Hungarian cooperative banks and financial exclusion after new integration processes

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Abstract: The Hungarian cooperative bank sector was characterized by the lack of integration and fragmentation before 2013. To solve this problem, several scientifically supported solutions with international examples (German, Italian) have been proposed but the Hungarian Government made an Act. for the rapid solution of this problem because of the slowness of the bottom-up models, alternatives. This top-down integration has several positive results related to economy of scale and resource efficiency, but this can also be characterized by an important disadvantage with little publicity. The 'bank of the countryside' function (Kiss, 2009) seems to be lost, the financial decision-makers are going further and further away from the local level, the financial exclusion rate increase in the peripheral and rural areas.

In this paper, we would like to describe a short history of the Hungarian cooperative banks, and examine the effects of the integration processes. We supplemented our Hungarian quantitative analysis with an international comparison between the European Union member states.

Key words: corporate savings banks, financial exclusion, distances, territorial differences, Hungary

JEL Classification: G21, P13, R12, R51

1. Introduction, transforming cooperative banks in Hungary

The history of Hungarian cooperative savings banks can be divided into more phases. The first credit cooperative was founded in the 1850's. The next period is characterised by the way towards the network integration (1898) while in the third period, in the early 20th century, the sector expanded dynamically. Historical and economic events (world wars, economic crisis) repeatedly interrupted these processes. During the communist era cooperative banks were oppressed and controlled by the political decision makers (Kulcsár, 2007; Moizs, Szabó, 2012).

Experience from the transition from planned to market economy suggests that the role of the state was especially significant in the case of reforming the post-socialist banking systems, while the concept of financial deregulation proposes the withdrawal of the state from financial markets. However, the post-socialist

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state had not only committed itself to the neoliberal restructuring, reforms required by EU accession, but unilaterally biased towards large foreign investors who played a key role in bank privatization (Raviv, 2008; Gál, Schmidt, 2017). The Hungarian government policy supported international companies, particularly foreign owned commercial banks, at the expenses of domestic banks (cooperatives) and local entrepreneurship. This policy also failed to recognize the potential advantages of the domestic cooperative banking sector in financing small businesses and mitigating financial exclusion (Gál, Kovács, 2018). In this period, the evolution of the Hungarian cooperative banks in turn not only followed international trends towards demutualisation, but the regulatory shortcomings and the dual banking system significantly affected their transformation.

The transformation crisis imposed a huge burden on the banking system and cooperative banks became particularly vulnerable. Cooperative banks which became vulnerable during the first domestic banking crisis after the change of regime during the first stage of economic transition were supported by the state through the newly established National Cooperative Banking Institution Protection Fund (OTIVA) and by strengthening the Takarékbank. Despite setting up these institutions, both the effective lobbying force by cooperative banks and the government policy will for further support have disappeared (Kalmi, 2010; Gál, Burger, 2013). The sector remained alone in the unequal/uneven market competition with commercial banks, all the while maintaining its 4–6% market share. The banking reforms of the early transition period offered a unique opportunity to strengthen the domestic cooperative banking sector, but it was not exploited and its internal and external framework conditions were totally lacking (Gál, Kovács, 2018).

The complex transition processes added some new problems to the cooperative sector. Due to the absence of adequate legal regulation, the corporate governance structure further weakened paving the way towards demutualization and the social embeddedness of the cooperative banking sector started to disappear in Hungary. Moreover, there was no mandatory membership at an institutional protection fund for Hungarian cooperatives, as it is typical in other European countries. The degree of heterogeneity was high and, at the same time, the propensity for stronger network integration remained low. Institutions often look at each other as competitors and not as partners. While some cooperatives chose to operate without any protection fund, and sometimes demutualized ex-cooperatives, operating as commercial banks, were admitted. As a result, up until 2013, three protection funds existed in the country (OTIVA, TAKIVA, REPIVA) with varying degree of control over the cooperatives and financial power (Gál, Kovács, 2018). In 2013, the government launched a forced integration of the cooperative banks passing the Act on Cooperative Banks (Act. 135/2013), which interrupted the bottom-up and voluntary integration processes within the sector. Instead of this the government introduced a mandatory, top-down and political-driven integration. Despite that this 'reform' had some cost-cutting results, it did not solve the main problems of the sector: for example the small market share, the lower efficiency and performance, and it led to the final erosion of territorial principle of cooperatives and the increasing of the financial exclusion (Kiss, 2009; Kovács, 2015). In this Act, the legislature created a new institutional framework of networks, established a new umbrella organisation of the integration, which is responsible for the institutional protection, the financial supervision and the crisis management, if it is necessary. In this duplicated structure, the Takarékbank (the former apex bank) became the old and new umbrella bank of the integration with extensive inspection rights, but its main task is the making of common strategy and business policy (Bodnár et al., 2015). Lastly, this Act influenced the network of cooperative banks, too. The integration process and the development of closer cooperation among the cooperative banks has not come to a halt; as a result of the mergers and acquisitions there were approximately 90 institutions in 2016 (Bodnár et al., 2015), in the end of 2019, we could identify only one aggregated institution due to multistage acquisition processes *(Table 1.)*.

A significant part of the relevant literature revealed that the financial service or banking sector has effects for the economic growth in different geographical (local, regional, national) scopes (Mitchell, 1970; Bekaert, Harvey and Lundblad, 2005; Beck, Demirgüç-Kunt and Martinez-Peria, 2010) so the presence of these institutions plays a significant role in the local economies. In this paper, I would like to analyse the changes of local presence of the Hungarian cooperative banks, and the impacts of these changes on the financial exclusion and its economic consequences.

Table 1. The number of cooperative banks and their branches, 2011–2019

	2011	2014	2018	2019.06	2019.11
Number of cooperative savings banks	142	129	22	17	1
Number of branches	1 945	1 733	1 658	1 231	1.021

Source: Own editing based on the data of National Bank of Hungary.

2. Data and Methodology

The main aim of this paper is to show that how has changed the availability of the Hungarian cooperative banks during last decade and after the integration act. These changes have an impact on financial exclusion so firstly we analyse the data of inclusion or exclusion of European Union member states based on the Global Findex database is prepared by the Worldbank (Demirgüc-Kunt et al., 2018). This comparative analysis examines the macro-regional differences according to the income status of individuals, as Horn and Kiss (2019) showed the relationship between income status and account ownership. Our second macro-regional analysis focus on territorial (urban-rural) differences of account ownership.

Our Hungarian analysis is based on the data of the National Bank of Hungary and we used some dataset from the Central Statistical Office of Hungary.

Different types of the financial distances describe that the territorial differences of the accessibility of financial products and services. As regards the types of distances that are interpreted in the field of financial services, the indices of physical distance and operational distance were demonstrated by Kovács (2014; 2017). Physical distance measures the distance between customers' location (settlements) and the nearest bank branch in kilometres and operational distance shows how many people served by a branch in the analyzed area (settlement, district, county, etc.). In this paper, we use the values of the functional distance indicator (Alessandrini et al., 2009; Kovács, 2018) of cooperative banks from 2011, 2014, 2018 and 2019. Functional distance takes into consideration, in addition to the simple physical branch–centre (and decision-making) distance, the disparities of the socio-economic indices (local participation activity, development level of non-governmental sector, housing conditions) of the respective territorial units, and also the diverse economic structures (breakdown of employees by sectors). So, this indicator contains the following three different components:

- physical distance component (FD_j^1): distance (KM_{jz}) between the settlement of analysed branch and the settlement of headquarter of its institute on public road in kilometres.
- social component (FD_j^2): we used different indicators (SC_j) for the description of the social status of the settlements e.g. income status, unemployment rate, voter turnout.
- economic component (FD_j^3): our index handles the economic differences of the settlements, so we analyzed the sectoral distribution of the labour force and the local enterprises (W_{hj})

$$\boldsymbol{FD_j^* = FD_j^1 + FD_j^2 + FD_j^3}$$

or

$$FD_j^* = \frac{\sum(branch_j \times \ln(1 + KM_{jz}))}{no.of\ branches_j} + \frac{\sum(branch_j \times \ln(1 + |SC_j - SC_z|))}{no.of\ branches_j} + \frac{\sum(branch_j \times \ln(1 + \sum_{h=1}^{m} |W_{hj} - W_{hz}|))}{no.\ of\ branches_j}$$

where:
j – is the analyzed district
z – is the district of the headquarter of analyzed branch
h – is the sectors of economy (1–m)

It is clear that in an optimum case the two regions are the same, the volume of functional distance is zero, while its increase leads to a growing number of financing limits in the respective region. Functional distance has a positive correlation to the financial assets of the businesses, the cash-flow sensitivity of investments and correlates negatively to the possibility of indebtedness or overdrawing according to the result of Alessandrini et al. (2009).

3. Results

3.1 Trends of financial exclusion in European Union

On average around the world, poorer adults are less likely to have an account than wealthier ones (Demirgüc-Kunt et al., 2018). However, we can see significant differences between the inclusion rate of the richest and poorest groups of the society in the European Union. *Figure 1* divides the countries into two groups, the first one contains mainly Northern and Western countries (exc. Slovenia, Estonia and Malta) and it is characterised by relatively high inclusion rates and low differences between social groups. In Eastern and Southern countries, we can see lower inclusion rate and higher differences between the analysed social groups. In Hungary, the account ownership status depends on the job status (leader, employee, physical works, etc.) too (Kovács, 2014).

The account ownership shows not only social, but also territorial differences. We examined that how much difference is in the rural value of inclusion rate compared to the national average values in the member states of the European Union *(Figure 2.).* According to the EU average, the rate of bank account holders in the rural population is about 0.5 percentage lower than the national average, but Figure 2 shows that this difference is the second highest in Hungary (6.1%) behind Bulgaria (6.6%), while, in some countries, for example, in the neighbouring Croatia, the proportion of the rural population having an own bank account is higher compared to that of the total population. The higher number of financially excluded people determined by the lower accessibility of financial services in the rural areas (Kovács, 2017).

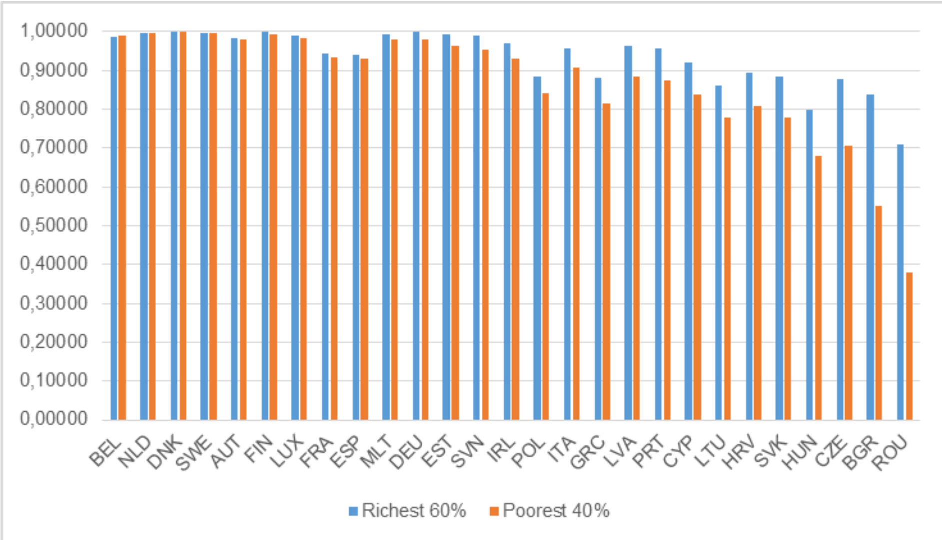

Figure 1. Proportion of account ownership by individuals from different financial situations, 2017 (%)

Source: Own editing based on data from Demirgüç-Kunt et al. 2018.

3.2 Exclusionary effects of the integration processes

After the analysis of the European trend of financial exclusion/inclusion, we analyse that the territorial effect of the cooperatives' integration. Firstly, according to *Table 1*, we checked and collected those settlements where the cooperatives closed definitively. The *Figure 3* shows that where closed the last cooperatives (red) and where opened a new branch (green). Since 2011, the "Takarék" Group has emerged as a financial service provider in two settlements (Sajószentpéter and Parasznya), while it has withdrawn from 631 small settlements *(Figure 3)*.

We used the functional distance indicator for the evaluation of the financial exclusion. Because of mergers and acquisitions, the decision making processes (e.g. decisions about loans, interest rates, etc.) are moved further away from the local level, thus reducing the local embeddedness of decisions and increasing information asymmetry. It is also true for the integration of the Hungarian cooperatives, because *Figure 4* shows that the map bacame darker and darker during the last decade.

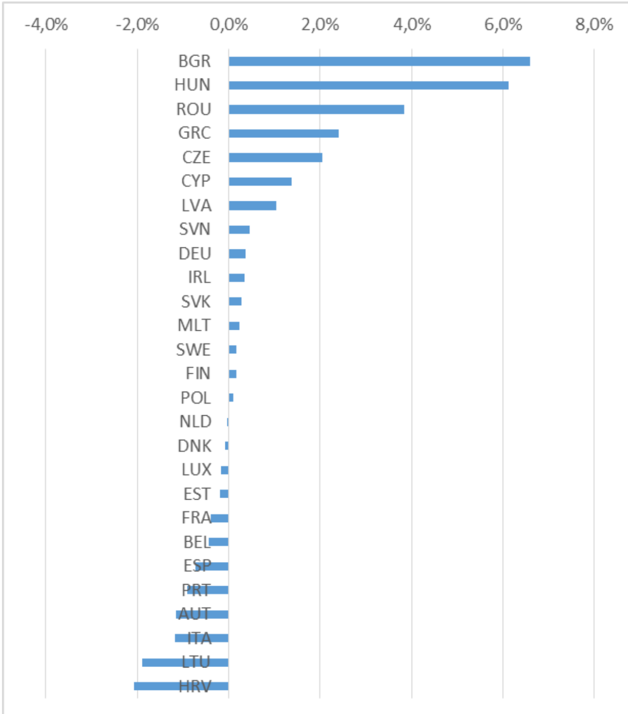

Figure 2. Differences in account ownership between total and rural population, 2017 (%)
Source: Own editing based on data from Demirgüç-Kunt et al. 2018.

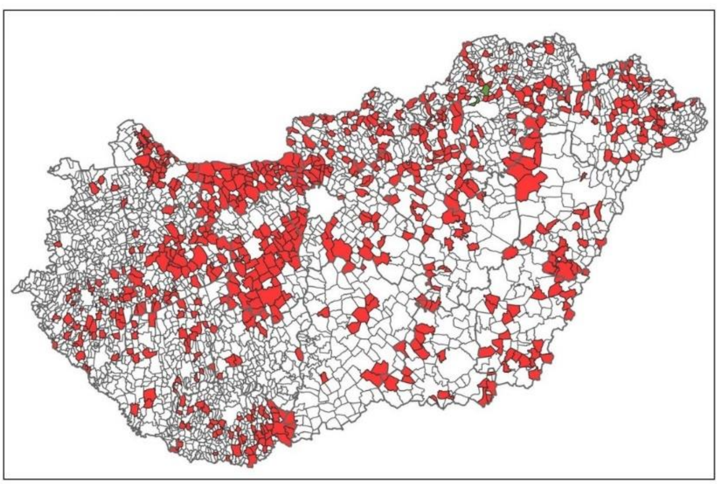

Figure 3. Cooperative branch closures and openings between 2011 and 2019
Source: Own editing based on the data of National Bank of Hungary

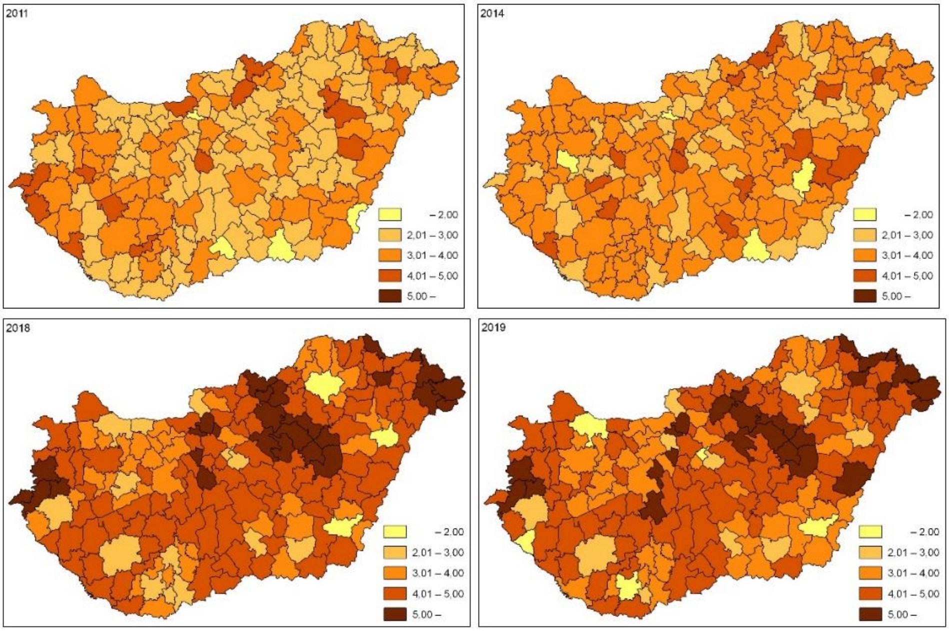

Figure 4. The functional distance of the cooperative savings banks at level of districts, 2011–2019

Source: Own editing based on the data of National Bank of Hungary and the Central Statistical Office of Hungary.

Overall, the integration of the savings cooperative sector was necessary due to the previous fragmentation and different strategic considerations, but the high Hungarian financial exclusion rates raise some problems. Poor accessibility of banking services (mainly in rural, periphereal areas) can lead to an increase in the number of excluded people. They not having access or not knowing how to use properly bank services can depending on status and life experience of people facing it, have an impact on self esteem and lead to (self)-isolation and depravation of social connections and social relationships with friends or family (Bayot, 2008).

4. Conclusion and discussion

As our results showed, the integration of Hungarian cooperative savings banks corresponds to a centralisation process in the context of decision making and strategic planning. This integration has some result in the common brand building (advertising, marketing), IT-developments, but it is not a good solution for the problems of financial exclusion. For the solution we can find many best practices and new forms of banking in the international literature and practice, but we need to see their limits.

The first solution is the possibilities of digitalization and online banking. Nowadays, many banking products are available on the internet or mobile apps (e.g. pay withdrawal, digital payment, other account using). However, some other banking activities do not have online substitute products (e.g. account opening, contract modification, etc.). The main problem in Hungary is increasingly not the shortage on the supply side of product, but the limitations of demand (income situation, education) and lack of physical infrastructure (branch network), which increases financial exclusion (Kovács, 2017; 2020). That is why it is essential to develop the necessary competencies, financial knowledge and culture, because without them no significant progress is expected. On the other hand, the problems of handling bank data and the dangers of data theft should not be forgotten (Burián, 2014).

Numerous international examples show that the involvement of local society in financial services and processes can be solved in an alternative way, with the help of alternative or local currencies. Currently, we know five operating local currencies in Hungary, but these are not yet significant factors in reducing exclusion and putting the local economy on the path of development, as their volume and acceptance have not yet reached a critical mass (Lakócai, Gál and Kovács, 2018).

The "Takarék" Group introduced a new way of banking in some rural and peripheral areas of Hungary. This is the mobile bank branch. It is a bank on four wheels which travel around excluded areas of the country and offer a lot of the same current account services as customers would find in a branch, including depositing cash, withdrawals and bill payments (magyartakarek.blog.hu; portfolio.hu). We think, this solution is good for serving existing customer but it doesn't offer services for new customers e.g. new account opening, new credit or loan contract, thus, it doesn't significantly reduce the financial exclusion.

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