1. Introduction

Books do not usually start with an appendix, but perversely this one does. The appendix provides a rather dull explanation of all the different terms used to describe the alternative to the ‘capitalist’ banks that have let us down so badly over the last few years. The problem is that we have become so conditioned to seeing investor-owned banks as the norm that when we try to describe an alternative words fail us; we do not know how to describe it. This book will show that there is an alternative banking system that has a long and distinguished history, and in many countries already is a serious competitor to other kinds of banks. However, because of historical accidents and misunderstandings it now comes in several guises: cooperative banks, credit unions, savings and credit cooperatives, building societies, mutual savings and loans, and so on. In order to *see* the alternative we first have to name it. We need an umbrella term, and so this book is about *customer-owned banks*.

The idea of *customer-ownership* is simple. Some banks avoid the need for a group of investors who take ownership rights over the business. They turn their customers into owners instead. There are all sorts of consequences to this decision that will be explored in the book. On the one hand, they are not all that different from investor-owned banks; they do the same kind of business, relying on managers and boards of directors to take decisions, using the same technology and providing similar products, but they have different motivations and their definition of business success is very different. Crucially, they do not have the incentive to take the kind of risks that have brought so many investor-owned banks to ruin and required the need for massive government bailouts.

The idea of a *bank* is also simple. It comes either from the Italian word for bench (*banco*), where moneylenders would sit, or from the other meaning of bank, as a mound or heap of money. For children it is a ‘piggy bank’, a box to put their coins into until they need to take them out again to buy something. This was true for adults as well in the days before banks evolved into businesses; in eighteenth-century Britain there were ‘box societies’ where people saved their money by putting it into a box kept in a local public house. They would elect trusted members to be the keyholders, and would share out the money according to rules agreed by

the group. As we shall see, there is a direct line of descent from these box societies to customer-owned banks such as building societies.

Some readers may object to the use of the term '*customer-owned banks*' because they do not like the idea of reducing members of a social movement to the status of customer. They may feel this is too commercial an image, but this is exactly why we should use the term. Traditionally, the promoters of credit unions among low-income people have seen them as members of a community who have a common bond, rather than as individual consumers, or small business people, or employees. We, on the other hand, are customers who expect banks to provide us with the services that we need regardless of what community we may belong to. Why should we treat poor people differently? Some readers will object to the use of the term '*customer-owned banks*' because only some financial cooperatives have the right to use the term '*bank*'. This is because, in each country, regulatory authorities have reserved for themselves the power to call a particular financial business a bank. Generally the test is whether it offers its customers current accounts, and takes part in the clearing system. Those who fail the test are then called '*non-bank financial institutions*'. This is clumsy, and also inconsistent; savings banks are still called banks even if they do not provide current accounts, simply because they have always been called banks!

What do we mean by customer-owned banks? The essential elements are ownership, control and benefit. The customers own the bank, with each person having one member-share. Nobody can sell it without their agreement. This does not mean that they should be able to demutualise it; the bank does not belong just to the current cohort of members but is an intergenerational endowment held by the cooperative for the benefit of current and future members. Membership is not transferable, and so there is no market for shares. The customers also control the bank. As members, they are an integral part of the governance structure, with powers derived from personal membership; they have one person, one vote, regardless of the amount of capital they have invested.

The customers are also the main beneficiaries. The main purpose of the bank is to benefit the members rather than to maximise profit. They can expect some of the profits to be distributed to them as a dividend, but this is proportional to the use they make of the bank rather than to their investment. Because of the intergenerational endowment, some of the profits also have to go towards strengthening the bank's reserves.

There are some operating principles that follow from these distinctive features of ownership, control and benefits. The main source of capital for the bank is retained profits added to reserves. The main source of money for lending to members is member savings. The banks are often part of

a network with powerful apex bodies that provide them with mutual financial services. This enables them to remain local while benefitting from economies of scale and scope. Their focus is on long-term relationships with their customer-owners, not on making profits for shareholders.

It follows from these distinctive features that customer-owned banks should be stable and risk-averse. The banking crisis of 2008 was a great test of this hypothesis. With a few exceptions, the banks we have identified as customer-owned confirmed it to be true. They came through it without needing any government bailouts, without ceasing to lend to individuals and businesses, and with the admiration of a growing number of people disillusioned with 'casino capitalism'. They really are an alternative to the investor-owned banks that may be too big to fail but are also too corrupt to be trusted.

The book begins with four chapters exploring the different types of customer-owned bank: how they began, why they became so popular and grew so fast, and how they have survived all the financial crises of the last 100 years. Chapter 2 begins by telling the story of the invention of cooperative banking in the 1860s by two German social entrepreneurs, Schulze-Delitzsch and Raiffeisen. It compares their two systems and then shows how their ideas took off all over Germany, with primary societies and then apex bodies being created that proved mutual savings and credit could be provided by people who would otherwise be unbankable. It then describes the way their systems were copied all around continental Europe until there were thriving cooperative banking sectors in nearly every country. Surprisingly, the contours of these social movements are still clear. Their recent history is told, and then a detailed analysis is made of the current situation, providing statistics on the size and extent of the sector and its relative importance in different countries. This shows just how large and important the cooperative banking sector is, with a 45 per cent share of the market in France, 40 per cent in the Netherlands, and so on.

Chapter 3 provides the same treatment for the credit union sector throughout the world, beginning with the work of two more social entrepreneurs, Desjardins in Canada and Filene in the USA. This is a continuation of the same story, as it was the German system that was adopted under a different name. The chapter shows how the idea spread from one continent to another, but also how promotion by colonial and then nationalist governments in some countries in Africa and Asia led to government-controlled sectors that paid little attention to the idea of membership. It then provides a detailed recent history and analysis of the current situation in each world region. It shows that again, in some countries such as the USA, Canada and Ireland, the sector has become a strong

competitor with other banking sectors. It has also become a major player in the micro-finance sectors of low-income countries.

Chapter 4 introduces another type of customer-owned bank, the building society (known in the USA as a thrift, or 'savings and loan' (S&L)) that specialises in savings and lending for house purchase. This type has its own distinct history, which stretches back even further than that of the cooperative banks into eighteenth-century Britain. The transition from terminating to permanent societies is explained, and then the story is told of the rapid development of the movement in Britain and the USA. Having become pre-eminent in their field, in both countries they suffered from demutualisation. The consequences of this are discussed: the failure of converted S&Ls in the USA in the 1980s, and the failure of converted building societies in Britain in the recent banking crisis. One result is that the benefits of mutuality have become more obvious; customer-ownership creates a stable, low-risk system for recycling savings into loans.

Chapter 5 provides a short introduction to yet another type of customer-ownership, though this time in an indirect form. Banks owned by other types of cooperative – in particular consumer, agricultural and worker cooperatives – have become very significant in some countries. The UK Co-operative Bank is the best example; the distinctive history of this bank, with its policy of ethical lending and vigorous championing of consumer interests, is then explored.

Chapter 6 assesses the performance of the three main types of customer-owned bank: cooperative banks, credit unions and building societies. It compares their performance to that of other types of bank in the period before the crisis, then estimates the impact of the crisis of 2007–08 on the banks, and describes losses made by particular central banks in the USA, Japan and Germany. It analyses the performance of the three types after the immediate banking crisis up to 2011, and asks how they will perform in the future. The conclusion is clear; before the crisis, customer-owned banks were competing successfully against investor-owned banks, during the crisis they were almost completely unaffected (except in the area where the crisis originated – the USA), and the losses incurred have been made up very quickly. The chapter concludes that there must be something about the customer-owned business model that makes it so strong.

Chapter 7 then takes up the challenge of making the advantages and disadvantages of these banks more systematic for their customer-members and the wider society. It provides a framework for understanding business advantage in terms of types of ownership. Then, as in the author's previous work on other types of cooperative (Birchall, 2012d), it discusses the advantages and disadvantages to members under three dimensions of ownership, control and benefit. In relation to cooperative banking, it

adds in a fourth dimension – federation. Then it discusses the benefits of the cooperative ownership model to the banking system, finding that customer-owned banks provide diversity and stability. It identifies several benefits to local economies: the banks mobilise savings so as to provide loans to local businesses, they organise the sending of remittances from migrant workers, and generally have a pro-growth impact.

Chapter 8 discusses alternative types of bank that might provide similar advantages. It provides a short history of the savings bank, and describes its current spread worldwide. Then it analyses the sector's performance during and after the banking crisis. Ayadi et al.'s (2009) 'stakeholder banking' model is evaluated as an alternative to the 'customer-owned' banking model. Savings banks are found to have some important similarities with customer-owned banks, but their vague ownership and control structures may lead to instability, as has recently been shown in Spain and Korea. The chapter then discusses the similarities and differences between credit unions and the Grameen bank model of micro-finance. Other types of micro-finance institution are also considered as an alternative; they suffer from too much reliance on donor support, are difficult to scale up and are not as sustainable as credit unions.

Chapter 9 introduces the concepts of regulation, supervision, governance and member participation, identifying the main issues facing customer-owned banks. It cross-references different types of customer-owned banking system by type of regulation, supervision and governance. Then it identifies four current issues: the need to deal with the tightening of government regulations in the aftermath of the banking crisis; problems caused by supervision of subsidiaries and the growth of hybrid forms of ownership; the difficulty of effective supervision and governance in developing countries; and the need to reform government-controlled credit cooperatives.

Chapter 10 tackles the issue of human motivation, providing evidence from a wide range of behavioural sciences concerning the ways in which members, boards of directors and managers are incentivised. First it draws on theories of cooperation from evolutionary biology, developmental psychology and game theory. These provide broad generalisations about the conditions under which people will be prepared to cooperate with each other. These generalisations are then applied to the current situation in customer-owned banks. The chapter then draws on the author's mutual incentives theory to explain the circumstances under which members will participate. It then presents findings from studies carried out by the author on member participation in cooperatives, applying insights from these to customer-owned banks.

Chapter 11 provides a wider picture of other types of customer-owned businesses in retailing, insurance, utilities, agricultural supply and small

business consortia. A short history is provided that shows how often they have intersected with the history of cooperative banks and credit unions. Their current situation is described, and interesting comparisons are made with the banking sector. The chapter then makes clear the advantages and disadvantages of each type, and the way mutual insurance in particular complements customer-owned banking.

The conclusion argues that customer-owned banks have proved they are a viable alternative to the investor-owned banks that have so far failed to serve the 'real economy'. They help us to move from an 'anti-narrative' in which we are paralysed by disillusion, to a 'counter-narrative' in which we regain the power to act. If this sounds enigmatic, it will become clear to those who trouble to read the book . . .