

The difficulty and necessity of keeping the pioneering spirit: Rabobank

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Introduction

This article discusses the origination, evolution and special position of the co-operative Rabobank Group. What is the Rabobank? Why is it different from other banks? Which guiding star does it have? Which special position does the Rabobank Group take between larger commercial banks and smaller credit unions? These questions are considered in detail, because they focus on the pioneering spirit. Also the question will be considered whether the original guiding star is still there. Is it possible or desirable that the Rabobank Group transforms to a shareholder-oriented company or will it stick to its original stakeholder-concept? Interesting to explore are the possibilities to shift from a socio-economic orientation to a sustainable business concept ('sustainable banking').

The origination of the Rabobank Group¹

The existing Dutch co-operative banking system, consisting almost entirely of the Rabobank Group, has its origin in the rural communities of the Netherlands. One century ago the basis was formed by hundreds of local credit co-operatives as an answer to the lack of credit possibilities for Dutch farmers. Dutch agriculture had taken a turn for the worse in the second half of the nineteenth century (1875-1895), as the Netherlands started to import products on a large scale from the United States and other territories which had developed agricultural surpluses. Prices for Dutch domestic agricultural products fell. If they were to compete, farmers needed to borrow so that they could rationalise production methods. But they had no access to the commercial banks and were forced to borrow from moneylenders at exorbitant rates.

This situation called for an organised system of agricultural credit. The preference in the Netherlands was for the approach of Wilhelm Raiffeisen, a German mayor. He aimed primarily at 'uplifting' the rural population in his community which found itself in a poverty spiral from the combined effects of crop failure and usury by moneylenders. He founded in 1864 the first rural co-operative credit society. Farmers as well as small trades- and craftsmen who wanted a loan from this society had to become members. At the same time the local population was called on to deposit the little savings it had with the co-operative, so as to be able to lend the money against reasonable interest rates to the member borrowers.

In Holland the first local co-operative banks appeared in 1896. They developed rapidly and were mostly the outcome of local initiatives by conscientious dignitaries, farmers and small businessmen, with the encouragement of progressive churchmen and farmers' organisations. They had no government funding, so their capital base could be no more than their members' liability and the collateral on loans. By the turn of the century the local banks felt the need for an umbrella organisation for support and co-ordination, resulting in the establishment of a central co-operative bank in Utrecht and one in Eindhoven. Due to differences in ideology (religion) and ideas about the juridical structure, two central institutions were formed. One in the south (the so-called "Boerenleenbank", Eindhoven) and one in the north (the so-called "Raiffeisenbank", Utrecht). Until 1970, these different co-operative banks were competitors. Besides functioning as an advisory body, these 'central banks' were acting as an intermediary

¹ For further reading see for example Lavelle, A. (1998), *The Art of Co-operation - The Netherlands and its Rabobank*, Wormer.

for the investment of the local banks' surplus funds, and as a financial reservoir for local banks, who lacked enough funds for their local lending operations.

The primary objective of the local Rabobanks is to finance their members, being local business borrowers, at the lowest possible rates and the most favourable conditions. The funds needed for member financing are allocated by tapping local markets for savings and time deposits. To facilitate this, the Rabobanks provide a wide range of financial services for both trade and industry as well as private individuals. Every Rabobank has a Board and a Supervisory Board, elected by the members. The board is responsible for the bank's local banking operations, which are exercised under the management of a professional banker.

The Rabobank Group today²

The present-day Rabobank Group is the product of a merger in 1972 between the two central institutions ("RA-BO" is an abbreviation of the two old institutions), with the local banks following their example shortly after. Today Rabobank ranks among the 40 largest banks in the world. In terms of balance sheet total - euro 250 billion - it is the second largest bank in the Netherlands (at Group level it ranks at the third place). In terms of market shares however, it is by far the largest bank in the Dutch domestic market. With some 1,800 branches it has the most extensive banking network of the Netherlands. The Rabobank Group consists of locally some 445 independent co-operatively organised Rabobanks, its central institution Rabobank Nederland, several specialist finance (home mortgage, ship mortgage, consumer finance, insurance, factoring and leasing) subsidiaries. In the hundred years of its existence the co-operative Rabobank became not only the largest bank in the Dutch home market, but also one of the strongest banks in the world. In fact it is the only commercial bank with the highest credit ratings (triple A) from the world's most important rating agencies: Moody's, Standard and Poor's and IBCA

Rabobank's size and dominant position is clearly reflected in the following figures which are also proof of the fact that it is no longer mainly a 'green' (i.e. agricultural) bank. Although still covering about 85% of the bank credit requirements of the Dutch agricultural sector, this is only about one fourth of its total loan portfolio. With a market share of 38% Rabobank now is also the Netherlands' leading bank in the sector of financing small and medium-sized (0-10 employees) companies. This sector largely dominates Dutch trade and industry in which more than one third of Rabobank's total loan volume is outstanding. The bank's share of the home mortgage market is about 25%. All these lending activities are mainly funded by the bank's 40% share of the Dutch bank savings market. This makes Rabobank also the largest savings bank in Holland. In addition, some 35% of the capital of investment funds in the Netherlands is entrusted to the Rabobank.

Rabobank Nederland has the legal form of a jointstock co-operative society, the local Rabobanks being both its members and shareholders. Rabobank Nederland's juridical position makes clear that it is not the local banks' headquarters. It advises and supports its member banks, supervises their liquidity and solvency positions and acts as bankers' bank for the whole Group. In addition, Rabobank Nederland has a banking business of its own, which operates as the Group's professional wholesale bank. It specialises in financial services for major national and international corporates, as well as in money market and capital market transactions. For

² See for example Rabobank Group, Annual Report 1998, Utrecht.

this purpose it offers a wide and comprehensive range of corporate banking and corporate finance products.

Rabobank's origins explain why the bank, for nearly 80 years, has been mainly domestically oriented. However, during the last two decades Rabobank's international activities have been growing rapidly. This is the logical consequence of the bank's co-operative mission. In the last two decades of this century Rabobank's corporate members became more and more involved in international links. In order to be able to service members interest which does not stop at the borderline properly, Rabobank simply followed its corporate customers abroad. Consequently, its international strategy is primarily to be defined as servicing its Dutch business clients in those countries which are of most importance for Dutch trade. Rabobank International (a subsidiary of Rabobank Nederland) is responsible for the international banking operations. The still growing foreign network of meanwhile 150 offices in 39 countries (Rabobank Group) plays an important role in becoming a global player in agribusiness finance and health care, Rabobank's international 'niche' specialisms.

The Group's basic strategy of the 1990's, is directed at keeping its strong position in the Dutch home market and rooted in the so called 'All-Finanz' concept. This strategy aims at being a broad supplier of a wide range of integrated bank, insurance and investment products.

Basic fundamentals of the 'Raiffeisen system'³

To understand the Raiffeisen principle it is necessary to have a closer look at its basic fundamentals. These fundamentals are:

- Compulsory membership for (business) borrowers;
- Liability of members;
- Limited area of operation for the local banks;
- Allocation of profits to the reserve;
- Democratic and decentralised structure.

In a co-operative the basic assumption is that common interest also is in the interest of the individual members. For that reason individual membership is compulsory. The local co-operative Rabobanks' compulsory membership was to be restricted to business borrowers in 1980. This was a logical decision because the articles of association were linking the co-operative objective exclusively to local businesses. In 1998 the Rabobank Group changed it's strategy in accordance with it's growing character of a broad financial institution. Membership is no longer compulsory and every customer can become a member and accordingly influence the companies policy. The only condition is that the customer has a certain commitment to the bank and it's ambitions, i.e. its primary objective.

As the first co-operative banks lacked own funds, depositors had to be given some other guarantee for the repayment of the money they had entrusted to these banks. This guarantee took the form of unlimited (personal) liability of the members for losses of the bank. Over the years however, the consolidated reserves had accumulated to such a level that unlimited liability was not reasonable anymore. Therefore in 1980 liability was restricted to about euro 2,300 (NLG 5,000) per member.

³ See for example Dierick, A.M. (1996), *Het coöperatieve bankwezen in Nederland*, Serie Bank- en Effectenbedrijf 26, Amsterdam.

A limited area of operation enabled and still enables the local co-operative banks to have a good view on the borrowers' business as well as his private circumstances. This was and is essential to prevent losses, to ensure a sound management of the funds entrusted, and to keep in close touch with the primary clients, being the members.

Allocation of the profits to the reserves is essential to prevent recourse to member liability. With visible reserves consisting almost entirely of own funds, which now are amounting to euro 10.4 billion (BIS-ratio of 11.3%), the Rabobank Group is the strongest capitalised bank in the Netherlands. This and the fact that all parts of the Rabobank Group are liable for each other through a so-called Cross Guarantee System make it unlikely that a call would ever be made on member liability. Therefore, this liability was abandoned totally in 1998. To commit members to the bank, so-called (voluntary) member-certificates have been developed as an alternative. Since membership is essential, a democratic structure to ensure members' influence is also essential.

The social contribution of the Rabobank Group

Being a co-operative company and not a listed one with shareholders, Rabobank does not pay any dividends. As we have seen, all profits are allocated to the reserves. This is a big advantage for two reasons. Not only has the bank throughout the years always been able to finance the growth of its activities with its own funds, without being forced to resort to external capital suppliers. Moreover, this strong capital base is also to a large extent the reason for its AAA credit ratings, through which the bank is able to tap the professional financial markets at the lowest possible funding costs.

Co-operatives are not based on capital suppliers' interest, but on members' interest. So the Rabobank Group is not aiming at maximising profit, as do equity driven companies on behalf of their shareholders, but at maximising the economic benefit for its co-operative members. Profit is only an instrument to serve the continuity of the co-operatives, which is done by demanding the lowest possible price for loans and credits from the member borrowers, and at the same time by creating the most favourable lending conditions. Inherent to the latter is that if a member's business is in financial difficulties, a local Rabobank will give support as long as possible. This long term orientation is also characteristic for the way in which all other customers are treated. Although every bank will state this, in the 1970s and 1980s customers of other commercial banks discovered the difference: Rabobank does not give up as simplistically as other banks do. Another aspect of long term orientation is that Rabobank considers it to be its duty to stimulate businesses getting from the ground. It has raised a special Guarantee Fund to be able to stimulate (starting) entrepreneurs having promising plans but insufficient own funds with subordinated loans.

Rabobank's large market shares are not something to boast on, because they are the condition for being able to do what every co-operative should do: influencing market prices on behalf of its members. This can be illustrated as follows. The average interest on savings is normally lower than on the professional money markets and capital markets. More than 60% of Rabobank's lending operations in guilders is funded from the enormous resource of Dutch savings of which Rabobank has a market share of 40 percent. Thanks to this strong position Rabobank's funding costs are lower than those of its competitors in the Netherlands, who have considerably smaller market shares. Lower funding costs are obligatory to be able to live up to our co-operative principle. It means being able to charge borrowers lower interest rates and pay a fair price to savers. It means also that its overall interest margin is better. Thanks to that Rabobank can

operate as a price setter for the whole market in the Netherlands. All customers will profit from that. As a matter of fact, the positive influence of co-operative banks on interest rates is not only felt in the Netherlands; Rabobank discovered that the average interest margin of banks in countries with a sound co-operative banking system is much lower than in countries who do not have one.

In propagating the co-operative credit philosophy, Rabobank does not restrict itself to the use of words only. The bank takes for instance action by providing know-how to help economic development in developing countries as well. Therefore, Rabobank has created, amongst others, the Rabobank Foundation. With voluntary donations of local Rabobanks and equal donations of Rabobank Nederland this foundation helps locally based small scale co-operatives to get started. The Rabobank Foundation supports these initiatives financially as well as by providing experts assistance.

The pioneering spirit and the future

In 1995 a discussion within the Rabobank Group was launched about its orientation. The question basically was: will we remain a credit co-operative? The alternative would be to transform ourselves to an equity-driven company. However, it was not a question of choosing between two rigid organisation concepts; i.e. the emphasis has been put on remaining a credit co-operative or transforming ourselves to a broader customer orientated co-operative. The discussion lasted for three years. In a completely democratic process the members of the Rabobank Group have decided to keep to its roots, i.e. a co-operative bank⁴, but to broaden our services to all customers. To facilitate this change voluntary membership has been introduced.

In short, the Rabobank has evolved from an (agricultural) credit institution to a (general) 'All Finanz' institution. The pioneering spirit is still an intrinsic element of the culture of especially the local banks. Also the present corporate philosophy is still in line with the pioneering spirit from the past, as the outcome of the so-called 'co-operation discussion' in 1998 pointed out. At an abstract level the corporate philosophy can be defined as a co-operation of people with different backgrounds in a specific member-organisation to support the self-sufficiency of some of the members, which will come to the good of the (local) society as a whole. This is still the case. Only the basis of organising has shifted: one hundred years ago this member-organisation started out to support the rural population in self-sufficiency and economic development; at the beginning of the 21st century this organisation stands for the self-sufficiency and economic self-reliance of all population groups and not only in the Netherlands, but also abroad (mainly in developing countries through activities of the Rabobank Foundation).

The culture and structure of the Rabobank is one where there is space for innovative ideas and bottom up processes. Moreover, decision processes and renovation have an organic character. This makes the Rabobank Group very flexible and interesting to work at. But it also means decision processes take time, mainly because of the space for discussion. However, a major advantage is that once a decision has been taken, it gets a lot of support and commitment.

A second discussion within Rabobank is about innovation and responsible business. It is clear that local banks in the Netherlands are better equipped to service the local community commercially and co-operatively. The professionalisation and internationalisation of the

⁴ Implicitly this also meant that the Rabobank Group wouldn't transform itself to an equity company.

Rabobank Group raises questions whether this can be extrapolated to our international activities as well. At the moment this seems to be very difficult. Especially in our international activities a dilemma exists in keeping up with our pioneering spirit. The shift from a (agricultural) credit co-operative to a co-operative aiming at fostering (all) customer value, raises the question how to fill in our co-operative ambition on an international scale. Contrary to the Netherlands the Rabobank internationally is a price-follower. The question will be how we internationally can distinguish ourselves from equity driven commercial banks. This (second) discussion is still going on.

Within the Rabobank a third discussion has been initiated about the question whether or not the emphasis on the social and economic aspects of life is still sufficient. Do the ecological aspects of life also have to be taken into account? That is, will the Rabobank evolve from a socio-economic orientation to an orientation driven by the concept of sustainability in which apart from a social and economic orientation, the concept of ecology comes into the picture? Within Rabobank this idea has been called the 'triple-P concept', which stands for - in arbitrary order - people (society), planet (ecology) and profit (economics)⁵. As far as banking is concerned, we're talking about sustainable banking⁶. The new ambition-statement of 1999 points this out: "The Rabobank Group believes that sustainable growth of prosperity and well-being must never be at the expense of nature or the environment. The Rabobank Group aims to keep this objective in mind in its activities and contributions to sustainable development." This also means helping customers becoming more sustainable. All kinds of products and services will be developed to facilitate this, like investment funds, insurances, environmental loans, advisory services et cetera.

This is a real major change. Firstly, because sustainable development is not a familiar subject in the banking community. Secondly, because of the sometimes conflicting interest of members in the short run. It is in this context that the Rabobank Group is elaborating on its pioneering spirit: self-sufficiency of all its customers, in the short run as well as in the long run. Or better, the very long run: the concept of sustainability also takes the (expected) interests of future generations in its decisions. To accommodate this, Rabobank has consciously chosen for being sustainable, also in an ecological sense. It will be a good thing to explore this new heading of banking. As a large commercial and co-operative bank, the challenge for the 21st century will be to make 'sustainable banking' the renewed pioneering spirit.

⁵ This concept originates from Elkington, J. (1998), "Cannibals with Forks: The Triple Bottom Line of 21st Century Business", London.

⁶ In 1998 the Rabobank published a book called "Sustainable Banking". At this time it's only available in Dutch (with a short English summary) : Jeucken, M.H.A. (1998), "Duurzaam bankieren - Een visie op bankieren en duurzame ontwikkeling", Rabobank, Utrecht.