Approved February 14, 1984
Date

MINUTES OF THE SENATE COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS.

The meeting was called to order by Sen. Neil H. Arasmith at
Chairperson

9:00 a.m./~~p.m.~~ on February 13, 1984 in room 313-S of the Capitol.

All members were present except:

Sen. Hess - Excused

Committee staff present:

Bill Wolff, Legislative Research
Myrta Anderson, Legislative Research
Bruce Kinzie, Revisor of Statutes

Conferees appearing before the committee:

Patrick Hurley, Kansas Association for Economic Growth
Dean Haddock, Kansas Association for Economic Growth and Guaranty State Bank and Trust Company of Beloit
Jeff Holmes, Kansas Association for Economic Growth, Riley State Bank, and First National Bank of White City
Charles J. Schwartz, Secretary, Kansas Department of Economic Development
Lanny Kimbrough, Kansas Association for Economic Growth

The minutes of February 9 were approved.

The chairman began the hearing on SB 673 dealing with banking structure by calling on Patrick Hurley, Kansas Association for Economic Growth, to give his testimony in support of the bill. (See Attachment I.) Mr. Hurley noted that he had included with his written testimony several attachments relevant to his testimony.

Next to give testimony in support of SB 673 was Dean Haddock, Kansas Association of Economic Growth. (See Attachment II.)

Jeff Holmes also with the Kansas Association for Economic Growth followed with his testimony in support of SB 673. He told the committee that he is connected with the Riley State Bank and the First National Bank of White City. He said that without the ability to use a holding company to purchase other banks, he cannot deal with other banks any more. Also, he noted that under the current banking structure a tremendous amount of time is spent filing reports and tax forms. He continued that when he first began banking, his loan limit was $150,000, but not it is $800,000 which is still not enough to keep some of his agriculture customers going. When he has to call a correspondent bank to fill hs customer's needs, the person making the decision is no longer himself but the bank in the other location.

Next to give testimony in support of SB 673 was Jamie Schwartz, Kansas Department of Economic Development. (See Attachment III.)

The chairman called on Lanny Kimbrough, Kansas Association for Economic Growth, to give his testimony which was in support of SB 673. He said that the provisions in the bill are important to the State of Kansas. Mr. Kimbrough feels that in order for banks to be competitive with such institutions as savings and loans which are not under the same regulations, it is imperative that the bill be passed. In response to opponents of the bill who feel that the banks would be under the control of outsiders who might cause problems for the community, Mr. Kimbrough said that he has been an absentee owner of three banks for seven years in which time the local customers have not been denied loans, and rates are not high. He reasoned that a simple structure change for banks would not change the services offered. He stated that if the customer is not treated fairly, he will go to another bank--the market place will take care of itself. He concluded by reiterating that savings and loans are in the banking business but operate under different regulations and that banks should be treated the same.

There being no further conferees wishing to testify, the hearing for proponents of SB 673 was concluded, and the chairman asked for questions from the committee. Sen.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

Pomeroy questioned Mr. Hurley regarding the intent of Section 9 of the bill as to what the 11% refers. Mr. Hurley explained that it refers to all insured deposits of the three described financial institutions. He explained further that this language is identical language to the Oklahoma bill which was passed last year when that state felt that since all institutions compete with each other, there should be a single limit on all of them rather than individually. Sen. Pomeroy said line 227 was in need of clarification by changing "and" to "or", and Mr. Hurley agreed to this. Sen. Pomeroy inquired further as to how Mr. Hurley would define "local area" in the phrase, "majority members must be from the local area". Mr. Hurley answered that the language is from the Oklahoma bill and comes under the consumer credit protection act of the bill which was modeled after federal filing requirements. He explained that the Federal Community Reinvestment Act has outlined banking communities and that the "local area" here would also apply to the state. In regard to line 185, Sen. Pomeroy asked for a definition of "proper county". Mr. Hurley could not give a definition but explained that this language is an incorporation of HB 2735 proposed by the Bank Commissioner who is seeking that authority.

Sen. Karr asked Mr. Hurley where the "teeth" to enforce community protection is located in the bill, and he explained this is accomplished by giving the Bank Commissioner the authority to deny application by a holding company if it has not performed well in meeting the needs of the other communities.

Sen. Harder asked Mr. Hurley what point he was trying to make in his testimony in referring to the proliferation of other financial institutions. Mr. Hurley answered that the old world statutes intended for banks in competition with other banks no longer apply to the present because the world has changed, and other institutions are competing with banks.

Sen. Harder asked Mr. Schwartz if his testimony reflects the Governor's opinion. Mr. Schwartz answered that the Governor is aware of his testimony, but the testimony does not indicate the Governor's endorsement.

Sen. Reilly noted that in a 1982 report it was indicated that approximately 40 families or individuals were owners of the state banks, and he wondered if the number has changed. Mr. Hurley said that the number of owners had increased to 55 families or individuals.

Sen. Feleciano asked if the State of Kansas can fund the additional staff needed by the Bank Commissioner to carry out the authority in the bill. Mr. Hurley replied that no more is needed than found in HB 2735 introduced by the Bank Commissioner who felt his office could handle it. He said that the only thing added to SB 673 is the additional criteria to which an applicant bank would be subject.

There being no further time, the meeting was adjourned.

SENATE COMMITTEE

ON

COMMERCIAL AND FINANCIAL INSTITUTIONS

OBSERVERS
(Please print)

DATE	NAME	ADDRESS	REPRESENTING
2-13-84	Jim Maag	Topeka	KBA
	HA Stones	"	KBA
	Jim McBride	"	United Way of Topeka
	Patrick J. Hurley	Topeka	KAEG
	Dean D. Haddock	Beloit	KAEG Guaranty State Bank & Trust
	Sophie George	Topeka	Sen. Feleciano
	John Fischer	Lyndon	KIB
	Sue Anderson	Carbondale	KIBA
	Bernard A. Griffiths	Long Island	K.IBA
	L. Ferguson	Topeka	Press
	Denny Burgess	Wamego	KAEG
	John Peterson	Topeka	KAEG
	Nelson Chandler	Topeka	Kansas Bankers Assn
	Pete McGill	"	KIBA
	Rob McNeely	"	KIN
	Ron Smith	"	KIBA
	Jackie Dehy	"	KDED
	James Schwartz	"	"
	John Spurgeon	Lawrence	Budget
	Carl R. Sandstrom	Topeka	Banking Dept
	Mitch Soul	Topeka	Rep. Dyck's intern
	Tom Fitzgerald	Lawrence	Sen Hess
	Mike Browning	Topeka	KLDH-TV
	Edward B. Hunt	"	KAEG

NATE COMMITTEE

ON

COMMERCIAL AND FINANCIAL INSTITUTIONS

OBSERVERS
(Please print)

DATE	NAME	ADDRESS	REPRESENTING
2/17/84	Donn Spencer	Topeka	KAEG
	M. Hawver	'	Cap-Journal
"	Jerel Wright	"	KCUL
	Jacque Kimbrough	"	KAEG
	LARRY KIMBROUGH	"	KAEG
	J. J. Holmes	Riley	KAEG.
	Wylie Pepin	Emporia Ks.	KAEG
	Joseph H. Stout	Emporia	KAEG
	Al Greenlee	Ness City	—
	Mary Greenlee	Ness City	—
	Mary L. Moore	Robinson	
	Paul E. Fleener	Manhattan	Kansas Farm Bureau
	Joan Lieber	Osage City	Kansas Farm Bureau
	Russell Walker	Topeka	Kansas Independent Bankers
	Clifford V Campbell	Beloit	House
	Viola Dodge	Olsburg Ks	Kans Agri. Women
	Jeanne Mertz	Manhattan	Kansas Agri. Women
	Marvin C. Umholtz	Topeka	KCUL
	Linda Sheetz	"	KIBA
	[illegible] SLAUGHTER	Topeka	KIBA
	[illegible]	[illegible]	KIBA
	Robert D. Nellis	Douglass	
	LYNDON O. WELLS	NEWTON	KAEG
	David Hanzlick	Topeka	House Wells

NATE COMMITTEE

ON

COMMERCIAL AND FINANCIAL INSTITUTIONS

OBSERVERS
(Please print)

DATE	NAME	ADDRESS	REPRESENTING
	Mrs. Dean Haddock	Beloit	KAEG

Mr. Chairman, Members of the Committee:

I am Patrick Hurley, Executive Director of the Kansas Association for Economic Growth. I appear here today representing the views of over 200 Kansas banks that support, and are seeking a modernization of Kansas banking laws. Those on the other side of the issue will probably tell you they also represent over 200 banks who oppose the issue.

But, what we are asking you to do, is not referee a dispute between banks. Rather, we are asking you to address a question of major state policy which affects the entire state banking industry and for that matter, the entire economy of this state.

It is an issue of major public policy that is being addressed in virtually every state legislature in the United States right now, but in a far different way than here in Kansas. For Kansas has not even take the first step in addressing the issue. Every other state already has.

Let me explain what I am talking about.

The real issue facing this state is what should the state of Kansas do to provide maximum protection and flexibility to its entire banking industry to enable it to meet the very real challenge of the competition from a rapidly changing financial world.

What is this new competition to Kansas commercial banking?

Attachment I

It comes in three forms:
First, it comes from within the state from the other financial industries - Savings & Loans, Finance Companies, and Credit Unions. Traditionally these four industries did not compete with each other for the same consumers and depositors, as they offered basically different services. But, Congress has changed all of that by the beginning of its deregulation of financial institutions. Each of these has now been given new powers and authorities allowing them to compete directly with banks. For example, Savings and Loans have been given powers virtually equal to banks. They can offer checking accounts, make consumer loans; they can even change their names to "bank" and some have already done so in Kansas.

Most importantly, bear in mind that added to these new powers, were their existing right to locate, branch, acquire, and merge indiscriminately throughout the state.

Keeping in mind this sudden new competition to your local banks, consider these startling statistics:

Today we have a single S&L in Kansas that already has 21 branches, another with 17, one with 18, and another with 19 - each now virtually equal to banks and able to continue to grow and relocate at will.

Consider this newly empowered competition to your local Kansas bank:

Today there are 62 independent finance companies and 27 chains in the state of Kansas. Those 27 chains alone, have 232 office throughout the state.

And there exist scores and scores of credit unions throughout this state, which in other states have already begun to merge and acquire one another as they begin offering their new services.

A final note for you to think about on just this domestic competition - there has always been an unwritten principle in the legislature, and in the Commercial and Financial Institutions Committees in particular of equity between Kansas financial industries, and it always meant that no one of the four industries would be placed at a competitive disadvantage in relationship to the others. Yet, that is precisely the situation we now face. To test that principle, that you yourselves have defended so often, just ask yourself this rhetorical question, "If the legislature were drafting the laws from scratch today for all four financial industries, with the powers they now have, do you believe the banking industry would be singled out for this competitive disadvantage?" I have not yet had a single legislator answer that question "yes". But that is exactly the current status of our laws.

Second - the second area of this new competition to all Kansas commercial banks, is that of interstate banking. Congress has begun the process of deregulation, and every indication is, it will continue until all geographic barriers to interstate banking are removed. I could quote from a hundred different articles on the subject, but I'll just quote from one - the Delphi Study, sponsored by Arthur Anderson and The Banking Administration Institute in their section on deregulation.

"Continued rapid regulatory change within the industry is a certainty. McFadden Act restrictions against interstate banking will be officially removed." Every day in banking newspapers, the Wall Street Journal, and even local newspapers, you read of more and more banking activity within the area and around the country.

Recent such headlines have read for example, "Chase Maps Strategy for Interstate Banking." Another read, "Interstate Banking Spreads Rapidly Despite Laws Restricting Practice", or a third read, "The First Nationwide Bank is Already Here", with a map showing the current presence of Citicorp alread offering financial services in direct competition with domestic banks in virtually every state, including Kansas.

Third - the third new area of competition for Kansas banks comes from a totally new set of players with ready-made claims to turf already in your local bank's neighborhood. Let me describe a few:

A) Sears Roebuck has purchased Dean Witter, Coldwell Banker, owns Allstate Insurance, and bought the second largest S&L in California. Its chairman has announced he will put a "bank" in every Sears outlet in the United States. They have scheduled 280 for 1984, 600 for 1985. Let me describe the significance of this effort - they have forty million households that use Sears credit cards, 831 stores, 2,388 catalogue outlets, and 2,000 Allstate Insurance offices. They have 80 existing outlets in Kansas today.

B) American Express has purchased Shearson Loeb, a national brokerage firm, and will offer financial services to their 1.3 million credit card holders throughout the United States.

C) Prudential Insurance has purchased Bache, a national brokerage firm, and will offer financial services through its 25,000 agents throughout the United States.

D) J.C. Pennys has affiliated with a California S&L to offer a package of financial services. Pennys has 1700 stores across the nation, open 84 hours per week, with 27 million credit card holders. They estimate they serve 100 million Americans a year. They have 49 outlets in Kansas.

E) Safeway (with 40 outlets in Kansas), Krogers (which purchased Dillions with 59 outlets in Kansas), and K-Mart (14 outlets in Kansas) have likewise announced they are all going into the business of competing for banks traditional customers.

F) As a final example, Household Finance, and Beneficial and Associates, all national finance companies with numerous outlets in Kansas, have purchased banks and S&Ls and plan to greatly expand their financial service package offered through these outlets.

These examples clearly describe the clear and present danger facing commercial banks.

Individual opponents may argue they aren't afraid of the competion, and maybe those individuals aren't. But ask your own banker and see how concerned he is if he already has these competitors in his community.

So what can, and should be done. Every other state in the United States has acted to remove the artificial barriers on their banks which restricted their ability to grow and expand in meeting this competition.

Today, according to an article published in Banking Expansion Reporter, in October, 1983:

45 states allow Multi-Bank Holding Companies

41 states allow some form of branch banking

All 49 other states allow one or the other, or both

Only Kansas continues to prohibit both by law!

However, having already resolved this intramural battle between their banks, virtually every other state is now considering going in one of two directions legislatively. Many have bills pending this session to do so.

The majority of states are considering the formation of interstate compacts allowing interstate banking between member states. The northeastern states, southeastern states, and the midwestern states are considering such compacts as this time.

A few other states, such as South Dakota, New York, Delaware, Iowa, Minnesota, Georgia, and New Mexico, are going the opposite direction considering proposals to remove all state barriers against interstate banking.

The point is that, this is clearly a major issue being dealt with nationally and in virutally every state.

So what would the bill before you establish as the public policy of this state?

First it would remove the prohibition against ownership of one Kansas bank by another Kansas bank under KSA 9-505.

This would merely give every Kansas bank a choice of structure. If a bank wanted to remain a unit bank, it could; but if a bank wanted to buy another Kansas bank, it could, if there was a willing seller. No bank would be required to form a holding company, to join a holding company, or sell to a holding company.

At the same time, the express prohibition against branch banking under KSA 9-1111, would remain the law of the state.

Let me illustrate the difference. There are 338 banks in Kansas that are the only bank in their town. Under this bill, no one of them could be affected, unless the owner of that bank chose to sell that bank. If they did, there would still be just one bank in that town. The law would still prohibit any bank from putting another bank, or branch, in those 338 towns.

Therefore, unit banking would remain totally protected against branch banking under this bill.

The bill goes on to provide two other important layers of protection:

A) One to banks;

B) The other to consumers in the communities where the banks are located.

Today in Kansas, believe it or not, the State Bank Commissioner has absolutely no standing to approve or disapprove the acquisition of any bank in this state. While Kansas law prohibits purchase of banks by other banks, it places no restrictions on acquisitions by individuals.

As a result, the phenomena of chain banking has developed whereby individuals, typically not residents of a community, and often not even residents of the state, bid on and buy Kansas banks when they come on the market.

This has so proliferated that the Kansas City Federal Reserve estimates that 25 to 30% of all the banks in Kansas are owned by chains - somewhere between 150 to 200 banks.

This bill, for the first time, would establish a public policy for the state of Kansas on the acquisition of Kansas banks.

In doing so, it would achieve three basic goals:

1) It would provide protection for the credit needs of the consumers in individual communities.

2) It would provide protection for local community banks against unfair competition and banking monopolies.

3) It would provide the Kansas banking industry as a whole with the flexibility needed to meet the changing financial conditions occurring throughout the state and the nation.

The bill would achieve these goals in the following ways:

I. For the first time under Kansas Law, the approval of the State Bank Commissioner would be required for acquisitions or mergers of banks based on the following criteria:

A. The past performance in meeting the local credit needs of the communities in which they own other banks.

B. Whether the application and plan filed with the Commissioner demonstrates that they will adequately

address the credit needs of the local community in which the bank is located which they seek to acquire.

C. Whether the acquisition would tend to be anti-competitive.

D. Whether it would create a monopoly in that part of the state.

E. The financial abilities of the individuals involved.

II. In addition, while it would allow a corporation, a bank, to acquire an additional bank, the applicant bank would also be subject to the following additional criteria:

A. A majority of the Board of Directors of the acquired bank must be from the local community.

B. The corporation or bank (holding company) cannot apply for a bank charter to start a new bank in a community in direct competition with an existing community bank.

C. A corporation or bank cannot acquire a bank that has not been in existence for at least five years. Therefore, it prohibits a bank from having someone else start a new bank in a community, and then immediately buying it.

D. The total deposits of a single corporation or bank holding company, cannot exceed a certain percentage (11%) of the total deposits of all insured financial institutions in the state (so that, contrary to the present law that has no limits, no one bank can control a disproportionate concentration of assests in this state).

That is the real story of this bill Gentlemen - why it is needed, what it would accomplish, and why it is good state policy.

We genuinely believe this bill would be, on the one hand, beneficial to the entire banking community, while safeguarding individual banks - and at the same time, we believe it would provide the broadest set of protections to consumers, communities, and Kansas citizens, of any law in the United States.

One final note - time will not permit us to offer live testimony on the empirical evidence from reports and documents on the impact of Multi-Bank Holding Companies in other states. We will however, file several sets of such documents with the Committee which we think answer each of the questions raised by the opponents.

Let me share with you one additional source of information on this subject.

As I read all of the arguments which the opponents raised in the last two years about the ills of Multi-Bank Holding Companies in different states, one thought struck me.

If those allegations were true, who would know better than the Bank Commissioners in those other states. So, I wrote to every Bank Commissioner in the United States, and asked them what the impact of Multi-Bank Holding Companies had been in their individual state.

To date, I have heard back by letter, often followed up by telephone conversations from all but two of the commissioners.

While each varied somewhat in certain specifics in their answers, there were certainly a number of uniform answers from them all.

None of the commissioners indicated that the Multi-Bank Holding Company structure had an overall detrimental effect on their state.

None of the commissioners felt that the Multi-Bank Holding Company structure had a detrimental effect on the allocation of funds over the major sectors of the economy in their respective states.

None of the commissioners felt the Multi-Bank Holding Company structure had a detrimental effect on the amount or type of credit available in rural areas.

None of the commissioners felt the Multi-Bank Holding Company structure had a detrimental effect on credit for consumer loans in their respective states.

None of the commissioners felt the Multi-Bank Holding Company structure had had a detrimental effect on credit for business or commercial loans in their respective states.

On the other hand, when asked to describe benefits to their state from the Multi-Bank Holding Company structure:

Nineteen commissioners responded that it resulted in the providing of new services for the consumers;

Twenty commissioners responded that it resulted in additional capital available for loans;

Twenty-five commissioners responded that it resulted in an increase in the size of individual loans.

Finally, let me share with you one other piece of empirical evidence. Opponents argue that no one but bankers support this legislation - that neither businessmen nor individual citizens support it or care about it. Let me cite the results of two recent studies:

A. In the most recent edition of <u>The Kansas Business News</u>, a survey is published polling 400 Kansas businesses. One of the questions asked was "Do you support branch banking?" Of those who held an opinion, 67%, or two-thirds answered "yes".

B. A second survey of 627 Kansas citizens was conducted in December of 1983, by Capital Research Services, Inc. The sampling was scientifically selected statewide to represent an approximation of the total adult population of Kansas living in private residences served by telephones. Let me share with you just two of the questions and the responses:

<u>Question</u> - "Any savings and loan association is allowed by law to provide financial services to more than one community at a time. Kansas law does not permit Kansas banks to do this. Do you think that is fair?"

<u>Response</u> - Of those who had an opinion, two-thirds, or 67%, indicated such a law was unfair.

<u>Question</u> - "Next month the state legislature will consider a proposal to allow banks to do business

in any community where they feel there is a need for their services. How do you feel about this proposal?"

Response - Of those answering who had an opinion, 78.5% favored passage of such legislation, or a ratio of more than three-and-a-half-to-one.

Nevertheless, in spite of all of this evidence, I'm sure the opponents will cite other studies and instances where purportedly Multi-Bank Holding Companies have been bad. You will then be called upon to decide which set of reports and which testimony to believe.

Let me close by simply telling you what a judge tells a jury which has heard testimony from expert witnesses on both sides of an issue which is seemingly in direct conflict.

The judge gives the jury this simple instruction:

"In weighing the evidence and arguments of both sides, you are allowed to use your own 'common sense'".

I would therefore ask you to apply that same test when you have heard both sides. Use common sense, and ask yourself these two questions:

1. If all the bad things that opponents say will occur, why has every state, nevertheless, decided to abandon pure unit banking; and

2. If all those bad things predicted to occur, did then occur, why hasn't a single one of the 49 states returned to unit banking.

I think common sense will give you the answer.

Editorials

In God We Trust

Multi-banking is here already

It took almost a month after the Legislature opened its 1984 session, but the question of whether to legalize multibank holding companies in Kansas is finally out in the open.

Senate President Ross Doyen, R-Concordia, has offered a compromise measure that addresses a frequently heard concern: local control. Doyen's measure specifies a certain number of local directors on any banks which are acquired by larger companies, and would limit the amount of money the bigger banks could take out of a community.

Critics of multibank holding companies have said that smaller banks would be swallowed up by larger ones which would not be as concerned about the local communities.

Another charge against multibank holding companies is that they would drain money from the the local community; i.e., a small bank would have to obtain loan money from large city banks. This happens now . Kansas banks, even the largest ones, often have to go out of state to money-center banks to finance large loans.

The fact is, commercial banks of all sizes in Kansas are getting stiffer competition now than ever before, due to recent major changes in laws governing financial institutions:

Savings and loans now are allowed to offer virtually the same services as banks, without the same restrictions.

Finance companies are getting into interstate banking. Several of these firms have purchased banks and savings and loan institutions and will offer their services through local offices in every state.

The country's biggest retailer, Sears Roebuck, now offers the services of a large brokerage firm, a large insurance company, and a large real estate company. Sears' chief executive officer recently announced that "Sears . . .will have a bank at every single Sears outlet in the United States."

Safeway and Kroger, the nation's two largest food retailers, have announced plans to offer financial services in their stores. Kroger just recently acquired the Dillon food stores, a leading grocery chain in Kansas.

And what Kansan has not received letters from big banks in California, Illinois, New York, and other states, soliciting their bank credit card business?

Other examples could be listed, but the point is that Kansas banks should be allowed to compete under the same rules as their growing competition.

Kansas is the only state that does not now permit some form of multibank holding company. There are still plenty of small, independent banks operating in the rest of the country, and there is no reason to believe it would be any different here.

Bank Battle in Kansas

EMPORIA 1-4-84 p. 4

BANKS of Kansas are caught up this year in the same sort of battle that has raged in the newspaper business for 15 years. Farmers face a similar struggle. So do dairies, retail stores — even undertakers.

The fight is between big corporations and small, mainly family-owned enterprises. The corporations want to combine small banks, or newspapers, or farms — whatever — into groups that will turn a bigger profit. In the newspaper business the conglomorates are called "chains." In agriculture, they are called "corporate farms." In the banking business, they are "multi-bank holding companies."

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The arguments are roughly the same in all fields. The small operators say they can give "hi-Joe, how-are-ya" service; they claim an interest in the community that corporations do not share; they cite links to local families that go back for generations.

The corporations offer efficiency. Because they are big operators, the chains have access to large assets, high-powered executives and the latest technology. There is seldom any dead wood in a corporate operation.

The battle rages among bankers; or newsmen; or farmers; or undertakers. By most indications, though, the public could not care less. Customers want the best products and services they can get for the lowest price.

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Now comes the question for 1984: What should the Legislature do about banks? Which would serve the public best, multi-bank holding companies or the present system?

Sad to say, there is not much choice. If the state is to have free enterprise, restraints must be lifted. Journalists may not like to see small papers gobbled up by chains and farmers may despair at the thought of corporate agriculture, but open competition is the American way.

How will it all end? Will corporations gobble up all privately-owned business? It's not likely.

Many private banks have surivived in states that do not have restrictions. Some privately owned newspapers thrive despite domination of the industry by chains. An efficient farmer can stand up to corporate agriculture.

Incorporation is no guarantee of survival.

The bitter pill must be swallowed. Government must not restrict free enterprise. — R.C.

JAN 17 1984

THE WICHITA EAGLE-BEACON Monday, January 16, 1984

Norman J. Christiansen, *President and Publisher*

Davis Merritt Jr., *Executive Editor* Peter B. Ridder, *General Manager*

George Neavoll, *Editorial Page Editor* Clark Hoyt, *Managing Editor*

Editorials/Opinion

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Change in Banking Law Is Needed

Considering that Kansas traditionally accords high value to fairness and to the responsible conduct of business, the state law forbidding banking corporations from acquiring a majority interest in more than one bank makes little sense. The time has come for the Legislature to recognize that the law not only is unfair, but is economically harmful to the state — and change it.

This isn't to say bank holding corporations should operate without restriction in Kansas. For example, banking corporations shouldn't be allowed to charter new banks in small towns, to drive out existing independent banks. But there's no valid reason the owners of that same independent bank shouldn't be permitted to sell it to a banking corporation in an arm's-length transaction — a willing seller to a willing buyer.

In fact, the Kansas Association for Economic Growth — the lobbying arm of 150 Kansas banks wanting the same corporate branch-banking rights already enjoyed by savings and loan corporations — has expressed its willingness to accept a new law forbidding large banks from chartering such branches. This suggests the association's motivation for seeking a multi-bank holding law isn't to gobble up little banks, but to enhance the flow of capital in the state — and profit thereby. There's nothing wrong with that.

The current law is a vestige of a long-gone era characterized by modest demand for venture capital, and by a sharp urban-rural cleavage. Designed to protect rural areas from big outside banks interested only in turning a fast dollar, and to keep a community's investment dollars at home, that law now constitutes a major barrier to full realization of the benefits of the present era — one characterized by large and growing credit needs, and an urban-rural partnership in developing business, industry and agriculture.

Oklahoma and Nebraska recently have recognized this and amended their banking laws accordingly — with no accompanying spate of rapaciousness by large banks — leaving Kansas the sole remaining state placing artificial and unfair restrictions on its banking corporations. The state can't afford that sort of uniqueness much longer.

REGISTER

PERSPECTIVE

OPINION AND ANALYSIS

A guest editorial

Kansas banks need power to compete

By BILL JAMES

As the 1984 Kansas Legislature convenes, one issue facing them which is of importance to all Kansans is that of multi-bank holding companies. The real issue is not one of competition among Kansas banks, rather allowing all Kansas banks to compete more evenly with the real competition, the new so-called "full financial service centers." Kansas banks are currently handicapped from effective competition by existing restrictive laws.

Savings and loans have been given the authority to offer services virtually equal to banks without the same restrictions. They can offer checking accounts, consumer loans, even change their name to "bank" and they can branch statewide.

Congress is close to authorizing inter-state banking, which will allow branch banks and multi-bank holding companies from other states to cross state lines. Citicorp and other giants have al[illegible] to prepare for the movement.

Finance companies are getting into inter-state banking. The Beneficial Corporation, Household Finance, and The Associates have begun to purchase banks and savings and loans across the country and will offer their services through their local finance offices in every state.

The nation's largest insurer, Prudential, has purchased a national brokerage firm, Bache Inc., and plans to offer a service of mutual funds through its thousands of agents throughout the country.

The nation's giant retailer, Sears Roebuck, now owns Dean Witter, Allstate Insurance, Coldwell Banker, and Allstate Savings & Loan of California, and plans to offer complete financial services to its 24 million credit card holders. The head of Sears recently announced "Sears . . . will have a bank at every single Sears outlet in the United States."

American Express recently purchased Shearson Loeb Rhoades, and plans to offer financial service packages to all its credit card holders throughout the United States.

Safeway and Krogers, the nation's two largest food retailers, have announced plans to offer financial services in their retail stores throughout the country. Krogers recently purchased Dillons, adding significantly to its retail outlets in Kansas alone.

Merrill Lynch, the nation's largest security broker, and Citicorp, the nation's largest bank holding company, are alreac offering nationwide financial services.

I believe these examples illustrate the dilemma facing Kansas banks as they strive to compete for depositors' dollars, and to keep those dollars working in Kansas.

Every recent major study of bank structure suggests that the multi-bank holding company is the best way for banks to more evenly meet this competition.

One final point — multi-bank holding company authority is totally voluntary under the legislative proposal. Absolutely no Kansas bank would be required to form a multi-bank holding company. Absolutely no Kansas bank could be required to sell to a multi-bank holding company. Thus, legislation would merely give each Kasas bank the right to choose the best structure for it to meet this future competition.

BILL JAMES, president of the Allen County Bank & Trust, has been in the banking profession since 1950. He started work at the First National Bank in Topeka, moved to Pittsburg in 1960 to go to work for the City National there and came to Iola in 1976 as a vice president. James became president of the Allen County Bank & Trust in 1978 at the retirement of Ray Pershall. He grew up in Quenemo, where he graduated from high school. He then moved to Topeka to enroll in Washburn University. His wife, Sue, is employed at Midland-Berg. The couple have three sons and four grandchildren.

MULTI BANK HOLDING COMPANIES ARE NOT BRANCH BANKING!

The issue of bank structure is complex and sometimes confusing. Opponents often incorrectly state that the issue is branch banking - it is not! The Kansas Association for Economic Growth has taken a firm position that Multi-Bank Holding Companies - not branch banks - will be the best bank structure to meet the economic needs of Kansas and its citizens.

The differences between Multi-bank Holding Companies (MBHC) and branch banking are clear:

MBHC's invest in existing banks - not compete with them - branch banks invest only in brick and mortar and compete with existing local banks.

MBHC's have a Board of Directors comprised of local citizens - branch banks do not.

MBHC' have a local president/CEO - branches have branch managers.

A change to MBHC is only a change to remove restrictions in corporate structure of Kansas Banks, not a license to allow indiscriminate and harmful expansion of existing banks.

This material is published by the Kansas Association of Economic Growth, an organization dedicated to the economic growth and enhancement of Kansas through the modernization of restrictive bank structure laws.

CONCLUSIONS OF SPECIAL COMMITTEE ON
COMMERCIAL AND FINANCIAL INSTITUTIONS

Based on the hearings and testimony presented to the 1982 Special Committee on Commercial and Financial Institutions, the legislative committee reached the following conclusions:

1. Permissive legislation to allow multi-bank holding companies in Kansas would provide for increased utilization of financial resources, such utilization could significantly enhance and support ecomonic growth and development in our state.

2. Permissive legislation to allow multi-bank holding companies would provide Kansas consumers enhancements to their existing bank services and more services because of a greater consumer base of demand and greater expertise of MBHC's.

3. Permissive legislation to allow multi-bank holding companies would provide a more competitive environment of financial services which in turn would benefit the consumer and the support and development of Kansas business.

4. Permissive legislation to allow multi-bank holding companies would provide greater parity between Kansas banks and other financial institutions and corporations offering financial services. With recent developments in federal legislation and deregulation, a continuance of multi-bank holding company restrictive legislation would place an unfair and unnecessary burden on the banking industry.

5. Permissive legislation to allow multi-bank holding companies would recognize by statute the type of bank structure which already exists through the ability of individuals and one-bank holding companies to own or control unlimited numbers of banks either separately or through voting stock arrangements with other one-bank holding companies or individuals.

Evidence and testimony strongly supports the following statements regarding Multi-Bank Holding Companies:

1. <u>MBHC's would enhance the economic growth opportunities for Kansas.</u>

> "Multi-bank holding legislation . . . would certainly enhance the opportunity for growth of both existing and potential business and industry in Kansas.

Terence Scanlon, Former Director of
Kansas Dept. of Economic Development
Testimony before the
Special Committee on Commercial and Financial Institutions
August 19, 1982

> ". . . restrictions on banking [that] harm the free flow of capital are counterproductive and tend to create artificial inefficiencies and harm the potential of our state to grow and prosper."

Robert Brock
Brock Hotel Corporation
Special Committee on Commercial and Financial Institutions
July 22, 1982

2. <u>MBHC's provide an opportunity for smaller banks to strengthen themselves so they can serve their communities even better.</u>

> "It is my sincere belief that multi-bank holding company structure will preserve the numbers of Kansas banks serving bank customers . . . I believe that under this structure Kansas banks will be better able to take care of the credit needs of their customers . . . I believe that small banks can use this vehicle to better compete with the larger organizations by affiliating between themselves. To be more comprehensive, I believe it will make for a stronger Kansas economy."

> ". . . under the multi-bank holding company structure we will be able to affiliate with other strong, agriculturally-oriented Kansas banks to provide better services to Kansas customers."

Gary Padgett, President and CEO,
Citizens National Bank, Greenleaf, Kansas
Testimony before the
Special Committee on Commercial and Financial Institutions
July 22, 1982

3. MBHC's will give additional financial strength to the communities of Kansas.

> "In most cases, the supply of financial resources to a community would be greater through a multi-bank holding company than through a unit bank."
>
> Jack E. Gaumnitz, Professor of Finance,
> University of Kansas
> "Multibank Holding Companies,
> Consumer Benefits and Competitive Aspects:
> Perspective Analysis and Summary of Research"
> September, 1982

4. MBHC's have a pro-competitive effect on the market.

William J. Carner, President of Carner & Associates, Ltd., of Springfield, Missouri, a firm that produces the BANCPEN Reports, a nationwide marketing and profitability consulting service, serving over 1,000 banks nationwide, states:

> "The main reasons for adopting multi-bank holding companies are that it is good for the consumer and increases competition."

Jack Gaumnitz, in his study of MBHC's and the consumer:

> ". . . either through entry into an area through an affiliate, because of the organizational form, or because of some perceived cost efficiencies, especially through automated processes, BHC's have been assumed to have a pro-competitive effect on the market."

5. MBHC's provide more bank services to the consumer.

William J. Carner, speaking of the Missouri experience, says:

> "Service to the consumer has not always been uppermost in the minds of small banks with little competition. Prior to the increased competition from holding companies, many small-town banks offered only checking and passbook services to customers. No CD's or market interest available. Anyone that wanted such luxuries could drive somewhere else to find them. Holding company banks not only offered a full range of services but brought new services such as automatic tellers, bank-by-phone, IRA's, NOW accounts, credit cards, and many others. Noncompetitive banks were forced to modernize and offer what the customer wanted."

Jack Gaumnitz says:

> "The benefit to the public of multi-bank holding companies, when compared to unit banks, is normally greatest on the consumer savings side. A greater abundance of savings instruments offering higher rates and greater flexibility than available in unit banking states often exists."

6. <u>MBHC's provide a greater capacity to meet the loan needs of major Kansas business and industry.</u>

> ". . . Kansas banks cannot service the needs of its largest companies that have the greatest potential for further growth."

Robert Brock, Brock Hotel Corporation
Testimony before the
Special Committee on Commercial and Financial Institutions
July 22, 1982

> "Holding company banks now provide larger volumes of bank financings for Texas-based business and industrial firms and especially for energy-related firms headquartered in Texas. Earlier, these larger business organizations had to go to New York, Chicago, and to banks located elsewhere to satisfy their financing needs."

Elvis L. Mason, Chairman and CEO,
InterFirst Corp.

7. <u>Multi-bank holding is the best structure to allow banks to face the challenges of a rapidly changing financial environment.</u>

Jack Gaumnitz notes:

> "Watkins and West* in their examination of bank holding companies concluded, '. . . Recent developments in financial markets have spurred Congressional interest in deregulation. Bank holding companies are well placed to take advantage of any deregulation of financial activities.'"

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* Watkins, T. G. and R. C. West. "Bank Holding Companies: Development and Regulation." <u>Economic Review</u>, Federal Reserve Bank of Kansas City, 67 (June, 1982), 3-13.

8. <u>Multi-bank holding provides the freedom of choice to all Kansas bankers to choose the bank structure that best serves their shareholders and their customers.</u>

Today there is no choice. A MBHC law would permit a bank, <u>if</u> it so chooses, the right to become part of a MBHC. This choice belongs to the shareholders and management of the bank - not the legislature.

9. <u>MBHC legislation addresses the inequity between Kansas financial institutions:</u>

In December of 1982, Savings and Loans were granted sweeping new power that includes virtually all traditional banking services. Savings and Loans recognize this new opportunity, some are beginning to change to include Bank or Banking in their names. Branching, which is certainly a far cry beyond multi-bank holding, is permitted and has been highly utilized for over 30 years by the Savings and Loan industry in Kansas.

Banks are the only financial institutions which are restricted in their ability to establish a corporate structure that will best serve the consumer, restrictions which are not placed on Savings and Loans, Credit Unions, finance companies, or the wide variety of other institutions now offering banking services.

In an era of deregulation, this inequity can be crippling to the growth and stability of Kansas banks.

An Analysis of the Arguments of Those Who Oppose MBHC's

Argument: MBHC's don't support Agriculture.

Analysis: Dexter Davis, former Commissioner of Agriculture of the State of Missouri, conducted a special study through his office to determine possible negative effects of MBHC's. In testimony to the Special Committee on Commercial and Financial Institutions on August 19, 1982, Mr. Davis stated:

"I have not seen or experienced agriculture enterprises hindered or suffering from the change over of the ownership of the various local banks into a multi-bank holding company."

Argument: MBHC's concentrate too much of the wealth.

Analysis: In his comprehensive study of research done on MBHC's, Professor Gaumnitz, University of Kansas, stated:

"BHC's have not significantly increased the concentration ratio in commercial banking at the national, state, or local level."

A specific example of this non-concentration is in Missouri where the concentration of deposits of the five largest bank companies has increased only 2.9% since 1957 - that is 2.9% in 25 years!

Argument: Loss of Local Control.

Analysis: 1. There is no law that guarantees local ownership of Kansas banks. The Federal Reserve has identified that at least one-third of all Kansas banks are owned by chains. Chain banking is ownership or control by individuals or partnerships of more than one bank and is perfectly legal in Kansas. Thus we have a de facto holding company structure already existing throughout our state.

2. Many banks in Kansas (and more each year) are owned by people not even living in Kansas. In fact, our current law restricting Kansas banks from owning Kansas banks, encourages and provides increased opportunities for Nebraskans, Missourians, Oklahomans, and others to establish a strong banking ownership presence in Kansas.

3. The ultimate control is always in the hands of the consumer. They decide the success or failure of the bank by using or not using its services. To suggest that a holding company would invest millions of dollars to purchase a bank in a community and then ignore the community's financial needs makes no sense whatsoever. The holding company must make its significant investment grow and prosper and can only do that by serving the community well.

4. The Savings and Loan industry has branched in Kansas for more than 30 years. If non local ownership of a financial institution is the problem some claim, would it not have become evident in the Kansas Savings and Loan industry the past 30 years?

There is strong evidence that the fears of those who oppose MBHC's are unwarranted. Graham and Rolnick, writing in the "Quarterly Review" of the Federal Reserve Bank of Minneapolis (Spring, 1980), about branch banking, which goes far beyond allowing multi-bank holding companies, stated:

> "The opposition to branch banking in these states has mainly been based on fears that the ability to branch will reduce competition in the banking industry and increase the cost and reduce the availability of banking services for rural consumers. Specifically, opponents fear that this will happen because they believe that:
>
> 1. Branch banks siphon funds out of rural areas.
>
> 2. Branch banks are less efficient than unit banks.
>
> 3. Large branch banks drive small unit banks out of business.
>
> 4. Branching leads to increased bank concentration.
>
> "The experience with branch banking in the United States has allowed researchers to test the validity of these concerns. Comparing states that allow branching to those that don't, comparing branch banks to unit banks in the same state, and comparing banks before and after they become part of a branching system has provided fertile ground for economic analysis. The evidence from these studies is quite conclusive: all four fears about branching are unwarranted."

Attitudes toward Multi-Bank Holding Companies

Conducted by

Capital Research Services, Inc.

December, 1983

For Kansas Association for Economic Growth

Results

One of the most controversial issues that the 1984 legislature will have to deal with is the law that prohibits multi-bank holding companies. It is likely to be a difficult issue for legislators not only because of the pressure from lobbyists on both sides of the issue but because few of them are likely to know where their constituents stand on this issue. This poll was conducted specifically for this purpose.

Kansas law does not prohibit other financial institutions from doing business in more than one community. With the deregulation of the financial community which allows non-banks to offer more and more services traditionally offered only by banks, many bankers feel that the prohibition against multi-bank holding companies is unfair. To find out how the people of Kansas feel about this, we asked them. The results are presented in the table below.

Any savings and loan association is allowed by law to provide financial services in more than one community at a time. Kansas law does not permit banks to do this. Do you think this is fair?

	N	Pct.
Yes	172	28%
No	341	56%
Not Sure	94	16%
	607	100%

Next month the state legislature will consider a proposal to allow banks to do business in any community where they feel there is a need for their services. How do you feel about this proposal? Strongly favor, favor, not sure, oppose, strongly oppose?

	N	Pct.
Strongly favor	87	15%
Favor	218	36%
Not sure	211	35%
Oppose	66	11%
Strongly oppose	20	3%
	607	100%

MULTIBANK HOLDING COMPANIES,
CONSUMER BENEFITS AND COMPETITIVE ASPECTS:
PERSPECTIVE ANALYSIS AND SUMMARY OF RESEARCH

Professor Jack Gaumnitz

University of Kansas

Lawrence, Kansas

September 1982

Jack E. Gaumnitz is currently a Professor of finance in the School of Business at the University of Kansas. He received his Bachelor's and MBA degree from the University of Wisconsin and his Ph.D. from Stanford (1967). His prime teaching interests are financial institutions, investments and capital budgeting.

Dr. Gaumnitz has co-authored a book on financial institutions and capital markets and has published several articles in the areas of portfolio management, securities investment, asset abandonment, leasing, and real estate. In addition, he is the president of an investment management group.

Previously related activities include (1) analysis and testimony pertaining to bank charters (2) assessment of income/loss in suit between two institutions (3) valuation of a closely held financial institution, (4) valuation of investment securities and (5) real estate appraisal and analysis.

This study examines the significance and impact of multibank holding companies on state and local economics, on local capital and money markets and on financial institutions. The conclusions are largely based on research drawn from scholarly publications pertaining to the varied impact of multibank holding companies (MBHC's). An assessment of the competitive effects on states that have recently enacted legislation favoring expansion of multiholding bank forms, a brief comment on the probable course of bank regulation in the future--especially at the national level--and the banking structure most suited for this challenge are also part of this report. For convenience the paper is divided into three major sections: (1) a general summary and conclusion; (2) a topical summary providing information on the major areas of research on multibank holdings company and (3) a further analysis discussing the research evidence in greater detail.

I SUMMARY AND CONCLUSION OF STUDY

Most research studies, discussed below, conclude that overall, the multiholding bank form is more beneficial to the public interest when compared to the unit or independent bank form. The evidence is reasonably clear that benefits to the consumer from this type of organization tend to outweigh the costs. Although the evidence and conclusions are not unanimous, there is a rather large body of research that shows that the fears of those who oppose any form of MBHC's are largely unfounded and in general cannot be substantiated to any reasonable degree.

Research has shown that multibank holding companies as compared to unit banks or limited branch banks generally (1) do not increase concentration, hence competition is presumably increased, (2) increase net public benefit relative to cost, (3) increase bank safety and soundness while at the same time causing increased lending to customers through loan diversification capabilities, (4) offer expanded financial services to bank customers,

(5) do not decrease, and in many cases, increase, the monies available for local lending, (6) overall hold the pricing of services about the same even though varying the pricing of some services considerably and, (7) increase the deposit mix and interest rate paid on time deposits thereby favoring the consumer.

The benefit to the public of multibank holding companies, when compared to unit banks, is normally greatest on the consumer savings side. A greater abundance of savings instruments offering higher rates and greater flexibility than available in unit banking states often exists. Moreover, this has been accomplished with no appreciable differences in loan interest charges. The net result is a narrowing of the net interest rate margin--the spread between average interest earned on assets and interest paid on deposit funds, a slight lowering of bank profitability as a percent of assets and, as a result, a greater net benefit to the public than previously available.

The growth in deregulation and the shift in balance towards more competition among all financial institutions tends to favor a multibank holding company form since it is at least a step closer to the most probable financial environment in the future. It also represents a better positioning in response to competitive pressures both here and abroad. Rudiments of interstate banking have existed for many years for foreign banking organizations.*[1] Recently, domestic banks, although under unusual circumstances, have been allowed defacto interstate banking.[2] Savings and loan associations with recently expanded loan authority already have statewide branching capabilities.[3] Some banks, notably Citicorp and Bank of America, have long operated loan

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* Footnotes are at the end of the paper before Bibliography.

offices throughout the country through subsidiaries in preparation for the expected eventual legalization of interstate banking.[4] Others with non-bank origins have banking type operations in place and in one form or another are continually encroaching or challenging the remaining legal constraints to wide open competition.[5]

The Federal Reserve, although favoring some increased competition, does not favor wide open destructive competition and in fact they have been quite firm in their denials of mergers where concentration is noticeably increased even though net public benefits (over costs) are positive.[6] Holding companies must still show that existing banks will not be unduly harmed and that de novo or foothold acquisitions by the expanding bank would not take place otherwise. In short, significant control over multibank acquisition or expansion is still exercised by the Federal Reserve.[7]

To be sure, all of the increased competition may not turn out to be highly beneficial, yet the overall balance weighs heavily in favor or the multiholding bank form when compared to the unit bank form. Public benefits exceed public costs and the future national financial institutional structure warrants it.

II TOPICAL SUMMARY

Although in existence since the early 1900's, the growth of bank holding companies (BHC's)--one bank and multibank--is clearly one of the significant developments in banking over the last twenty years. As a result, a large body of research has been published on their performance and impact as it affects bank and non-bank affiliates. Where there are conflicting research results, some explanation or comment on the differences is noted. Not all of the studies discussed below relate strictly to the BHC form. Some studies, for example, make branch and chain bank comparisons to unit banks. These studies are discussed here because of their similarities to

BHC's in substance if not in form. Furthermore, Federal Reserve rulings have often treated these structural forms in the same manner.[8]

The areas discussed are categorized along general lines of research inquiry regarding BHC's. This would include effects of bank holding companies on (1) concentration of resources, (2) cost efficiency, (3) competition, (4) bank soundness, (5) public benefits and costs, (6) supply of financial services to customers and (7) future competitive structure of financial markets.

1. Concentration of resources. Multibank holding companies have not increased their control over total financial resources in the economy. Although BHC's have continued to increase their share of domestic bank deposits, most of the recent increase is due to conversion by existing unit banks to the BHC form of organization. Less than ten percent of the total BHC bank deposits are outside the lead bank.

BHC's have not significantly increased the concentration ratio in commercial banking at the national, state, or local level. Since the mid 1930's, concentration ratios have actually shown a declining trend for all three governmental divisions. (Here concentration ratios have frequently focused on the percentage of total deposits held by the five largest banks in a given statistical area.) Although there is some conflicting evidence especially at the state level, concentration has declined greatest in states with heavy or light initial concentration and increased the most in states with low to moderate initial concentration. At local levels, there has been little or no discernable effect on concentration due to bank holding companies. This result can be explained in part by the Federal Reserve Board's strong stance in procompetitive bank expansions.

In non-banking but closely allied activities such as leasing, mortgage banking, courier services, BHC's have not made a noticeably impact.

2. Cost Efficiency. There is only fragmentary and partial information on cost efficiency and some of the evidence in this area is conflicting. Affiliation with a large BHC generally results in initial savings in organizational costs and a reduction in costs through economics of scale. Gains tend to be greatest for small affiliate banks. In many cases, the benefits of economics of scale tend to diminish (but not become negative) once affiliated banks reach asset size around thirty million dollars. Certain economies in costs can be achieved by affiliated banks but these may be offset by home office charges to the unit. A reasonable conclusion, on balance is that operating expenses of affiliated companies do not differ much from those of unaffiliated companies.

3. Competition. The Federal Reserve is required to assess the competitive effects of any affiliation before approval is granted. Some increase in competition at least as it relates to reduced concentration and/or expanded markets is viewed favorably while excessive competition and significantly lowered profitability is viewed unfavorably.

Conclusions regarding the effect of BHC on competition are somewhat limited in this area because of the few reported studies. As a minimum, however, either through entry into an area through an affiliate, because of the organizational form, or because of some perceived cost efficiencies, especially through automated processes, BHC's have been assumed to have a procompetitive effect on the market.

4. Bank Soundness. Bank holding companies are expected to reduce the risk posture of banks through multibank diversification and expansion into closely allied non-banking areas.

Again through diversification, BHC loan portfolios have tended to be more flexible (of benefit to the consumer) than independent banks. This is favorable for those credit worthy customers who may now receive needed

loans in larger size and with better terms than previously available. Diversification throughout a larger geographical area and into other diverse but closely related bank activities should enable BHC's to better withstand any increased loan risk exposure.

BHC's have increasingly leveraged themselves in recent years with borrowed funds; however, as suggested by some, this may be a temporary phenomenon brought on by acquisition costs as the expanded organization was being put in place.

5. Public Benefits and Costs. The Federal Reserve Board as part of its responsibilities under the Bank Holding Company Act of 1956, and as amended in 1966 and 1970, is required to consider the convenience and needs of a community in evaluating a proposed acquisition by a bank holding company. The Board has usually taken a rather strict interpretation of the law and Supreme Court rulings, and has normally rejected applications where the anti-competitive effects outweigh the perceived benefits to the community.

In evaluating BHC applications, the Board has focused on such factors as providing new services, ability to obtain additional capital for customers, increased efficiency, better management and increased competition. Often availability of additional credit to the community--both private and public--has been an important factor. Yet, as noted earlier, despite these benefits, if significant anti-competitive factors exist, there is a high probability of Board denial. Greater leverage and in some cases, probable poorer operating performance, may also lead to Board rejection of an application.

There have been few studies in assessing public benefits largely because of the difficulty in quantifying or measuring beneficial effects. Of those reported, the majority tend to report positive net public benefits. One major study, in conclusion, found that BHC's fulfilled most of their public benefit actions.

6. Supply of Financial Services to Customer. An argument in favor of BHC's--and one that is often advanced when making an acquisition application--is that BHC's can provide expanded financial services to consumers. This expansion of services could take the form of (1) more and different types of saving instruments for prospective savers, (2) loan size expansion to any one borrower, (3) a larger number of buyers receiving loans, and (4) a greater number of bank and bank related services being offered. Included would be such services as trust activities, data processing and retirement counseling.

Most evidence, although again limited, shows that BHC's do fulfill most of the proposed added consumer benefits.

Supplying expanded financial services seems to result, on the average, in lower profit margins as costs for these services are not always offset in a more competitive environment. Often higher costs paid to depositers on new instruments are not offset on the loan side in the form of higher rates to borrowers thereby resulting in a lowering of the net interest rate spread. The most recent study on profitability of insured commercial banks showed a net interest margin (the difference between interest earned and interest expense) of 5.31% for small banks (under $25 million in assets) compared with a return of 3.12% for bank holding companies.[9]

7. Future Competitive Structure of Financial Markets. The passage of the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) in 1980 has been characterized as "...the most sweeping piece of legislation in U.S. history." The Act had as its prime objective a more and better competitive posture for depository institutions. In addition, to the well known removal of interest rate ceilings over time, a number of other significant changes were also made. For example, thrifts will be allowed to invest up to twenty percent in consumer loans, commercial paper or corporate debt. With most thrifts largely unrestricted in location of facilities and

several already owning interstate operations they are currently, or seem to be, essentially quasi multibank operations at this time.

The recent merging of many thrifts (to take over ailing institutions) brings to ten the number of interstate S & L's authorized by the Federal Home Loan Bank Board this year and the fourteenth since the bank board approved the concept in 1981.

Several financial institutions may not have the management talent nor resources required to meet the challenges from a highly competitive environment in the future. One estimate stated that the twenty thousand five hundred banks, savings and loan associations (S & L's) and mutual savings banks as of 1980 could shrink to as little as six thousand in coming years. This shrinkage, whether by acquisition merger or failure will indirectly promote eventual acceptance of interstate banking.

Citicorp's purchase of Fidelity Savings and Loan Association of San Francisco if upheld by the Federal Reserve Board, would mark the first time federal regulators have allowed a bank holding company to cross both state lines and industry lines to buy a thrift operation. "Citicorp already has one hundred and twenty person-to-person financial centers in twenty-eight other states, eight hundred fifty-three regional offices and a national network of interstate credit card and real estate financing. Interstate banking has already got so far in the financial back door that it is setting up housekeeping in the kitchen."

If recent developments in the financial markets spurs further Congressional interest in deregulation their bank holding companies should be well situated to take advantage of any deregulation of financial activities.

III SUMMARY OF RESEARCH: REVIEW

1) Concentration

Erderig (20)* in a study on trends in concentration in multiholding bank

states, indicated an actual decline in concentration in standard metropolitan statistical areas (SMSA) from 1965 through 1979 and in non-SMSA districts. She also noted that, "Decreases in concentration generally occurred more frequently in those areas with a high initial level of concentration. Multi-bank holding company activity has had little effect on concentration in local areas, probably because the requirement for prior regulatory approval has inhibited the acquisition of competition in local markets."

Allardice (3)* in a simliar study of structural change in Wisconsin, noted that , "...the effect of large multibank holding companies on concentration in Wisconsin's urban centers appear to have been insignificant." His study showed that in the 1970's banking concentration declined in all fourteen of the urban centers (in Wisconsin). Two major explanations for this result were (1) the entry of new banks and (2) deposit migration to suburban banks.

Dahl, et. al., (17) concluded that high concentration does not necessarily mean less competition. They examined prices and services in Minnesota where forty-eight percent of deposits were held by two banks--a high concentration ratio. The authors found that in some cases, prices for services were higher and in some cases they were lower but, in any event, holding companies provided more services. The authors note that, "Few of the differences were statistically significant, but those that were, indicated that bank competition was keener in Minnesota."

Graham and Rolnick (25) in a broad study on branch banking noted that branch banking generally tends to increase concentration in urban areas. Effects are almost the opposite in rural areas, however. "Rural banks are not likely to branch in their own small local markets, so an increase in the number of offices in these areas can safely been assumed to represent an

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* Numbers in parentheses refer to Bibliography.

increase in the number of competing firms and thus a decrease in the concentration of banking services there."

2. Cost Efficiency

Studies by Benston (6) and Bell and Murphy (5) found that bank branches were more efficient than unit banks.

Stover (52) in his analysis of single-subsidiary bank holding companies, found that changing to a BHC from a single bank, especially in rural areas, had no significant effect on bank performance.

Early studies by Alhadeff (2), Schweiger and McGee (48) and Horvitz (29) showed that branch banks were less efficient than unit banks although recognizing that branch banks provided more convenience and service. Mullineaux (42) and Longbrake (35) after correcting for earlier studies especially for convenience and service factors generally concluded that there were no significant differences in cost efficiencies.

Drum (18) studied two hundred eight seventh district banks and found that banks ranging in asset size from $50 million to $200 million were generally the most efficient regardless of organizational form (i.e., bank affiliate or independent bank). In some cases, he found that independent banks had economies of scale. "There appeared to be no justification that affiliation with a multibank holding company will produce economies of scale not otherwise available to independent banks." This statement could be viewed favorably since it implies that independent banks and future newly chartered non-affiliated banks should be able to compete effectively, and mitigate concerns about undue economic cost efficiencies in favor of affiliated banks.

3. Competition

Graddy and Kyle (23, 24) in two separate studies, found that bank holding company banks compared to independent banks:

1) held a significantly higher fraction of total resources in business and consumer loans,
2) had a lower average loan rate, maintained a smaller proportion in U.S. securities,
3) gave a stronger response to market growth and new areas,
4) paid a higher average deposit rate but also charged higher fees for checking,
5) held a higher proportion of total deposits in demand deposits.

Mayo (39) noted that since 1977, the Federal Reserve Board has considered chain banks as de facto multibanks and denied holding company status if anti-competitive effects were present. "The Board has denied dozens of applications that would have eliminated competition between two banks in the same market. The benefits to bank customers in the form of lower priced services, just from denials of applications that would have eliminated existing competition, have been more than sufficient to outweigh all other costs associated with the Act."

The Board has also been concerned by holding company acquisition of leading banks in markets that could be entered by more procompetitive means such as charting a de novo bank or by acquiring one of the smaller banks in the same market. Graham and Rolnick (25) noted that many states have permitted some form of branch banking and their experience analyzed expensively:

> "The evidence clearly supports allowing banks more freedom. It strongly suggests that many common concerns over the impact of branching on competition in the banking industry are unwarranted. Permitting branching does not drive small independent banks out of business or reduce the amount of credit rural communities can get or increase what they have to pay for it and other banking services. On the contrary, where branch banking has been allowed, large and small banking systems compete quite vigorously and on average consumers in rural areas are offered more places to bank and a wider variety of banking services. While branching clearly changes some features of the banking market, it has not led to monopoly pricing, but rather to more banking services offered to more people at competitive prices.
>
> The evidence, in short, shows that branch banking has had a positive influence wherever permitted..."10

"The opposition to branch banking in these states has mainly been based on fears that the ability to branch will reduce competition in the banking industry and so increase the cost and reduce the availability of banking services for rural consumers. Specifically, opponents fear that this will happen because they believe that:

1. Branch banks siphon funds out of rural areas.
2. Branch banks are less efficient than unit banks.
3. Large branch banks drive small unit banks out of business.
4. Branching leads to increased bank concentration.

The experience with branch banking in the United States has allowed researchers to test the validity of these concerns. Comparing states that allow branching to those that don't, comparing branch banks to unit banks in the same state, and comparing banks before and after they become part of a branching system has provided fertile ground for economic analysis. The evidence from these studies is quite conclusive: all four fears about branching are unwarranted."11

4. Bank Soundness

Aharony and Swarz (1) measured the effects of the 1970 Amendment to the Bank Holding Company Act (1956) on the profitability and risk of BHC's. Their study compared BHC's and a control group comprised of independent banks. They found no significant differences in performance and no change in relative risk of any of the portfolios. They also examined the impact of non-bank activity expansion and found that changes in risk in the banking industry were not related to non-bank expansion, but rather to the economy itself.

Graddy and Kyle (24) noted that bank holding companies tended to move over a three year period to an improved capital/risk assets ratio. This apparently was the result of improved operations and lower bank acquisition costs.

Mayo (39) noted that the Board has rejected applications when the excessive use of debt at the holding company level made a problem for debt servicing. Nevertheless, he concluded that, "The holding company form offers the financial, product and geographical flexibility and diversification that is beyond the reach of an individual (unit) bank."

5. Public Benefits and Costs

In a study of the potential competition policy of the Federal Reserve Board, Smith (50) noted:

> "The Board of Governors is presently pursuing a relatively strong potential competition policy. While there are costs associated with any of the Board's available alternatives, the potential costs associated with a strong policy appear to be significantly lower than those associated with a weak policy. Moreover, the available empirical evidence, limited as it may be, tends to support the assumption underlying the potential competition doctrine. ...the Board can best serve the public interest by making a firmer commitment to pursue the strong potential competition policy..."[12]

Graham and Rolnick (25) in their study on banking, noted that branching benefited the public because it provided more banking offices, offered a wider range of banking services such as revolving credit, trust services, special checking, payroll services, and foreign exchange services. Weintraub and Jessup (57) and Kohn (33) found that, especially for small banks, branching offered these services more than small unit banks.

In another study, Graham (26) studied the effects of a recently enacted limited branch banking law (1977 to 1981) to see if the new law benefited consumers in the State of Minnesota. He concluded that: "Allowing Minnesota banks some freedom to branch has so far probably benefited consumers: it has given them many more places to bank and it does not appear to have adversely affected the prices and availability of their banking services."

6. Supply of Financial Resources

In most cases, the supply of financial resources to a community would be greater through a multibank holding company than through a unit bank. Sheer size plays an important part but as Mayne (38) showed, BHC's operate as integrated entities. As a result, legal limits on the size of a loan lent directly is not a problem or an effective constraint.

Bank affiliates in one form or another often supply financial resources or services to the community. This would be an added benefit, since, as Mayne

pointed out that non-bank affiliates earnings to total bank earnings is small by comparison and hence equity buildup would be slow otherwise.

7. Future Structure, Markets

Banks have come under increasing pressure from other financial institutions. As a result, savings and loan associations, mutual savings banks, and brokerage firms have been allowed entry into financial areas previously largely reserved for commercial banks. In response to this changing environment, many bills continue to be introduced in Congress that would further and more rapidly reduce barriers to complete financial institutional competition than those originally proposed in the Depository Institutions Deregulation and Monetary Control Act. Bills by Senator Garn and by Representative St. Germaine are but two recent examples. The Garn bill, for example, among other provisions would allow banks to underwrite limited types of securities which heretofore had been largely prohibited by the Glass-Steagal Act (1933). Such limited security underwriting however, could take place only in an affiliate. Thus, in order to underwrite, if approved, would require some form of bank holding company anyway. Watkins and West (55) in their examination of bank holding companies concluded, "...Recent developments in financial markets have spurred Congressional interest in deregulation. Bank holding companies are well placed to take advantage of any deregulation of financial activities."

If the multiple facility/affiliate form seems to be best suited for the present and future competition among financial institutions, what form especially as it relates to banking, is apparently the best? Evidence in this area is sketchy; in one related study, though, Savage (47) asked how state branch banking and/or bank holding company laws impacted the economic prospects of new banks. Savage examined the performance of new banks, established in 1967 and 1968, after ten years (in 1977). He looked at such factors as

level of deposits, market share and profitability of new banks, and concluded that, "...Except for a small negative impact for statewide branching on new bank market share, state structure laws do not have a statistically significant impact on the viability of new banks." It might be implied from this statement that if new banks are to be chartered--presumably because of need, less concentration, et cetera--they might prosper more in a state that allows the bank holding company form as opposed to statewide branching.

Rhoades and Savage (45) in a similar study, focused on the relative merits of bank holding companies and branch banking in a multimarket system. They examined measures of profitability, operating efficiency, risk and service to the local community. Their results showed no clear cut superiority, however, BHC systems tended to be less risky and have lower costs in some categories of non-interest expenses which was attributable to the fewer offices under the BHC form.

FOOTNOTES*

* (Numbers in parentheses refer to Bibliography)

[1]Rhoades (44, p. 3) in his article on interstate banking noted that, "Although the McFadden Act of 1927 expressly prohibits interstate banking, major banking organizations have established a significant nationwide presence during the past decade. They have done so through institutions that do not perform the basic banking function of accepting deposits and so do not violate the law. ...Moreover, the offices of foreign banks form a de facto interstate network.

[2]Time Magazine (53) p. 67 describes Citicorp's recent proposed acquisition of a California savings and loan institution.

[3]For a good summary of recent legislation on savings and loan see Savings and Loan Association, Fact Book, U.S. Savings and Loan League, 1982.

[4]Wall Street Journal, August 16, 1982, p. 7.

[5]Time Magazine, op.cit., p. 67.

[6]MAYO, (39).

[7]Ibid.

[8]Federal Reserve Bulletin, January 1980, p. 61-4. Also, Federal Reserve Bulletin, August 1982, p. 477, and MAYO (39).

[9]Federal Reserve Bulletin, August 1982, p. 458.

[10]Graham and Rolnick (25), 8.

[11]Ibid, 9.

[12]Smith (50), 23.

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Impact Study on Effects
of Multi-bank Holding Companies

prepared by

Carner & Associates, Ltd.
Springfield, Missouri

August 19, 1982

I am William J. Carner, President of Carner & Associates, Ltd. of Springfield, Missouri. My firm produces the BANCPEN Reports, a nationwide marketing and profitability consulting service, serving over 1,000 banks nationwide. The firm is five years old and in addition to banks, my clients include Arthur D. Little Co., Booz, Allen, Hamilton and Rand McNally.

I hold an MBA in banking from the University of Missouri and have completed the Graduate School of Banking and the Graduate School of Bank Marketing both at the University of Wisconsin. In addition, I have completed all certificates in the American Institute of Banking (A.I.B.) and have been an instructor for the A.I.B. I have also been an instructor in economics at Drury College in Springfield, Missouri.

In over ten years in the banking field, I have been in all phases of banking, commercial lending and branch management at Bank of America in Los Angeles; Director of Marketing, Commerce Bank of Springfield, Missouri; and Director of Affiliate Marketing and Planning, First Union Bancorporation, St. Louis (now Centerre). Since starting Carner & Associates, I have consulted with banks of all sizes and affiliations, ranging from $10 million independents to $100 billion giants of the industry.

I have been asked to present today, the facts and figures of multi-bank holding companies and their effects in general, and in particular on the state of Missouri.

Service to the Community

The main reasons for adopting multi-bank holding companies, are that it is good for the consumer and increases competition. This statement can be born out looking at the facts. In many small towns and counties throughout the Midwest, banks with little or no competition paid little heed to the community's needs. They invested most of their assets in profitable, riskless government securities. We had banks in Missouri with loan/deposit ratios as low as 20% while the industry norm is considered to be 60-70%. As the old saying goes, "You can tell the makeup of a bank's portfolio by looking at the mainstreet of town". Since 1972, the year holding companies began actively acquiring, average loan to deposit ratios have risen from 51% to as high as 60% for independent banks. Bank failures in Missouri during the same period have numbered two; one in a highly competitive metropolitan area in 1973 and the other this year in a rural area with no competition in the area and the nearest holding company competitor two counties away.

Consumer Loans

In 1972 in Missouri, holding company banks had $1.18 billion or 57.7% of consumer loans (see chart) while independent banks had $867 million or 42.3% of consumer loans. At yearend 1982, holding companies had $2.42 billion of 69.7% and independents had $1.05 billion or 30.3%. While the independents' total loans had grown by 78.5% since 1972, their consumer loans had grown by only 21.4%. Holding

companies, on the other hand had increased total lending 171.3% and consumer loans 105.7%. The total market for consumer loans increased by 69.6%. The independent banks funded less than 1/3 of the demand of consumer loans. If the holding companies perceived consumer lending as unprofitable and something to do away with, it was not evident in Missouri in the last decade.

Agricultural Loans

In Missouri, since 1972, loans to farmers have increased from $548M to $1.3 billion at yearend 1981 and real estate loans secured by farmland have increased from $260M to $544M in the same time period. During this period independent banks have garnered over 60% of both of these types of loans. Holding companies have actually increased their share of both these markets, again showing a committment to the American farmer and agriculture. This is in spite of increased competition for Production Credit Associations and other agricultural lenders.

Deposit Services

Service to the consumer has not always been uppermost in the minds of small banks with little competition. Prior to the increased competition from holding companies, many small town banks offered only checking and passbook services to customers. No CD's or market interest available. Anyone that wanted such luxuries could drive somewhere else to find them. Holding company banks not only offered a full range of services but brought new services such as automatic tellers, bank-by-phone, IRA's, NOW accounts, credit cards and many others. Non-competitive

banks were forced to modernize and offer what the customer wanted. We had a bank in a small town in Southwest Missouri, who until two years ago, had never offered its customers anything but a checking account and didn't make consumer loans. It could, however, loan money to its friends at 8%. Was it serving its community? Not hardly. Only when a bank in a neighboring town was acquired by a holding company and began offering a full range of deposit services and consumer loans, did it change from the practices it had followed since 1889. Competition was enhanced and the consumer profited from it.

Loss of Local Control

Among other issues raised in opposition to holding company legislation are loss of local autonomy and control. Most all banks purchased by holding companies are purchased for two primary reasons; (1) the holding wishes to compete in the market and (2) the bank is profitable and well run. Because the ability to compete goes hand-in-hand with a profitable well-run bank, most holding companies do not change local management. They do put in place standard accounting and personnel procedures. In the accounting area, this gives the bank an extra audit every year and makes sure standard loan and accounting practices are used. If Penn Square or Abilene National had been subsidiaries of a holding company, neither would have had the leeway to go as far as they did. If Seafirst or Chase Manhattan's auditors had seen the loan documentation before those loans were purchased from Penn Square, they also

would have been in better shape. In my banking career, I have been through national, FDIC, state and holding company audits and you can get away with more or postpone the inevitable much easier with our regulatory authorities than with internal holding company auditors.

For personnel, compliance to federal regulations such as OSHA, EEOC etc., is easier and training is more consistent because it is planned by an expert in either field. An example of how the holding company personnel department could help was shown clearly to a bank in Crystal City, Missouri which was cited for discrimination when they came into the St. Louis metropolitan area. They were cited for not having minority employees even though the nearest minority of any type was more than 50 miles away. Without the personnel department of the holding company, they would not have been able to formulate an acceptable plan for the EEOC and would have been caused great expense in trying to remedy a bad situation. Hiring for the individual banks is still done locally. Only for the position of president do the holding companies put in their choice and most every time this is a person who has been with the local bank several years. Whoever the president is, however, he is expected to move to the community and become a part of it. The holding companies have a committment to the communities they are in because they see a need for a vital local economy for them to prosper. The only time I have seen rather random quick moving of officers within a holding company was in metropolitan areas where the lead bank and its affiliates are more coordinated in all phases.

I have worked for holding companies both in metropolitan areas and more rural areas. For anyone who has only worked in the metropolitan, they don't realize the difference. In St. Louis, for instance, the whole area is considered St. Louis, whether it is St. Peters, Webster Groves or Florissant. The banks in metro areas generally coordinate their total activities more because of proximity and efficiency.

Outstate, in Springfield for example, Commerce Bank offered products not offered in Kansas City or St. Louis and even had its own internal employee newspaper. We had our own ad agency and ran our own promotions. Centerre Bank in Cape Girardeau also operated in that more independent manner.

Commerce Bancshares is known in Missouri as having the most control exerted from the holding company headquarters. However, in every case throughout the state their banks and officers are often the best corporate citizens of the local community. They are totally involved in seeing the local area prosper.

As I mentioned before, there are two reasons for a holding company to buy a bank. In some cases, the first takes precedence over the second, in other words, need to enter the market outweighs the need to buy a well-run bank. In this case, the holding company does what any good businessman would do if he bought a bank or company with bad management, they clean house. In Springfield,

Missouri, we have had two cases like this. One bank was part of a chain of banks which had shakey loan practices and had not qualified for FDIC insurance. United Missouri bought the bank, brought in new people and brought it up to par. Another bank had federal indictments against certain top officers and directors. Central Bancompany bought the bank, again, replacing part of top management and turned the bank around. This seems to be a better practice than what I have seen some independent owners do such as buy a bank, fire good management and put in their new college-graduate son or son-in-law to run it.

Another part of the local control issue is the loss of authority to make local loans or the insistence on buying participations in place of making local loans. I know of no instance in Missouri or any other state where a bank has been forced to buy participations when local lending was available. Participations were voluntary. If a bank had a low local demand for loans such as Centerre Bank of Kennett (MO), 40% loan/deposit ratio, then participations were encouraged to achieve a better yield. The St. Peters area, mentioned before by Mr. Whited, is a suburb of St. Louis, and in 1970's was the second faster growing area in the United States. Loan demand there was such that no bank including Centerre needed downstream participations. First National of St. Peters had loan/deposit ratios during that period from 80-100%. It certainly didn't need participations. Such a growth area always generates much more in local loans to build an economy

than it collects in deposits. To keep up their lending ability, capital has been added to the bank and this year will mark the first year the holding company has taken a dividend from St. Peters. Interestingly enough, three new banks have been chartered in that area since 1974 when Centerre acquired St. Peters.

On the other side, the upstream participation, Springfield, Missouri will have a new Civic Center Plaza complex in its old downtown area thanks largely to the committment by major holding companies in Kansas City and St. Louis who have affiliates in Springfield. Without their participation and, in one case underwriting, the project would have "died on the vine". This is significant because areas of the St. Louis and Kansas City metropolitan areas have a better yield and offer more opportunity than Springfield.

Also mentioned was the correspondent network and lack of choices within a holding company. For processing and other services, I have listed principal correspondents:

Bank	Principal Correspondents
Commerce Bank of Springfield	Commerce Bk-KC-Mercantile St. Louis
Empire Bank-Spfd (Central Bancompany)	Charter Bank-KC-Mercantile St.Lo
Centerre Bank - Springfield	Boatments UNB Spfd-Centerre St. Louis
Centerre Bank - Kennett	Memphis Bk & Tr Memphis TN-Centerre St. Louis

As you see, they deal with who serves them the best. Obviously, for efficiency in operation, standard procedures and on-line capabilities to a central computor are desired. But as you can see, some banks even go out of state for the services they want or feel best with.

Concentration of Resources

It is said when holding companies start up, the resources of a state will become more concentrated in the hands of a few big banks. In fact, for the Missouri holding companies, and this is true in most other holding company states, the holding companies below #5 or #6 are small regional holding companies serving well-defined areas of the state. The seventh largest holding company in Missouri, County Tower, serves the St. Louis Metropolitan area only. Number 8, General Bancshares serves only St. Louis city and number 9, Ameribank only outstate Missouri. Since 1977, the marketshare of total deposits for independent banks has held steady at 32.0% in Missouri, but the concentration of deposits in the five largest bank companies has increased only from 38.8% to 41.7% since 1957. A 2.9% increase in concentration in 25 years doesn't sound significant to me. In fact, according to the U.S. Senate Committee on Banking, Housing and Urban Affairs, only in Massachusetts and New Mexico did the top five banking organizations in the state control more than 60% of the state's deposits for those states which have unit banking or limited branching. Furthermore, most Missouri holding companies are small, more like independents or chain banks. Out of 204 holding companies

only 15 have more than five member banks. Most are one bank holding companies.

One reason the concentration of the large banking companies has been kept down is the chartering of new banks. At yearend 1972, there were 706 banks. At June 30, 1982, there were 735. With the two failures mentioned earlier, that gives Missouri 31 new banks in less than 10 years. Not bad for a state that isn't growing enough in population to retain all of its congressional seats in that same time period. The opportunity to start a new bank is definitely not lost.

Earnings are always a concern. As you can see on the attached chart, earnings for both Missouri independents and holding companies have had a steady uptrend in the last five years as measured by both return on average equity and average assets. Both groups of banks are above national average for banks their size. As you can see, the independents make a slightly larger spread between their costs and what they charge. Some of this is due to lower cost of doing business, some due to the paying of lower interest rates while charging market rate. Either way the larger spread between costs and yields is a detriment to the consumer, who pays more even when costs are less.

One thing I have learned in my years in banking and my work with banks all over the United States. An aggressive well-run independent bank will prosper in any environment, holding company

or even national branching. A complacent conservative bank that does not care about service, only profit, will have problems with any competition - independent, holding company, money fund or whatever. A stronger, more viable banking community, both independent and holding company, will be the result of multi-bank holding company legislation.

Data Sources: BANCPEN® Market Penetration Analysis and BANCPEN® Performance Analysis compiled from the Board of the Federal Reserve System. Copywrite Carner & Associates, Ltd. 1977, 1979, 1982.

"Compendium of Issues Relating to Branching by Financial Institutions" Prepared by the Subcommittee on Financial Institutions of the Committee on Banking, Housing and Urban Affairs, United States Senate. October, 1976.

APPENDIX

Total Deposits ------------------------ I

Total Loans --------------------------- I

Total Loans to Farmers --------------- II

Real Estate Loans Secured by
Farmland -------------------------- II

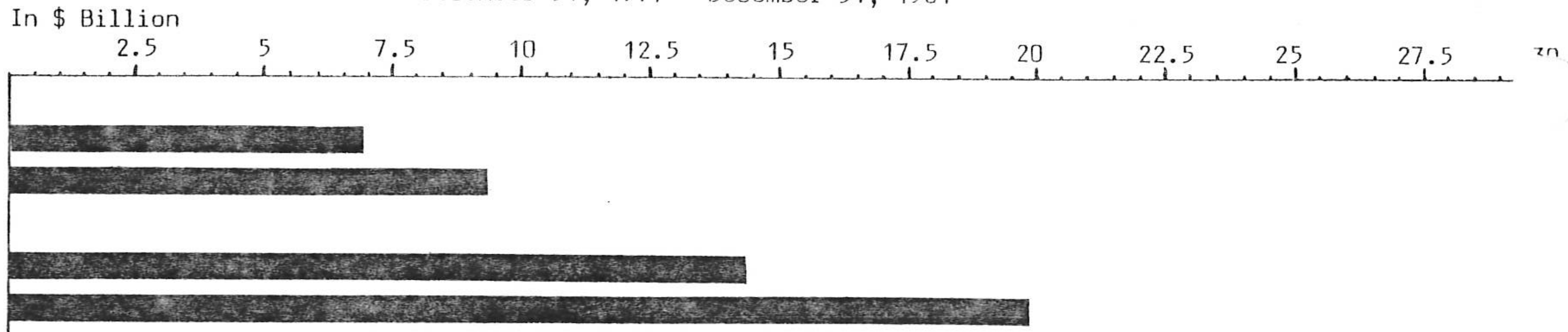
Consumer Loans --------------------- III

Key Ratios -------------------------- IV

Average Income Statement ----- V, VI, VII

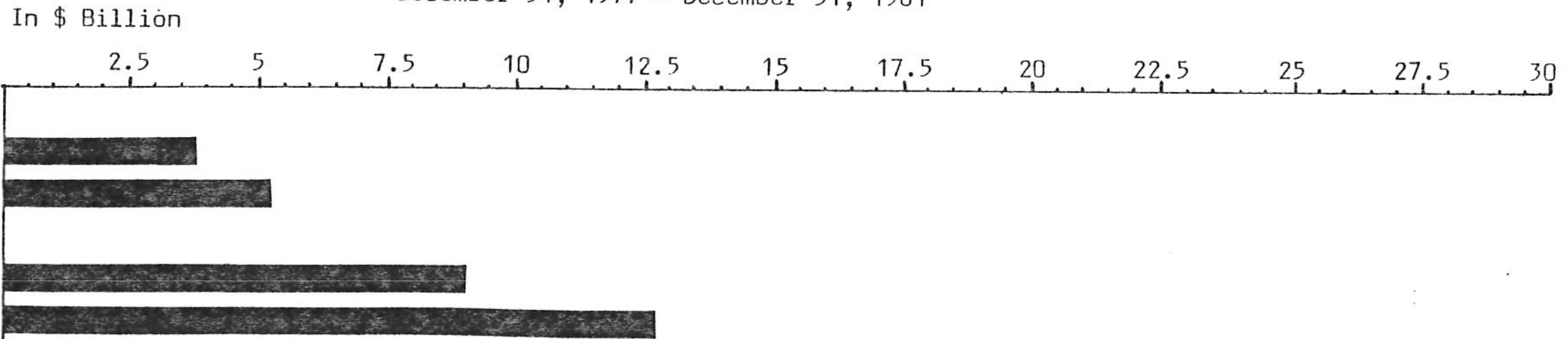
Average Balance Sheet ---------- VIII, IX

BANCPEN PENETRATION ANALYSIS
TOTAL DEPOSITS
State of Missouri
December 31, 1977 - December 31, 1981



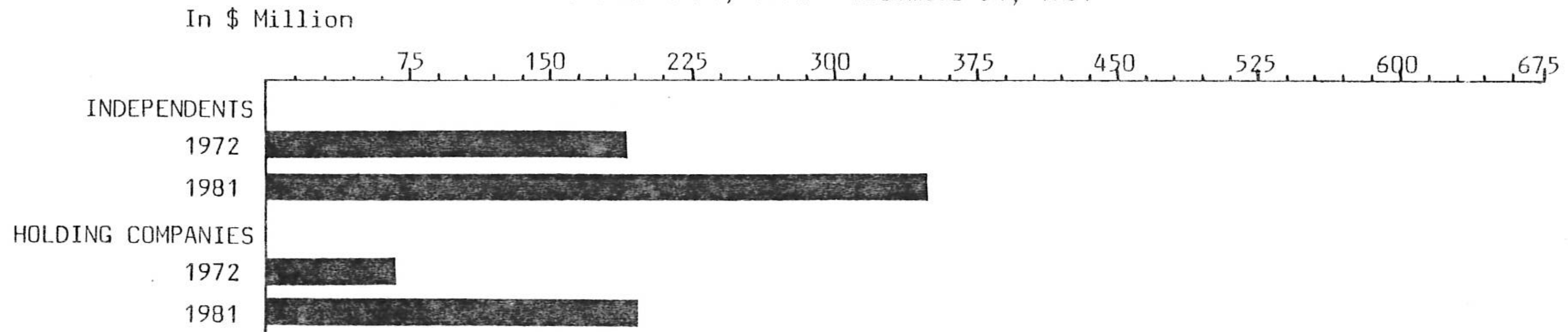
	December 31, 1981 $000	%	December 31, 1977 $000	%
Independents	9,346,263	31.99	6,814,257	32.02
Holding Companies	19,867,112	68.01	14,469,137	67.98
TOTAL MARKET	29,213,375	100.00	21,283,394	100.00

BANCPEN PENETRATION ANALYSIS
TOTAL LOANS
State of Missouri
December 31, 1977 - December 31, 1981



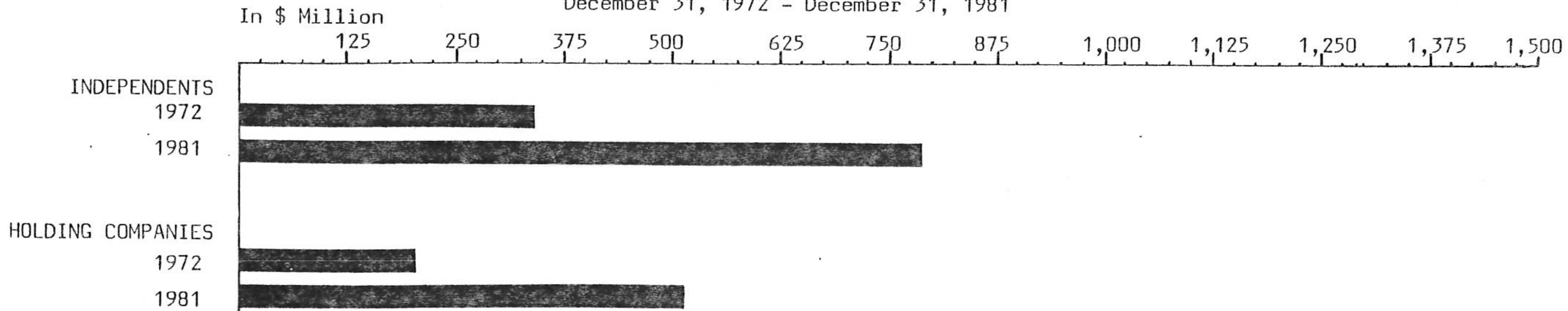
	December 31, 1981 $000	%	December 31, 1977 $000	%
Independents	5,401,780	29.92	3,844,092	29.88
Holding Companies	12,654,639	70.08	9,022,921	70.12
TOTAL MARKET	18,056,419	100.00	12,867,013	100.00

BANCPEN PENETRATION ANALYSIS
REAL ESTATE LOANS TO FARMERS (SECURED BY FARMLAND)
State of Missouri
December 31, 1972 - December 31, 1981

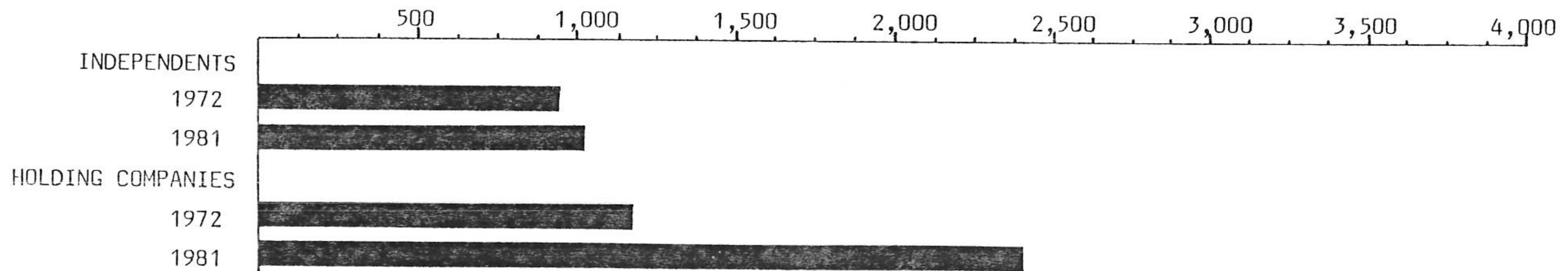


	December 31, 1981 $000	%	December 31, 1972 $000	%
Independents	349,873	64.25	191,616	73.64
Holding Companies	194,645	35.75	68,587	26.36
TOTAL MARKET	544,518	100.00	260,203	100.00

BANCPEN PENETRATION ANALYSIS
TOTAL LOANS TO FARMERS
State of Missouri
December 31, 1972 - December 31, 1981



	December 31, 1981 $000	%	December 31, 1972 $000	%
Independents	785,774	60.19	344,527	62.83
Holding Companies	519,758	39.81	203,784	37.17
TOTAL MARKET	1,305,532	100.00	548,311	100.00



	December 31, 1981		December 31, 1972	
	$000	%	$000	%
Independents	1,053,050	30.31	870,880	42.52
Holding Companies	2,421,359	69.69	1,177,276	57.48
TOTAL MARKET	3,474,409	100.00	2,048,156	100.00

BANCPEN PERFORMANCE ANALYSIS
AVERAGE KEY RATIOS YEAR END - 1977-81
MISSOURI INDEPENDENT BANKS/HOLDING COMPANIES

	1981		1980		1979		1978		1977	
	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*
Return on Average Assets	1.22	.95	1.20	.93	1.22	.88	1.09	.86	.94	.77
Return on Average Equity	13.91	15.03	13.81	14.71	14.46	13.98	13.24	13.16	11.47	11.45
Loan/Deposit	56.02	62.58	57.22	62.48	60.43	64.72	59.18	64.70	54.57	60.44
Yield on Earning Assets	12.11	13.03	10.17	11.25	8.81	9.55	7.80	8.01	7.28	7.08
Cost of Funds	7.68	8.92	5.77	6.99	4.47	5.54	3.80	4.24	3.55	3.59
Net Interest Spread	4.44	4.12	4.39	4.26	4.34	4.01	4.00	3.77	3.73	3.49
Net Int. Margin/Total Assets	3.91	3.28	3.88	3.40	3.82	3.19	3.54	3.03	3.29	2.81
Non-Int. Income/Total Assets	.52	.91	.45	.77	.41	.70	.36	.66	.35	.66
Non-Int. Expense/Total Assets	2.89	2.80	2.81	2.71	2.69	2.56	2.57	2.51	2.48	2.47
Tot. Demand Dep./Earning Assets	23.70	30.68	30.00	36.62	33.69	40.51	36.35	41.67	37.21	45.67
Saving Dep. IPC/Earning Assets	18.08	13.50	16.07	13.18	18.38	14.25	21.60	17.49	22.60	19.51
Time Dep. IPC/Earning Assets	51.93	39.53	48.02	36.02	42.43	31.30	36.47	27.82	35.50	26.09
Purchased Funds/Earning Assets	77.92	79.99	71.72	75.39	68.75	71.26	66.14	69.57	65.67	68.03
Equity/Earning Assets	9.89	7.81	9.91	7.97	9.76	7.82	9.31	7.98	9.24	8.33
Loans & Leases/Earning Assets	55.43	58.07	57.09	59.30	60.98	62.40	59.54	62.56	55.62	59.29
Investments/Earning Assets	38.75	26.39	37.87	27.23	34.22	24.63	36.50	25.09	29.09	27.70
Fed. Funds/Earning Assets	5.90	16.16	5.12	14.11	4.89	13.53	4.05	12.84	5.38	13.40
Net Charge-Offs/Average Loans	.40	.43	.35	.45	.25	.29	.24	.24	- .48	- .51
Bad Debt Expense/Average Loans	.49	.51	.41	.53	.35	.43	.33	.41	.28	.35
Loan Loss Reserve/Average Loan	1.00	1.20	.96	1.16	.94	1.15	.99	1.14	.96	1.06
Loan/Equity	5.59	7.35	5.75	7.36	6.24	7.90	6.38	7.77	6.00	7.06
Premises Expense/Total Assets	1.50	1.58	1.50	1.44	1.47	1.36	1.39	1.43	1.35	1.51
Salaries & Emp. Benefits/Assets	1.42	1.23	1.40	1.20	1.35	1.14	1.29	1.12	1.26	1.11
Average Salary & Emp. Benefits										
Independent Banks	15,956.40		15,044.80		13,526.40		12,074.00		10,723.70	
Holding Companies	16,635.60		15,125.00		13,811.50		12,257.60		10,997.30	

BANCPEN PERFORMANCE ANALYSIS
INCOME STATEMENT YEAR END - 1977-81
MISSOURI INDEPENDENT BANKS/HOLDING COMPANIES

PERCENTAGE OF OPERATING INCOME

	1981		1980		1979		1978		1977	
	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*
Interest and Fees on Loans	59.50	60.69	61.74	62.57	64.23	65.85	62.90	64.51	60.89	61.37
Interest on Balances in Banks	1.38	2.78	1.06	1.91	.56	.75	.26	1.25	.25	1.53
Interest on Federal Funds Sold	7.07	12.99	7.47	13.32	4.85	10.56	3.66	8.22	3.07	6.82
Interest on Treas. Securities	17.53	6.73	14.88	5.92	13.67	5.67	15.54	6.88	13.34	7.52
Interest on U.S. Govt. Oblig.	4.29	3.61	3.67	2.80	4.45	2.71	4.46	2.62	8.38	3.94
Interest on State/Sub.Oblig.	5.23	4.98	5.96	5.24	6.90	5.69	7.78	6.84	8.55	7.99
Income on All Other Securities	.33	.20	.41	.29	.35	.29	.50	.34	.40	.48
TOTAL INTEREST INCOME	95.34	91.99	95.81	95.05	95.01	91.52	95.09	90.65	94.89	89.66
Direct Lease Financing Income	.01	.33	.13	.38	.12	.50	.10	.42	.09	.80
Income of Fiduciary Activities	.19	1.45	.18	1.57	.16	1.70	.17	2.09	.16	2.42
Service Chgs. on Dep. Accounts	2.37	1.71	2.32	1.90	2.34	1.98	2.14	1.91	2.16	2.04
Other Service Chgs. Comm./Fees	1.12	2.10	1.30	2.22	1.44	2.76	1.59	2.95	1.61	3.20
Other Income	.87	2.42	.89	1.88	.94	1.53	.91	1.98	1.10	1.88
TOTAL NON-INTEREST INCOME	4.66	8.01	4.82	7.95	4.99	8.48	4.91	9.35	5.11	10.34
TOTAL OPERATING INCOME	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

*I.B. - Independent Banks

*H.C. - Holding Companies

BANCPEN PERFORMANCE ANALYSIS
INCOME STATEMENT YEAR END - 1977-81
MISSOURI INDEPENDENT BANKS/HOLDING COMPANIES

PERCENTAGE OF OPERATING EXPENSE

	1981		1980		1979		1978		1977	
	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*
Interest on C/Ds Over $100,000	8.40	18.45	7.20	14.37	6.78	13.82	5.07	10.58	3.94	7.24
Interest on Other Deposits	49.27	25.53	44.86	24.03	39.31	22.37	39.66	24.06	41.47	28.64
Interest on Fed. Funds Purchased	2.40	17.44	1.55	17.26	1.57	15.19	1.31	12.67	.65	9.11
Interest on Borrowed Money	.25	1.40	.29	1.36	.38	1.49	.12	.40	.05	.16
Interest on Capital Notes/Deb.	.11	.13	.15	.17	.18	.22	.19	.26	.17	.29
TOTAL INTEREST EXPENSE	60.43	62.94	54.05	57.19	48.22	53.09	46.35	47.97	46.29	45.44
Salaries and Employee Benefits	12.68	10.87	14.81	12.28	16.56	13.68	17.83	15.73	18.55	17.47
Occupancy Expense Bank Premises	2.64	1.94	3.01	2.24	3.06	2.49	3.44	3.02	2.76	3.00
Furniture & Equipment Expense	.67	1.60	.78	1.64	1.16	1.94	1.14	2.14	2.04	2.66
Provision for Loan Losses	2.05	1.99	2.17	2.52	2.21	2.45	2.22	2.63	2.06	2.62
Other Expenses	7.76	8.39	8.96	9.11	10.00	10.24	10.80	11.91	11.15	13.21
TOTAL NON-INTEREST EXPENSE	25.80	24.79	29.74	27.80	33.00	30.80	35.43	35.42	36.55	38.95
TOTAL OPERATING EXPENSES	86.23	90.05	83.78	87.85	81.22	86.56	81.77	84.70	82.84	84.39

BANCPEN PERFORMANCE ANALYSIS
INCOME STATEMENT YEAR END - 1977-81
MISSOURI INDEPENDENT BANKS/HOLDING COMPANIES

PERCENTAGE OF NET INCOME

	1981		1980		1979		1978		1977	
	I.B.	/H.C.*	I.B.	/H.C.*	I.B.	/H.C.*	I.B.	/H.C.*	I.B.	/H.C.*
Income Before Taxes & Sec. Gain	13.77	9.95	16.22	12.15	18.78	13.44	18.23	15.30	17.16	15.61
Applicable Income Taxes	3.43	1.99	4.03	2.95	4.36	3.42	3.93	3.86	3.33	3.53
Income Before Securities Gains	10.34	7.96	12.18	9.20	14.42	10.02	14.29	11.44	13.82	12.07
Securities Gains (Loss), Gross	-1.18	-1.69	- .83	- .32	- .83	- .32	- .61	- .30	.72	.33
Applicable Income Taxes	- .45	- .77	- .27	- .15	- .26	- .15	- .26	- .14	.27	.15
Securities Gains (Losses), Net	- .73	- .87	- .56	- .17	- .56	- .17	- .34	- .16	.46	.18
Income Before Extraordinary	9.61	7.09	11.63	9.03	13.86	9.85	13.95	11.28	14.28	12.25
Extraordinary Items Net of Tax	.00	.00	.01	.00	.00	- .01	.05	.04	.02	.04
NET INCOME	9.61	7.09	11.64	9.03	13.86	9.84	14.00	11.32	14.30	12.29
NET INTEREST MARGIN	34.91	29.04	41.13	34.86	46.78	38.44	48.75	42.68	48.59	44.22

BANCPEN PERFORMANCE ANALYSIS
BALANCE SHEET YEAR END - 1977-81
MISSOURI INDEPENDENT BANKS/HOLDING COMPANIES

PERCENTAGE OF ASSETS

	1981		1980		1979		1978		1977	
	I.B./H.C.*		I.B./H.C.*		I.B./H.C.*		I.B./H.C.*		I.B./H.C.*	
Cash and Due from Banks	8.02	15.00	8.15	15.73	9.00	16.41	8.77	15.98	9.20	16.07
U.S. Treasury Securities	11.89	5.30	11.94	5.44	10.59	5.03	12.03	5.44	13.81	7.03
Oblig. U.S. Govt. Agcy. & Corps.	11.60	4.89	10.52	5.16	8.25	3.97	8.19	3.75	8.09	3.47
Oblig. States & Pol. Subdiv.	10.52	9.88	10.74	10.14	11.09	9.66	11.85	10.43	12.30	11.01
Trading Account Sed. Book Value	.00	.82	.00	.69	.00	.66	.01	.27	.01	.40
All Other Securities	.17	.17	.28	.28	.20	.29	.22	.27	.35	.36
Fed. Funds Sold & Sec. Agreemt.	5.21	12.90	4.53	11.25	4.30	10.77	3.59	10.31	4.76	10.77
Loans, Total	49.32	46.38	50.85	47.31	54.09	49.77	53.08	50.37	49.56	47.85
Less: Reserve - Loan Losses	.47	.53	.48	.54	.49	.54	.48	.52	.47	.50
Loans, Net	48.84	45.85	50.37	46.77	53.61	49.23	52.60	49.85	49.09	47.35
TOTAL EARNING ASSETS	88.25	79.81	88.37	79.74	88.04	79.61	88.48	80.31	88.40	80.39
Direct Lease Financing	.07	.49	.07	.52	.08	.45	.08	.39	.07	.32
Bank Premises, Furn., & Fixt.	1.50	1.58	1.50	1.44	1.47	1.36	1.39	1.43	1.35	1.51
Real Estate Owned	.23	.16	.12	.12	.11	.11	.09	.10	.10	.14
All Other Assets	1.79	2.90	1.51	2.39	1.16	2.03	1.04	1.72	.88	1.57
TOTAL ASSETS	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

*I.B. - Independent Banks
*H.C. - Holding Companies

BANCPEN PERFORMANCE ANALYSIS
BALANCE SHEET YEAR END - 1977-81
MISSOURI INDEPENDENT BANKS/HOLDING COMPANIES

PERCENTAGE OF LIABILITIES

	1981		1980		1979		1978		1977	
	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*	I.B./	H.C.*
Demand Deposits of IPC	18.24	17.10	23.23	20.91	26.20	23.31	28.18	24.45	28.42	26.21
Total Demand Deposits	20.91	24.48	26.52	29.20	29.66	32.25	32.17	33.47	32.89	36.71
Time and Savings Dep. of IPC	61.79	42.33	56.63	39.23	53.54	36.27	51.39	36.39	51.36	36.65
Total Time and Savings Dep.	66.28	46.92	61.52	44.10	59.05	41.81	56.71	41.61	57.06	41.63
Deposits of U.S. Government	.15	.28	.16	.34	.23	.35	.27	.32	.58	.86
Dep. of States and Pol. Subdiv.	6.05	4.21	7.01	5.53	7.73	6.65	7.74	6.36	8.40	6.82
All Other Deposits	.18	8.11	.18	8.00	.17	8.52	.30	8.42	.31	7.18
Certified and Official Checks	.78	.50	.82	.51	.84	.57	.99	.65	.89	.61
TOTAL DEPOSITS	87.19	73.27	88.04	74.85	88.71	76.07	88.88	77.04	89.96	78.34
Federal Funds Purchased	2.29	15.64	1.55	14.70	1.16	12.97	1.36	12.32	.96	12.91
Liab. For Borrowed Money	.19	1.28	.31	1.31	.31	1.96	.45	1.94	.03	.15
Mortgage Indebtedness	.05	.13	.06	.15	.04	.16	.04	.20	.01	.20
Other Liabilities	1.42	3.25	1.14	2.40	1.01	2.36	.85	1.81	.70	1.39
TOTAL LIABILITIES	91.15	93.57	91.09	93.42	91.24	93.52	91.58	93.30	91.66	92.99
Subordinated Notes/Debentures	.12	.20	.15	.23	.17	.25	.18	.29	.17	.31
PERCENTAGE OF EQUITY CAPITAL										
Preferred Stock	.02	.01	.02	.01	.02	.02	.01	.02	.01	.02
Common Stock	1.22	1.00	1.29	1.09	1.34	1.14	1.35	1.24	1.44	1.36
Surplus	2.14	1.76	2.29	1.89	2.40	1.99	2.52	2.14	2.68	2.38
Undivided Profits	5.35	3.46	5.16	3.36	4.82	3.09	4.37	3.01	4.04	2.93
TOTAL EQUITY CAPITAL	8.73	6.23	8.76	6.35	8.59	6.23	8.24	6.41	8.17	6.70
TOTAL LIABILITY AND EQUITY	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Multibank Holding Companies and Local Market Concentration

by David D. Whitehead and B. Frank King

There is currently much concern that enactment of multibank holding company legislation will undermine independent banks and stifle competition in the banking industry. This concern centers on the belief that multibank holding company expansion increases concentration of banking resources and, at the same time, erodes bank competition. This issue is of particular interest in the Sixth Federal Reserve District this year. Three states in the District have recently considered or will probably soon consider bills affecting multibank holding company expansion.

Whether multibank holding company expansion is in the public interest is a complex issue. This article focuses on only one aspect, the impact of multibank holding companies on concentration of banking resources in local banking markets. Economic theory implies that, at least in the short run, higher market concentration results in higher prices and lower output, causing a misallocation of resources. Empirical research on concentration and performance in banking markets has found that the relationship between higher concentration and higher prices is statistically significant but is fairly small.[1]

This study is a two-part exploration of the influence of holding company entry on local market concentration. We first review evidence from previously published studies. We then develop new evidence from the experience of three Sixth District states—Alabama, Florida, and Tennessee. These states have allowed multibank holding companies for some time and, therefore, offer fertile ground for studying the effects these organizations have had on local market concentration.

Issues

It is often argued that banks acquired by multibank holding companies gain competitive advantages over independent banks. Even opponents

[1]Early studies are summarized in Neil B. Murphy and Steven J. Weiss, "The Effect of Concentration on Performance: Evaluating Statistical Studies," **The Magazine of Bank Administration**, Vol. 45 (November 1969), pp. 34-37; studies since that time include A. A. Heggested and J. J. Mingo, **Prices, Nonprices, and Concentration in Selected Banking Markets** (Washington, D. C.: Research Papers in Banking and Financial Economics, Board of Governors of the Federal Reserve System, 1974), Donald P. Jacobs, **Business Loan Costs and Bank Market Structure** (New York, Occasional Paper 115, National Bureau of Economic Research, 1971), Donald R. Fraser and Peter S. Rose, "More on Banking Structure: The Evidence from Texas," **Journal of Financial and Quantitative Analysis**, Vol. 6 (January 1971), pp. 601-611, Robert F. Ware, "Banking Structure and Performance: Some Evidence from Ohio," **Economic Review**, Federal Reserve Bank of Cleveland (March 1972), pp. 3-13.

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of holdin pany banking assert that a b subsidiary of a multibank holding company may enjoy increased operating efficiencies, financial strength, the ability to offer a wider range of services, and improved management and management succession. These may help the subsidiary bank gain in deposits and market share at the expense of independent banks. This, it is often argued, would increase the concentration of deposits in markets that multibank holding companies enter. Conversely, it has also been argued that independent banks may be able to avoid losses to multibank company subsidiaries through a superior understanding of local markets and economic conditions, personalized service, and specialization in certain product lines.[2] Indeed, independent banks' response to multibank companies may intensify competitiveness.

In addition to giving their subsidiaries competitive advantages, multibank holding companies may influence market concentration in other ways. The type of holding company entry itself may have an important influence. Concentration would increase if a multibank company acquired more than one bank in the same market, though enforcement of Federal holding company and antitrust laws discourages such acquisitions. The relative size of an acquired bank could have a bearing on concentration changes. If multibank company subsidiaries have competitive advantages over independent banks, then acquisition of new or small banks would be expected to reduce local market concentration for a time as the acquired bank took business away from larger independent competitors; acquisition of larger banks, on the other hand, would be expected to increase concentration. If independent banks increase their competitive edge, the opposite would be expected. Thus, the ultimate effect of multibank company acquisition depends on whether (and by how much) banks gain or lose competitive advantages when acquired by multibank companies and on the number and relative size of the banks acquired.

Concentration changes in local markets may have nothing to do with multibank holding companies. Concentration may increase when two independent banks merge or when an independent bank makes changes in its operations that increase its deposits at a greater rate than those of other banks in the market. Concentration may decline if new independent banks enter a market, if deposits at existing smaller banks grow more than the market average, or if existing banks compete for deposits on a more equal footing.

All of these possible influences make it difficult to predict **a priori** whether or not multibank company expansion will raise local market concentration. To see if, in practice, concentration rises when multibank companies expand, one must review the experience of communities where holding companies have acquired banks. Several studies have focused on this question.

Studies of Multibank Company Entry

Previous studies give little evidence that multibank companies systematically increase local market concentration. We divide these studies into three groups. The first compares the performance of multibank holding company subsidiaries with the performance of similarly-sized independent banks in the same local areas. A second group looks at changes in the share of market deposits held by banks acquired by multibank holding companies. The third measures concentration changes in markets multibank holding companies entered.

The first group hypothesizes that holding company subsidiaries obtain competitive advantages through affiliation with a larger financial organization. If they do, banks acquired by multibank holding companies would be expected to lower their prices, show increasing rates of return and faster growth, and expand their market shares relative to independent banks in the same market. Generally, these studies have found that asset portfolios of acquired banks change relative to those of independent banks. These studies have not, however, generally found differences in prices, earnings, or profitability between holding company banks and independent banks.[3]

Three studies in this group give additional evidence on changes in growth rates and market shares. Lawrence's study of a national sample of holding company banks found no significant difference in deposit growth rates of holding company subsidiaries and independent banks. Hoffman's study of banks acquired by two large Florida companies shows no statistically significant difference

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[2] For a more detailed discussion of these questions, see Jerome C. Darnell and Howard Keen, Jr., "Small Bank Survival: Is the Wolf at the Door," **Business Review,** Federal Reserve Bank of Philadelphia (November 1974), pp. 17-18, and William Jackson, **Multibank Holding Companies and Bank Behavior** (Richmond, Virginia: Working Paper 75-1, Federal Reserve Bank of Richmond, 1975), pp. 3-5.

[3] Studies using national samples include Robert J. Lawrence, **The Performance of Bank Holding Companies** (Washington, D. C.: Board of Governors of the Federal Reserve System, 1967), and Samuel H. Talley, **The Effect of Holding Company Acquisition on Bank Performance** (Washington, D. C.: Staff Economic Study, No. 69, Board of Governors of the Federal Reserve System, 1971). Regional samples are studied in Joe W. McLeary, "Bank Holding Companies: Their Growth and Performance," this **Review,** October 1968, pp. 131-138, Robert F. Ware, "Performance of Banks Acquired by Multibank Holding Companies in Ohio," **Economic Review,** Federal Reserve Bank of Cleveland (March/April 1973), pp. 19-28, and Stuart Hoffman, "A Florida Case Study: Performance of Holding Company Banks," this **Review,** December 1975, pp. 202-205.

Table 1

Subsidiaries of Multibank Holding Companies in Alabama, Florida, and Tennessee

	Alabama	Florida	Tennessee
Number of bank subsidiaries acquired by multibank holding companies between June 1970 and December 1974	54	306	53*
Number of bank subsidiaries in existence in December 1974	54	430	59
Percent of bank subsidiaries in December 1974 acquired between June 1970 and December 1974	100	71	90

*Two were sold in late 1974.

between the change in market shares of acquired banks and similarly-sized independent banks in their markets.[4] Another recent study of smaller independent banks competing with banks merged into larger banks in Pennsylvania found no significant changes in balance sheet ratios, operating ratios, or deposit growth of independent banks after mergers involving their competitors.[5] The mergers studied are the initial entries of large banks into the towns of the independent banks. In this respect, they are similar to holding company acquisitions.

The second group of studies concludes that multibank holding companies had little to do with changes in market shares of banks they acquired in the late 1960's.[6] One study finds this to be so for acquired banks of all sizes and market shares;[7] however, the other finds some tendency for relatively large banks acquired by large, aggressive holding companies to increase their market share after acquisition.[8]

Studies of changes in local market concentration in four states with substantial holding company development fail to support the hypothesis that holding company acquisitions necessarily increase local market concentration. Schull studied concentration changes in metropolitan areas in New York between 1960 and 1971 and in Virginia between 1962 and 1971; concentration had increased in two of six areas in New York and in two of five areas in Virginia. Schull found no systematic relationship between holding company entry and changes in local market concentration.[9] In an as yet unpublished study of holding company acquisitions in Alabama, Martell and Hooks found evidence that concentration in markets entered by multibank holding companies tended to decline relative to other markets.[10] Ware studied concentration changes in Ohio areas where multibank holding companies had acquired subsidiaries beiween 1969 and 1974. He found that concentration, measured by the Herfindahl Index, declined in a majority of SMSA's and in one half of non-SMSA counties.[11]

These three groups of studies cast considerable doubt on the contention that multibank holding company acquisitions lead to increased local market concentration. The first group indicates that banks acquired by holding companies do not gain (or at least fail to use) sufficient competitive advantages to enable them to change significantly their profit rates, rates of return, or growth rates relative to

[4] Lawrence, pp. 20-21, and Hoffman, p. 205.

[5] Jerome C. Darnell and Howard Keen, Jr., pp. 20-22.

[6] R. Alton Gilbert and Nancy Jianakoplus, "The Impact of Holding Company Affiliation on the Market Share of Banks," Federal Reserve Bank of St. Louis, Mimeographed, 1973, and Lawrence G. Goldberg, "Bank Holding Company Acquisitions and Their Impact on Market Shares," Board of Governors of the Federal Reserve System, Mimeographed, 1974.

[7] Goldberg, p. 17-18.

[8] Gilbert, p. 21.

[9] Bernard Schull, "Multiple-Office Banking and the Structure of Banking Markets: The New York and Virginia Experience," **Proceedings of a Conference on Bank Structure and Competition,** October 26-27, 1972, Federal Reserve Bank of Chicago, pp. 36, 40.

[10] Terrence F. Martell and Donald L. Hooks, "The Impact of the Multi-Bank Holding Company Organizational Form on Local Market Competition," Mimeographed, 1974. Some results of this study are summarized in "Holding Company Affiliation and Economies of Scale," **Journal of the Midwest Finance Association,** 1975, pp. 57, 69, by the same authors.

[11] Robert F. Ware, "Banking Concentration in Ohio," **Economic Commentary,** November 24, 1975, Federal Reserve Bank of Cleveland.

Table 2

Proportions of Markets Recording Increased Concentration, June 1970-December 1974

	All Markets	Markets Entered June 1970-December 1974
Number of Markets	98	61
Proportion with increases in three-bank concentration	.10	.13
Proportion with increases in Herfindahl Index	.09	.13
Markets with deposits of more than $300 million	25	13
Proportion with increases in three-bank concentration	.00	.00
Proportion with increases in Herfindahl Index	.04	.08
Markets with deposits of $100-300 million	34	23
Proportion with increases in three-bank concentration	.12	.13
Proportion with increases in Herfindahl Index	.00	.00
Markets with deposits of less than $100 million	39	25
Proportion with increases in three-bank concentration	.15	.20
Proportion with increases in Herfindahl Index	.21	.28

competing independent banks. The second group finds little effect of holding company acquisitions on the market shares of acquired banks, and the third finds no systematic evidence of increasing local market concentration in holding company states.

The results of these studies are consistent; however, the direct evidence presented is limited, drawn from only a few of the states which allow multibank holding company activity. For this reason, we have developed additional evidence from the three Southeastern states which allow this type of banking organization.

Evidence from Alabama, Florida, and Tennessee

During the 1970's, bank holding companies have expanded rapidly in Alabama, Florida, and Tennessee. Between June 30, 1970, and December 31, 1974, multibank companies in Alabama acquired 54 bank subsidiaries; in Florida, they acquired 306; and in Tennessee, they acquired 53.[12]

To determine whether multibank holding company entry in these three states resulted in higher local market concentration, we studied all markets with three banking organizations and at least one multibank company subsidiary on December 31, 1974. We first computed measures of deposit concentration for June 30, 1970, and December 31, 1974.[13] We then used changes in these measures—the combined shares of the three largest banks (three-bank concentration) and the Herfindahl Index of concentration—as the basis for analyzing the effects of multibank holding company acquisitions

[12] Two of the Tennessee acquisitions were sold in late 1974.

[13] June 30, 1970, data were used because branch data are available for direct adjustment for multimarket branch banks in Alabama and Tennessee. Data for December 31, 1974, were available from another study and were indirectly adjusted.

on [illegible]tration in local markets.[14]

The market areas we chose for this study had been designated banking markets by the Board of Governors of the Federal Reserve System. The Board defines banking markets in its analysis of the competitive effects of bank acquisitions by multibank holding companies. The most recently cited market definitions were used. These definitions differ from those used by Schull and Ware, who based market areas exclusively on county or SMSA boundaries. Market definitions used by the Board of Governors incorporate some study of economic patterns and customer-bank relationships prior to the banking market designation.[15] The Board's designations are approximate, but they are not so arbitrary as those based exclusively on county and SMSA boundaries.

In all, there were 98 markets in the study—25 in Alabama, 46 in Florida, and 27 in Tennessee. The markets varied greatly in size; the smallest had $20 million in deposits on December 31, 1974, and the largest had upwards of $6 billion (see Appendix I). In discussing these markets, changes in the Herfindahl Index will be emphasized, since it is a superior measure of concentration.

Only a small proportion of these markets showed increased concentration (see Appendix I). Of the 98 markets, 9 had higher Herfindahl Indices and 10 had higher three-bank concentration ratios. Thus, only about 10 percent of the markets recorded increased concentration. Smaller markets tended to have increased concentration more often than large ones. Twenty-one percent, or eight of the 39 markets with deposits of less than $100 million, had increased concentration. Only one of the 59 markets with deposits of more than $100 million had a higher Herfindahl Index.

If holding company subsidiaries have competitive advantages over independent banks, those advantages should be most obvious shortly after acquisition. Thus, some tendencies toward increased concentration might be masked by using markets entered before mid-1970. We, therefore, took the additional step of separating markets entered before June 1970 from those entered between June 1970 and December 1974. Sixteen of the 46 markets in Florida, 20 of the 27 markets in Tennessee, and all of the 25 markets in Alabama were entered after June 1970.

The 61 markets entered after June 30, 1970, account for all but one of the increases in concentration recorded in this study (see Appendix I). However, even in markets entered after mid-1970, the proportion with higher concentration is quite small—13 percent as compared with 10 percent in markets entered before and after that date. Concentration declined in most markets in this group, just as it did in most markets studied.

These results are consistent with those Schull and Ware found in their studies of New York, Virginia, and Ohio. Concentration declined in a majority of areas in each study. As in Ware's Ohio study, we found a smaller proportion of large markets showing concentration increases than smaller markets. Our results differ from those found in New York, Virginia, and Ohio in that we found increased concentration in a far lower proportion of markets in each state and market-size class than did previous studies.

Markets Where Concentration Increased

Analyzing in greater detail those nine markets with increased concentration produces no evidence that holding company entry is systematically related to rising concentration. Four of these markets are in Tennessee, four are in Alabama, and one is in Florida. All subsidiaries of multibank holding companies had reduced market shares in four of the nine markets. In two of the remaining five, mergers between independent banks were directly responsible for the market's increased concentration; the subsidiaries of holding companies in each of these markets either maintained their rather small market shares or increased them slightly.

In only three markets did subsidiaries of holding companies manage to increase market shares between June 1970 and December 1974. Two were in Tennessee and one was in Florida. In one of the two Tennessee markets, the holding company subsidiary was small and increased its share by less than one percentage point, while the largest independent bank substantially increased its share. The one holding company subsidiary in the other Tennessee market was the market's largest bank. It managed to increase its share from 47 percent of deposits in June 1970 to 51 percent in December 1974. This particular bank has been a subsidiary since its holding company registered in 1956. Its 51-percent market share in 1974 was on a par with its market share in 1956. Therefore, its increased share of the market from mid-1970 through 1974 seems no more due to its holding company affiliation than was its loss in market share between 1956 and mid-1970.

The one Florida market with increased concentration has three banks, each a subsidiary of a different multibank holding company. Therefore, it would be very difficult to suggest that holding company affiliation was responsible for the market's overall increase in concentration. The higher concentration in this market came, in fact, from a substantial increase in state and local government deposits in one of the market's two largest banks. This raised the bank's relative share of market

[14] See Appendix II for a discussion of concentration measures.

[15] See Charles D. Salley, "Uniform Price and Banking Market Delineation," this **Review**, June 1975, pp. 86-93.

deposits ... 8 percent to 51 percent and a... raised deposit concentration.

Conclusion and Implications

Like the evidence presented in previous studies, the experience in Alabama, Florida, and Tennessee from June 1970 to December 1974 provides no support for the proposition that multibank holding companies systematically cause increased bank deposit concentration when they enter local markets. In the three states studied, concentration increased in only 10 percent of all 98 local markets with holding company subsidiaries. Of the 61 markets entered between June 1970 and December 1974, only 13 percent recorded increased concentration. An analysis of the nine markets where concentration rose failed to discover any direct relationship with holding company entry.

This study's conclusion is based on changes in concentration during a four-and-one-half-year period and may not reveal all long-run effects. However, one would expect the major competitive advantages of holding company membership discussed above to show up rather soon so that there would be little difference between short- and long-run effects.

Although strongly contradicting the contention that multibank holding company entry increases local market concentration, this evidence sheds no light on two other related issues: the influence of multibank companies on statewide concentration and the relationship of multibank company entry to concentration decreases. These results relate strictly to local banking markets; they should not be applied to statewide concentration. Two studies by economists on the staff of the Board of Governors of the Federal Reserve System have found that statewide concentration increases more (or decreases less) in unit and limited branching states allowing multibank holding companies than in all other states.[16] However, the implications of changes in statewide concentration for the public interest are difficult to assess. State boundaries do not usually conform to the market boundaries for any bank service; thus the theory and evidence linking market concentration and performance do not necessarily apply.

Finally, from the conclusion that multibank holding company entry is not systematically related to local market concentration increases, does it follow that such entry causes reduced concentration? The evidence developed here does not necessarily support or contradict this hypothesis. Concentration may decline, as already noted, because of the type or number of holding company acquisitions, the actions of independent banks, and competitive interactions between holding company subsidiaries and independent banks. Further analysis of local market shares will be necessary in order to expand our conclusion (that holding company entry is not related to concentration increases) into a comprehensive set of evidence concerning the influences of such entry. ■

[16] Lawrence G. Goldberg and Samuel H. Talley, "Statewide Concentration in Banking," Mimeographed, March 11, 1974, and Samuel H. Talley, **The Impact of Holding Company Acquisitions on Aggregate Concentration in Banking** (Washington, D. C.: Staff Economic Studies, No. 80, Board of Governors of the Federal Reserve System, 1974).

APPENDIX I

Exhibit 1

Changes in Concentration in Markets with Multibank Holding Company Subsidiaries, June 1970-December 1974

Banking Market	December 1974 Deposits ($ millions)	First Entered after June 1970	Three-Bank Concentration 1970	1974	Change	Herfindahl 1970	1974	Change
Alabama								
Jefferson County	$2,272	X	.84	.81	− .03	.30	.28	− .02
Mobile Area	914	X	.86	.83	− .03	.30	.28	− .02
Montgomery SMSA	739	X	.79	.74	− .05	.27	.24	− .03
Columbus SMSA	448	X	.79	.79	.00	.23	.24	.01
Madison County	344	X	.79	.70	− .09	.26	.22	− .04
Anniston Area	254	X	.66	.60	− .06	.18	.15	− .03
Florence Area	217	X	.74	.72	− .02	.26	.25	− .01
Tuscaloosa County	213	X	1.00	.98	− .02	.47	.46	− .01
Etowah County	202	X	.60	.53	− .07	.16	.13	− .03

Exhibit 1 (cont'd)

Changes in Concentration in Markets with Multibank Holding Company Subsidiaries, June 1970-December 1974

Banking Market	December 1974 Deposits ($ millions)	First Entered after June 1970	Three-Bank Concentration			Herfindahl		
			1970	1974	Change	1970	1974	Change
Alabama (cont'd)								
Dothan Area	194	X	.84	.86	.02	.31	.30	− .01
Morgan County	193	X	.83	.83	.00	.30	.28	− .02
Marshall County	148	X	.51	.47	− .04	.13	.13	.00
Dallas County	139	X	.87	.85	− .02	.27	.27	.00
Opelika-Auburn Area	123	X	.61	.63	.02	.19	.19	.00
Covington County	110	X	.77	.78	.01	.23	.23	.00
Walker County	94	X	.77	.82	.05	.33	.36	.03
DeKalb County	78	X	.72	.65	− .07	.22	.18	− .04
Barbour County	72	X	.63	.68	.05	.17	.19	.02
Limestone County	53	X	1.00*	1.00	.00	.50	.44	− .06
Marion County	49	X	.79	.80	.01	.28	.29	.01
Randolph County	38	X	.80	.80	.00	.26	.25	− .01
Uniontown Area	35	X	.88	.78	− .10	.32	.26	− .06
Lamar County	34	X	1.00	.87	− .13	.35	.28	− .07
East Lauderdale County	31	X	1.00	1.00	.00	.37	.37	.00
Macon County	26	X	1.00	1.00	.00	.45	.45	.00
Florida								
Miami Area	6,185		.32	.31	− .01	.06	.06	.00
Jacksonville Area	1,882		.60	.50	− .10	.13	.10	− .03
Tampa Area	1,750		.58	.52	− .05	.13	.11	− .02
North Broward Area	1,615		.39	.26	− .12	.08	.05	− .03
Orlando Area	1,383		.51	.41	− .10	.13	.09	− .04
South Pinellas Area	1,267		.48	.38	− .10	.10	.07	− .03
West Palm Beach Area	1,258		.33	.26	− .07	.07	.05	− .02
North Pinellas Area	820		.43	.35	− .08	.09	.07	− .02
Sarasota Area	597	X	.66	.59	− .07	.18	.15	− .03
Lee County	563	X	.76	.61	− .15	.23	.16	− .07
West Polk County Area	421		.67	.63	− .04	.23	.21	− .02
Pensacola SMSA	410		.47	.41	− .06	.11	.09	− .02
Bradenton Area	389	X	.75	.67	− .08	.21	.17	− .04
East Volusia County Area	321	X	.61	.52	− .09	.17	.12	− .05
Leon County	309	X	.82	.67	− .15	.23	.16	− .07
East Polk County Area	308		.58	.54	− .04	.16	.14	− .02
Boca Raton Area	271	X	1.00	.94	− .06	.41	.36	− .05
Naples Area	230	X	.99	.75	− .24	.40	.23	− .17
North Lake County Area	229		.52	.51	− .01	.15	.14	− .01
Alachua County	225		.75	.62	− .13	.22	.17	− .05
Marion County	204		.78	.68	− .10	.22	.18	− .04
New Port Richey Area	196	X	1.00	.76	− .23	.65	.24	− .41
Bay County	180	X	.91	.84	− .07	.41	.29	− .13
East Martin County Area	174	X	.96	.88	− .08	.41	.31	− .10
Central Brevard County Area	173		.70	.68	− .02	.22	.19	− .03
West Volusia County Area	165		.81	.82	.01	.27	.26	− .01
Sebring Area	164	X	.62	.62	.00	.18	.18	.00
South Brevard County Area	162		.65	.58	− .07	.19	.17	− .02

Exhibit 1 (cont'd)

Changes in Concentration in Markets with Multibank Holding Company Subsidiaries, June 1970-December 1974

Banking Market	December 1974 Deposits ($ millions)	First Entered after June 1970	Three-Bank Concentration 1970	1974	Change	Herfindahl 1970	1974	Change
Florida (cont'd)								
Okaloosa County	151	X	.70	.54	– .16	.20	.14	– .06
Venice Area	125	X	1.00	1.00	.00	.48	.40	– .08
Indian River County	124		1.00	.81	– .19	.45	.28	– .17
St. Lucie County	119		1.00	.87	– .13	.42	.33	– .09
Port Charlotte Area	117	X	1.00*	.91	– .09	.50	.34	– .16
East Pasco County Area	109		1.00	.91	– .09	.37	.31	– .06
North Seminole County Area	93		.89	.88	– .01	.31	.29	– .02
North Brevard County Area	81	X	1.00	1.00	.00	.36	.39	.03
Putnam County	70		.86	.88	.02	.34	.33	– .01
St. Johns County Area	69		1.00	1.00	.00	.48	.42	– .06
East Hernando County Area	66		1.00*	1.00	.00	.56	.40	– .16
Key West	61		1.00*	1.00	.00	.50	.36	– .14
North Osceola County Area	58		1.00	.96	– .04	.37	.33	– .04
Belle Glade Area	45		1.00	1.00	.00	.36	.34	– .02
Chipley Area	38		1.00	.92	– .08	.35	.30	– .05
Nassau County	28		1.00**	1.00	.00	1.00	.50	– .50
Madison County	27		1.00*	1.00	.00	.50	.37	– .13
Moore Haven Area	20	X	1.00**	1.00	.00	1.00	.63	– .37
Tennessee								
Nashville Area	3,083	X	.81	.77	– .03	.25	.21	– .04
Memphis Area	2,690	X	.90	.81	– .09	.31	.26	– .05
Knoxville SMSA	1,120	X	.65	.58	– .07	.18	.15	– .03
Chattanooga SMSA	1,070		.95	.87	– .08	.36	.32	– .04
Johnson City Area	231		.77	.76	– .01	.24	.23	– .01
Obion County Area	191	X	.49	.47	– .02	.12	.11	– .01
Montgomery County	132	X	1.00	1.00	.00	.34	.34	.00
Gibson County	130	X	.48	.47	– .01	.11	.11	.00
Bradley County	121	X	1.00	.94	– .06	.34	.30	– .04
Hamblen County	100		1.00	.97	– .03	.36	.35	– .01
Lawrence County	99	X	.89	.73	– .16	.32	.20	– .12
Green County	99	X	.89	.73	– .16	.32	.20	– .12
Warren County	94	X	1.00	.94	– .00	.43	.41	– .11
Sevier County	79	X	.93	.81	– .12	.31	.24	– .07
Giles County	78	X	.96	.96	.00	.38	.36	– .02
Roane County	77		1.00	1.00	.00	.36	.39	.03
Coffee County	74	X	.82	.79	– .03	.27	.24	– .03
Loudon County	64		.89	.89	.00	.30	.29	– .01
Henry County	62	X	.98	.98	.00	.45	.46	.01
Polk County	57	X	.91	.86	– .05	.30	.27	– .03
Franklin County	54	X	.73	.83	.10	.23	.29	.06
Hardeman County	46	X	.81	.80	– .01	.30	.27	– .03
Jefferson County	41	X	1.00	1.00	.00	.38	.35	– .03
Rhea County	39		1.00	1.00	.00	.45	.42	– .03
Marion County	36		1.00	1.00	.00	.44	.37	– .07
Hardin County	31	X	1.00*	1.00	.00	.50	.37	– .13
Cannon County	25	X	.98	.99	.01	.55	.58	.03

* Only two banking organizations in market
** Only one banking organization in market

APPENDIX I

Exhibit 2

Number of Markets with Increases in Concentration June 1970-December 1974, All Markets

	Alabama	Florida	Tennessee
All Markets			
Number	25	46	27
Number with increases in three-bank concentration	6	2	2
Number with increases in Herfindahl Index	4	1	4
Markets with deposits of more than $300 million			
Number	5	16	4
Number with increases in three-bank concentration	0	0	0
Number with increases in Herfindahl Index	1	0	0
Markets with deposits of $100-300 million			
Number	10	18	6
Number with increases in three-bank concentration	3	1	0
Number with increases in Herfindahl Index	0	0	0
Markets with deposits of less than $100 million			
Number	10	12	17
Number with increases in three-bank concentration	3	1	2
Number with increases in Herfindahl Index	3	1	4

Exhibit 3

Number of Markets with Increases in Concentration, June 1970-December 1974, Markets First Entered Between June 1970 and December 1974

	Alabama	Florida	Tennessee
All Markets			
Number	25	16	20
Number with increases in three-bank concentration	6	0	2
Number with increases in Herfindahl Index	4	1	3
Markets with deposits of more than $300 million			
Number	5	5	3
Number with increases in three-bank concentration	0	0	0
Number with increases in Herfindahl Index	1	0	0
Markets with deposits of $100-300 million			
Number	10	9	4
Number with increases in three-bank concentration	3	0	0
Number with increases in Herfindahl Index	0	0	0

...ibit 3 (cont'd)

	Alabama	Florida	Tennessee
Markets with deposits of less than $100 million			
Number	10	2	13
Number with increases in three-bank concentration	3	0	2
Number with increases in Herfindahl Index	3	1	3

APPENDIX II

Measuring Concentration in Banking Markets

The measurement of market concentration often appears to involve varying proportions of necromancy, legerdemain, and alchemy. The following brief discussion of concentration is an attempt to dispel some of the aura of mystery (if not the mystery itself) about this subject.

Market concentration refers to the distribution of the business in a market among sellers. Markets with many sellers who control the total business more or less equally are less concentrated than markets in which fewer sellers control a disproportionately large share of the total business. There is no entirely satisfactory way to measure concentration. The combined market share of the market's largest sellers is commonly used. Thus, concentration is often discussed in terms of the combined shares of the two, four, or ten largest sellers in a particular market. Measures of this type do not account for the total number of sellers and the distribution of business among them. Thus, a market with three sellers may have a .90 two-bank concentration ratio and a market with 100 sellers of which two are disproportionately large may have the same .90 two-bank ratio. Yet one would expect more effective competition in the latter.[1]

[1] This problem and the use of the Herfindahl Index to solve it are discussed more fully in Charles D. Salley, "Concentration in Banking Markets: Regulatory Numerology or Useful Merger Guideline," this **Review**, November 1972, pp. 186-193.

The Herfindahl Index is one of several concentration measures developed as an attempt to solve this problem. This index is the sum of the squared market shares of each seller in the market. It is superior to measures using combined shares of the largest firms because it varies with both the number of sellers and the distribution of market shares. Though it does not uniquely describe the distribution of market shares, it does encompass what are believed to be the most important facets of market concentration in a single number.

So far, we have referred to sellers' shares of the business in a market. To apply this to banking, some specific measure or measures of business in a market must be chosen. No measure is without fault. Both tradition and decisions of the U. S. Supreme Court, however, lean heavily toward the use of deposits as a measure of the product of banks and the percent of a market's total deposits held by an individual bank as a measure of that bank's market share.[2]

[2] For a more thorough discussion of the concepts, disagreement, and evidence on this subject, see Joel M. Yesley, "Defining the Product Market in Commercial Banking," **Economic Review**, Federal Reserve Bank of Cleveland (June/July 1972), pp. 17-31, and W. F. Mackara, "What Do Banks Produce?," this **Review**, May 1975, pp. 70-74.

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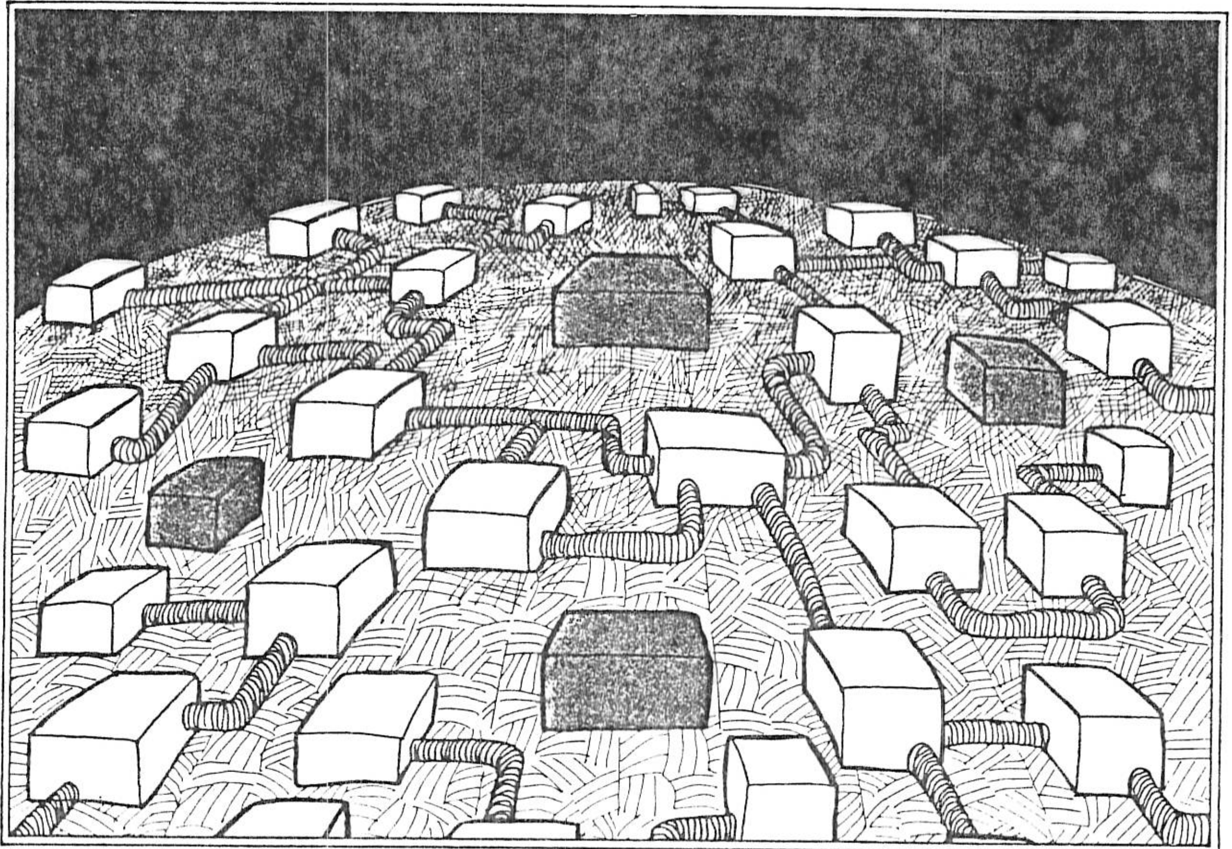

Branch Banking Laws, Deposits, Market Share and Profitability of New Banks

ABSTRACT

The preservation of the ability to form successful new banks is one aspect of the maintenance of competitive banking markets. The issue examined here is whether state branch banking and bank holding company laws impact the economic prospects of new banks.

The study examines the 1977 levels of deposits, market share and profitability of banks formed between mid-1967 and mid-1968. The findings suggest that, except for a small negative impact of statewide branching on new bank market share, state structure laws do not have a statistically significant impact on the viability of new banks.

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The Compendium of Issues Relating to Branching by Financial Institutions[1] reviewed and updated much of the evidence relative to branch banking and has served as a basic reference document for the reexamination of the McFadden Act required by the International Banking Act of 1978. One issue, cited only in the *Compendium's* Outline for Study,[2] is the impact of differential branching laws on new banks. Specifically, the Outline poses the question, "Are liberal branching laws conducive to newly organized banks being able to grow and thrive?"

The likelihood of maintaining competitive banking markets is clearly decreased if certain forms of branching laws represent insurmountable barriers to new bank entry, deposit growth, achievement of market share and profitability. For example, extensive branching within a market might produce a situation in which a new bank, lacking a marketwide network of branches, would suffer a severe competitive handicap and be unable to grow, capture a significant share of the market and achieve profitability. In another situation, extensive branching might result in the preemption of all attractive banking office sites.

An argument can be presented, however, to suggest that liberal branching laws do not have negative effects on new banks. The relatively low economies of scale in banking[3] may permit a small new bank to achieve profitability even in a market dominated by large branch banking organizations. The existence of a sizeable number of unit banks in California (78 in 1979) suggests that relatively small organizations can survive extensive branch bank competition, although turnover in the unit bank category is high due to new entry, mergers and establishment of branches by former unit banks.

This paper presents some empirical evidence relative to the effects of state branching and bank holding company laws on the 1977 market share and profitability of 67 banks organized between June 1967 and May 1968.[4] During that period, 98 new insured commercial banks were chartered; 94 were formed as independent banks and four were formed as *de novo* bank holding company subsidiaries. Of the banks formed in the period, 16 subsequently merged with other banks,[5,6] and two failed. Two banks were dropped from the sample because less than 80% of their total 1977 deposits were obtained from their home office market; all but four of the banks in the final sample obtained all of their deposits from their home office markets. Eleven banks in markets encompassing parts of two or more states were eliminated. The remaining 67 banks are the observations for this study.[7]

THE 1977 DEPOSITS AND MARKET SHARE OF 1967-68 BANKS

The analysis in this section examines the growth of deposits and market share of new banks with the emphasis on the impact of banking structure laws on this growth. The specific hypothesis tested is that branch banking and bank holding company laws did not have a significant effect on the 1977 total deposits[8] and market shares of the 67 banks studied. Each bank's market was defined as its SMSA or non-SMSA county, and the bank's deposits and share of total market deposits were calculated from *Summary of Deposits* data for June 1977.

The June 1977 deposits of the sample banks ranged from $2.2 million to $1,396.3 million,

[1] *Compendium of Issues Relating to Branching by Financial Institutions*, 94th Congress, 2nd Session, Subcommittee on Financial Institutions of the Committee on Banking, Housing and Urban Affairs of the United States Senate. Washington, D.C.: U.S. Government Printing Office (October 1976).

[2] *Ibid.*, p. XIV.

[3] The evidence on economies of scale and branching is summarized by George J. Benston, "The Optimal Banking Structure: Theory and Evidence," *Journal of Bank Research* (Winter 1973) pp. 220-237.

[4] This period was selected because of the availability of market data from the June 1968 *Summary of Deposits*.

[5] None of the banks retained in the study was the acquiring bank in a merger. Four of the mergers involved the consolidation of subsidiary banks within holding companies.

[6] While the omission of these observations could bias the results of the empirical analysis, examination of market share and profitability data at the last available date for these banks does not suggest systematic relationships between branching laws and market share or profitability. The evidence is provided in subsequent footnotes.

[7] The structural characteristics of these banks are provided in the appendix.

[8] The 1977 new banks' absolute amount of IPC savings deposits and market share of IPC savings deposits was tested as an alternative dependent variable on the theory that new banks might be better able to compete for small savings accounts than for larger corporate deposits. Results using this dependent variable are noted in a subsequent footnote.

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with an unweighted mean of $39.2 million. Market shares for the banks ranged from 0.02% of total deposits in the market to 44.94% of market total deposits; the unweighted mean value of 1977 market share was 8.50 percent. Eighteen of the 67 banks held a market share of less than 1%; 41 banks had achieved a market share of 5% or less. Only 20 of the 67 banks had captured a market share in excess of 10%.[9]

The 1977 deposits and market shares of the new banks were hypothesized to be a function of market characteristics, bank structure laws and the branching and bank holding company status of the sample banks. The specific variables included in the regressions and the reasons for their inclusion are discussed in the following paragraphs.

Figure 1. 1977 Bank Deposit and Market Share Regressions.

Independent Variables	Dependent Variables 1977 Deposits	1977 Market Share
MKTDEP68	−0.0140	0.00000
	$(-2.6093)_b$	(0.2407)
BCR68	−0.8703	0.00000
	(−0.4359)	$(4.2573)_a$
COMPGRTH	−70.3805	−0.00011
	(−1.1669)	$(-4.1663)_a$
LGMKGRTH	248.1493	0.00054
	(1.1212)	$(5.7073)_a$
SMSA · *BCR68*	−11.0236	−0.00000
	$(-3.1750)_a$	$(-2.7562)_a$
SMSA · *LGMKGRTH*	260.1455	0.00010
	$(3.2607)_a$	$(2.8677)_a$
BR1	36.0673	0.00003
	(0.7265)	(1.4351)
BR2+	−37.3947	0.00003
	(−0.6497)	(1.2760)
OBHC	−60.4471	−0.00007
	(−0.7210)	$(-2.0463)_b$
MBHC3	−4.7713	−0.00003
	(−0.0659)	(−0.8704)
MBHC4+	110.3410	0.00001
	$(1.8814)_c$	(0.5515)
LB	42.1805	−0.00000
	(0.6604)	(−0.1555)
UBLBMBHC	42.0117	0.00001
	(0.8397)	(0.5442)
SB	55.1690	−0.00007
	(0.6524)	$(-1.9312)_c$
Intercept	−798.184	−0.002
$\bar{R}^2$	0.2273	0.6553

t values are in parentheses below the coefficients.
a = Significant at the 99% confidence level (2 tail test).
b = Significant at the 95% confidence level (2 tail test).
c = Significant at the 90% confidence level (2 tail test).

Market Variables

Six variables are included to control for characteristics of the markets in which the new banks were formed. The first of these variables, *MKTDEP68*, is the dollar volume of bank deposits in the market as of mid-1968. It is hypothesized that the new bank's deposits would increase as market deposit size increases and that the new bank's market share would decrease as market size decreases. In a larger market the bank would accumulate more deposits than in small markets, but the accumulation of market share would be more difficult than in a small market.

Second, the 1968 three-firm concentration ratio, *BCR68*, for the bank's market is added.[10] This variable could have one of two effects. First, in a highly concentrated market dominated by a few firms the accumulation of deposits or market share may be difficult. Alternatively, in a highly concentrated market the prices of bank services may be above perfectly competitive levels and the new entrant may be able to obtain deposits and gain market share by offering lower prices or better services.

COMPGRTH, the percentage growth of the number of competitors in the market between 1968 and 1977, is included as a third independent variable. It is hypothesized that a large increase in the number of firms represented in the market would decrease the deposits and market share of the new bank.[11]

[9] Market share data, as of the last date on which the bank appeared in the *Summary of Deposits*, were obtained for 14 of the 20 banks dropped from the population because of merger or failure. The mean value of the last market share figure was 4.08% with a range from 0.01% to 18.98%. As would be expected, the banks for which the last market share could be calculated in 1970 had substantially lower market shares than those banks that were dropped in 1976. For these 14 banks, length of time in the market appeared to be a more important determinant of final market share than the state branching law, although the size of the group limits the reliability of generalizations.

[10] All concentration ratios are consolidated for bank holding companies.

[11] The absolute number of competitors in the market in 1968 was also considered as an independent variable. Because this variable was nearly perfectly correlated (r = 0.99) with total market deposits it was not included.

The fourth independent market characteristic variable is *LGMKGRTH*, the log of the percentage change in total market deposits between 1968 and 1977. In a rapidly growing market, a new bank can increase its size and market share without reducing the absolute amount of deposits held by its established competitors. In addition, above-average market growth usually reflects population growth, including a movement into the market of new customers who do not have established banking relationships with the older banks. Thus, it is hypothesized that a new bank's market share will be positively related to growth of total market deposits. Growth of market deposits is also tested in absolute form; differences are noted subsequently.

A final market characteristic, a dummy variable having a value of one for those banks located in an SMSA and zero for those banks located in non-SMSA counties was also entered. SMSA, however, was relatively highly correlated with *BCR*68 ($r = -0.63$) and *LGMKGRTH* ($r = 0.81$). Therefore, two interaction variables SMSA * *BCR*68 and SMSA * *LGMKGRTH* were used in the regression.

Branching Variables

The number of branches operated by the sample banks was specified in a series of dummy variables for a unit bank (the omitted dummy), *BR*1 for one branch office and *BR*2 + for two or more branches. It is hypothesized that branches should increase the deposits and market share of the banks.

Bank Holding Company Variables

Affiliation with a bank holding company may assist a bank in achieving a higher level of deposits and market share because of its access to the managerial and other resources of the parent holding company. A series of variables were added to specify holding company affiliation. The possibilities include being an independent bank (the omitted dummy), the subsidiary of a one bank holding company (CBHC) and the subsidiary of a multibank holding company (MBHC). While only two of the sample banks were formed by holding companies, subsequent acquisitions resulted in 16 of the banks being MBHC subsidiaries by June 1977. Thus, multibank holding company affiliation was specified in two variables based on the duration of affiliation. The dummy variable *MBHC*3 has a value of one in those cases in which the bank had been affiliated with the holding company for three years or less and the dummy variable *MBHC*4 + has a value of one in those cases in which affiliation had been for four or more years.

Branching and Holding Company Law Variables

States are classified into four groups on the basis of their branching and bank holding company laws as of the end of 1968.[12] The first dummy variable (the omitted dummy variable) is *UB*, unit banking states in which multibank holding companies are not active.[13] The maximum percentage of state deposits held by multibank holding companies in these states in 1968 was 10.2%. The second variable is LB, limited branching states in which multibank holding companies are not active.[14] The maximum percentage of state deposits held by multibank holding companies in these states was 3.4%. Third, *UBLBMBHC* represents unit and limited branching states in which multibank holding companies held a higher proportion of total state deposits.[15] The lowest percentage of deposits held by MBHCs in these states was 10.4%. *SB* is the dummy variable for statewide branching states with or without multibank holding companies.[16]

Regression Results

Examining the regression results in Figure 1, the most important variables for the questions under investigation are the dummy variables for state branching and bank holding company laws. The results suggest that none of these law dummies

[12]Given the relatively small number of changes in state branching and bank holding company laws over the period of the study, the choice of beginning or ending date laws does not appear to be critical. 1968 laws were used to specify the conditions facing the organizers of the bank at the time of its formation.

[13]*UB* states were AR, KS, WV, IL, MO, TX, OK, IA and NE. In this group were 22 banks.

[14]*LB* states were AL, LA, MS, NJ, PA, IN, MI and TN. In this group were 13 banks.

[15]*UBLBMBHC* states were WY, CO, SD, FL, ND, MT, MN, KY, OH, NM, NH, NY, ME, MA, GA, VA and WI. In this group were 26 banks.

[16]States not classified above are in this group. Six banks are in this group.

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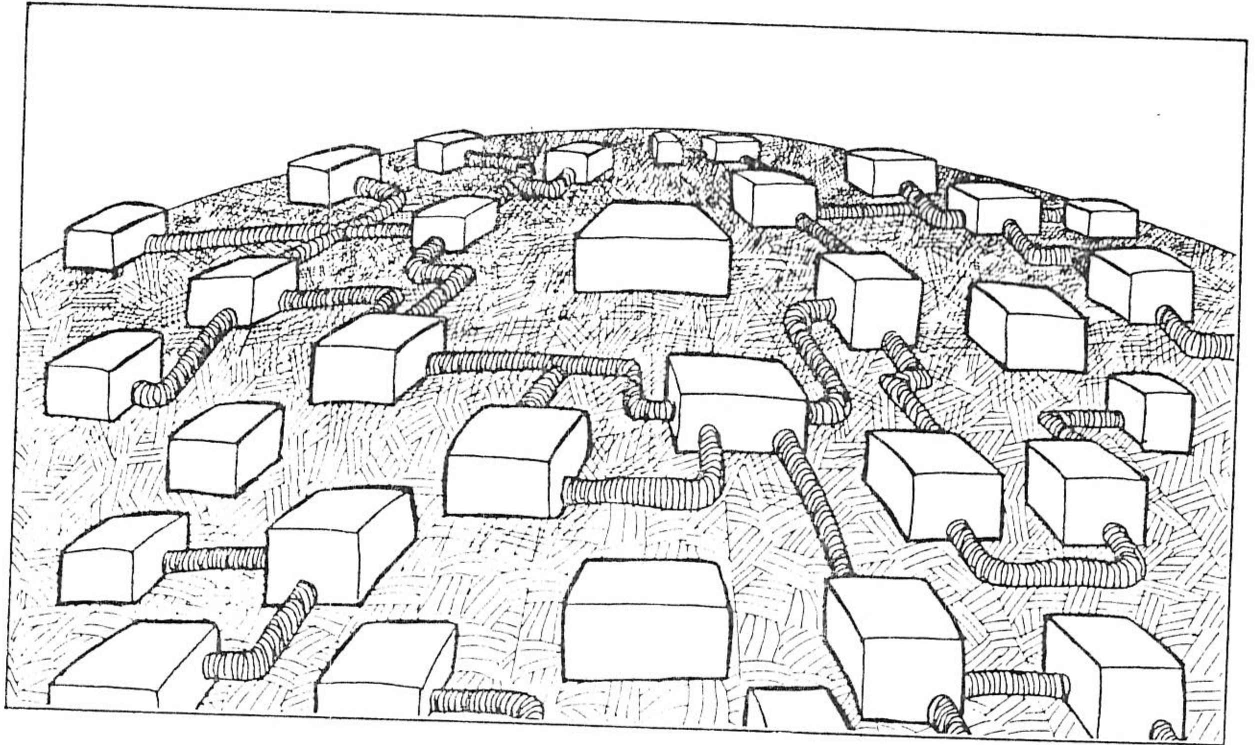

is statistically significant in the 1977 bank deposits regression.[17] In the market share regression the coefficient of statewide branching is negative and statistically significant, indicating that the new banks formed in statewide branching states had achieved statistically significantly lower market shares than the new banks formed in unit banking states.[18] The strength of this conclusion, however, should be judged in light of the fact that only six banks in the group being studied were in statewide branching states.

With respect to the structural characteristics of the new banks, the number of branches operated was not statistically significant in either regression. The one-bank holding company dummy variable was statistically significant and negative in the market share regression, while the dummy variable for banks that had been in a multibank holding company for four or more years was statistically significant and positive in the absolute level of deposits regression.[19]

The market characteristics variables generally conformed to expectations, especially in the market share regression. In the market share regression, all of the market characteristic variables except 1968 market deposits were statistically significant with the expected signs. Concentration and the log of market growth had positive and statistically significant impacts on market share while the growth of the number of competitors had a statistically significant negative impact on market share. The interaction of SMSA and *BCR*68 was statistically significant and negative suggesting that *BCR*68 had a lesser impact on market share in SMSAs than in non-SMSA markets. The coefficient of the interaction of SMSA and *LGMKGRTH* was positive and statistically significant and suggests that market growth had a statistically significantly larger impact on market share in SMSAs than in non-SMSA markets.

In the deposit regression, 1968 market deposits and the two interaction variables are statistically significant, but the other variables are not statistically significant. The limited number of statistically significant variables in the deposit regression suggests that new bank deposit growth tends to follow a pattern relatively independent of the included variables.

[17] Using market growth in absolute, rather than log form, resulted in *UBLBMBHC* becoming negative and statistically significant in the absolute level of deposits regression.

[18] In the regressions using IPC savings deposits as the dependent variable, the dummy variable *UBLBMBHC* was negative and statistically significant in the absolute level of IPC deposits regression. The other branching-bank holding company dummy variables were statistically insignificant.

[19] The two multibank holding company affiliation dummies were also aggregated so that only the fact of affiliation, rather than the duration of affiliation, was tested. The combined dummy was not statistically significant in either regression.

THE PROFITS OF THE 1967-1968 BANKS

The profitability of the banks chartered in 1967-1968 is the second area of investigation. Specifically, our concern is whether banks in statewide branching states were less profitable than those in restrictive branching states.

Two dependent variables are used in this analysis: The ratio of net income after taxes, securities gains and losses and extraordinary items to net assets and the ratio of net income (as defined above) to total equity capital. In order to avoid the influence of year-to-year fluctuations in income, the ratios were averaged for three years. The unweighted mean value of net income/total assets for the 67 banks was 0.663% and the unweighted mean value of net income/total equity capital was 9.243%.[20, 21]

The income regressions in Figure 2 employ the same independent variables used in the previous regressions. It is hypothesized that income would be statistically negatively related to market deposit, market concentration, growth of the number of competitions, positively related to market growth, negatively related to an SMSA location, of uncertain relationship to the bank's branches, positively related to bank holding company affiliation and negatively related to the more liberal state branching and bank holding company laws.

The results shown in Figure 2 indicate that the state branching and bank holding company law dummy variables have no statistically significant effect on the profitability of the new banks in either of the profit regressions. The variables describing the structural characteristics of the sample banks indicate no statistically significant profit impact of branches. The bank holding company variables indicate a statistically significantly lower return on assets for those banks affiliated with multibank holding companies for three years or less.[22] It should be noted, however, that only six banks were in this category.

The variables describing the characteristics of the markets in which the new banks operate show statistically significant results for the two interaction variables. The interaction variable SMSA * *BCR*68 suggests that in SMSAs, relative to non-SMSAs, concentration has a statistically significant negative impact on income by both measures. The SMSA * *LGMKGRTH* variable in the income/asset regression suggests that in SMSAs, relative to non-SMSAs, a high

Figure 2. Income Regressions.

Independent Variables	Dependent Variables Net Income/ Total Assets	 Net Income/ Total Equity Capital
*MKTDEP*68	−0.0000 (−1.0981)	−0.0001 (−0.4964)
*BCR*68	0.0065 (0.8563)	0.0578 (0.5664)
COMPGRTH	−0.1990 (−0.8699)	−3.5257 (−1.1429)
LGMKGRTH	−0.0991 (−0.1181)	11.3943 (1.0066)
SMSA * *BCR*68	−0.0342 $(-2.5951)_b$	−0.3102 $(-1.7465)_c$
SMSA * *LGMKGRTH*	0.6716 $(2.2195)_b$	6.7375 (1.6511)
*BR*1	0.0084 (0.0447)	1.4485 (0.5704)
*BR*2+	−0.0472 (−0.2161)	−0.5896 (−0.2003)
OBHC	−0.0162 (−0.0509)	−1.5995 (−0.3730)
*MBHC*3	−0.8088 $(-2.9434)_a$	−12.4805 $(-3.3608)_a$
*MBHC*4+	−0.2599 (−1.1685)	−4.3230 (−1.4412)
LB	0.0969 (0.3999)	0.9992 (0.3059)
UBLBMBHC	0.0568 (0.2996)	−0.3096 (−0.1210)
SB	0.3975 (1.2393)	5.6530 (1.3070)
Intercept	0.630	−33.109
$\bar{R}^2$	0.1838	0.1805

t values are in parenthesis below the coefficients.
a = Significant at the 99% confidence level (two tail test).
b = Significant at the 95% confidence level (two tail test).
c = Significant at the 90% confidence level (two tail test).

[20] The unweighted mean ratio of net income to total assets for all insured banks in 1977 was 0.96% and the unweighted mean ratio of net income to total equity capital was 12.01%. The three-year income averages for all banks were 0.92% on assets and 11.31% on equity.

[21] Profit rates for the 14 of 20 banks which failed and/or merged prior to June 1977 indicate that six (two in statewide branching states) had negative returns on assets on the last date for which data could be obtained. Three (one in a statewide branching state) had profit rates in excess of 1% of assets. While the size of the group is small, there did not appear to be an obvious association between profit rate and state branching law.

[22] When only one dummy variable was used to test the effect of affiliation *per se*, rather than duration of affiliation, the dummy was negative and statistically significant in both income regressions.

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rate of market growth has a positive and statistically significant effect on bank income.

SUMMARY

The paper has examined the 1977 assets, market share and income of 67 banks formed in 1967-68 to determine the extent to which we would expect these variables to be affected by state branch banking and bank holding company laws. The general finding is that these state laws have little, if any, statistically significant effect on new banks. None of the state structure law dummies were significant in the income regressions. The absolute level of 1977 deposits appeared to be independent of state structure laws, while the existence of statewide branching had a negative statistically significant impact on 1977 market share only when market growth was entered in log form. Overall, the results do not provide any strong evidence to indicate that the expansion of branch banking would be detrimental to the growth and profitability of new banks. □

The views expressed in this paper are those of the author and do not necessarily reflect the views of the Board of Governors or its staff. The author wishes to thank Robert A. Eisenbeis, Stephen A. Rhoades and two anonymous reviewers for their helpful comments and Susan Moody and Pat Lapczynski for their research assistance.

APPENDIX

1977 Structural Characteristics of New Banks Formed June 1967—May 1968.

State	Number of Banks	Number in SMSAs	Number Owned by One Bank Holding Company		Number Owned by Multibank Holding Company		Number of Branches Operated		
			For 3 years or less	For 4 years or more	For 3 years or less	For 4 years or more	None	1	2-4
Alabama	2	1	0	0	0	0	2	0	0
Arkansas	2	0	0	0	0	0	2	0	0
Colorado	3	1	0	0	1	1	2	1	0
Florida	4	2	0	0	0	3	0	3	1
Georgia	3	1	0	0	0	0	1	1	1
Idaho	1	1	0	0	0	0	1	0	0
Illinois	7	4	1	0	0	0	6	1	0
Iowa	1	0	0	0	1	0	0	1	0
Kansas	4	0	0	1	0	0	3	1	0
Louisiana	6	3	0	0	0	0	3	0	3
Maryland	1	1	0	0	0	1	0	0	1
Massachusetts	1	1	0	0	0	1	0	1	0
Missouri	2	0	0	0	0	1	1	1	0
Montana	2	0	0	1	0	0	2	0	0
New Hampshire	1	0	0	0	1	0	0	0	1
New Jersey	2	2	0	0	1	0	0	0	2
North Dakota	1	0	0	0	0	0	1	0	0
Ohio	2	2	0	0	1	1	0	1	1
Oklahoma	2	2	1	0	0	0	0	2	0
Oregon	2	1	0	0	0	0	1	1	0
Tennesse	3	0	0	0	1	1	2	0	1
Texas	1	1	0	0	0	0	1	0	0
Virginia	3	1	0	0	0	0	0	1	2
Washington	2	1	0	0	0	0	1	0	1
West Virginia	3	0	0	0	0	0	2	1	0
Wisconsin	6	3	0	0	0	1	4	2	0
Totals	67	28	2	2	6	10	35	18	14

Source: Federal Reserve Board Structure Files.

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The Effect of Merger on the Lending Behavior of Rural Banks in Virginia

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The structure of the commercial banking industry in the United States is undergoing rapid changes. These changes are reflected in numerous bank mergers and the proliferation of bank holding companies during recent years.[1] It is generally believed that the structure of the banking industry affects the performance of individual banks, but there is considerable disagreement regarding the precise character of this relationship. Because the various federal and state bank regulatory authorities significantly influence the banking structure, it is essential that the likely effect of particular structural changes on particular aspects of bank performance be delineated as accurately as possible.

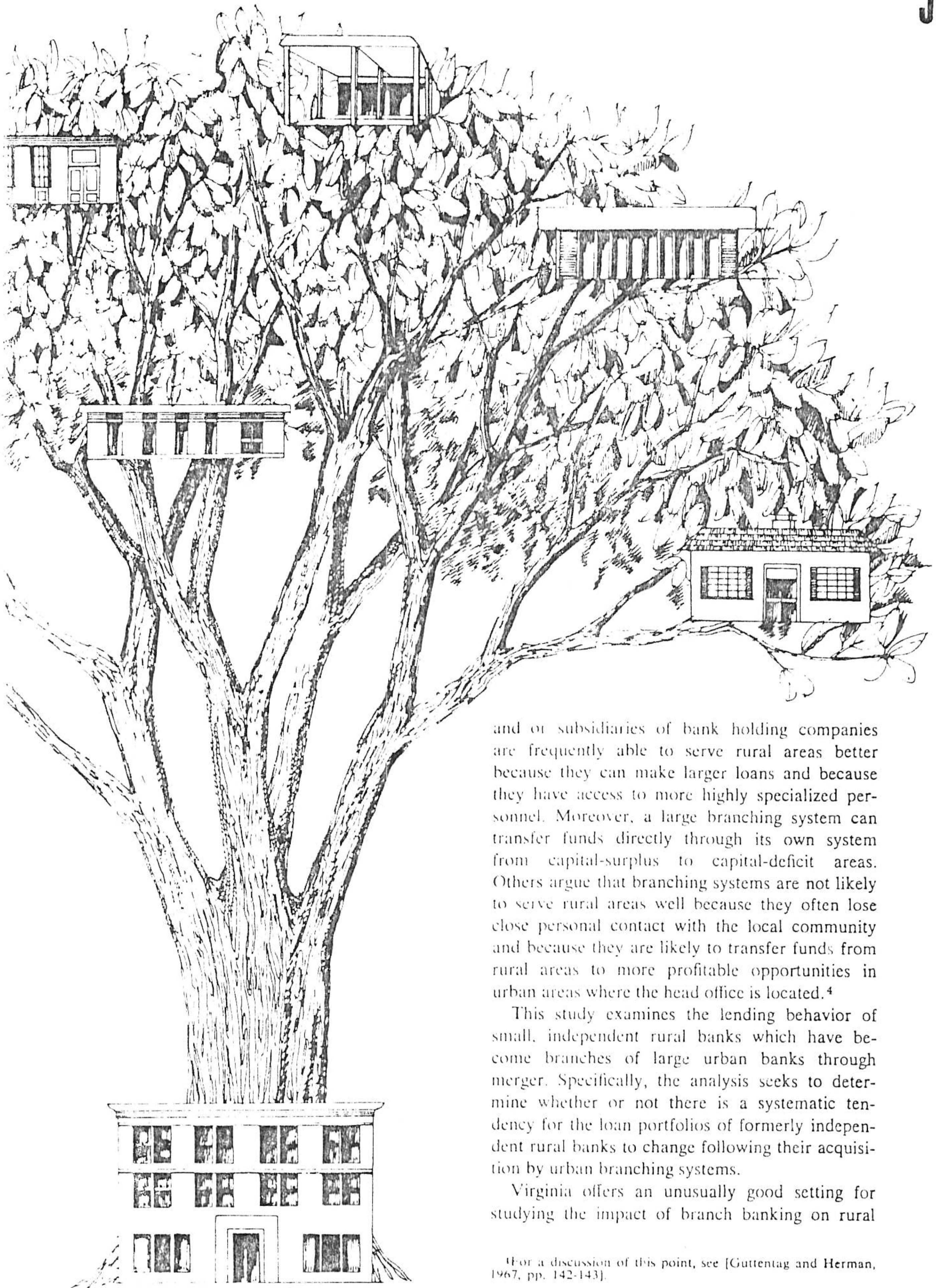
During recent years, numerous studies[2] have examined various aspects of the relationship between banking structure and bank performance. These studies have analyzed the effect of structural changes on such performance factors as the price of banking services and bank costs. Relatively little attention, however, has been given to the impact of structural changes on the allocation of funds over the major sectors of the economy.

One possible allocative effect, of considerable potential significance, relates to credit availability in rural areas [Brake, 1970]. Many large, urban-based[3] banking organizations have acquired rural banks, either by merger or via bank holding company affiliation. If the lending policies of the acquiring banks differ systematically from those previously pursued by the acquired banks, the availability of funds to rural borrowers could be affected. Some would argue that branch banks

[1]For a discussion of recent changes in banking structure, see [Board of Governors, 1970].

[2]The literature on bank structure and performance is voluminous. For a detailed summary and appraisal of the literature on this topic, see [Guttentag and Herman, 1967]. Two recent articles especially relevant to this study are [Lawrence, 1967] and [Smith, 1971].

[3]Throughout this study, urban banks are defined as banks which have their main office located in an SMSA and rural banks are defined as banks which have their main office located outside of an SMSA.



and or subsidiaries of bank holding companies are frequently able to serve rural areas better because they can make larger loans and because they have access to more highly specialized personnel. Moreover, a large branching system can transfer funds directly through its own system from capital-surplus to capital-deficit areas. Others argue that branching systems are not likely to serve rural areas well because they often lose close personal contact with the local community and because they are likely to transfer funds from rural areas to more profitable opportunities in urban areas where the head office is located.[4]

This study examines the lending behavior of small, independent rural banks which have become branches of large urban banks through merger. Specifically, the analysis seeks to determine whether or not there is a systematic tendency for the loan portfolios of formerly independent rural banks to change following their acquisition by urban branching systems.

Virginia offers an unusually good setting for studying the impact of branch banking on rural

[4]For a discussion of this point, see [Guttentag and Herman, 1967, pp. 142-143].

areas. Virginia legislation permitting branching, passed in 1962, allows statewide branching only through merger.[5] Since the change in the law, the banking structure has undergone dramatic changes. In the period June 30, 1962 to December 31, 1968, there were 93 bank mergers in Virginia. Of these, 74 involved banks located in rural areas, and 50 were mergers through which a rural bank was acquired by an urban bank.

Method of Analysis

This study compares the loan performance of banks before and after they became branches of an urban branching system. Observed changes in the performance of a given bank following a change in its status may, of course, be due to changes in general economic conditions or other factors, rather than to the change from an independent bank to a branch. In order to control other possible sources of variation, each rural bank which became a branch was paired with a nonmerging independent bank of the same general asset size serving the same banking market. If the independent bank was located in the same county as the acquired bank, the two banks were considered to be serving the same market. The loan portfolio of each acquired bank and its paired bank was then compared before and after merger. Thus, changes that occurred in the loan portfolios can reasonably be attributed to the fact that one of these banks became a branch.[6]

Each of the bank mergers considered in this study took place in Virginia during the period June 30, 1962 to June 30, 1968. All acquisitions of independent rural banks by urban branch systems were considered eligible for inclusion in the study. During the period under study there were only ten urban banks in Virginia which acquired rural branches, and four large branching systems accounted for 42 of the 50 urban-rural mergers.[7] Because four branching systems accounted for most of the urban-rural mergers and because of data availability, only mergers by these banks were studied. Due to inadequate data, only 36 of the 42 urban-rural mergers could be analyzed. Since four branching systems consummated all of the mergers under study, the results can not be conclusive but only suggestive of the effect of urban-rural mergers generally. Most of the urban-rural mergers were included; therefore it seems reasonable to presume that the results are representative of the situation in Virginia during the period under study and may be suggestive of the likely effects of subsequent mergers in Virginia.

These branching systems were asked to provide loan portfolio data for each rural branch acquired by merger for a three-year period before and after the merger. Previous bank performance studies have not analyzed changes in the loan portfolios of individual branches.[8] Each bank which became a branch was paired with a similar bank which remained independent. Data for the paired banks were obtained from Reports of Condition filed with the Federal Reserve Bank of Richmond. Premerger performance measures were based upon a three-year average before the merger; post-merger performance measures were based on a three-year average following the merger (not including the year of meger).

From the data, five "difference" statistics were calculated for each pair of banks for both the before merger period and the after merger period. These difference statistics were derived from the following loan portfolio ratios:

1. $\frac{\text{Gross loans}}{\text{Total deposits}}$
2. $\frac{\text{Real estate loans}}{\text{Total loans}}$
3. $\frac{\text{Farm loans}}{\text{Total loans}}$
4. $\frac{\text{Commercial and Industrial loans}}{\text{Total loans}}$
5. $\frac{\text{Loans to Individuals}}{\text{Total loans}}$

The following example illustrates how the difference statistics were calculated. Consider the ratio of farm loans to total loans. Assume that the merger took place in August 1965. First, the three-year average values of this variable for the acquired bank and for the paired bank, respectively, were computed using data for June 30, 1963, 1964 and 1965. Second, corresponding statistics

[5] State regulations affecting Virginia banking are discussed in [Cohen and Reid, 1967] and [Haymes and Phillips, 1968].

[6] For studies using similar methodology, see [Jessup], [Lawrence, 1967] and [Smith, 1971].

[7] It should be pointed out that three of these branching systems are members of holding companies. In each case, however, the branching system was the "lead bank" in the holding company. Thus, it seems unlikely that the performance of these banks would be affected significantly by the holding company.

[8] In a study of branch banking and bank mergers in New York State, loan to deposit ratios for individual branches and total loans outstanding at individual branches were analyzed. See [Kohn, 1964].

were calculated using data for June 30, 1967, 1968 and 1969. Finally, the difference between the average ratios for each acquired bank and its paired bank was calculated, one such difference for the before merger period and another for the after merger period. For example, if the average ratio of farm loans to total loans before merger was .14 for the acquired bank and .12 for the paired bank, the before merger difference would be .02; if the average ratio after merger were .16 for the acquired bank and .13 for the paired bank the after merger difference would be .03.

Two statistical tests were used to analyze the data. First, the mean difference for each ratio before merger was subjected to a *t* test to determine whether or not it was significantly different from zero. A significant difference would indicate that the acquired banks followed systematically different policies from their respective paired independent banks before merging.

Second, the change in the difference (the difference after merger minus the difference before merger) was calculated for each of the five ratios for the 36 pairs of banks. In the example cited earlier, the change in the difference would be .01. Using a *t* test, the mean change in the difference for each ratio was tested to see if it differed significantly from zero. A significant difference would indicate that a merger significantly affected the performance of acquired banks with respect to the ratio in question. Because each acquired bank and its paired bank served the same market area, both statistical tests used were for nonindependent samples [Croxton and Cowden, 1958, pp. 654-657].

Characteristics of Acquired and Nonacquired Banks Before Merger

Comparison of the loan portfolios of the acquired banks with those of the nonacquired banks indicates no significant differences in the before merger period (See Figure 1). In the three-year period before merger, the acquired banks had an average loan-deposit ratio of 53%. They held 45% of total loans in real estate and 29% in loans to individuals. Farm loans accounted for about 17% of total loans while commercial and industrial loans made up 14% of the total. The nonacquired banks had a slightly higher loan-deposit ratio, 56.4%, and a higher proportion of total loans in farm loans. Loans to individuals were approximately the same for both groups, but nonacquired banks held a smaller proportion of real estate loans and a slightly higher proportion of commercial and industrial loans. The average growth rate of deposits was 8.9% for the merging banks compared to 10.0% for the nonmerging banks.

Figure 1. Selected Variables for 36 Acquired Banks and 36 Nonacquired Banks

	3 Year Average Before Merger			3 Year Average After Merger		
	Mean for Merged Banks	Mean for Paired Banks	Mean Difference	Mean for Merged Banks	Mean for Paired Banks	Mean Difference
Loan / Deposit	52.98	56.41	-3.43	53.11	59.56	-6.45
Real Estate Loans / Total Loans	45.51	43.12	2.39	44.15	43.41	0.74
Total Farm Loans* / Total Loans	17.16	20.17	-3.01	13.75	15.26	-1.51
Commercial & Industrial Loans / Total Loans	14.00	15.09	-1.08	11.68	14.96	-3.28
Loans to Individuals / Total Loans	29.33	28.89	0.44	34.16	31.13	3.03
Mean Growth Rate of Deposits	8.85	9.96	1.11	12.90	12.19	0.71

* Real estate loans secured by farmland plus loans to farmers

EFFECT OF MERGER

Figure 2. Mean Change in the Difference of Selected Variables for 36 Acquired and 36 Nonacquired Banks

	Mean Change in the Difference*
Loan / Deposit	-3.02 (1.95)
Real Estate Loans / Total Loans	-1.64 (1.54)
Total Farm Loans / Total Loans	1.42 (1.20)
Commercial & Industrial Loans / Total Loans	-2.20 (1.39)
Loans to Individuals / Total Loans	2.59 (2.37)
Mean Growth of Deposits	1.82 (2.13)

*The standard errors of the means are given in parentheses

The fact that there were no statistically significant differences between the variables for the acquired and nonacquired banks before the merger suggests that, in terms of the variables under study, the two groups of banks were similar in the period before merger and that any differences which appear in the postmerger period may reasonably be attributed to the change in status of the merging banks.

Effects of Merger on Loan Portfolio

As measured by the mean change in the differences shown in Figure 2, none of the changes in the loan portfolio of acquired banks compared to nonacquired banks was statistically significant. The average loan to deposit ratio for both acquired and nonacquired banks increased between the before and after period. The mean change in the difference between the before and after period was −3.02, which means the average loan to deposit ratio of the nonacquired banks increased 3.02 percentage points more than the loan to deposit ratio of the branches. One plausible explanation for this result would be that the nonacquired banks pursued a more aggressive lending policy than the branches.

Both groups of banks actually decreased the proportion of total loans in farm loans between the before and after period. For this ratio the mean change in the difference was 1.42, indicating that for the period under study the branches decreased the proportion of farm loans to total loans 1.42 percentage points less than the nonacquired banks. Thus, the evidence does not support the argument that, compared to independent rural banks, urban-based branching systems are inclined to slight farm borrowers.

The acquired banks had a higher proportion of loans to individuals both before and after merger. Although not statistically significant, the mean change in the difference for this ratio was 2.59, indicating that the branches increased this ratio 2.59 percentage points more than the nonacquired banks. This suggests that on average the branches were more consumer oriented than the independent banks.

The data indicate that both groups of banks reduced the proportion of total loans in commercial and industrial loans, but this ratio declined 2.20 percentage points more for the branches than for the nonacquired banks.

Lawrence has suggested that a reasonable proxy for the general quality of banking services is the rate of growth of deposits [Lawrence, 1967]. According to this criterion, if branches are offering more and better services, their rate of

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deposit growth should be significantly higher than comparable independent banks. Analysis of this proxy variable showed that the average rate of deposit growth increased for both groups between the before and after period. Although not statistically significant, the mean difference indicated that the rate of growth for branch deposits increased 1.82 percentage points more than for nonacquired banks.

The results of this study differ in part from the results reported by Smith [1971] in a study of bank mergers in the Fourth Federal Reserve District. Smith found that changes in the loan portfolios of merging and nonmerging banks differed significantly with respect to real estate and business loans. Smith's study differs from the present study with respect to two important items, however. First, whereas this study focuses on changes in the loan portfolios of the *acquired* bank before and after merger, Smith analyzes changes in the loan portfolios of the *acquiring* bank before and after merger. Second, this study analyzed only cases where an independent rural bank was acquired by an urban-based branching system, whereas Smith analyzed all mergers regardless of the location of the acquired bank.

The findings of this study are consistent with those of Kohn [1964] in a study of branch banking and bank mergers in New York state. Regarding the performance of major branch banks which had acquired rural branches through merger, Kohn reported that, "The available evidence does not support the view that there was any systematic policy on the part of these banks to slight rural communities" [Kohn, 1964, p. 55]. Kohn, however, did not analyze changes in the composition of the loan portfolio of merger acquired rural branches.

Conclusions

In general, the results of this study indicate that recent changes in the Virginia banking structure have not materially affected the amount or type of bank credit available in rural areas. Statistical tests indicate that changes in the loan portfolios of independent rural banks which became branches of urban-based branching systems were not significantly different from changes in the loan portfolios of nonacquired banks in the same areas. The loan to deposit ratio of nonacquired banks, however, appeared to increase more than that of the branches in the period after merger. Farm loans as a proportion of total loans, while declining during the study period for both groups of banks, actually dropped off more at the nonacquired banks than at the branches.

Because of variations in economic conditions and state regulations affecting bank structure, one should obviously use caution in extrapolating the results of this study to other areas. Also, because all of the acquisitions studied were made by four branching systems, the results may not be conclusive but only suggestive of the impact of urban-rural mergers. □

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Senate ...ttee on Commercial ...nancial Institutions

Hearing on Senate Bill No. 673-entitled the Community Credit Protection Act-9:00 a.m. Monday February 13, 1984. State House, Topeka.

I am Dean Haddock, Chairman of the Board of the Guaranty State Bank & Trust Co. of Beloit and of the State Bank of Delphos.

I thank you for this opportunity to appear in behalf of the passage of Senate Bill 673. My credentials are that I am from Beloit, Ks. where I started 32 years ago as the second man in Kansas with full time agricultural representative duties, to be employed by a bank in this state. Our bank has totals around $36,000,000. Our bank owns about 24.8% of a second bank about 30 miles down the Solomon River Valley at Delphos, Ks. which has totals of about $10,500,000. Three of our 11 officers participate in the management decisions of the Delphos Bank.

In both banks our loans run about 70% agriculture and the balance in commercial and personal loans. We are confident we are bringing a better service than ever before experienced by the Delphos Community and have been able to help both banks by virtue of the total size loans we can make without going to upstream correspondants. We get along very well with our correspondents; but we get along better with ourselves. This illustrates why we stongly support the multi bank holding company concept. We wish to do more of this joining together in our community and we are dedicated, absolutely, to showing no partiality between either of the two areas we operate in.

The one bank holding concept is awkward and cumbersome to work with and does not permit economics of scale, that we might otherwise employ. We believe the present Kansas law to be out of step with this nation; and it is hurting our economic development for all industry and commerce. A glaring weakness of the present law is its failure to have a sensible organized method to prevent the defacto chain banking now taking place.

It would appear to be the better part of wisdom, if not just old common sense to proceed with a more orderly controlled growth, where the numerous protections delineated in the Senate Bill 637 will clearly state the path to follow.

A point was made by KIBA member, the other evening, on a TV program where we had a joint appearance, that conceivably as few as 10 big banks could control all of 752 commercial financial entities within this state. Perhaps this was a greatly exaggerated figure to make their point of argument against the 11% limitation of control of resources rule mentioned in the bill. We interpret this as being a "quick fix" attempt to discredit this point in the bill. In my opinion this is a very impractical viewpoint. The safeguards incorporating State Bank Commissioner approval are far reaching and thorough, it would

Attachment II

be most difficult to establish any form of monopoly as the bill is proposed.

I am personally disappointed in the efforts of people to not see the real world we live in and the one developing. It appears many bankers are so involved in defensive maneuvers, fighting within their own banking family that they fail to see who the real enemy is, such as the so called "non-bank" banks and whom are we to say that Savings and Loans and Credit Unions may now have just as much license to call themselves banks as we old traditional bankers.

It would seem that we are all being reborn into a whole new financial world of unlimited horizons and dynamic challenge that perhaps we just stand on the threshold of. We simply ask that you let us help bring Kansas to its rightful place in history by using all the resources we have to work with. Hopefully you will see your way clear to give your active support to this bill.

Thank you!

TESTIMONY BEFORE THE

SENATE COMMERCIAL AND FINANCIAL INSTITUTIONS COMMITTEE

S.B. 673

February 13, 1984

Charles J. Schwartz, Secretary

Kansas Department of Economic Development

Attachment III

KANSAS DEPARTMENT OF ECONOMIC DEVELOPMENT
503 Kansas Avenue, Sixth Floor, Topeka, Kansas 66603
Phone (913) 296-3481

JOHN CARLIN
Governor

CHARLES J. "Jamie" SCHWARTZ
Secretary

Mr. Chairman and Members of the Committee:

The first task which Governor Carlin gave me in October of 1981, when I was named Secretary of the Department of Economic Development, was to convene a special "Task Force on Capital Formation." This was my first exposure to the subject of multi bank holding companies and the adequacy or inadequacy of state laws regulating them.

The Task Force report transmitted to the Governor in December 1981, made no mention of the issue, even though it had been extensively discussed, because the chairman of the task force (me), was attempting to stay away from such a politically volatile issue in his first assignment on a new job.

In the months since that time the issue has become one of such magnitude and is interjected into economic development discussions with such frequency that it has become evident that politically volatile as it is, the issue should be addressed publically by the Department of Economic Development.

Reasonable, carefully crafted legislation providing Kansas banks the option to expand their services would have a beneficial impact in our state. Modernization of our banking laws would strengthen our economy and, thereby, improve the daily lives of thousands of Kansans. I have come to this conclusion after almost three years of discussions and experience with those involved in economic development across this state.

I am privileged to be a member of the board of directors of both the Kansas Industrial Developers Association and the Kansas Chamber of Commerce and Industry. KIDA adopted a position favoring multi bank holding companies last week and KCCI has the question before it to consider. The Task Force on High Technology of which I was a member addressesd the issue stating, "The development and support of high technology industry requires capital in large amounts and continuous availability. Statutes which restrict the growth of the Kansas banking system also restrict the growth of capital and its free flow. In order to effectively promote economic growth by developing and encouraging high technology industry, it is necessary to remove restrictive bank structure laws."

This issue is not just a disagreement between two different groups of bankers over how to carry on their business. It has ramifications which will affect how all Kansans will conduct their lives and their businesses. It is a fact that our banking laws are

outmoded. They need revision; they need improvement. As in so many other areas, our rapidly changing economic and technological society is outpacing the relevance of laws which regulate the banking industry. Fair and equitable change is needed for Kansas to modernize and strengthen its commercial banking structure while at the same time maintaining the benefits of a diverse and independent banking system. In order to grow and prosper economically Kansas must move with the times.

Change for change's sake is neither necessary nor desirable. But, change when our state can be improved, when economic growth and consumer benefits are achieved together, should be promptly undertaken. Complacency in these fast changing times will result only in lost opportunities for all of us. I urge your support of S.B. 673.