

The role of Trustfulness for the Success in Finances (Case Studies of Czech Credit Cooperatives)

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Introduction

Co-operatives should be considered as special organizations aimed to satisfy economic and/or social and cultural needs and wants of their members. The co-operative movement can be presented as a traditional practical application of solidarity ideas based on ethical principles. The International Co-operative Alliance (ICA) approved in 1995 the following internationally agreed co-operative principles: voluntary and open membership, democratic control, economic participation, autonomy and sovereignty, education and instruction of its own members and of the public, co-operation between co-operatives, and responsibility for the state of society. The co-operatives should strive for the permanently sustainable development of society. The old traditions of co-operatives are also based on ethical values like integrity, openness, social responsibility and care for others. The ethical aspect of the co-operative ideas was well emphasized by the prominent French theoretician of the co-operative movement Charles Gide (1847–1932) who formulated twelve principles (virtues) by means of which the co-operative movement was to enrich the mankind.

Unfortunately the actual practice in some renewed co-operatives in post-communist countries with the occurring transformation process is different. Such a development has affected the re-introduced Czech credit co-operatives. The aim of this paper is to make a short reflection to their present problems connected with ethics.

Co-operatives in the Czech lands

Credit co-operatives cannot be separated from the context of the whole co-operative movement and from its history. Furthermore the development of financial co-operatives in the Czech territory also should be considered in a broader context in view of simultaneous similar development – especially in neighbouring Austria and Germany. Surprisingly already in 1845—just one year after the founding of the historically first co-operative at Rochdale in England – the first co-operative in the European continent was a credit coop build up by Samuel Jurkovič at Sobotiště in the actual territory of Slovakia (then part of Hungary).

In the history of the co-operative movement the credit co-operatives in Central Europe were among the most successful and highly respected financial institutions offering services in the most remote localities with a perfect know how of local conditions and also with

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a considerable social impact and moral influence. In Europe they were spreading since the second half of the 19-th century. The names of at least two pioneers of credit co-operatives should be mentioned: *Friedrich Wilhelm Raiffeisen* and *Franz Hermann Schulze – Delitzsch*. Mutual loan associations were a particularly important part of the whole co-operative system. They collected savings from farmers and other less well-off classes of the population and on the other hand they extended credits on easier terms than banks of the local money lenders practising usury. Their role was not only economic but also social and cultural one.

Many examples can be given including the *kampelichkas* in Bohemia named after their pioneer *F. C. Kampelik* (1805–1872). These co-operatives applied the principles introduced by Raiffeisen. Their role was to provide credits to the poorer social classes – especially in the countryside – under interesting conditions (low interests rate etc.) and to collect the savings. But their role was not only of economic character. Kampelichkas also encouraged and financially supported building of new schools, sport centers and libraries and organizing various cultural and education activities. A high respect and moral credit – characteristic for them – was covering all typical properties of ethical behavior: integrity, fairness, fair play, participation on common prosperity, truthfulness, honesty, credibility, orderliness, trust and – first of all – human solidarity of the co-operatives members. As to the Czech towns the co-operative saving banks based on principles of Schulze – Delitzsch as well as private banks predominated. Many of these saving organizations were oriented to specific clients (small and medium entrepreneurs, civic loan offices, former members of the Czechoslovak legions from the World War I etc.).

The most popular type of co-operatives in Czechoslovakia until WW II were agricultural credit co-operatives. During the World War II the tradition was interrupted by the German nazi occupation. The activities of the co-operatives were subordinated to the nazi control. After the war the co-operatives in general were returning to the pre-war conditions in the connection with the reconstruction of the national economy. This period lasted only for two years. The communist coup d'état in February 1948 started the process of transition from the capitalism to the socialism. The private sector was nationalized and substantial changes concerned also the co-operative movement. Many types of co-operatives were liquidated and the remaining co-operatives had to integrate the small private producers, farmers and tradesmen. This process was called as a „socialization“.

It is necessary to take into consideration that under the communist system the whole co-operative sector was subordinated to the central planned economy system and to a delimitation of tasks between co-operatives and the state sector. All economic activities were under a strong political control of the leading communist party. On the contrary to other socialist countries only four types of co-operatives were admitted at that time in Czechoslovakia: agricultural, consumers, production and housing co-operatives. As to the credit co-operatives their activities were stopped and their network was integrated with state saving banks.

After the velvet revolution in November 1989 a transformation process started replacing previous centrally planned economics by the free market economy. Besides purely economic problems also deep changes in political and social structure occurred. The transformation process has been realized in both state and co-operative sectors of the previous national economy system. Common trends occurring in all post-communist countries of Central and Eastern Europe have not erased differentiating of national trajectories in any country.

The fast large-scale privatization with a significant role of the voucher (coupon) elements concerned only the state owned enterprises. The existing co-operatives had to be

transformed in accordance with the new transformation co-operative law whereas their activities had to be subordinated to the new commercial law. In accordance with them the co-operatives in the Czech Republic should be considered as entrepreneurial subjects based on the private ownership of their members. All their activities are to be conformed to the internationally acknowledged democratic co-operative principles. The new commercial law has acknowledged to the Czech co-operatives the same position and the same operating possibilities as to other economic bodies on the national economic scene.

The transformation process in the co-operative movement – which survived the socialist period – had its own ethical problems and dilemmas. These problems can be described as underestimated solidarity, preference of special interests of smaller groups of members, efforts to maximize profit without any regard to the social responsibility, manipulated members' opinion, neglected education problems in the new social climate etc.

Specific Problems in the Renaissance of the Czech Credit Co-operatives

When after 1989 new political and economic changes in the Czech Republic occurred an attempt has been realized to restore traditional useful and successful credit co-operatives movement (completely liquidated after 1948). The demands for the re-introduction of the credit co-operatives into the financial system in the country were expressed early after the changes but the first legislation did not take credit co-operatives into account. There were various pros and cons to restore credit co-operatives besides the existing banking institutions, the main objection consisted in the private banks and their fear from a potential concurrence. It was only after the visit of the World Council of Credit Unions representatives in the Czech Republic and their meeting with representatives of the Czech co-operative movement and with the banking committee of the Czech Parliament in 1993 when an initiative group was established. This group included the representatives of all political parties and its goal was to put through an appropriate legislation for credit co-operatives. The renaissance of the *kampelichkas* network besides the existing banking institutions has been made possible by the Credit and Saving Co-operatives Act No. 87/1995 Coll. (valid from January 1, 1996).

It is not the aim of this article to completely describe this Act but some of its basic regulations should be mentioned to understand the later arising problems. The Act No. 87/1995 has a liaison with the previous Commercial Law where the chapter II about co-operatives had been approved as a compromise. Accordingly to the new law the foundation of any new credit co-operative needed the minimum of 30 founding members with the minimum capital of 100000 Kč (Czech crowns). Besides other functions the credit co-operatives have been authorized to accept savings from individual members and from jurist persons and to afford credits. Credit co-operatives have to establish democratic organs for their management including the control commission as well as a special commission for affording credits. The controlling role of the state has been determined by establishing a special authority for co-operative credit bank surveillance. Also a special fund for savings assuring has been established. There were various shortcomings in the Act that made it possible to credit co-operatives to found their own „daughter companies“ or other societies for entrepreneurial activities. In fact in a relatively near future this appeared as one of the most serious sources of the collapse of many credit co-operatives.

In the early 1996, a Union of Czech and Moravian Credit Co-operatives was established as a voluntary interest-based organization without any formal link with the top

Czech co-operative organ (DAČR = Co-operative Association of the Czech Republic). The official title of the Union has been changed several times, the goal was to lobby and protect the interests of the credit and saving co-operatives. On January 1, 1997, in accordance with the law the State established a special authority for co-operative credit bank surveillance. Its mission was to improve the credibility of co-operative banking in the public and to prevent the credit co-operatives from going bankrupt.

At the same time also the Foundation for Support and Growth of Credit and Saving Co-operatives was established. Its task was to prepare a system of education, to gather contacts abroad and to draft specific materials for the cooperatives themselves. The Foundation was dissolved at the end of 1998 as a result of a controversy with the above mentioned Union. The reason of this controversy consisted in the different issues of understanding, concepts and future of the credit co-operatives in the Czech Republic. Original misunderstandings had an unfortunate influence on the further development and final collapse of many credit co-operatives.

Based on the Act No. 87/1995 Coll. a rapid growth of credit co-operatives „kampelichkas“ has started – both in their quantity and in the number of members. Lot of people – especially in the countryside – entered them thanks to the image of kampelichkas before WWII believing that their style of work would be very similar. Unfortunately in the process of the renaissance of the Czech credit co-operative movement new deformations have occurred and co-operative ideas have been misused for personal profits and aims. The fundamental co-operative principles like mutual solidarity of members, democratic management and control have been completely neglected and violated. Extremely negative experiences in some credit co-operatives have awakened a wave of mistrust to the credit co-operative movement as a whole, especially after 1999. In many cases the state authorities dealing with criminal affairs had to be engaged because the membership savings (mostly coming from small savers) have been either endangered or even completely lost after tunnelling realised by their irresponsible or criminal management. This happened because of a lack of know how in the banking operations or because of a violation of the respective law and of co-operative statutes. Also a control from both the membership and the top co-operative and state organs was not satisfactory. It appeared that the members did not know the existing laws and their own rights and duties. Many people joined the new credit co-operatives just with a dream of getting high interests from their saved money. In a naïve trust they were expecting a high level of banking ethics as before WW II. This trust has been strongly shocked. Despite the immediate engagement of police and justice state organs many members had considerable financial losses and the population in a very short time lost any confidence in the new kampelichkas as it can be demonstrated by Table 1 (e.g. drastic decrease in the only year 2001!).

Of course not all kampelichkas lost their original image and confidence of clients. This can be shown by the following comparison of two different credit co-operatives (one successful, the other collapsing). The successful credit co-operative has been working in a relatively small territory, in an agreeable environment. Both official representatives and clients knew each other, they have been affording credits for short term investments keeping all classic rules of solidarity. On the other hand the collapsing credit co-operative was operating in the whole territory of the state. Its founders did not know the members; they asked their own agents to get new members promising them high interests. Individual members did not know at all their representatives, they believed only in the apparent luxury equipment of many new territorial branches without any knowledge about long term credits granted for dubious investments. To their great surprise the credit co-operative went bankrupt.

Tab. 1: Development of Credit Co-operatives in the Czech Republic in the Period 1996–2004

Year*	Number of credit coops	Number of members
1996	52	10500
1997	70	25533
1998	75	62300
1999	110	125000
2000	88	111740
2001	45	10876
2002	46	14200
2003	42	11174
2004**	36	-

* the situation in any year is given to the December 31

** estimation

In spite of initial enthusiasm credit co-operatives mostly have been not successful and many of them go bankrupt. In such a situation new changes in the respective laws have been accepted by the Parliament as the Act No.100/2000 Coll. The new Act has made the regulations of the previous Act more severe. It has enlarged competencies and responsibilities of the elected organs of credit co-operatives, it has improved the role of state surveillance organs and – above all – it has forbidden any founding of „daughter companies“ and any participation on entrepreneurial activities.

The actual problems in the Czech credit co-operatives movement have to be considered and solved not only as pure problems of law and justice but also as problems of co-operative principles and of business ethics. Let us only remind the main principles applied in founding the original *kampelichkas*:

- territorial limit (usually only one village or municipality or parochial district),
- voluntary work of the representatives (only the accountants and cashiers were paid for their work),
- solidarian unlimited liability with all the personal propriety,
- low interest rate for all the members,
- short term credits granted,
- inadmissible use of bills of exchange for a credit,
- using profits for reserve funds and partially also for publicly useful purposes,
- the moral influence of co-operatives.

The comparison of the original *kampelichkas* with present credit cooperatives is presented in Table 2.

Tab. 2: Comparison of Original Kampelichkas with Present Credit Co-operatives under Collapse

Original Kampelichkas	Present Credit Co-operatives under Collapse
they were a movement	they cannot be considered as a movement
mostly in the countryside	mostly in towns
territorial limit	various territorial range of activities (including the whole republic)
small number of members	large number of members
the members knew each other	the members do not know each other
unlimited liability	limited liability
mutual trust	mutual mistrust
aim: to improve conditions for credits	unsatisfactory motivation for members
motivation: no more dependence on banks	motivation: promising high interest from savings
a good legislative frame	defects in laws, lack of a special law on small banks, tunneling
effective system of control	bad control from members as well as from
from members	the Authority for Co-operative Credit Bank Surveillance
low costs for administration	high costs for administrative works incl. luxurious buildings and advertising
voluntary functionaries	paid functionaries
pride to serve voluntarily for kampelichkas	lack of interest for unpaid voluntary functions
moral authority of kampelichkas	no moral authority of credit co-operatives
high credit in the population	despite ethical codes a mistrust of the population
support to solidarity ideas	solidarity ideas discredited
social and cultural role in the countryside	neither social nor cultural role

In accordance with negative experiences it is possible to find a positive solution. What to recommend as a way out? First of all it is necessary to maintain actual laws and co-operative principles, to control activities of the management at any level, to realise a perfect work of the supervising state organs. Management of any co-operative should be perfectly and professionally prepared for the special work in co-operatives, also the active involvement of all members is needed. The same ethical banking principles should be applied in the credit co-ops as in the whole banking sector: trustfulness and transparency, justice, moral responsibility, professionalism and competency, service to clients, cautiousness, legality and excellency in work (effort to achieve optimum quality of services).

Conclusions

Ethics has to be considered as an inseparable part of economics as well as a precondition of both economic and political stability of the democratic society.

The existing Czech credit co-operatives as all other co-ops should maintain all usual ethical banking principles as well as other ethical standards and measures used in the economic life. They should try also to follow the old traditions and to use very positive

experiences of the Czech co-ops from the history. Negative experiences connected with the renaissance of the *kampelichkas* can serve as a warning and as a memento for any future co-operative development. The credit co-operatives should be founded by the real members and for their own needs.

New possibilities for the further development of the Czech credit co-operatives hopefully have been just open by the recent entry of the Czech Republic with the European Union on May 1, 2004. More intensive contacts of the Czech co-operative movement can be expected with those European countries where the development of co-operative movement has been never interrupted nor violated by any totalitarian régime. Nevertheless EU legislation demanding higher basic capital for any credit co-operative will need some restructuring of several still existing small Czech credit co-operatives which have proved their fidelity to the original solidarity ideas and co-operative principles and have been able to overcome any crisis of the renewed system of *kampelichkas*. Unfortunately to my deep regret these EU demands – not taking into consideration historical roots and development – can lead to liquidation of the small credit co-ops or to their fusion with the big ones. Therefore the future of the Czech credit co-operatives and their role in the financial market are not clear.

Let us believe that in the future Europe the real solidarity idea will serve as one of priorities values of credit co-operatives as well as of the whole co-operative movement.

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Abstract

In the history of the co-operative movement the credit co-operatives in Central Europe were among the most successful and highly respected institutions offering financial services in the most remote localities with a perfect know how of local conditions and also with a considerable social impact and moral influence. Their role was not only economic but also social and cultural one. Their network was in early 1950' replaced by State saving banks as part of the centrally planned economy system. After 1989 the renaissance of their network besides the existing banking institutions has been made possible by a new law. Unfortunately in the course of this renaissance new serious deformations occurred and

co-operative ideas were misused for egoistic personal purposes. Extremely negative experiences with some credit co-operatives evoke suspicions and distrust of the population. An almost complete collapse of the system occurring since about 1999 had many reasons. Radical consequences for the existence of this sector are expected with the EU legislation process.

Key words: Czech credit co-operatives history; renaissance of Czech credit co-operatives after 1989; collapsing reasons; Czech credit co-operatives expectations in the EU.

Role důvěryhodnosti pro finanční úspěch (Případová studie česká úvěrová družstva)

Abstrakt

Úvěrová družstva ve střední Evropě patřila v dějinách družstevního hnutí k nejúspěšnějším a vysoce respektovaným institucím. Družstva nabízela finanční služby v nejvzdálenějších místech a proslula vynikající znalostí místních podmínek. Jejich činnost podpořila sociální stabilitu, a i proto se družstva těšila vysokému morálnímu vlivu. Jejich síť byla na počátku 50. let nahrazena státními spořitelny; toto opatření bylo zavedeno jako součást centrálně plánovaného hospodářského systému. Po roce 1989 byla jejich obnova vedle existujících bankovních institucí umožněna novým zákonem. Nově vytvářená úvěrová družstva však byla velmi často zneužita pro egoistické osobní cíle podnikatelů. Mimořádně negativní zkušenosti některých úvěrových družstev vzbuzují podezření a nedůvěru obyvatelstva. Téměř úplné zhroucení systému následovalo z mnoha důvodů po roce 1999. Zásadní význam pro existenci tohoto sektoru se očekává v souvislosti s legislativním procesem Evropské unie.

Klíčová slova: dějiny českých úvěrových družstev; obnova českých úvěrových družstev po roce 1989; důvody zhroucení; očekávání českých úvěrových družstev v EU.