An analysis of the relative performance of UK banks and building societies

Cass Business School,
City University London

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Building Societies Association

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What we do

Building Societies Association

We fulfil two key roles. We provide our members, all 44 building societies and two credit unions, with information to help them run their businesses. We also represent their interests to audiences including regulators, the government and parliament, the Bank of England, the media and the general public.

Our members have total assets of over £330 billion, and account for approximately 20% of each of the UK mortgage and savings markets. It's estimated that more than a third of the UK population has a financial service relationship with a building society.

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Cass Business School, which is part of City University London, delivers innovative, relevant and forward-looking education, consultancy and research.

Cass is located in the heart of one of the world's leading financial centres. It has strong links to both the City of London and its corporate, financial and professional service firms, as well as to the thriving entrepreneurial hub of Tech City – located close to the School.

Foreword

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This research examines the performance of UK building societies, relative to banks, over the last 15 years. The impact of the financial crisis is clear, and the financial services industry continues to undergo a deep transformation which affects all industry participants.

Building societies have recovered well from the financial turmoil and they appear less risky than banks on a variety of measures. Their recent performance should put them in good stead to face the challenges driven by regulatory pressure and reform.

We are aware that assessing customer-owned building societies against standard bank performance metrics is unlikely to be entirely appropriate. However, we believe that this analysis will be informative for policymakers when weighing up what the future shape of the banking sector should be, as it helps to demonstrate the differences between types of organisations competing in the market.

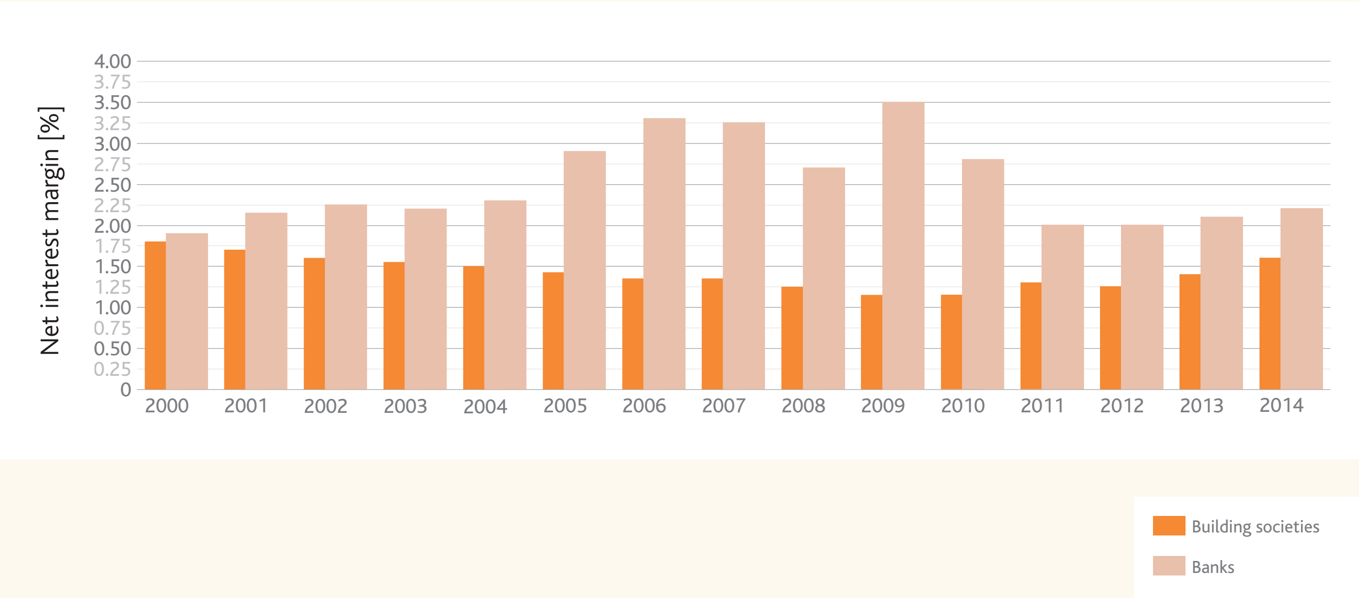
The main findings are summarised below, and the full report can be found on www.cassknowledge.com

A better deal for consumers

The net interest margin measures the ability of managers to perform banks' primary intermediation function by managing assets and liabilities as to maximise the spread between the interest income earned on assets and the interest costs of liabilities.

Building societies will typically have a lower net interest margin than banks, as they tend to offer higher saving rates and/or lower mortgage rates to their customers, as a way to provide value rather than maximising returns to shareholders.

As the chart illustrates, building societies do seem to offer customers a better deal by consistently maintaining lower net interest margins compared to banks.



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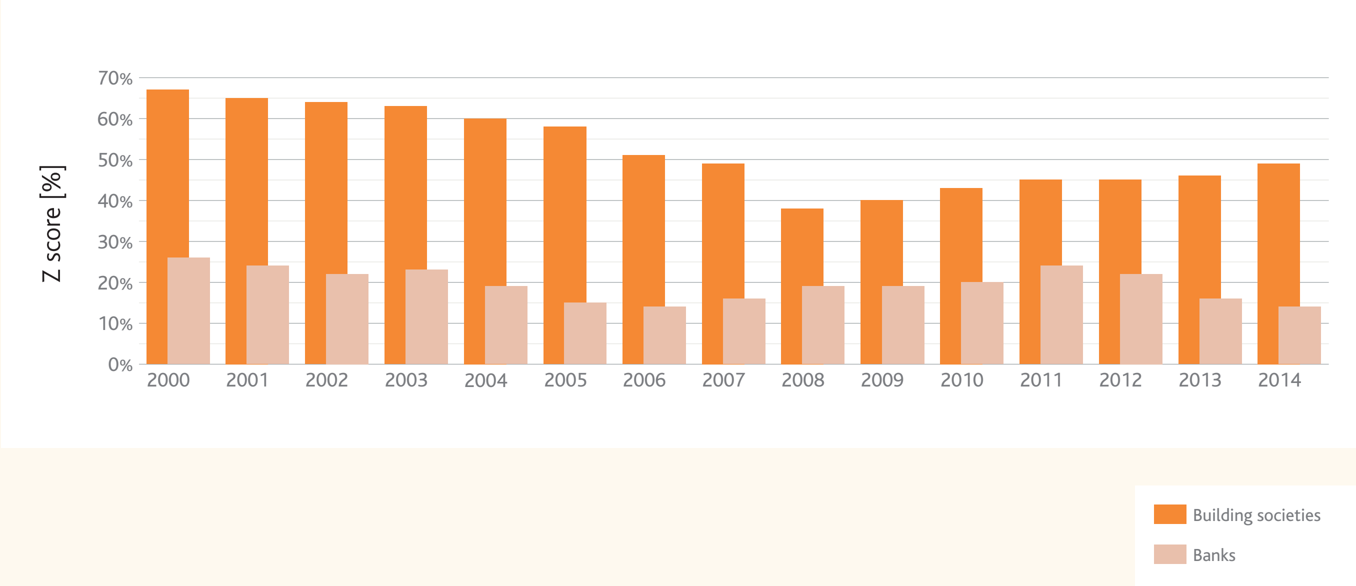
Lower risk and better capitalised

Building societies are, on average, better capitalised than banks as shown by their 2014 core equity tier 1 capital ratios.

An increasingly popular measure of bank stability is the z-score, a measure of the distance from insolvency for a given institution which combines profitability, capitalisation and volatility of returns.

A higher z-score indicates that a bank is more stable, or less likely to become bankrupt. Thus, a higher z-score value indicates a lower probability of failure.

The results show that the z-scores for building societies are significantly higher than those of banks over the sample period, indicating that building societies are, on average, less risky than banks.



More stable earnings

As building societies do not seek to maximise profits they can be expected to typically record lower returns, as measured by returns on equity or assets. However, it is also important to consider the composition and volatility of those earnings.

While the average ROE is higher for banks than for building societies, at least pre-crisis, the volatility of returns is also higher (as indicated by the standard deviation of returns, captured by the vertical bars in the chart).

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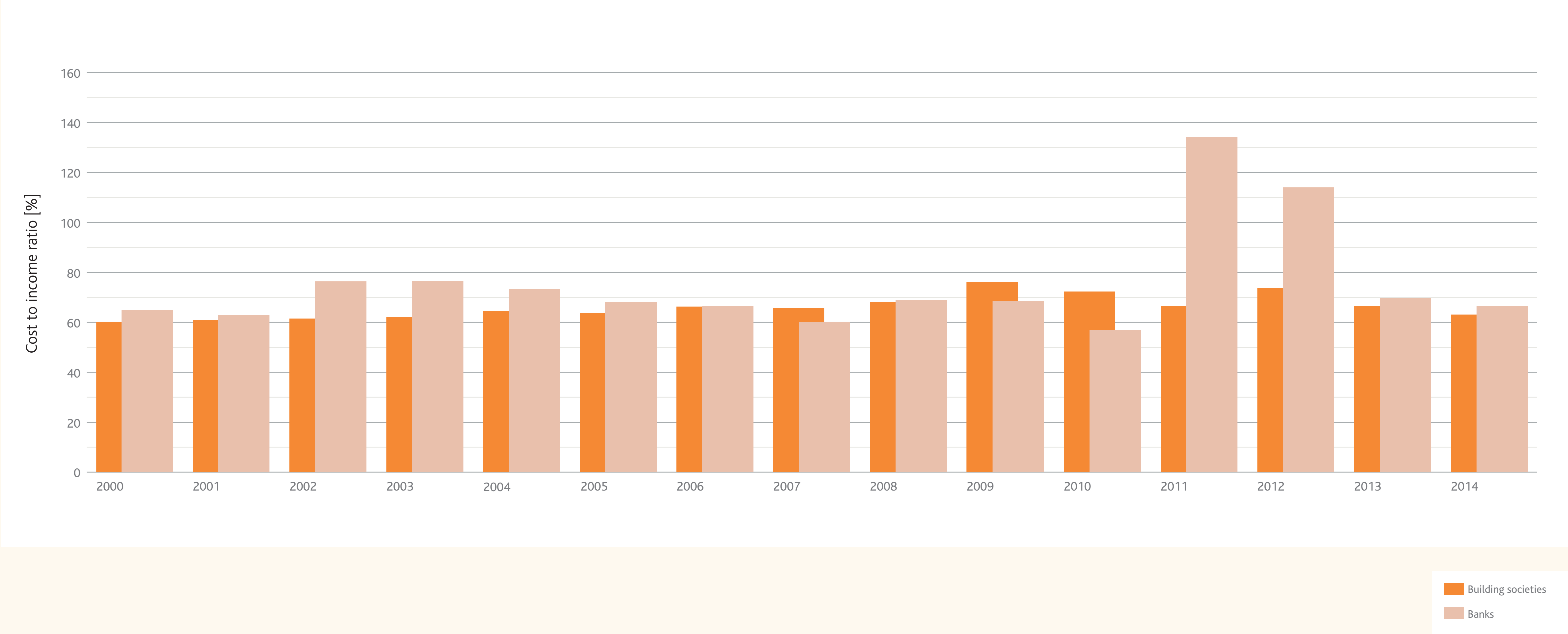
Efficient operations

The cost to income (C/I) ratio is a quick test of efficiency that reflects non-interest costs as a proportion of income.

Building societies' C/I ratios are not, on average, higher than those of banks, with the sector displaying good levels of efficiency with ratios around 60% on average during the sample period. Overall, building societies are just as efficient as banks.

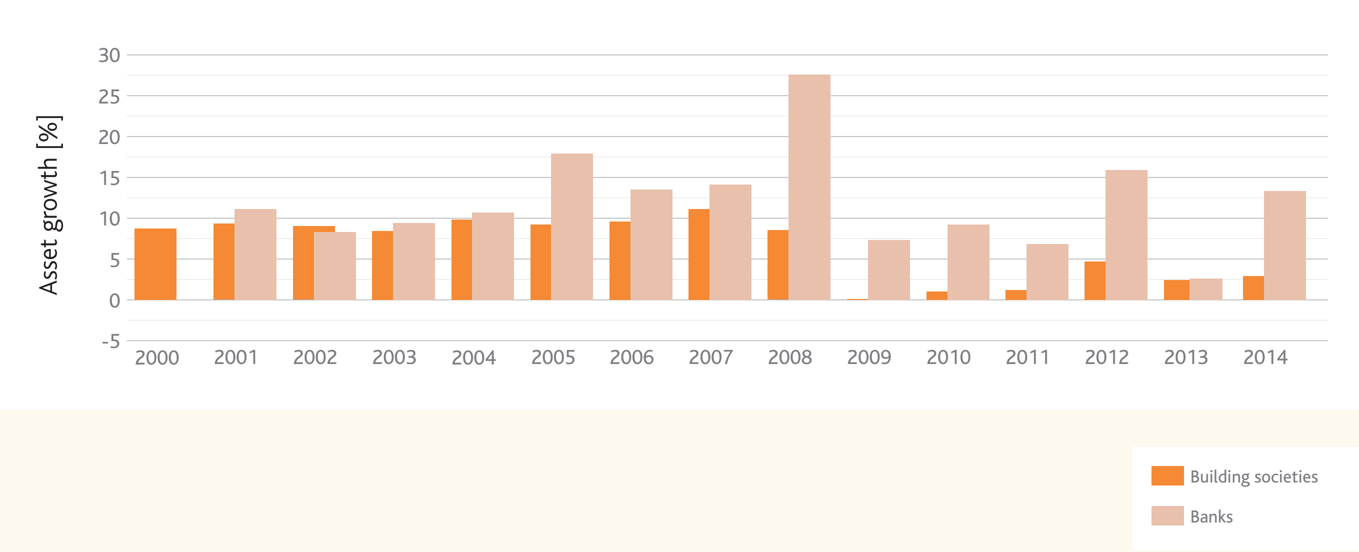


More stable asset growth

The chart illustrates the asset growth (year on year) of banks and building societies over the sample period. Although growth has been positive for both groups, banks outperformed building societies in the run up to the financial crisis.

During the recession years, building societies' lending was limited. The sector, however, seems to have recovered from the financial turmoil faster than their major banking counterparts; asset growth has been on average positive since 2010, although at lower rates than in the pre-crisis period.

Building societies have more stable asset growth than banks. Fast asset and lending growth are often considered as indicators of increased risk-taking in the financial sector. In particular, banks with high rates of loan growth in the pre-crisis period reported a more significant drop in their performance during the crisis.



Source for data in charts: Bankscope; SNL Financial, Building Societies Association (BSA) and author's calculations.

View the full research at www.cassknowledge.com

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