presentations and panel discussions stressed cooperative banks' strengths as well as the most significant weaknesses which should, as far as possible, be eliminated (Table 3). The participants often made references to the heritage and historical achievements of the Polish cooperatives.

In the case of the cooperative banks' strengths, the most frequently highlighted assets were: the origin of own capital, good knowledge of the local market and well-established position in the provision of financial services for agriculture, small enterprises and territorial self-government units. Cooperative banks take part in the distribution of the Union and national financial resources within aid schemes, subsidies for agricultural production and promotional loans, as well as they grant bank guarantees connected therewith.

⁹ Cooperative banks allocate excess of deposits over loans mainly in associating banks in the form of short-term investments and in safe debt instruments, for example in treasury bonds and National Bank of Poland bills.

¹⁰ Supervisory review and assessment (BION) – a regular analysis and measurement of risks to which individual banks are exposed. The details about the performance of the review are in: *Metodyka badania i oceny nadzorzej banków komercyjnych, zrzeszających oraz spółdzielczych (Metodyka BION)*, Urząd Komisji Nadzoru Finansowego, Warszawa 28 marca 2018 r., https://www.knf.gov.pl/dla_ryнку/Informacje_dla_podmiotow_nadzorowanych/Sektor_bankowy/metodyka_BION_bankow

¹¹ Interpretation of the assessment of the bank's general status: 1–1.75 – very good status; 1.76–2.50 – satisfactory status; 2.51–3.25 – status giving rise to concerns; 3.26–4.0 – highly disadvantageous status; "F" – bank at risk of insolvency. The 2.61 indicator means the occurrence of irregularities which – if not eliminated – may be significant from the point of view of the deposit safety.

Table 3. Cooperative banks' weaknesses and strengths in the opinion of participants of the Forum of Cooperative Bank Leaders

Weaknesses	Strengths
<ul style="list-style-type: none"> – low share in loans of the banking sector – low quality of the portfolio of loans for enterprises, – low profitability and cost effectiveness, – great sensitivity to interest rate changes, – low work productivity, – insufficiently developed sale functions, – declining number of cooperatives' members and problems with obtaining capital, – little use of available databases and sources of information, – fragmented development of IT systems, – insufficient organisational support provided by associating banks, – limited cooperation within the association, – limited scope of services provided for the client. 	<ul style="list-style-type: none"> – good knowledge of the local market, – national origin of own capital – established position in providing financial services for agriculture and territorial self-government units, – high level of trust in local communities, – long-term multi-lateral relationships with clients, – high social effectiveness, – flexible approach to the client, – expanded network of outlets, – highly valued employer in the local environment, – well-established liquidity position, – efficiently operating IPS.

Source: Compilation based on the analysis of presentations and statements made by participants of the 13th Forum of Cooperative Bank Leaders.

The generation of financial surpluses by a cooperative bank is necessary for the bank's safe functioning and development and, as far as possible, it is also used to finance common purposes of the local community. Similarly as in the case of the financial effectiveness, the sector is characterised by high diversity: there are banks actively engaged in the social community life, banks being sponsors of important local events and performing charity activities in the form of support for different organisations and institutions (children's homes, education care centres, residential care homes, associations, etc.) and even private persons in a difficult situation, as well as banks focused mainly on financial purposes.

The operations of most cooperative banks focus in the first place on basic banking services – taking deposits and granting loans. Their service offer (mainly the offer of small and medium-sized banks) is limited in comparison with the offer of commercial banks, which results from the clients' smaller level of expectations as well as limited readiness or financial possibilities of the banks. Despite high trust in local communities and good relationships with clients, cooperative banks face problems connected with keeping their clients and acquiring new ones. Clients have become more mobile, the structure of agriculture has changed, as well as the requirements concerning the quality and scope of services offered, process automation or availability of distribution electronic channels are growing. Weakly developed sale functions of these banks

in connection with the operation model based on direct contact with the client (despite its many advantages) are the main reasons for this situation. Additionally, the extended network of outlets resulting from the business model along with high employment is, to a great extent, a cost burden for banks. There is no consensus in the cooperative banks' environment whether the extended network of outlets and employment are strengths of cooperative banking, which should be maintained, or whether they are reasons for low effectiveness and should be limited. The extended network of outlets perceived as an advantage is the basis for traditional relationships with the client, which are one of the most notable characteristics of local banking. In the case of high employment, we mainly encounter social aspects – the importance for the local labour market, employment stability, high level of employees' satisfaction or the client's need to have direct contact with the bank's employee in the case of more advanced services and solutions. The weakness of high employment is the low work productivity measured by nett assets per employee, which at the end of August 2019 was PLN 4,720,585 (the average for the entire banking sector was at the level of PLN 12,623,714) and indicated poor use by the banks of their distribution potential. The employment generates high costs of operations in relation to their scale and results achieved and is one the reasons for low profitability and cost effectiveness in the sector.

The banks' continuing low profitability limits their possibilities to increase own funds by the accumulation of profits and, at the same time, does not contribute to acquiring new shareholders¹². And although cooperative banks meet capital norms, the sector's position on the market is relatively weak. Poland is one of a very small number of European countries where the number of cooperative banks' shareholders decreases every year, which causes the reduction in the value of the share fund and, consequently, the decrease of its share in the sector's own capital. Securing the possibilities for faster limited development, prevented by too low own capitals of the banks is becoming a large problem.

The cooperative banks' weakness is credit activity: both its scope and its quality. And although cooperative banks efficiently acquire deposits from the market, they are worse at the management of financial resources acquired from clients. The excess of deposits over ¹³ loans are most frequently located by cooperative banks in the form of short-term investments in associating banks. On the one hand, it is caused by a lower risk connected with such an investment, but on the other hand by limited possibilities of the safe development of lending. Banks usually operate on local markets, often in peripheral areas, areas of low level of economic activity or areas where persons on low incomes, with limited creditworthiness or lack of creditworthiness live. Moreover, farmers who have been using banking financing

¹² A cooperative member has limited possibilities to recover their shares and, moreover, for years there have been regulatory restrictions concerning the distribution of the financial result in the banks and the rule that a cooperative member cannot have more rights than the bank's client.

¹³ The very high share of deposits (almost 90%) covered by BFG guarantees is characteristic for cooperative banks with clearly dominating deposits and accounts not exceeding the equivalence of EUR 100,000.

for many years – due to the large availability of the EU subsidies and promotional loans (also from national funds) – are considerably less interested in ordinary commercial loans.

The concerning phenomenon in the cooperative bank sector is the increase of receivables at risk, which is significantly faster than in the banking system, although the cover for loans at risk of writes-off is also increasing. Many banks face the risk of concentration often resulting from undertaking operations in more risky areas, quite often exceeding their staff's competences, including in the area of granting loans for large enterprises¹⁴. The concentration of credit exposures in these banks proved to be a significant source of the risk being the effect of inadequate identification of capital and personal ties of entities receiving the loans¹⁵. The risk of excessive concentration is also generated by the increase in the banks' credit exposures mainly to regular clients¹⁶. The regulatory authority's representatives indicated the generally low quality of the credit risk management (insufficient competencies), presenting the results of inspections carried out in 90 cooperative banks. They drew attention to such irregularities as:

- wrong measurement of the risk,
- insufficient monitoring of the credit risk,
- doubtful measurement of the value of securities,
- inappropriate classification and measurement of credit exposures,
- lack of independence in the management of the credit risk at the first and second level,
- inappropriate identification of relationships between clients,
- irregularities in the performance of stress testing,
- deviations from credit procedures.

The inspected banks also had problems with obtaining data about borrowers and the identification of negative trends, as well as with updating securities which require the introduction of new prices and have impact on the amount of provisions created. It is characteristic for cooperative banks that they use in a limited way databases of clients, debtors, prices and financial markets, offered by banking-related commercial entities (e.g. Biuro Informacji Kredytowej S.A.), which results from the necessity to pay fees and, in the case of databases co-created by banks – the necessity to share information in order to update data on an ongoing basis as well as from the stereotype of the knowledge of the clients in the area of the bank's operations.

¹⁴ In the cooperative members' opinion, it results from the past and distorts the assessment of the sector's current situation in this scope.

¹⁵ In addition, along with the poor quality of loans for enterprises, there is also relatively low coverage of impaired loans with writes-off. This situation does not correspond to the situation of small and medium-sized banks in which – pursuant to reports of the Polish Financial Supervision Authority – the quality of loans is significantly better than in most large banks, even in commercial banks.

¹⁶ W. Żółtkowski, *Dokąd zmierza bankowość spółdzielcza*, „Bank”, 2019, nr 9, pp. 24–30.

The cooperative bank sector was forced by the regulatory authority's decision to create the institutional protection scheme (IPS). Unfortunately, the creation of two IPSs at both associations preserved the sector segmentation, increasing at the same time expenditure on their creation and functioning. The previous operations of IPSs in the scope of liquidity, capital adequacy, operation safety and profitability were assessed very positively by the cooperative bank environment. It is assessed that the adopted solutions strengthened the control and supervision over the banks, improved the quality of reports, allowed faster identification of threats, improved the risk management, and through all these actions the sector stability was generally improved. The fact that 10 cooperative banks are not covered by the IPS structures, which is an evident manifestation of these banks' moral hazard towards the network of financial safety (especially the guarantees of deposits) was negatively assessed¹⁷.

The cooperative bank sector's weakness is an insufficient integration of their operations within associations, especially non-uniform IT systems, procedures connected with banking activities as well as insufficient outsourcing of a number of management functions. The expectations in the sector concerning the associating banks' engagement in solving problems are growing. The implementation of the common IT system, unification of procedures, common products and marketing, training preparing staff for operations which would allow cooperative banks to rationalise their operations and to increase the development potential. Additionally, associating banks have financial indicators much worse than indicators of cooperative banks, they struggle to deal with problems connected with the quality of the risk management and low own capitals, which in the face of significant surplus of cooperative banks' deposits (38%) located pursuant to regulations in associating banks constitutes a risk for this sector's stability. Mainly – by capital ties with cooperative banks and common participation in both IPSs.

¹⁷ Pursuant to the applicable provisions, previous agreements expired at the end of 2018 and the banks with too low capitals for conducting independent operations should join the IPS.

3. Chances and threats for the cooperative bank sector in the opinions of the forum's participants

Definitely much more attention in presentations and statements was paid to chances and threats for the further development of the cooperative bank sector (Table 4).

Table 4. Chances and threats for the cooperative banks in the opinions of the forum's participants

Chances	Threats
<ul style="list-style-type: none"> – development of IT technologies and cyber-security – digitalisation, – integration increase within the association, – development of the intra-association cooperation, – engagement in the implementation of the Strategy for Responsible Development (SOR), – engagement in the programme of voluntary long-term saving – Employee Capital Plans, – intensification of the cooperation with external institutions in the distribution of funds from the Union and national financial resources, 	<ul style="list-style-type: none"> – increasing competition of other credit institutions, lenders and finteches, – increase in cyber-crime, – legislative amendments unfavourable for banks, – limited availability of highly-qualified employees and increasing staff costs, – regulatory charges, – individualism and competition between banks, – increasing ecological problems and climate changes.

Source: Own compilation based on the analysis of presentations and statements made by participants of the 13th Forum of Cooperative Bank Leaders.

The greatest chances for the improvement in the cooperative banks' situation and position on the market as well as their further development are in computerisation and digitalisation. Cooperative banks have high (even too high) expectations connected with the development of electronic economy and digitisation; they expect, for example, that the above changes significantly influence profitability and cost effectiveness, work productivity, quality and scope of services for local enterprises and individual clients, they will improve the cooperation within the association and with external entities and primarily allow the acquirement of new, young and more mobile clients.

The use by the banks of modern IT solutions requires high standards in the scope of safety, the management of the operational risk and monitoring. Recently, cyber-crime has become a serious threat to local credit institutions. Cyber attacks cause not only financial, but also image losses for banks. The vast majority of cyber attacks concern not the banks themselves, but their clients being the weakest and least aware link in the entire system. In the case of cooperative banks' clients, their education in the area of cyber-security is a great challenge.

Chances for the increase in the cooperative banks' participation in the financial market are created by new initiatives and programmes, such as: Employee Capital Plans (PPK)¹⁸, Strategy for Responsible Development (SOR)¹⁹ r programmes financed from the EU resources supporting the development of rural areas, e.g.: Rural Development Programme (PROW)²⁰. The cooperative banks' engagement in their implementation requires closer cooperation with the public sector and entities dealing with the distribution of foreign and national financial resources, for example with: Bank Gospodarstwa Krajowego (BGK), the Agency for Restructuring and Modernisation of Agriculture (ARiMR), or the National Fund for Environmental Protection and Water Management (NFOŚiGW). For years, cooperative banks, using their advantage in the form of the extended network of outlets and the knowledge of the local markets, have been participating in the distribution of financial resources for the agricultural sector and financial aid for farmers affected by natural disasters. Employee Capital Plans, i.e. the new government programme, constitute, on the one hand, the extension of the offer for the cooperative banks' clients (companies obliged to implement Employee Capital Plans) by pension services and, on the other hand, financial benefits from the distribution of these services. The cooperative banks has a facilitated access to the programme thanks to obtaining by the entity from the BPS association – Towarzystwo Funduszy Inwestycyjnych (BPS TFI) – the entry into the list of entities authorised to carry out and manage Employee Capital Plans. The Strategy for Responsible Development (SOR) indicates areas of cooperative banks' engagement in its implementation and operations which may have significant impact on their position on the market. It includes, for example, government operations in the scope of the increase of domestic capital share in the banking sector, the implementation of the promotion system of Polish food, the assurance of access to long-term instruments of financing development projects and legal mechanisms supporting processes of structural changes or the implementation of mechanisms eliminating gaps in financing for development undertakings at the local and regional level.

¹⁸ Employee Capital Plans constitute the government saving programme aimed at increasing future pensions. The Employee Capital Plan was developed jointly by the government, the Polish Development Fund, employers' organisations and trade unions. The capital gathered within this programme is to be a boost for the economic development and then a supplement to pensions from the social security system for Polish pensioners. The capital is created jointly by employees, employers and the state. Payments are transferred to the participants' individual accounts created by a financial institution which carries out and manages the Employee Capital Plan.

¹⁹ The Strategy for Responsible Development (SOR) is the Polish government's programming document in the area of medium- and long-term economic policy. It determines basic conditions, purposes and directions of the country's development in the social, economic, regional and spatial dimensions in the perspective of 2020 and 2030. It contains a new development model based on individual territorial potential, investments, development, export and highly processed goods. The SOR was adopted by the Council of Ministers on 14 February 2017, *Strategy for Responsible Development till 2020 (with the perspective till 2030)*, <http://www.miiir.gov.pl/media/48672/SOR.pdf>

²⁰ The purpose of the programme is to improve the competition of agriculture, the sustainable management of natural resources, climate actions and the sustainable territorial development of rural areas. More about the programme: <https://www.gov.pl/web/rolnictwo/-program-rozwoju-obszarow-wiejskich-2014-2020-prow-2014-2020>

The extension of the cooperative banks' cooperation with the public sector increases the requirements concerning the standardisation and automation of processes and the possession of consent for the confirmation of the trusted profile, i.e. electronic signature certifying the identity of clients in the administration electronic systems. The possession of the trusted profile allows the submission of applications, requests, complaints, fees and declarations by electronic means. The additional problem is the amount of own funds, which limits the cooperative banks' engagement in large projects.

Moreover, the limitations for the cooperative banks' development have been generated by recent legislative amendments in the scope of restructuring of agricultural holdings and pursuing claims by banks. As a result of favouring the debtor, the banks' situation in relation to the debtor have deteriorated significantly and indirectly caused the reduction in the quality of the loan portfolio. The source of concern for banks as employers is the procedure and amounts of the statutory rise of minimum wage, which – in connection with the fall in unemployment and increase in wage expectations – may create greater problems with recruiting and retaining highly qualified human resources and the increase of staff costs.

The significant burden is imposed on the cooperative banks in the form of growing supervisory requirements, identical for all banks, irrespective of the scale of their operations. The implementation of changes resulting from the provisions of law engages limited resources (for example: financial, human resources, systemic resources) available to cooperative banks, which consequently translates into the reduction in their profitability or limitation of expenditure on development activities.

In the case of cooperative banks, their functioning will be under the impact of increasing ecological difficulties, especially climate changes. Weather anomalies constitute the main cause of natural disasters and are connected with people's lives and large economic losses. Cooperative banks are primarily exposed to threats resulting from ecological risks of their clients and, therefore, must take them into consideration in the management process. Currently, it does not constitute a standard and banking regulations concerning risks generally do not take into account ecological and social risks. In the nearest future, it will be necessary to accept the transfer into applicable regulations of the *Principles for Responsible Banking*²¹. And although the banking operations themselves do not have a direct negative impact on the environment, their indirect impact may be essential by financing clients or taking part in financial investments. The banks may have a significant share in financing low-carbon technologies, pro-ecological and pro-social investments as well as shaping appropriate behaviours or attitudes of economic entities or population. In the case

²¹ The Principles for Responsible Banking were developed by 28 leading banks in the world and are aimed at adjusting banking operations to the society's needs and expectations expressed in the document entitled *Sustainable Development Goals* and the Paris Agreement. The official announcement together with the ceremony of signing the Principles was held on 22 September 2019 at the United Nations headquarters in New York (parallel to the UN High-Level Meeting of the General Assembly). The Principles were signed by 129 banks from the entire world, <https://www.unepfi.org/wordpress/wp-content/uploads/2019/07/FINAL-PRB-Signature-Documents-2-Interactive-22-07-19.pdf>

of cooperative banks, the chances are in the cooperation with the National Fund for Environmental Protection and Water Management, which finances investments in the scope of the environment protection.

4. Current status of works concerning institutional and business changes in the cooperative bank sector

Since 2018 – within the Convention for the Cooperation and Development of the Polish Cooperative Banking – meetings of management staff of cooperative banks have been held cyclically. They are devoted to the assessment of the status, current problems and development directions of the cooperative banks and sector. Their effects include, for example, recommendations aimed at the improvement of the cooperative banking image, safety of functioning and effectiveness, the assurance of high quality financial services on the local market as well as the development of uniform rules for preventing intra-sector competition between local financial institutions²². As a result of these meetings, associating banks and IPSs have informed about the following undertakings:

- elimination of intra-association competition,
- determination of rule for communication and cooperation between IPSs and the Polish Financial Supervision Authority as well as between IPSs and cooperative banks,
- review of associating banks' effectiveness in individual areas of operations,
- appointment of the joint Association Service Centre by associating banks,
- agreement with IT companies on the joint IT platform for cooperative banking,
- implementation in the SGB association of a number of payment mobile solutions,
- commencement of works on the mobile platform for all cooperative banks,
- joint marketing and promotions in the scope of mobile payments,
- joint hub for the purposes of the implementation of the Payment Services Directive (PSD2)²³,
- uniform rules for control methods and monitoring of risks in associations,
- the Museum of the History of the Polish Cooperative Movement, in which an exhibition showing the importance of cooperative banking in the development of Poland was opened,
- creation of the Strategic School of the Cooperative Banking Sector whose purpose is to prepare the future management staff as potential leaders of transformations in the cooperative sector²⁴.

²² The developed recommendations are being implemented by associating banks and IPSs in cooperation with association councils, supervisory boards, the Polish Bank Association (ZBP) and the National Association of Cooperative Banks (KZBS).

²³ PSD2 – the EU directive adjusting provisions concerning payment services to the digital reality.

²⁴ Further recommendations concern the creation of the model statute for cooperative banks, new model association agreement, further implementation of system solutions for the IT purposes, cooperation in the preparation of a product common for all cooperative banks, facilitation of communication between IPSs and cooperative banks.

The joint operations of the banks within associations and between associations are mainly connected with computerisation and digitisation. In this way, unit costs of the implementation of new technological solutions and costs of ensuring safety for the clients will be limited and, primarily, barriers for many banks in participation in electronic economy resulting from insufficient capacity and economies of scale will be eliminated.

Despite the introduced changes, the scope and pace of the business model modification is considered insufficient. It results from ²⁵the report on the surveys on the opinions of cooperative banks' management staff and local environments (cooperative banks' stakeholders, i.e.: individual persons, territorial self-government units and entrepreneurs) on the unsatisfactory pace of changes in the sector that it is caused mainly by cooperative banks' fear of losing autonomy, cooperative banks' weaknesses and lack of positive experiences connected with associations²⁶. The consolidation treated as the key to the expansion of the cooperative sector on the financial market still creates controversies among cooperative members and the division into its supporters and opponents is very clear. An essential factor slowing down changes is the structure of the management staff's age and competencies. Resistance to changes is typical mainly for bankers at the pre-retirement and retirement age and the real ownership impact of shareholders and their representatives in the bank's bodies is relatively weak. We deal with reluctance to the integration, especially to the merger of banks, caused on the one hand by fear of the loss of power and the necessity to submit to the common system and on the other hand – particularly in the case of banks with strong capital and efficiency – the necessity to finance the restructuring of weaker entities. Only few banks allow the merger with other bank in order to rationalise costs. For many banks, the acceptable solution is the creation for the sector of the joint marketing resources, operational, IT and reporting resources, mobile and internet banking systems or finally unification of the service offer within the association or voluntary agreement of cooperative banks. It results from the management staff's opinions that reluctance to changes and lack of many banks' actions could be overcome by:

- consulting, marketing and organisational support for banks undertaking the restructuring,
- incentives, indication of the directions of changes and the improvement perspectives,
- financial support for restructuring changes,
- clients' pressure.

The cooperative bank environment has clearly been communicating for a long time that it expects the support from state institutions not only in the regulatory, but also in the financial scope. The argument put forward is the government's policy

²⁵ The report was prepared by the ALTERUM Centre for Research and Analysis of Financial System, which has undertaken the initiative of supporting the process of changes in the functioning of cooperative banks in Poland.

²⁶ See: L. Kurkliński, M. Idzik, *Obraz i przyszłość polskiej bankowości spółdzielczej w oczach samych spółdzielców i społeczności lokalnych*, „Głos Banków Spółdzielczych”, 2019, nr 1, pp. 32–37.

of the repolonisation of banks, which requires the allocation of significant financial resources on acquisitions from foreign investors of commercial banks being natural competitors of cooperative banks. We can encounter requests for the allocation of at least part of these resources for the restructuring of the cooperative bank sector, which has only the national capital and, moreover, fulfils the essential role in the development of local communities. On the other hand, state institutions' representatives stated that no financial support or preferential treatment is planned for cooperative banks. It was indicated that the insolvency of cooperative banks in the last decade was financed mainly from resources coming from banks with the dominating State Treasury's capital. It was added that the safety infrastructure and IPS funds constitute the first financing source in the case of problems in the cooperative sector and until the external resources – especially connected with insolvencies – do not have to be used, the regulatory authority will not interfere in an authoritarian manner, including in the legislative scope, in the process of changes and shape of the cooperative banks' business model. This position is questioned by part of the cooperative environment proposing primarily the modification of the current policy of the state towards the entire banking sector. In particular, it is stated that the supervisor has too high expectations regarding IPSs, including mainly their capital intervention capacity. The issue of the academic circles' contribution to the development of models corresponding to the conditions of the cooperative banks' functioning in Poland in the twenty first century is also mentioned.

5. Expectations regarding a new business model of cooperative banks

Both experts and representatives of the financial safety national network indicate that the change in the model is necessary – especially in the scope of using in a better way the cooperative sector potential and supporting them in going out from the market niche. The National Bank of Poland (NBP) in the last *Report on the stability of the financial system*²⁷ devoted much attention to desirable changes in the cooperative banking model, raising for example the following issues:

- continuation of the use of the current potential and advantages of cooperative banks, including: knowledge of the local market, focus on services for local communities (farmers, small and medium-sized enterprises and territorial self-government units),
- avoidance of attempts to go beyond current well-known markets,
- increase in the integration and cooperation within associations (joint credit consortia, IT projects, marketing, financial products) in order to rationalise operation costs,

²⁷ *Raport o stabilności systemu finansowego, czerwiec 2019*, NBP, Departament Stabilności Finansowej, Warszawa 2019, <https://www.nbp.pl/systemfinansowy/rsf062019.pdf>

- in the case of small banks, consolidation as a way to increase their effectiveness and to develop activities,
- use of associating banks as service centres for cooperative banks and limitation of their independent commercial operations,
- strengthening IPS control functions and financial support in relation to associated banks.

The Polish Financial Supervision Authority expects that the new business model contributes to:

- creation of strong and safe banking groups supported internally by IPSs,
- use of consolidation potential,
- inter-association cooperation in the area of the IT technology development and cyber-security,
- strengthening the competitive position and increase in safety of operations conducted.

The direction of changes in the cooperative bank model determined by the National Bank of Poland as well as expectations of the Polish Financial Supervision Authority in this scope are convergent in many points with the sector's efforts. Cooperative banks – with different effects – undertake many actions in the scope of increasing the integration and cooperation within and between associations. The close cooperation is very important both from the point of view of effective implementation of IT solutions and from the point of view of the quality and scope of services provided.

For the cooperative banks' representatives, the very important factor in the new model of functioning – in addition to safety and operational effectiveness – is the preservation of the cooperative heritage and achievements. Since the beginning, the cooperative is based on such values as: honesty, openness, responsibility, democracy, equality and justice, and the cooperation, group solidarity and shaping member ties are its constructive elements²⁸. Cooperative banks refer to cooperative values and traditions, being part of their mission, and they want to preserve and fulfil them²⁹. The integration understood as the close cooperation of all entities in the sector is the direction compliant with the cooperative idea and commonly accepted therein, whereas consolidation (merger of banks) creates controversies and fears among cooperatives in the scope of maintaining member ties which, to

²⁸ A. Michalik, *Korzenie polskiej spółdzielczości a rozwój sektora spółdzielczego w III Rzeczypospolitej*, „Ekonomia społeczna”, 2013, nr 1, s. 49; *Spółdzielczość wiejska jako jedna z głównych form wspólnego gospodarczego działania ludzi*, red. M. Martynowski, Krajowa Rada Spółdzielcza, Warszawa 2014, p. 20.

²⁹ For a long time, such historic cooperative principles as the territoriality and subsidiarity principle are subject to erosion as a result of cooperative banks' commercialisation and regulatory interventions in their operations. It is particularly visible in relation to the operation area and – to a smaller extent – to the cooperative type (open vs. close) and membership (determined in the statute of the cooperative bank). J. Szambelańczyk, *Znowelizowana konstytucja bankowości spółdzielczej w Polsce*, „Nowoczesny Bank Spółdzielczy”, 2015, nr 9, pp. 37–38.

a great extent, determine the maintenance of the banks' cooperative character³⁰. The consolidation is accepted, but only in the case of necessity, i.e. lack of other possibilities. Banks expect regulations which would take into consideration the specificity of operations in the cooperative model and the diversity of banks with regard to their size (the application of the principle of proportionality)³¹.

The purpose of cooperative banks is not only the acquirement of new clients, but also retaining the lost agriculture and food market and services for clients not attractive for commercial banks, having specific expectations, requiring non-standard products going beyond the competitors' offer. Fulfilling the cooperative mission, they may contribute to the development of economic activity at the local level.³² In the case of more effective use of their potential and advantages as well as regulatory support taking into account their specific nature, cooperative banks see the chance to increase their share in the market of banking services and to come back to the territoriality principle – to be the bank of the local community.

Summary

The cooperative bank sector as a whole functions stably, but it has to face the number of short- and long-term challenges. Their scale is large and it seems that only common mobilisation of cooperative banks, associating banks and IPSs may meet these challenges. Activities undertaken by the cooperative bank sector in order to strengthen its position in the banking system, without an appropriate adjustment of organisational structures and clear determination of relationships (authorisations and responsibilities) between the entities do not bring the expected results. The sector clearly lacks the uniform approach and common initiative in the scope of the desirable shape of the new functioning model. Many banks expects that computerisation and digitisation will bring a significant improvement, even solutions to problems, and they do not see the need to introduce important changes into the existing business model. Moreover, not all banks in the sector are satisfied with the centralisation and consolidation processes imposed by the provisions. It is stated that they are actually inconsistent with the cooperative ideas – they cause that banks depart from the specificity of cooperative banks, which still has several important roles to play in the local community. The conflict between the traditional model of credit institution and the model determined by the regulatory and prudential requirements (without proper application of the principle of proportionality and institutional separation in the state's economic and fiscal

³⁰ M. Król, *Procesy konsolidacyjne w bankowości spółdzielczej*, „Bank”, 2019, nr 9, pp. 18–21.

³¹ Although the EU and national documents declare support for the credit cooperative development in order to increase the financial activity at the local level, it is reflected to a small extent in the Polish economic reality.

³² E. Kulińska-Sadłocha, J. Szambelańczyk, *Credit co-operatives in the social market economy as illustrated by the co-operative banking sector in Poland*, [in:] *Social Aspects of Economic Activity*, red. P. Pysz, WSB University in Poznan, Research Journal 2016, Vol. 68, No. 3, pp. 159–173.

policy), as well as the market and institutional imitation limit possibilities to use potential advantages resulting from the cooperative achievements and historic heritage. The target model should minimise the existing weaknesses of cooperative banks, use chances and also constitute a response to long-term challenges, including challenges connected with the sustainable social and economic development.

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