The surprising case of Austrian *Raiffeisen Zentralbank* through the 2006-2010 crisis

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In France the head groups of mutualist banks *Banques populaires* and *Caisses d'épargne* have been stricken harshly by the banking crisis in 2007-2008; in Germany, the regional half-central or federal banks (*Landesbanken*, as state banks linked with savings banks) are mostly crippled by a dire crisis of governance, management and strategy; even in Spain, a few thrift institutions commenced to bear the load of their over-investments or -lending in favour of real estate and building companies. All over Europe, mutualist banks are confronted to the direct (bad loans, errors in proprietary trading) or indirect (global crisis of confidence, refinancing and even illiquidity) effects of the finance bust. Against such a background, very few of them seem to cross the tempest without leaks, mainly Rabobank (= a cooperative bank), *Crédit mutuel Centre-Est Europe*, or the *Raiffeisen Zentralbank* group. This very latter will be at the centre of this chapter: without consulting archives or management records, and therefore relying only on official documents released by the firm and on general economic news (press, internet, etc.), this case study of "immediate business history" (stake-holders, strategy, skills, corporate culture, performance) will ponder the reasons why *Raiffeisen Zentralbank* (RZB) escaped the strikes of the crisis for several terms and what chances it disposes of to resist the further developments of the slump. We shall first remind of the recent strategy of the group; then consider its advantage edge and its portfolio of skills; last, determine its very resistance to the crisis.

1. From cooperative heritage to Austrian banking might

Like its German sister institutions, RZB is the inheritor of the *Raiffeisen* movement which spilled all over the German-cultured areas since 1862. The first savings and loan *Raiffeisen* bank had been founded in Lower Austria in 1886, and, beginning in 1894, the local cooperatives set up regional *Raiffeisen* banks, before a joint federal association appeared in Vienna as soon as 1898 (now: *Österreichischer Raiffeisen Verband*), which gave birth to an executive instrument in 1927, *Genossenschaftliche Zentralbank*, renamed in 1989 as *Raiffeisen Zentralbank Österreich*. In 2007, 548 autonomous local *Raiffeisen* banks (with 1,702 branches) controlled nine regional *Raiffeisen* banks (operating as clearing tools and as little universal banks), while the third tier was constituted of RZB.

Raiffeisen regional banks

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Raiffeisen Landesbanken Holding (mere screen company)
Raiffeisen Landesbanken Beteiligung

81%

↓

Raiffeisen Zentralbank

69%

↓

Raiffeisen International

This latter manages the back-office affiliates (IT, credit cards), the specialist subsidiaries (real estate, trading, private equity, leasing, housing credit-*Bausparkasse*, etc.), the foreign connections (apart from Central Europe), and a national clearing platform, *Centrobank*. The key advantage edge therefore lays in the construction of a rational and coherent structure, of a genuine "group", (apparently) deprived of internecine fighting like those which have been splitting German *Landesbanken* from the 1990s, preventing them to build efficient groups and to mutualise banking tools and skills. Its second advantage edge was its discreet conquest of market shares because it succeeded in taking profit from its local basis to go surfing on the wave of mass banking. Its embeddedness and skills paved the way to a more rapid growth than is competitors (table 1).

Table 1. A few clues of the fighting spirit of *Raiffeisen* banks at the emergence of mass banking				
	Market shares for loans		Market shares for loans	
	1953	1970	1953	1970
Joint stock banks	56.4%	25.7%	44.2%	21.2%
Savings banks	16.9	27	24.3	35.6
Raiffeisen banks	9.5	16.7	7.4	18.3
Volksbanken	6.5	6.6	4.5	7.8
Bausparkassen			0.3	6.3
Gunther Tichy, "Drei Phasen des Strukturwandels im österreichischen Kreditapparates", Wien, *Bankarchiv*, 9/1977. Gunther Tichy, "Zu einigen wichtigen Strukturmerkmalen des österreichischen Kreditapparates", Wien, *Bankarchiv*, 9/1977. Gunther Tichy, "Strukturwandel im Kreditapparat und die auf uns zukommenden Finanzierungsprobleme. Aktuelle Beiträge zum Geld- und Bankwesen", Wien, Österreichisches Forschunginstitut für Sparkassenwesen, 4/1980. Dieter Stiefel, „'The bankers' view': Austria's economic and political development and the role of the Creditanstalt", in EABH (ed.), *Finance and Modernisation*, to be published.				

Mutualist customers' faithfulness, skills in proximity banking, embeddedness within connections among small and medium-sized companies and among the Austrian German-like *Mittelstand* (mechanics, electronics, etc., and the economy of cultural and rural tourism), were levers to such an assertiveness indeed. We could also enhance the fact that, all in all, Austria was some kind of a "national *Land*" by itself, disposing of a sense of unity: a region the size of a few German *Länder* was equipped with two far more rationalised and efficient thrift institutions (twelve federal regional banks), RZB and the savings bank group (around *Erste Bank* group[1]). Vienna was altogether a "regional" pole of banking economy at the center-east of developed and market-economy Europe and a "capital" of banking rich with two philanthropic poles of competence, the mutualist RZB and a mixed *Erste Bank/Sparkassen*. – philanthropic being understood as a way to entice petty producers and savers to take in charge their assets and banking needs without the intermediation of capitalist banks.

The might of RZB was reinforced by its Vienna basis: it could rely on the heritage built by *Raiffeisen Niederösterreischische-Wien*, its key *Raiffeisen Landesbank*, because this universal banking company had been fuelled by the span and the diversity of its regional economy, first at the heart of a rich rural area (with 82 Raiffeisen cooperative banks in the single Region of Lower Austria), second at the core of Austrian industries, urban population and entrepreneurship (with 40 per cent of Austrian small and medium-sized enterprises). RNW had therefore enjoyed a unique market share and piled up deposits (70 outlets in Vienna itself; networks of private banking facilities) profits and reserves, thanks to which, as the main shareholder of RZB (31.3 per cent), it could foster the whole group with its capital of experience and commercial sway (table 2).

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Table 2. A few clues about *Raiffeisen Niederösterreischische-Wien*				
	Return on average equity	Cost-income ratio	Profit before taxes (€ million)	Operating results

[1] Because *Erste Österreichische Sparkasse* had been founded in Vienna as early as 1819.

2006	16.5	49.62	219	246
2007	16.42	46.51	255	288
Source: *Raiffeisen Niederösterreischische-Wien* website				

Generally speaking, the RZB group accounts for nearly 44 per cent of all banking outlets in Austria and key market shares in its various activities (table 3).

Table 3. RZB's market share in Austria		
	2002	2007
Total non-banks deposits	25.5	27.8
Savings deposits	28.2	30.9
Sight deposits	23.6	24.3
Total time deposits	23.6	24.3
Direct lending to domestic non-banks	22.1	23.8
Total securities funds	25.9	29
Internet retail banking		41

When the Berlin Wall collapsed, RZB was almost coincidentally ready to grasp opportunities of geographic growth and strategic offensives because it had already and recently reached a relevant level of maturity. Its curb of experience and its portfolio of skills in local banking and national universal banking had crossed some kind of a threshold of reliability, which open doors to further developments. That had not been the case in Germany, France, Spain, Italy or the UK, where thrift and mutualist banks were still fragmented and could not enough overcome their political and regional background to reach a strong common mindset and mutualize action. Mergers, rationalisation and learning universal banking were still stages to follow, throughout the 1990s-2000s, whereas RZB appears retrospectively to have been ready earlier – like *Rabobank* in the Netherlands (fruit of the merger of two cooperative groups in 1972) or Erste Bank in Austria –, thus more profitable (alongside costs and the cost/income ratio) and resilient.

Meanwhile, the Austrian banking industry crowned such a perseverant strategy to constitute a strong group: RZB could resist to the concentration move which led to two hard-pushing banks. First, crises at other banks spurred mergers: the *Österreichischer Länderbank* had to be rescued by *the Zentralsparkasse and the Kommerzialbank AG* in 1991, which led to the creation of the *Bank Austria* group; then *Creditanstalt-Bankverein AG* was privatised in 1997 and purchased by *Bank Austria*; the new group (according to the website of the Bank Austria the merger between the two banks took place in 2002) extended westwards and got control of the Bayerische *Hypo- und Vereinsbank* in München in 2000. But this new leading Austrian bank faced managerial hardships and was itself bought back (and financially supported) by Italian giant Unicredit. Paradoxically both thrift- and mutual-spirited institutions, *Erste Bank* (and *Sparkassen*) and RZB emerged as the national flags bearing Austrian banking interests, propping the vitality and future of the Vienna sub-regional Danubian market place, and finally treading throughout Eastern and Central Europe thanks to a sweeping strategy of growth. To complete it successively, both institutions could rely on their capital of skills and experience, for retail banking, commercial banking with medium-sized companies and with public bodies (local authorities, chambers of commerce, social insurance agencies, public services firms, etc.), which were the key outlets in the "virgin territories" to be prospected.

We presume thus that heritage from the 1950s-1990s in banking management is the first explanation to the present success of RZB, because it could enjoy a solid corporate banking culture before starting its offensive eastwards. It could balance its revenues from its locally-anchored stronghold on the west and its risky undertaking on the east, using the leverage of its capital of competence to support and develop the position of the group in Central and Eastern Europe. Standards in the management of risks could also favour a sensitive role in the maturity transformation of money there, either mobilising domestic deposits in each country, or injecting liquidities, to propel a credit-based economic growth. An acute corporate banking culture and some kind of an osmosis of business cultures between Austrian bankers and East European markets (public bodies, small and medium-sized enterprises, agro- and hotel-business, for example) could be comparative advantages against western European competitors. It could also take part to the introduction of managerial methods, mainly to lower the cost/income ratio from its high peak in the ancient communist economy to more competitive standards, through drastic staff reorganisation and IT progress. Economies of scale in the use of IT, excellent market knowledge for small and medium-sized enterprises and public bodies, sound command of operating costs, were decisive assets throughout this eastward offensive.

Table 4. Cost/income ratio within RZB group in 2007	
Austria	45.3%
Central Europe	61.8%
Countries from CIS-Community of Independant States (ex-URSS)	56.8%
Southeastern Europe	58.6%
Total	56.9%

2. RZB from Vienna to central and eastern Europe developments

At the start of the 1990s the strategic dilemma was obvious at RZB: it could not stretch its grip westwards because competition was too intense on the main markets (Germany, for instance) or because cooperative institutions had no views on their respective inner markets, whilst rejecting any global confederation able to draw a pan-European mutual bank – as it had been tried by Rabobank together with DZ and French mutuals, but the initiative failed, conversely with Eureko insurance group –, and succeeding only in setting up a meager and informal institution for cooperation among mutual banks, Unico. RZB could only extend itself eastwards to seize the opportunity of the liberalization and privatization move, and to take profit of the dismantlement of huge diversified public banks: in fifteen years, foreign banks conquered between half and two-thirds of local markets in each country. When prospects became clearer[2], several west-European banks (and corporations) shaped punchy strategies of spillover in central, eastern and balkanic Europe: competition was thus harsh, especially with US Citigroup, Belgian KBC, French *Société générale* and *Crédit agricole*, even National Bank of Greece, and later on Italian Unicredit.

A. An eastward strategy of duplication

From the 1990s RZB had trodden a perseverant and coherent strategic path to duplicate its portfolio of skills all over the area, to prospect emerging small & medium-sized firms, wealthy consumers, local authorities thirsty of treasury loans and project financing for city equipment, and even modernizing farms, etc. This very "local" bank, confined to a little country like Austria, constituted a high-standing case study for a successive completion of a strategic geographical expansion[3] without destroying its core skills and its management methods. It

[2] A pioneering book was: John Bonin, Kalman Mizsei, Istvan Szekely & Paul Wachtel (eds.), *Banking in Transition Economies. Developing Market Oriental Banking Sectors in Eastern Europe*, London, Edward Elgar Publishing, 1998. Later on, it was followed by the comprehensive analysis of Stephan Barisitz, *Banking in Central and Eastern Europe, 1980-2006*, London, Routledge, 2007.

[3] See Daniel Spulber, *Global Competitive Strategy*, New York, Cambridge University Press, 2007.

kept focused on its heritage, only duplicating it in each country, without dreaming of "world-wide universal banking", which only a very few banks tried then (Spanish banks, US banks, ABN-AMRO, Barclays, mainly).

RZB could bet on the high potential of eastern markets within the credit business. The average of loans (to non-financial sectors) per capita was far smaller than in west-European Union and Austria (€46,000 in Austria, versus 6,100 in Czech Republic, 3,100 in Poland, or 1,800 in Rumania in 2006, for example). On one side low wages in relation with productivity (unit labour costs) would durably offer a competitive advantage to lure outsourcing and new plants and services; on the other side, because wages are likely to catch up, they will support domestic demand and thus more savings, bank deposits, and consumer credits. All in all, the elasticity of demand in this area couldn't but broaden the basis of banking growth and guarantee a somewhat steady pace of development and profitability. Such an extension was rife with opportunities of scale, because of the same managerial requirements, when creating almost from scratch privately owned retail banks throughout central and eastern Europe.

B. A dedicated holding affiliate, *Raiffeisen International*

To achieve such a strategy, RZB transformed itself into a true "European company"[4] because it set up a European banking house, an affiliate dedicated to its Central and East European strategy, *Raiffeisen International*. It adopted thus an opposite path than *Erste Bank*, which maintained its international activities at the level of its mother company and lodged its Austrian activities into a special affiliate in July 2007/August 2008, *Erste Bank Österreich*. Was it important that the Erste bank turned it business division into a stock corporation? Starting in 1986 only, when it founded its first banking subsidiary in Hungary, but achieving an actual strategy of deployment of retail banking services in central and eastern Europe only from the 1990s[5], Raiffeisen International purchased or created several banks and sometimes merged a few ones here and there, to result in a network of sixteen banks in 2008, often among the leaders in their country, and of 2,500 branches (outside Austria, where RZB gathered 2,260 branches in 2007). In parallel, but out of consideration in this case study, Raiffeisen International deployed connections in Asia and on the main world finance markets, and thus provided Vienna with an independent hub active worldwide, though on a modest scale against big world players. One sign of success was the agreement with RZB's Dutch *alter ego* Rabobank in October 2008, recognizing Raiffeisen International as the preferred correspondent of Rabobank customers in central and eastern Europe[6].

The metamorphosis was astonishing, as RZB transformed itself from a domestic Austrian bank into an Central and East-European multinational company, with sixty thousands people active out of Austria, and with a role of a linchpin between West and East, thanks to Raiffeisen International's global network strategies and to global platforms of skills and specialised

[4] See Harm Schröter (ed), *The European Enterprise. Historical Investigation into a Future Species*, Berlin, Springer, 2008.

[5] 1987: Hungary (fifth-largest of country); 1991: Poland, Slovakia (third-largest); 1994: Bulgaria (fourth-ranking), Croatia (fourth-largest); 1996: Russia (largest foreign bank) 1998: Romania (third-largest); 2000: Bosnia & Herzegovina; 2001: Serbia (first-largest) & Montenegro, Slovenia (tenth-largest); 2002: Kosovo (second-largest); 2003: Belarus; 2004: Albania; 2005 (first ranking): Ukraine (second-largest); 2006: Czech Republik (sixth-largest).

[6] "Rabobank and *Raiffeisen International* solidify cooperation in cross-border financial services", website News (www. rabobank.com), 21 October 2008. The agreement excluded Poland, where Rabobank disposed of its own retail bank.

subsidiaries, like *Raiffeisen Investment* for (especially cross-border) M&A and corporate finance advise, itself cooperating with Paris/London/New York investment bank Lazard). Such a balance may be found out through a few tables of figures:

Table 5. RZB regional collection of deposits from customers			
	Amounts in 2006 [€ thousands]	Amounts in 2007 [€ thousands]	Per cent in 2007
Austria (without taking into account the *Raiffeisen* local banks' own deposits)	4,360,256	6,916,040	12
Central Europe	14,197,744	17,005,426	31
Countries from CIS-Community of Independant States (ex-URSS)	7,344,326	9,070,943	16
Southeastern Europe	10,300,625	12,867,902	23
Total	44,727,489	55,368,996	

Table 6. RZB regional allocation in 2007 [€ thousands]				
	Net interest income (after provisoning for impairment losses)	Net commission income	Profit before tax	Total assets
Austria	556,179	272,374	322,336	58,528,370
Central Europe	682,859	465,518	401,852	28,428,660
Countries from CIS-Community of Independant States (ex-URSS)	681,700	385,385	356,298	18,639,608
Southeastern Europe	647,469	370,142	410,658	21,752,920
Total	2,634,631	1,515,671	1,484,824	137,401,999

Among the top five international banks in terms of total assets active in central and eastern Europe, RZB ended outstripping Erste Bank on the second position, mainly due to its large CIS exposure. Both Austrian banking groups (with a market share of 4.6 per cent of total assets in central and eastern Europe) managed to reduce the gap to the still leading Unicredit (with a market share of 6.4 per cent in central and eastern Europe). Overall, Raiffeisen International offered in 2007 the strongest distribution network with a total of 3,077 branches in fifteen central and eastern Europe markets followed by Unicredit with 2,858 branches in sixteen markets and *Société générale* with 2,727 branches in fourteen countries.

3. RZB and Raiffeisen International well armed to confront the present crisis?

RZB's growth was fed by this dualist structure, the classical Austrian basis and the junior twin banks in central and eastern Europe: it crossed the boom years with punch (+145 percent for the balance sheet from 2003 to 2007).

Table 7. The evolution of RZB balance sheet during the recent boom					
	2003	2004	2005	2006	2007
Raiffeisen International balance sheet (€Bn)	20,1	28,9	40,7	55,9	72,7
RZB balance sheet (€Bn)	56,1	68	93,9	115	137,4
RZB Group consolidated balance sheet			176,008	205,361	236,264
Equity			9,073	10,652	12,849

A. Balanced activities within a successful "universal banking" strategy

RZB succeeded in broadening its retail banking basis all over central and eastern Europe, and found out fresh corporate and public customers, which allowed a rather balanced endowment of resources and staff, and fostered somewhat balanced incomes. Meanwhile, proprietary trading had been kept within sound limits, (apparently) avoiding such a volatile activity to reach speculative processes.

Table 8. RZB in 2007					
Four main activities:	Corporate customers	Retail customers (individuals and small and medium-sized enterprises	Financial institutions and	Proprietary trading	Total

		with revenues of less than € 5m)	public sector		
Staff dedicated to each activity	8,642	41,818	2,408	2,148	58,408
Net interest income (after provisoning for impairment losses) [€ thousands]	875,227	1,231,744	232,405	156,458	2,634,631
Per cent	33%	47%	9%	6%	
Net commission income [€ thousands]	488,536	814,384	154,961	26,405	1,515,671
Profits before tax [€ thousands]	847,626	494,881	197,817	-102,576	1,484,824
Average equity dedicated to each activity [€ thousands]	2,839,521	1,405,428	1,072,043	1,022,042	6,689,356
Return on equity before tax	28.8%	38.6%	20.5%	/	22.2%
Risk-weighed assets (including market risk) [€ thousands]	39,747,699	19,715,221	15,006,492	14,306,580	93,637,813
Per cent	42%	21%	16%	15%	

Although RZB's accounts did not register the retail banking activities of the local Raiffeisen banks, its own Austrian retail banking segment (encompassing personal banking customers and moreover small & medium-sized enterprises) and private banking segment join the retail banking activities outside Austria to draw the outlines of a steady development because the group became able to self-finance part of its deployment, on its collected resources.

Table 9. RZB returns in 2007

	Corporate customers	Retail customers	Financial institutions and public sector	Proprietary trading	Total
Net interest income (after provisioning for impairment losses)	966,077	1,441,582	233,398	156,928	2,942,219

B. More acute and cautious risks management?

One stimulus to respect such a focus could have been the steep crises endured by numerous east-European financial and banking economies in the 1990s (1991-1993, then 1997-1998): they could not shape up a reliable and durable "banking system"; several new banks failed, bad loans prospered, and the curb of managerial apprenticeship was long to evolve positively. On the contrary, banks like RZB (among a few others, of course) were able to mobilise their portfolio of skills, in particular for risks assessment and customer scoring, as almost "schools for banking". It brought a direct contribution to the construction of a banking system and of a portfolio of standards in assessing risks and in asserting sound rules of compliance – along with the phenomenon of "spillover" of managerial cultures. The very fact that the conquest of such markets was completed against a dire background of uncertainty, blurred balance sheets, junior corporation life, sometimes corruption, and an ambiance of failure risks, could have been one explanation to RZB's success: because it could not develop its strategy on a sound basis, it had to be more cautious and it had to avoid commonplace blindness fostered by cyclical booms among overstretched actors of growth. Because of the tense environment, RZB had to apply strictly its array of standards through the duplication process of its own organisation and management. That was quite different with the booming years fuelled by cyclical growth in well-developed banking markets in western Europe and in America: cautiousness was required to avoid pitfalls and land mines due to low managerial and accounting practices and to habits to rely on the state money to cross slowdowns. Through its expansion eastwards, RZB contributed to the export of (financial) "stability" to the junior market economies, of compliance rules, of self-managed habits of transparency, accounting and, all in all, "accountability" mindsets (far from planning schemes of centralised economies). Each of its affiliates was involved into a "positive domino effect", where each sound institution became part of a "glocal" healthy banking system – despite the remnants of bad governance and corruption still kept in a few countries (Bulgaria, Romania, etc.).

The inner code of procedures for banking processes (or codex) which had been instaured within Austrian RZB was displayed through a cross-border stretch, which could have helped managers of each affiliate to reach a better apprehension of risk assessment. Raiffeisen International enhanced in its *2007 Annual Report* the rigors of its risk management. Even if "lip service" often prevails within official institutional documents, such highlights reveal a specific "corporate culture", nurtured through mutualist layers of governance, through "inner schools of risk assessment": "Outstanding expertise in risk management is the basis for sound growth in central and eastern markets given their varying degrees of development. By permanently integrating its network banks into the processes of risk management, the group will continue its growth trend in awareness of the risks."[7] "The ability to implement the principles of risk management in daily business required well-founded, relevant knowledge as its first pillar. A pioneer with over twenty years of successful operation in central and eastern Europe, Raiffeisen International has valuable experience in active risk management. That forms the basis for establishing a strong risk management team in the Vienna head office and reliable teams in the network banks, reinforced by local chief risk officers."[8]

Commonplace discrepancies between codes of procedures and achievement of drastic risk assessment seem to have been avoided at Raiffeisen International because of a systematic flow of controls and self-consciousness of risk management, part of a specific culture, mixing entrepreneurial growth and cautious lucidity about the real state of the market – and eight pages[9] were dedicated to reports on risk management in the *2007 Annual Report*. New procedures for the process of risk assessment had been set up in 2006, reinforcing policies and guidelines and validation tools, and in 2008, about the evaluation of risks caused by the segment of small and medium-sized enterprises.

C. Mutualism as a factor of managerial rigor?

Whereas the "capitalist-minded" Austrian group *Bank Austria-Credit Anstalt* did not succeed in sketching an efficient mode of governance, both Erste Bank and RZB apparently reached a relevant modus operandi, although the configuration of their groups is quite opposite. *Erste Bank* chose to join the fray of quotation on the stock exchange, whilst RZB kept faithful to its mutualist heritage, as it capital is controlled mainly by the regional mutual banks.

TABLE 10. RZB's shareholders in 2007

1,7 million members	548 *Raiffeisen* local banks	*Nieder-Österreischiche Raiffeisenlandesbank*	31.34%
		Raiffeisenlandesbank Steirmark	14.91
		Raiffeisenlandesbank Ober-Österreischiche	14.91
		Raiffeisenlandesbank Tirol	5.83
		Raiffeisenlandesbank Salzburg	5.79
		Raiffeisenlandesbank Kärnten	5.62
		Raiffeisenlandesbank Burgenland	4.62
		Raiffeisenlandesbank Voralberg	4.59
		Zveva Bank	0,04
		Total regional *Raiffeisen* banks	87.65
		Volksbanken	5.14

7 Raiffeisen International, *Annual Report 2007* (booklet *Success in 15 Languages*), p. 93.
8 *Ibidem*, p. 93.
9 *Ibidem*, pp. 93-100.

		Etc.	

Did such a mutual structure help fixing better standards of compliance to rules of risk assessment? Did it impose a more cautious way of managing the endowment of resources, because they were constrained by the low grade of quotation on stock exchanges and by the dependence on self-resources (either customers' deposits or mutualist-originated equity)? The risks of internationalisation and "capitalist standards" were confined to the affiliate Raiffeisen International, as a listed "instrument" and the bearer of pioneering risks eastwards. The group asserted officially to avoid following the mainstream of rush to huge (greedy?) profitability margins: the 2007 annual report told of the role of the managing board and of the supervising board of RFZ as "they define the risk appetite, set limits for all material risks, and demand a minimum risk-adjusted return in the group's risk strategy. Special attention is paid to concentration risks and therefore the targets also define limits on large exposures, product/sector/industry weights and regional concentrations." But, even without any excessive "risk appetite", academic experts have to stay cautious because discrepancies always appear within a firm organisation between patterns and practices, and only the near future of the crisis will sort out bad assets and risks.

4. RZB and Raiffeisen International facing the present crisis (2007-2010)

Sure, the RZB group "has become an established leader in the investment banking market. It is the pre-eminent player on the Vienna stock exchange, in the bonds trading segment and in the new issues in equities and bonds. Specialist subsidiaries round off RZB's line, which also include [...] asset management, private banking, property services and trading"[10]. But experts have been used recently to assess with suspicion companies' self-assertive declarations and truncated figures, because so many banks and insurance firms all at sudden near-collapsed or confessed adamant numbers, losses and errors in risk assessment on one side, and poor processes in risk assessment on the other side, as rules of compliance did not resist crises on the finance and credit market.

A. Pervading trust at RZB (2006-2008)

A first step seemed to prove the reliability of the business model and of the mode of governance of the mutualist RZB group. Figures for the 2007 year first stayed in line with those of 2006: "Provisions for impairment losses on loans and advances" ("covering recognisable counterparty risks"), "negative fair values of derivative instruments" did not progress so much, and did not reveal a sudden "toxic" drift towards an internal crisis, first because central and Eastern European economies still clung to growth, second because RZB seemed to escape bad loans and moreover bad investment for assets management, proprietary trading – especially if we consider hedging on derivatives – even if a slow trend towards degradation might be perceived, but the ratio remained stable indeed.

Table 11. A few clues about negative trends (€ thousands)

	2006	2007
Sovereigns	192	1,789
Banks	12,042	8,908
Large corporate customers	771,159	787,622
Corporate small business	108,294	137,285
Private individuals	307,905	428,411
Small and medium enterprises	89,659	88,510

[10] Overview of RZB, RZB website, February 2009, p. 60.

Total	1,288,251	1,452,505
Total amount of loans and advances	53,105,075	73,070,577
Ratio against total	2%	2%
Negative fair values of derivative instruments	2,325,564	2,841,919
Aggregated negative fair values in fair value hedges, in cash flow hedges, of bankbook derivatives without hedge accounting, of credit derivatives	943,578	1,305,139

Table 12. Clues of a sound situation at RZB						
	2002	2003	2004	2005	2006	2007
Return on assets before tax	0.53	0.67	1.11	1.17	1.25	1.17
Net provisioning ratio	0.60	0.72	0.64	0.52	0.63	0.41

The results of the sole Raiffeisen International were preserved intact till the end of 2008, as if the crisis already maturing in the West was belated in the East: “The loss rate (written-off loans to total lending) improved by 4 basis points to 0.12 per cent.”[11] “Despite a fourth quarter 2008 that was very difficult for the entire banking industry, Raiffeisen International succeeded in meeting the forecast it had presented and achieved another record result for the full year 2008.” But “market turbulence” was noticed at the end of 2007, thus explaining net losses from derivative instruments, for instance in Russia; this prompted the bank to a cautious policy of provisioning for impairment losses (more than doubling in 2008).

Table 13. Development of consolidated profit at Raiffeisen International only (€millions)					
	2005	2006	2007	2008	2009
Profit from operating activities	724.754	1,174.059	1,607.477		
Provisioning for impairment losses	167.260	308.877	356.977	780	1,738
Profit before tax	568.557	891.165	1,237.604	2.452	1.199
Profit after tax	459.593	685.925	973.455	1,429	368
Consolidated profit	382	594	841	982	212
Total assets (billions)	40.7	55.9	72.7	85.4	76.3
ROE before tax	21.8%	27.3	25.7	22	5.7

B. Raising concerns all over central and eastern European bankers (fourth term 2008-first term 2011)

Misfits in risk management far away from the classical territories of RZB showed that even such a strict mutualist institution started being lured by fairy tales of brokers on “toxic” markets. It had to declare losses on trading markets: for 2008, losses from re-evaluations of its investment portfolio will amount to around €750 million; provisions grew (to 487m) to cover expected losses from the bank's exposure to the Icelandic banking sector (for about €600m) and to bad assets (bonds) at US investment bank Lehman Brothers (252m[12]) – against RZB group first-half gross profits (879m). When RZB provided earnings guidance for the full year 2008, it expected a 53 per cent drop in 2008 pre-tax profit, to around €700m, due mainly to re-evaluation losses and loss provisions, even if its profitability was preserved in the first half of 2008. But profits after tax remained steady from 682m to 651m from June 2007 to June 2008, and consolidated profit shrinked only slightly from 481m to 393m.

A 57m loss on derivatives, a 84m decrease in the mark-to-market valuations of credit derivatives, and a 97m loss on financial investments (because of 200m decreases in the mark-to-market valuations of securities) were part of the 284m which RZB had to recognize as

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[11] Raiffeisen International, *Annual Report 2007* (booklet *Success in 15 Languages*), p. 82.
[12] "Raiffeisen Zentralbank Österreich AG (RZB) holds Lehman debt (mainly bonds) and is therefore directly affected. RZB’s net risk position (entirely in senior debt) amounts to 252 million euros," RZB.

valuation decreases in the first half of 2008 – against a profit before tax of 878m. The schock of the krach struck therefore RZB strongly: it had to admit a cost of risk which countered its Austrian tradition of cautious oversight of risks, and even the legacy of evolving without herdism, that is without scrambling to rush behind capitalist commercial banks in seizing market shares and professional constituencies. It had dreamed of the old-time "Austro-Hungarian" spirit of extending its stretch to central Europe from its Austrian stronghold, as a "natural" tendency to look eastwards and prospect the Danubian area and its surroundings. And such a move was all the more legitimate that the capital of funds, skills and spirit of enterprise were at disposal to bolster such an entrepreneurial move and the will to spill such banking knowledge to emerging constituencies.

Table 14. The rapid deterioration of the borrowing customers of Raiffeisen International: Non-performing loans by regional segment

	December 2008	March 2009	June 2009	September 2009	December 2009
Amounts (millions euros)					
Russia	178	282	547	621	648
Central European countries	820	995	1,340	1,581	1,737
South-Eastern Europe	383	685	826	889	987
Other countries of the CIS	400	690	917	971	1,071
Ratios of non performing loans					
Russia	1.9	3.3	7.2	9.2	10.1
Central European countries	3.1	3.9	5.3	6.2	7
South-Eastern Europe	2.3	4.2	5.2	5.7	6.5
Other countries of the CIS	6.1	10.5	15.5	17.7	19.9

Anyway, the deterioration of several central and eastern economies in 2008-2010 fuelled concerns about the solidity of companies active in the area. Risks on change (for non-euro currencies) and even rumours about the solvency of a few states (The Baltics, Hungaria, Romania) broadening spreads on credits, drift towards bad debts, all in all could stir worries about banks' accounts, not speaking of the overall crisis of confidence crippling money markets and threatening liquidity. Concerns were even raised about a "systemic banking crash" and of bankruptcy. The slump which had burst out on the western (and Asian) markets slowly encroached on central and eastern Europe – all the more because the Russian economy deteriorated rapidly and because central and eastern Europe is under the great strain, having binged on international borrowing in recent years and depending more and more on exports to western Europe. RZB could not therefore avoid such a background: it had itself to admit shrinking credit, growing bad loans, and a commencing slowdown of overall operations.

At the very date of completing this chapter (April 2011), clues of a durable banking crisis in several countries of central and eastern Europe have become obvious. The whole banking community active in this region commenced being suspected of big risks pending: *Société générale* (with its Russian, Romanian and Czek affiliates, mainly), Unicredit, Erste Bank, KBC and of course RZB were rejoined by the mood of uncertainty. Worries were raised about the risk of demise of the small and medium-sized enterprises all over central and eastern Europe, about the threat of non-performing loans, and about the ability of retail banks to keep financing them – which is the historical mission of such mutual banks. But confidence from depositors – still preserved in 2008 for Raiffeisen International which increased its customer deposits by 9 per cent to €44.2 billion – has also to be maintained to co-refinance the credit machine (with an amount loans and advances to customers reaching 57.9b in 2008), and a business historian cannot anticipate on such cognitive trends.

Differenciation is now onwards at stake: only the more robust banks will be able to face the rubb off of bad losses in their central european assets. The pervasing crisis will weigh on the required provisions against uncertain credits. The balance between such a raising cost of risk and the costs of exploitation is being gauged drastically throughout 2009-2011, which questions RZB's strategy of becolming a "multidomestic" bank from Vienna to an eastward pioneering front through the diffusion of its franchise. Whilst Erste Bank dived deeply into financial torments in 2009-2010 (doubling its provisions in central Europe), Raiffeisen International had to entail its net profit from 74 per cent in 2009 (to 368m), which did not respond to the expectations – even if it could avoid true "risk of reputation" thanks to the support of its mother bank RFZ (with 824m profits). But, as in numerous European banks, its books are loaded with marred assets, the fate of which depends on the take off of positive climate of business in the countries where it is settled – as Hungary, Ukraine or Rumania did not for example offer comfort thereabout.

Among the unstability of political majorities and the issues raised by graft and crony capitalism, the ability of the layers of middle-sized capitalism to resist the crisis is the cornerstone of any further rebirth and development, and to assert itself as sound constituencies for day to day commercial and retail banking. Bad-debt charges remain high, even if banks active in then area hinted that the pace at which loans were turning sour was slowing, even if there is still a big stock of troubled assets to clean up in the terms ahead (2011-2013) as the recovery is promised to stall or be slow. Will this allow banks like Raiffeisen International to declare overall loss rates on eastern European loans under the 10 per cent which the International Monetary Fund had reckoned in 2009 as a probability (even 30 per cent in Ukraine)?

C. Financial reserves to face grim outlook?

Questions focused on the ability of both big Austrian banks to bear the load of so many assets throughout ailing central and eastern Europe. Will their business model (spillover of retail banking) face mere setbacks or reach deadlocks? One key motive helping to alleviate such concerns might be the strong equity ("tier 1") and "own funds" basis of the mutualist RZB group, with stable and sound ratios of permanent funds ("core capital ratio") and its relatively small dependency on stock exchange markets. It still can rely on the fundamental good health of its shareholders and mutualist stake-holders, the local and regional Raiffeisen banks. As it was the case in France in 2007-2009 for the regional banks of *Crédit agricole*, *Banques populaires* and *Caisses d'épargne*, which refinanced the mother companies through the issuance of equity of these latter and its subscription thanks to deep reserves due to the stable revenues of mass retail banking, those mutual institutions could be mobilised to refuel the equity of their mother Zentralbank.

"RZB is a solid bank and was able in 2008 to compensate for the effects of the global financial market crisis using only its own resources, thanks to its outstanding operating business. As of the end of 2008, RZB had core capital of around 8 billion euros, and with a core capital ratio of over 7 per cent (and well over 8 per cent when calculated for credit risk), it has a healthy level of own funds. The mandatory minimum ratio in Austria is 4 per cent. Nevertheless, as market conditions have changed, higher ratios are now among the new conditions required of large internationally active banks for refinancing operations – and it is only possible to cover the existing volume of credit and originate new loans if the bank has secure access to refinancing. At the same time, customers have now come to view capital ratios as a key indicator of how safe a bank is. Including the 1.75 billion euros, RZB would have a core capital ratio of around 9 per cent (or well more than 10 per cent calculated with regard to credit risk). Accordingly, its ratio would be in line with the 9 per cent figure that has been taken as an international target since the autumn of 2008. Simultaneously, the participation capital will expand RZB's cushion in terms of own funds, which will allow the bank to better soften the possible impact of the current economic downturn and volatile developments on the currency markets."[13] Ii a very long citation, can we do without it?

As everywhere in Europe, Austrian public authorities started fighting the flaring crisis of confidence: within the framework of a "Financial Market Stabilisation Act", the Republic of Austria has offered banks measures to bolster their equity capital position, within a framework package approved by the European Commission. From October 2008, it guaranteed the issuance of equity by Erste Bank and RZB; and this latter benefited from some kind of recapitalisation with the issuance of "participation capital" amounting to €1.75 billion (2,7b for Erste Bank): it was subscribed by the state in January 2009 after a first increase of 750 m had been subscribed by shareholders (that is mainly regional Raiffeisen banks). It also successfully issued its first benchmark issue in 2009 with a volume of 1.5 billion of fixed-rate bonds guaranteed by the Republic of Austria with a tenor of five years[14]. The bond was an attractive investment, as it offered the safety of a government bond, combined with a yield premium. RZB's bond issue met broad interest amongst investors the world over: the lion's share of demand was concentrated in Germany, Austria, and the United Kingdom. The syndicate further achieved a 32 per cent allocation to fund managers, which is an outstanding level of participation for Austrian government guaranteed debt. An ultimate sponsoring initiative was completed in the spring of 2010, when the State extended its guarantee till 30 June 2010 as a way to ease a soft transition to more balanced moods on the markets.

All in all, a (for now) ultimate stage was reached when the RZB Group was branded "solid" by the Committee of European Banking Supervision on 23 July 2010: it was submitted to the famous "stress tests", which weighed up the balance sheets, sifted into aggregated subtleties, mixing accounting and accountability. And finally the 7.8pc "tier 1 ratio" drawn up for RZB from such a cross-examination revealed as more then the 6pc required by the European authorities, pending further stages of (*Basel II* and *III*) regulatory monitoring.

Table 15. RZB equity (€ thousands)

	2002	2003	2004	2005	2006	2007	June 2008
Consolidated equity					3,573,721	4,888,619	
Total permanent equity funds (with retained earnings, capital reserves, minority interests, etc.)	2,275,000	2,445,000	3,343,000	4,950,000	6,637,200	8,422,372	10.5
Core capital ratio (banking book, tier 1)	7.4%	7.5	9.2	8.3	9	8.8	7.3
Own funds ratio	10.3%	10.2%	9.3%	10.8%	10.8%	11%	

RZB and (listed) Raiffeisen International escaped thus the overall dual crisis of confidence and liquidity during the dire months of the rampant krach, and avoided the fate of a few other European banks, and even the illness of Erste Bank. Nonetheless, because of the grim prospects in their eastern European fields of activity, and despite the promising markets opened in Poland and Russia (ZAO Raiffeisenbank), the profitability of the whole "system" will need time to be consolidated, through economies of scale, the spillover of skills, the strengthening of digitalised operations and intermediation, the development of shared scoring

[13] RZB CEO presentation of the first three quarters of 2008: "Solid performance", RZB website.
[14] The price of the issue was fixed at mid-swaps plus 68 basis points, paying an annual coupon of 3.625 per cent.

of customers, even if competition will be alleviated because of the departure of a few contenders. With the almost closure[15] of the era of external and geographical growth (till a Polish purchase in 2011), time has come to “managerial consolidation”, to a mere organic growth earmarked to densifying and intensifying returns, product crossselling, and conquering new layers of more stable customership.

5. The strategic dilemma: getting backwards or clinging to expansion?

The issue of the success of the business model set up by RZB comes to the forefront: had it actually time enough to forge a strong and resilient corporate culture of risk management and of financial rigour? Did its mutualist “morale” and “wisdom” apply to the day to day building of balance sheets, of accurate accounts, of basis of confidence among its various stake-holders through the quality of its banking books? Which levels of safeguards did it reach when the crisis occurred? Which degree of vigilance towards the affiliate Raiffeisen International was imposed by Austrian poles of mutualist power to avoid the drift which appeared within the corporate and investment banking subsidiaries of cooperative groups Calyon and Natixis in Paris? Was the strategy of structuring this second and cross-border layer of management to be proven relevant? The very ability of the group to resist the near-future development of the crisis in central and eastern Europe will provide the answers.

A. The consolidation of the international activities of RZB (2010)

A managerial answer to such questions had been provided anyway by the mother bank itself. It wished to alleviate the threats pending on its “daughter” bank, would it be left alone facing the markets, ranking agencies, regulators, etc. RZB thus decided to split itself off into one Austrian mother house, intimately connected with its mutualist basis, and into a part dedicated to corporate banking in Austria, mainly its portfolio of corporate and investment banking with Austrian and international corporate customers. And that letter was brought to Raiffeisen International, of which the fundamentals instantly were broadened and consolidated. Its ratios, customerhip, deposits basis, and creditworthiness were therefore enhanced. Such a capitalistic and economic operation, completed on 11 October 2010, was a landmark of the sense of reality of mutualist stakeholder from Austria. They kept faithfull to their strategy of building and entertaining a “big bank” all over Eastern and Central Europa, to reinforce its creditworthiness and competitiveness altogether.

The “western” part of the merger brought a far more developed basis of resources (deposits from companies) whilst the “eastern” part was still much earmarked to credit distribution – pending a sufficient development of Eastern and central Europe to fuel fresh amounts of resources. In the meanwhile, Raiffeisen International (renamed RBI) could assert itself as less “East and Central European” and more as “internationalised”, through an operation which was not an artificial or leveraged one, and which not deprived the mother house RZB of its ultimate function of the central institution of the whole Austrian Raiffeisen Banking Group. And its “mother house” function is well established, as it controls about 78.5 per cent of the equity of its affiliate (still being quoted on the Vienna Stock Exchange) and as its CEO remains the chairman of RBI.

B. Still clinging to the eastwards strategy

[15] Frédéric Therin, « L’autrichien Raiffeisen ne fera plus d’acquisitions à l’international », *Les Échos*, 15 February 2011.

Sure, the RZB group's communication insists on its network of branches and bureaux all over western Europe and Asia, but it also reminds that its is playing as a "niche" corporate and investment banker in these areas. It is still firmly clinging to its three-decades old strategy, it core philosophy of being a bigwig all over Central (starting with Austria) and Eastern Europe (with about 3,000 outlets in the area). The RZB group epitomized far ahead its steady path about banking geography when Raiffeisen International dared purchasing the affiliate of Greek EFG Eurobank in Poland. That country, thanks to its size (38m inhabitants), its level of development, its better management through the boom cycle, and the variety of its small & medium-sized enterprises is offering better-balanced chances for profitable and broad outlets than its fragile neighbours. In February 2011 Raiffeisen International thus acquired Polbank (for €490m), which, despite having been set up only in 2006, is already rich with 344 branches, 2,900 employees and 800,000 customers, whereas its subsidiary there since 1991, RBPL, was dedicated to medium-sized corporate banking (with 123 branches and 3,000 employees).

Table 16. The growth of the RZB Group

	2005	2006	2007	2008	2009	First term 2010
						(millions euros)
Net interest income	1,606	2,186	2,942	4,010	3,462	1,192
Net fee and commission income	819	1,177	1,516	1,768	1,422	715
Net trading income	172	257	94	19	418	181
Provisioning for impairment losses	207	346	308	1,150	2,247	608
Net provisioning ratio	0.52	0.63	0.41	1.19	2.76	
Profit after tax	705	1,631	1,190	432	571	487
Consolidated profit	451	1,169	778	48	433	402
						(billions euros)
Loans and advances to customers	39,6	53,1	73,1	84,9	75	72,9
Loans and advances to banks (the Austrian Raiffeisen banks)	29,6	32	30,9	29,1	33,9	31,6
Deposits from customers	39,2	44,7	55,4	59,1	55,4	55,5
Deposits from the banks (the Austrian Raiffeisen banks)	43,4	44,1	48,9	54,1	49,9	51,5
Total assets	93,9	115,6	137,4	159,9	147,9	154,2
Equity (total permanent equity funds; with retained earnings, capital reserves, minority interests, etc.)	4,950	6,637	8,422	8,587	10,308	11,007
						(units)
Employees (without those of the Austrian Raiffeisen regional and local banks)	46,243	55,434	61,351	66,651	59,800	
Outlets	2,461	2,866	3,036	3,251	3,038	

Conclusion

Having been crowned by some *Euromoney* professional journal "bank of the year" for central and eastern Europe in 2007, RZB had reached a capital of legitimacy which sanctioned its recent metamorphosis from a regional-Austrian mutualist bank in to a "big player" of European banking, competing with Unicredit, KBC and *Société générale* (and also *Erste Bank*) to build a banking market all over the area and assuming part of the key function of duplicating the construction of sound banking practices and of banking systems in emerging countries learning about market economy. Through its business model, borne by *Raiffeisen International*, it had become a hub for the allocation of resources (equity and refinancing coming from Austria, collection of domestic deposits) in central and eastern Europe, with a growing self-financing "machine" thanks to cash flow returns and to a large collection of deposits. Till the turn of 2009, such a strategy seemed to be solidly propped up by drastic rules of compliance and risk management; the entry into the recent crisis confirmed the subjacent resiliency of the firm, but also revealed shortfalls in the management of proprietary funds, but on a moderate scale (like *BNP Paribas*), like potholes through the crisis more than drifting towards a blackhole (like Fortis, both big Swiss banks, or US banks, for example).

Such a case study based on "immediate history" can only highlight the basic competitive edge of RZB: strong culture of risk management, clear-cut governance under the control of a few mutualist institutions and boards, rich strongholds of retail banking in Austria, etc. The business model seems to be relevant: RZB avoided the hubris of challenging big players of worldwide universal banking; it focused on a model of "regional universal banking", because it duplicated its Austrian type of portfolio of banking activities to central and eastern Europe, without a disruption in its corporate culture; its type of internationalisation was to build a "multi-domestic" internationalisation, not to transform itself into a "globalised" organisation, which seems to have preserved its core capital of embeddedness practices, as a bank of "proximity".

Our case study can then guess the reliability of risk controls throughout the firm organization, the quality of its banking books and the rejection of broad involvement in "globalised trading", especially about collateralized debts obligations (CDOs), credit default swaps (CDSs) or derivatives, the range of "products" which swallowed so many banks recently[16]. A broader issue would be the mutualist mode of governance itself: due to its several layers of decision and risk assessment, of its heritage of values, was it a better form of banking management against the risk of self-censorship which prevailed in many banking organisations of firm, as a habit to ignore "dissenting" information among assets managers, analysts, traders and investment bankers? Which level of lucidity and "rationality" was better entertained there than elsewhere? Much more comparative enquiry would be necessary to grapple such issue. And a key issue lies around the very contradiction between the nature of Raiffeisen as a mutualist institution in Austria and its development along corporate banking in Austria itself and moreover aloing retail and commercial banking in central and eastern Europe. Along the same argument which was raised in France about the *modus operandi* of *Crédit agricole* group (with a discrepancy between its "bankers" and its "mutualist patrons" – opening doors to the reshuffling of the way of governance and of the upper teams in 2009-2011 –, the leeway left to RZB or newly-set up RBI might seem contestable, all the more that the core Austrian mutualist bank has been and still is pledging its name, riks of reputation and even permanent funds for the sake of its federation of affiliates. One last issue could turn around the legacy and spirit of mutualism: why RZB does not commence spreading mutualist mindsets and practices in a few case countries in central and eastern Europe, as a laboratory to replace ex-communism by new cooperative business?

Last, our case study can only bet on the ability of RZB to resist the near-future shocks; we can presume that it will anyway benefit from the "fly to quality" reaction, that is the enhancement of banks which were prevented from huge involvements in risky market adventures, even if central and eastern Europe might have entered a period of uncertainty and of risks of defaults among firms and public bodies. The support of the Austrian state proved anyway that it would not leave the country being deprived of its two "banking stars", both inherited from philanthropic mindsets and now onwards key actors of Austrian economic patriotism and influence throughout central and eastern Europe. But grim prospects ahead will foster arguments about the business model of a mutualist institution: will such an organisation of

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[16] See Paul Jorion, *La crise. Des subprimes au séisme financier planétaire*, Paris, Fayard, 2008.

firm, which exemplified mutualist entrepreneurship at the turn of the 21st century, be still relevant to face a crisis of euro-globalised capitalism? Another issue lies with the ability of mutualist banks to co-operate, to “mutualise” their portfolios of skills beyond the mere informal alliance Unico which they set up at the end of the 20th century.

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SUMMARY

Far less known than big capitalist banks, a few institutions issued from philanthropic sectors succeeded in stretching all over new European and even international markets. Two Austrian banks maintained the rankings of the Vienna place, Erste Bank and Raiffeisen Bank. This latter duplicated its Austrian activities through an array of subsidiaries in balkanic, central and eastern Europe. This raised issues about the evolution of its portfolio of skills, its mode of governance through the process of fixing rules to risk-taking, and about its ability of practicing “regional universal banking” without weakening its corporate culture in risk management and in supervising retail banking and customership among professionals and small and medium sized enterprises. The recent crisis altogether raised concerns about this success and cases studies to gauge the resiliency of this new big actor of European commercial banking.