Approved 3-2-89
Date

MINUTES OF THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT.

The meeting was called to order by Senator Dave Kerr at
Chairperson

8:00 a.m./~~p.m.~~ on February 28, 1989 in room 123-S of the Capitol.

All members were present except:

Committee staff present:

Bill Edds, Revisor of Statutes Office
Lynne Holt, Kans Leg Research Dept
Carol de la Torre, Secretary to the Committee

Conferees appearing before the committee:

Charles Warren, President, Kansas Inc.

The meeting was called to order by Senator Dave Kerr, Chairman.

The Chairman called attention to a letter received from KTEC providing information pertaining to KTEC's Training Equipment Grant Program, Attachment 1), as requested in a previous meeting.

Charles Warren, President, Kansas Inc., briefed the Committee on the report Capital Availability and the Kansas Banking Industry. (Attachment 2). He stated big banks loan a higher percentage of their assets than small banks. Questions and discussion by the Committee followed.

There being no further business, the meeting was adjourned.

GUEST LIST

COMMITTEE: SENATE ECONOMIC DEVELOPMENT DATE: 2-28-89

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
Lenny E. Lyon	[illegible]	[illegible]
Harold Stones	Topeka	KBA
John Peterson	Topeka	4th Financial
Ann Patterson	Topeka	KDOC
Rich Bailey	Topeka	KDOC
Alan Steppat	Topeka	Pete McGill & Associates

KTEC KANSAS TECHNOLOGY ENTERPRISE CORPORATION

FEB 24 1989

February 22, 1989

Senator David Kerr
State Capitol, 120-S
Topeka, Kansas 66612

Dear Dave:

In your letter dated February 17, you requested information pertaining to KTEC's Training Equipment Grant Program. We have worked closely with Ferman Marsh, Assistant Commissioner for Community Colleges and Vocational Education, Kansas Department of Education and administrators from the junior colleges. Both the groundrules and the guidelines were coordinated with them in order to assure a cooperative effort.

The guidelines were distributed in January, 1989 and the deadline for proposals is March 31, 1989. A copy of the guidelines is attached. I have asked Ferman Marsh to prioritize the proposals, through a panel of experts, and submit the results to KTEC's Applied Research Matching Grant Committee. They will, in turn, make recommendations to the Board of Directors. It is hoped that KTEC will receive the funds from EDIF in May or June, at which time the awards will be made.

If you need additional information, please call me.

Sincerely,

Bill

William G. Brundage
President

WGB:cc
Enclosure

112 W. 6th, Suite 400 ▪ Topeka, KS 66603
913/296•5272

Sen Eco - Devo
2-28-89
Attachment 1

Kansas State Department of Educatic

Kansas State Education Building

120 East 10th Street Topeka, Kansas 66612-1103

DATE: January 30, 1989

TO: Community College Presidents
AVTS Directors

FROM: Ferman P. Marsh, Assistant Commissioner
Community Colleges & Vocational Education Division

SUBJECT: Guidelines for KTEC Equipment Grants

Please find enclosed a copy of the guidelines for application for the KTEC equipment grants.

COMMUNITY COLLEGES AND AREA VOCATIONAL TECHNICAL SCHOOLS EQUIPMENT GRANT FUND

Fiscal Year 1989 Guidelines and Procedures

The Kansas Technology Enterprise Corporation (KTEC) will provide equipment grants to community colleges and area vocational technical schools for the purpose of developing and enhancing economic development in areas with greatest potential for impacting the Kansas economy. KTEC has allocated up to $250,000, subject to the availability of lottery revenues, for this fund in fiscal year 1989.

Philosophy

Kansas Technology Enterprise Corporation (KTEC) has set aside $250,000 for community colleges and area vocational technical schools in 1989-90 to purchase needed equipment in the training/retraining of Kansans for jobs in new and/or existing business and industry. Successful grants will be awarded for a minimum of $25,000 and a maximum of $100,000 to any one requesting entity with a required dollar for dollar institutional match. Priority will be given for proposals exhibiting: greatest need based upon economic assessment; support for new jobs in new and/or existing business and industry. Eligible applicants are community colleges, area vocational technical schools and/or consortiums of either or both of the previously mentioned.

Guidelines and Procedures

Qualified Applicants

Community colleges or area vocational technical schools in Kansas are eligible to apply.

Allowable Costs

Grants are only for new equipment purchase. Construction, renovation, service, operation, maintenance, and installation costs are not included.

Matching Requirements

KTEC may award up to 50% of the total purchase cost of the equipment. The balance is to be provided by the institution. Match may be in the form of cash, new state-of-the-art equipment, renovation and installation, and staffing of new positions.

Application Procedure

Submission date for fiscal year 1989 is March 31, 1989.

Proposals shall include:

a) cover page;

b) proposal narrative must be limited to 5 pages and should address the following:

(1) economic impact and utilization of equipment;

(2) statement of potential on the area economy, including:

(A) impact on particular industries which address current market needs and potential needs over the next five years; and

(B) potential for developing new startup companies, modernizing and/or expanding existing companies;

(C) potential for generating new jobs in new and/or existing business and industry;

(3) existing capabilities and facilities;

(4) how the proposed equipment fits within the overall mission of the institution;

c) level of corporate interaction should be specified, including supporting letters;

d) budget information should include documentation of equipment to be purchased and/or donated, including:

(1) price quotation from vendor(s), reflecting standard educational discount and dated within 60 days of submission date; and

(2) model number, product description and date of manufacture;

Proposals must be signed by the authorized officer of the institution. Twenty (20) copies of the proposal should be delivered to KTEC at 112 West 6th, Suite 400, Topeka, Kansas 66603.

Review Process

1. KSDE staff, with the assistance of technical and business peer reviewers, will review each proposal and formulate recommendations for funding to the KTEC Board of Directors, which holds final authority for approval.

2. KTEC will respond to each proposal within approximately 60 days of submission deadline.

Reporting Requirements

1. One year from the date the equipment is installed and operational, a brief report will be filed with KTEC relative to equipment utilization and participation by industry.

2. Appropriate acknowledgment of KTEC support should be noted in papers and publications.

Contact for Information

Division of Community Colleges
& Vocational Education
Kansas State Department of Education
120 East 10th Street
Topeka, Kansas 66612
(913) 296-3047

KANSAS RESEARCH REPORT

CAPITAL AVAILABILITY AND THE KANSAS BANKING INDUSTRY

KANSAS inc.

"Building a Strategic Kansas Economy"

Sen Eco-Devo
2-28-89
Attachment 2

KANSAS INC.

Kansas Inc. is a public-private partnership created by the 1986 Kansas Legislature. The organization, through objective research and analysis, seeks to provide the Kansas leaders and decision-makers with policy direction that can improve the economic competitiveness of Kansas. Kansas Inc. serves as advisor to the Cabinet and Legislature, analyzing the State's tax, regulatory, and economic development policies. It conducts research and recommends actions to produce a growing Kansas.

A Board of Directors of 15 members directs the activity of Kansas Inc. The Board is Co-chaired by Governor Mike Hayden and Mr. Eric Jager of Kansas City. Board composition is defined by statute and contains a majority of private sector membership from the following industries: oil and gas, financial; aviation; agriculture; and, a value-added manufacturing firm. Additional membership comes from labor, the Board of Regents, the Commanding General of the Kansas Cavalry, the Secretary of the Department of Commerce, and holders of the four Legislative Leadership posts. Kansas Inc. is funded two/thirds by the State of Kansas and one/third through private sector investment.

This study of Kansas' financial industry was identified as a key element of Kansas Inc.'s Fiscal Year 1989 research agenda. Meetings with leading academicians, state and local leaders, business owners/mangers, and economic development professionals culminated in identifying solutions to problems of capital availability as critical to the state. This first effort involved a review of a number objective data sources to develop an understanding of the state's financial industry as it relates to business lending. The Appendices listed with the Table of Contents are available as a second volume.

ACKNOWLEDGMENTS

Kansas Inc. would like to acknowledge the efforts of Mr. Scott Gard and Mr. David Kersley with Scott Gard Associates (SGA) who conducted the research and analysis for this report under contract with Kansas Inc. Jerry Lonergan, Vice-President for Research with Kansas Inc., managed the research.

In addition, many individuals and organizations have had much input and suggestions regarding the direction of this study and the critical subject of capital availability. A partial list of those people include:

Newton Male, Kansas Banking Commissioner, Marshall Crowther, Rex Wiggins, Marty Bloomquist, Tom Holman, Sam Forrer, Sue Anderson, Gary Sherrer, Bill Wolf, Chuck Stones this group participated in round table discussions with the Board of Directors.

Jack Gaumnitz, Kansas University; Carl C. Nielsen, Wichita State University; and, David Ross and Richard Hay, Pittsburg State University for their contributions in a review and critique of a preliminary report draft.

John Walsh, Dick Nichols, and Ladd Seaberg members of the Board of Directors of Kansas Inc. who served as a review committee of the report.

This list only begins to acknowledge the contributions made by many Kansans in making this report possible. While the issues involved with capital availability in Kansas will remain controversial, it is Kansas Inc.'s belief that this report provides a factual base on which future debate can proceed.

Charles R. Warren,
President

TABLE OF CONTENTS

APPENDICES
(Available upon Request)

DIRECTORY OF TABLES

DIRECTORY OF TABLES (Cont'd.)

DIRECTORY OF FIGURES

EXECUTIVE SUMMARY

INTRODUCTION

In the Summer of 1988, Kansas Inc. initiated a study of capital availability in the state in order to determine if public policy options existed that could help assure business owners sufficient capital for creation, growth, and expansion of businesses. As a first step in this process, Scott Gard Associates (SGA) was retained to review and analyze the wealth of data that existed on the financial industry. This executive summary provides an overview of the key findings of the SGA research drawn from the body of the report.

PURPOSE OF THE RESEARCH

The research conducted by SGA seeks to provide an objective analysis of the Kansas financial industry, particularly with regard to commercial and industrial lending in the state. While several sources of financial industry data were readily available, there was no single source that provided an objective overview of the industry. A primary goal of the research project was to elevate discussion of capital availability to a neutral and quantifiable set of information that would provide insight for policy-makers on the state's financial industry. With this project completed, individuals have an additional source of information to use when weighing the very real subjective concerns of business owners, bankers, and communities.

STUDY RESULTS

<u>Banks serve as the key participant in commercial and industrial lending in the State and the study's focus is on commercial banking</u>:

Interviews, reviews of existing reports, and analysis of data indicate that commercial banks are the major supplier of conventional loans for commercial and industrial businesses in the state. Kansas banks, in 1987 reported total deposits of $21.7 billion with 17 percent ($3.7 billion) of the total deposits in commercial/industrial loans. Savings and loans, headquartered in Kansas, during 1987 reported deposits totaling $13.2 billion. Two percent ($0.3 billion) of total deposits in savings and loans was in commercial loans. Credit unions have deposits of slightly more than $1 billion and were not considered significant participants in commercial lending.

A survey of manufacturers in mid-sized Kansas communities indicated banks serve as a source of funds for 54 percent of business expansion. Internal financing is a second major source for expansion funds with 52 percent (respondents could select more than one source). The remaining sources were selected as options less than 10 percent of the time including savings and loans selected as a source by only 3 percent. The magnitude of bank commercial lending and the dependence of business on banks for financing led SGA to focus its commercial/industrial lending analysis on the state's banking industry.

<u>The financial industry has undergone significant change led by the easing of regulation at the federal level, customer interest sensitivity, and competition from non-financial firms</u>:

From a once very highly defined industry, financial institutions have had to adjust and adapt to a permanently changed environment. The impact of these factors has focused on competition for deposits (liabilities to a bank) and not on loans (part of a bank's assets). With automatic teller machines and other technological advances, and competition from non-financial firms a community's pool of investment money is mobile and no longer dependent on local institutions.

<u>From a statewide perspective, Kansas has a highly decentralized and unconcentrated banking industry</u>:

In 1987, 413 communities had commercial banking services. The 413 communities include 306 that had one bank in 1987. Among the 306 one-bank communities, 275 communities are located in counties that contain no metropolitan areas. In these 275 smaller communities, 93 percent of the banks are independent and have average total deposits of $13.7 million. Nearly half the banks in the state are characterized as independent and are the sole provider of commercial banking services in their communities.

In 1987, there were 598 banks in the state with average total deposits of $36 million. Within a five-state region (Kansas and Colorado, Missouri, Nebraska, and Oklahoma), Kansas had the largest number of banks. Nebraska had the lowest average deposit at $34.2 million per bank. Nationally, banks average total deposits of $170 million. Regionally, Missouri's bank deposit average of $75.5 million is twice the Kansas average.

The ten largest banks in Kansas control almost 25 percent of the state's total deposits, this is the lowest share in the region. Oklahoma's ten largest banks control almost 31 percent of total deposits (second lowest share in the region), from this point the share increases to slightly more than 68 percent in Colorado. The formation of larger banks, typically from merger or through acquisition, is a significant national trend. From 1983 to 1987 the number of banks with assets over $100 million increased by 40.3 percent while the number of banks with less than $25 million in assets declined by 22 percent.

<u>Statewide, the Kansas banking industry is not highly concentrated, however, the number of towns with one bank suggests the local market is very concentrated</u>:

SGA conducted a test of concentration, the Herfindahl-Hirschman Index, a factor reflecting the number of banks serving a defined area and the relative size and market dominance of each bank. Out of 105 counties in the State, 88 exceed the federal threshold of a highly concentrated market area.

Smaller banks are heavily dependent on a local economy frequently tied to the health of one or two industries. The smaller banks are subject to loan limits and cannot take advantage of the finance industry's economies of scale. Consequently, they have higher operating costs relative to their asset size. These characteristics of small banks and the concentration at a local level of the State's banking industry force one to ask whether competition is enhanced by 598 banks spread throughout the state, or by a smaller number of larger banks aggressively competing for customers.

<u>Larger banks in Kansas have performed at a level superior to the region's while smaller banks have mirrored the downward trend of similar sized banks in the Tenth Federal Reserve District</u>:

Since 1980, Kansas banks with less than $100 million in assets have reported return on assets comparable to similar sized banks in the Tenth Federal Reserve District. These smaller banks throughout the Tenth District have demonstrated a downward trend in the annual percent return on assets through 1986. In 1987, banks with under $25 million in assets and banks with between $25-$50 million in assets experienced a slight turnaround. These trends reflect the smaller banks' and the region's dependence on agriculture and energy industries which have slumped during the early 1980s.

Kansas banks with assets greater than $100 million have performed significantly better than the Tenth district banks and the State's smaller banks. The better than average performance by larger banks in Kansas is attributable to a more diversified lending base and operating efficiencies. These operating efficiencies are demonstrated by larger banks' operating costs which average 1.7 percent of total assets. At smaller banks, these operating costs averaged 2.53 percent of average assets (banks under $25 million assets) and 2.17 percent (banks between $25 and $50 million assets).

Kansas' ratio of loans to total deposits is 59.8 percent, higher than Nebraska and Oklahoma and below Colorado and Missouri:

The national loan-to-deposit ratio is 79.8 percent, no state among the 5 exceeds the national average. In Kansas, the average loan-to-deposit for banks with assets below $25 million was 50.8 percent compared to 53.4 percent ($25-$50 million), 57.9 percent ($50-$100 million), and 69.0% for banks with assets over $100 million.

An analysis of bank size and lending patterns reveal that there is a statistically significant relationship between bank size and its loan-to-deposit ratio:

* 34.6 percent of all banks have a loan-to-deposit ratio greater than the state average;
* Among the 39 banks with over $100 million in total assets, 61.5 percent have a loan to deposit ratio greater than the state average;
* Almost 48 percent of the 88 banks with assets between $50-$100 million exceed the state average;
* Of the 328 banks with assets under $25 million, 234 (71.3 percent) have loan-to-deposit ratios below the state average.

To determine the economic development potential, SGA conducted a review of the loan ratios for bank lending for commercial/industrial purposes:

* Kansas banks' average commercial/industrial loan-to-deposit ratio is 17.4 percent. Of the 598 total Kansas banks, 136 banks (22.7 percent of all banks) exceed this state average. These 136 banks could be considered the most active and aggressive in business lending in Kansas;

* the 136 banks, in 1987, loaned almost $2.6 billion for commercial/industrial purposes. These banks which represent less than one-fourth of all Kansas banks loaned were responsible for over 69 percent of commercial/industrial loans;

* Over 56 percent (22 banks out of 39) of the state's banks with deposits greater than $100 million exceed the state's average commercial/industrial loan-to-deposit ratio; and,

* Among the 328 banks with less that $25 million in deposits, only 13.1 percent have commercial/industrial loan-to-deposit ratios above the state average.

<u>The research shows that while banks in Kansas' more populated regions will on average be larger and more active as lenders, the extent of loan activity is related to the size of the individual bank not to a town's population or the local economy</u>:

Bank sizes vary on a geographic basis in Kansas with the average larger banks and higher loan-to-deposit ratios in more populated areas. An area, identified as East Urban which includes Johnson, Douglas and Shawnee counties, has significantly higher average bank asset size (over $85 million), deposit growth of over 5 percent from 1986-87, and an average loan-to-deposit ratio of almost 72 percent. The 5-year average return on assets, for this region was .89 percent. In contrast, the smallest banks were located in the Southeast and Northwest area where average deposit size was just over $25 million and loan-to-deposit ratios were 46 percent.

From another perspective, an analysis of the loan-to-deposit ratio suggests bank size is a critical determinant to the extent of lending activity. This relationship between bank size and business lending hold under different socio-economic variables including: communities with populations below 15,000 and with population below 1,000; communities with only one-bank; those communities experiencing declining population; and, communities most dependent on farm income. In all cases, the significant relationship between bank size and commercial/industrial lending is demonstrated, larger banks are more aggressive lenders to the business community.

MAJOR FINDINGS

A key product of the research is the determination that loan capital exists that could fund additional commercial/industrial lending in the state:

SGA estimated that if Kansas banks loaned money at 68 percent of total deposits an additional $2.4 billion in loans would be made. The 68 percent approximates the mid-point between the current rate of lending by Kansas banks (58.9 percent), and the national average loaned by banks (78.8 percent). The commercial/industrial lending potential at Kansas banks, if they could loan at the national level of 25.3%, is over $2.0 billion.

Larger banks regardless of their location lend a larger share of their deposits for commercial/industrial purposes:

Data in the report, support the existence of a significant relationship between bank size and share of deposits used for commercial/industrial loans. Several advantages exist for larger banks that make irrelevant the bank's location in rural or urban areas. These advantages include: bank operation efficiencies; loan officer expertise, and greater loan limits. The question of capital gaps in Kansas is not an urban-rural problem so much as it is a problem of bank size.

All banks in Kansas face a significant amount of competition, primarily for deposit dollars:

Consumer awareness of interest rates in investment decision, the inclination of bank customers to seek the highest interest rate; expanded telecommunication technology; and, national marketing by competitors have all created an era of aggressive competition for depositors' dollars.

CONCLUSION

This study does not suggest that to create economic growth in a rural or declining community, all that is needed is a large bank or more banks. There are several variables beyond the control of local bankers, citizens, and state and local decision-makers. Bank examiners and the quality of existing business projects are included among major hurdles that restrict the banking industries ability to lend to business. However, the research supports the conclusion that consideration should be given to implementation of policies that help ensure the reduction and eventual elimination of barriers to growth in a state's banking industry.

SECTION I: INTRODUCTION

STUDY OBJECTIVES

The State of Kansas has committed substantial resources to promote economic development and diversification in an economy that has had a tradition of reliance on the recently unstable agricultural and energy sectors. The state's economic development program has focused on marketing efforts aimed at attracting new industry and, more recently, promoting various state-administered public and private-public partnership loan programs designed to enhance the availability of capital to Kansas businesses for expansion and growth. The primary objective of this study is to evaluate the availability of debt capital for business expansion from conventional financial institutions. The strengths, weaknesses, and capabilities of these institutions to provide business capital were analyzed in detail.

STUDY APPROACH

In order to achieve the objectives of this study, several distinct research tasks were undertaken to evaluate the capabilities of Kansas financial institutions to meet the debt capital needs of Kansas businesses. These tasks included analyses of the following:

regulatory trends and legal considerations;

financial institution structure;

competitive environment;

financial institution profitability; and,

financial institution lending patterns, as related to:

bank size;

competitive environment and market concentration;

multi-bank or bank holding company affiliation;

market area economic characteristics; and,

market area population growth.

The study required substantial analysis of data obtained from several sources including: the National Credit Union Administration; the Federal Savings and Loan Insurance Corporation; the Federal Reserve System; the Federal Reserve Bank of Kansas City; and, the Federal Deposit Insurance Corporation. In addition, information pertaining to population and economic characteristics of Kansas communities and counties was compiled. The key source of this data was the Kansas Statistical Abstract, published by the Institute for Public Policy and Business Research at the University of Kansas.

Numerous members of the Kansas banking and savings and loan community were interviewed for input concerning lending patterns among financial institutions in the state. Representatives of the Kansas Bankers Association, the Kansas Independent Bankers Association, the Kansas Bank Board, and the American Bankers Association were also contacted regarding the status of financial institutions and current regulations. The state bank commissioners offices and bankers' associations in Kansas and in Nebraska, Iowa, Missouri, Oklahoma, Massachusetts, Indiana, and Florida provided insight and information on bank structure and regulation.

SECTION II: PROFILE OF KANSAS FINANCIAL INSTITUTIONS

This section profiles Kansas financial institutions, including the three major types of depository institutions--banks, savings and loans, and credit unions. The impacts of intra-industry competition, national regulatory changes and the existing structure of Kansas banking is analyzed to provide a basis for evaluating the capabilities of Kansas financial institutions to provide conventional debt capital financing to Kansas businesses.

COMMERCIAL BANKS, SAVINGS AND LOANS, CREDIT UNIONS: A STRUCTURAL OVERVIEW

At year-end 1987, Kansas contained 598 commercial banks[1], 39 savings and loan associations headquartered in Kansas, and 122 credit unions. Credit unions held 3.6% of the state's financial institution deposits at year-end 1987, while savings and loans controlled 36.5% and commercial banks 59.9%. Credit unions extended 3.1% of all credit extended by the state's financial institutions, compared to 52.4% for savings and loans and 44.4% for banks (Table II-1).

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[1] Data for year-end 1987 come from two different sources and results in minor variation in some totals. The report uses two main secondary sources: data from the Federal Reserve Bank of Kansas City; and, Carner Associates data drawn from Federal Depositors' Insurance Corporation tapes. The Federal Reserve data report 599 Kansas banks and include one wholly-owned Kansas trust company. The other data source reports information from only the 598 banks in Kansas.

Table II-1

Kansas Banks, Savings and Loans, and Credit Unions
Analyzed by Assets, Deposits, and Loans
(in Billions of Dollars)

Kansas	Banks	S & Ls*	CUs**	Totals
12/87 Assets	$24.6	$20.5	$1.4	$46.5
12/87 Deposits	$21.7	$13.2	$1.3	$36.2
12/87 Loans	$12.8	$15.1	$0.9	$28.8
% of Total Assets	52.9%	44.1%	3.0%	100.0%
% of Total Deposits	59.9%	36.5%	3.6%	100.0%
% of Total Loans	44.4%	52.4%	3.1%	100.0%

* Excludes out-of-state savings and loans operating in Kansas, the data for which was not available; includes Franklin Savings and others which invest substantially in federally insured pass-through securities which are reported as loans by the FSLIC.

** One recently re-located credit union has been excluded.

NOTE: Due to a rounding factor, percentages shown above may not total one hundred percent.

SOURCES: Federal Deposit Insurance Corporation
Federal Home Loan Bank Board
Federal Savings and Loan Insurance Corporation
National Credit Union Administration

Loan-to-deposit ratios averaged 69% at Kansas credit unions, 114% at savings and loans, and 59% at commercial banks. There are several reasons for the difference in loan-to-deposit ratios among the different types of institutions. For example, regulators and bank examiners differ on acceptable loan ratios within the financial industry. Also, reporting methods vary between these institutions. For example, some mortgage-backed securities held by savings and loans are reported as direct extensions of credit, which accounts for the high loan-to-deposit ratio for savings and loans.

An examination of lending patterns among the three primary types of financial institutions suggests that commercial banks are the primary source of conventional debt capital for the state's business enterprises. Commercial loan data was not available for credit unions, and it is assumed that credit unions do not represent a significant potential source for commercial credit. Total commercial loans and commercial lease financing volumes for savings and loans were summed and divided by total savings and loan deposits, yielding a business loan-to-deposit ratio of 2% and $0.3 billion for all Kansas-headquartered savings and loans, compared to 17% and $3.7 billion for commercial banks in the state (Table II-2).

Savings and loan associations are statutorily empowered to engage in commercial lending activities, but are subject to federal regulations which limit their business lending activity. Some tax and accounting privileges (established by

Table II-2

Loan-to-Deposit and Commercial Loan-to-Deposit Ratios for Kansas Financial Institutions 1987

	Loan-to-Deposit Ratio	Total Loan Volume ($ Billions)	Commercial Loan-to-Deposit Ratio	Total Commercial Loan Volume ($ Billions)
Banks	59%	$12.8	17%	$3.7
Savings and Loans	114%	$15.1	2%	$0.3
Credit Unions	69%	$0.9	-	-

SOURCES: Federal Deposit Insurance Corporation
Federal Home Loan Bank Board
Federal Savings and Loan Insurance Corporation
National Credit Union Administration

the Garn-St. Germain Depository Institutions Act of 1982) are lost if a savings and loan's volume of loans not "directly related to domestic residential real estate" surpass 60% of its tangible assets (as defined in 12 CFR 583.27; qualified thrift lender status). A 60% threshold indicates savings and loans could, in fact, be a major source of commercial or industrial credit. However, the Kansas savings and loan executives that SGA interviewed, during their study, indicated no future plans to deviate from current investment philosophies.

BACKGROUND ON INTRA-INDUSTRY COMPETITION

Historically, the nation's financial institutions enjoyed highly distinct powers with regard to both assets (how banks invested their resources) and liabilities (type and source of deposits and other funds). For example, the activities of savings and loans were primarily restricted to the extension of residential mortgage loans (assets) and savings accounts bearing federally-restricted rates of interest (liabilities).

Significant increases in interest rates and enhanced competition from non-depository firms were two major developments in the 1970s which impacted traditionally-defined roles of commercial banks and other financial service businesses. The significant rise in interest rates led non-depository financial service firms, most notably stock brokerages, to develop "money market" investment vehicles, resulting in substantial competition for deposits among an array of non-depository firms and commercial banks.

Concurrently, many savings and loan associations came under extreme financial stress and were subject to liquidity problems because their income was linked to previously-extended mortgages bearing substantially lower interest rates than were then prevailing in the market. Also, savings and loans faced restrictions on the type of deposit instruments that could be offered to the public (passbook savings accounts) and interest rate regulation. The savings and loans needed to obtain new funds to loan at higher mortgage rates, and to address enhanced competition for deposits from both banks and non-depository firms.

Both banks and savings and loans sought an expanded array of asset (investment) and liability powers. These initiatives culminated in Congressional approval of sweeping changes through deregulation.

The 1980 Depository Institutions Deregulation Act attempted to provide a "level playing field" for financial institutions; the primary effect was to give savings and loans powers similar to those previously reserved for commercial banks: new, flexible, interest-rate deposit instruments (such as money market accounts); and, NOW accounts, which "act like" checking accounts (offering access to savings account funds without actually visiting a savings and loan facility as had been required with passbook savings accounts). The 1980 act also granted additional lending authority to thrifts including consumer and commercial loans.

The 1982 Garn-St. Germain Depository Institutions Act provided for a restructuring of the troubled thrift industry, further broadening the deposit-taking powers of savings and loans. Garn-St. Germain authorized a new "money market deposit account" with no interest-rate-paid ceiling and reduced reserve requirements, and it provided for a removal of any difference in interest rate restrictions between banks and thrifts (Regulation Q). The bill allowed savings and loans to extend commercial loans for the first time so they could provide thrifts with loan diversification opportunities. In an attempt to help troubled thrifts, the bill allowed the federal government to issue net worth certificates, instruments which "acted like capital" for accounting purposes, to give regulators additional flexibility in dealing with savings and loans facing insolvency. As competition among financial institutions increased, the non-depository sector spawned even further competition by offering consumers a more expanded array of services, many of which were closely aligned with those of banks. These competing firms included: consumer loan companies; insurance companies; brokerage firms; and, others. Appendix D provides a list of financial services currently offered by both financial and non-financial institutions and companies.

Bank holding companies emerged as a vehicle by which banks could offer certain products and services pursuant to laws regulating bank holding companies. Regulation Y empowers bank holding companies to engage in certain activities, and offer products that were considered "so closely related to banking or managing or controlling banks as to be a proper incident thereto" as to allow "a bank holding company or a subsidiary thereof" to engage in them. These activities include: making and servicing loans; industrial banking; trust company functions; providing limited investment or financial advice; leasing property; securities brokerage; underwriting government obligations and money market instruments; providing fee-based management consulting services to banks; and, acting as a futures commission merchant (12 CFR. 225.25 - List of Permissible Nonbank Activities; FRB Regulation Y, Section 4(c)(8)).

> (Another provision of Regulation Y relates directly to economic development by allowing bank holding companies "to make equity or debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas by providing housing, services or jobs for residents". While subject to regulatory interpretation, the provision for bank holding company direct equity participation in projects to "promote community welfare" may represent a means for the banking community to engage quite directly in economic development initiatives.)

Because of deregulation, dynamic financial markets, and provision of historically traditional banking products and services by non-depository firms, the competitive environment for financial services has changed dramatically in the last ten years. The impact of deregulation on banks and savings and loans, however, has primarily been in competition for deposits rather than for assets (loans).

STUDY FOCUSES ON BANKS

Kansas savings and loans were excluded from a detailed analysis of lending behavior, given the study's focus on business capital lending. The primary reasons were: savings and loans still have certain statutory limits on commercial lending; they appear to be not actively engaged in commercial lending; and, as indicated by savings and loan executives, have no future plans to enter the commercial lending market. Credit unions are not now and do not appear to be future participants in business lending in Kansas.

Besides the analysis of deposits and loans, other data available suggests that banks are a primary source of financing, particularly for Kansas business expansion. Table II-3 indicates that 54% of business firms surveyed reported financing from banks as a source for expansion capital. Only 2% and 3% (respectively) reported financing sources from credit unions and savings and loans.

Thus, the focus of this study is appropriately upon commercial banks as the state's primary potential source of conventionally financed commercial and industrial-related debt capital.

Table II-3

Survey Responses of Firms to Question of How Expanison Is Financ
By Firms Located in Mid-Size Kansas Communities
with Population Sizes of 10,000 to 100,000

Bank	Credit Union	Savings and Loan	Internal Financing	Private Sources	Small Business Admin.	Certified Dev. Comp.	Industrial Revenue Bonds
54%	2%	3%	52%	7%	3%	1%	4%

n = 828

NOTE: Since firms could give more than one source, total percentages may not add to 100%.

SOURCE: Business Retention and Expansion Survey for Kansas Mid-Size Communities with Populations of 10,000 to 100,000, Institute for Public Policy and Business Research, The University of Kansas

REGIONAL AND KANSAS BANKING STRUCTURE

An analysis of banking structure focuses on the three major categories of bank ownership characteristics--multi-bank holding companies, one-bank holding companies, and independent banks. Banks affiliated with multi-bank holding companies are owned by a holding company controlling a minimum of two commercial bank subsidiaries. One-bank holding company banks are the singular bank subsidiary. Independent banks are owned directly by individual stockholders and are not directly affiliated with another bank or bank holding company.

Multi-bank holding company status gives banks an opportunity to share cost for services. The holding company is capable of borrowing money for stock purchase and can establish subsidiary companies to provide insurance, stock-brokerage, and other services to member banks. One-bank holding company banks have the same legal and operational advantages of multi-bank affiliates and differ only in that they are the single bank in the holding company, as defined by 12 CFR 225.2; FRB Regulation Y, Sub-part A (b)(1).

In analyzing bank structure, there is a distinction between concentration of banking deposits at the state level and at the county level within the state. Bank deposits can be highly unconcentrated at the state level with the state's larger banks controlling a very small percentage of the state's total deposits while also having many counties in the state that are highly concentrated with a small number of institutions controlling 100% of the county's deposits.

In comparison to other states, on a state-wide basis, Kansas has a highly decentralized and unconcentrated banking system. Kansas multi-bank holding companies control only 26.3% of the state's deposits, the lowest in the seven-state Tenth Federal Reserve District which had an average of 53% of multi-bank holding company-controlled deposits. Missouri and Colorado recorded 71% and 74.3%, respectively, for multi-bank-controlled deposits (Table II-4).

The concentration of deposits among multi-banks increased in the seven-state region from an average of 39.5% in 1983 to the current 1987 level of 53%. Because Kansas did not allow multi-banking until 1985, the concentration of deposits has expanded for this group from basically zero to its current 26.3% level with 28 multi-bank holding companies representing 68 affiliate banks. Of the $57 billion deposit base controlled by Kansas multi-banking firms, approximately 37% is controlled by Fourth Financial Corporation, the largest multi-bank holding company in Kansas.

A regional comparison of the deposit concentration among the ten largest banking organizations in each state provides a further analysis of banking structure. In 1982, the ten largest banks in Kansas controlled 17.15% of the state's total banking deposits and by 1987 this percentage had increased to 25.96%. (Table II-5).

The ten largest banking organizations in 1987 operated only 26 affiliate banks (just over 4% of the state's total

Table II-4

Regional State Deposit Summary
by Type of Ownership Structure

State	Multibank Holding Company: Deposits ($ Billions)	Multibank Holding Company: Number of Organizations	Multibank Holding Company: Number of Banks	Multibank Holding Company: Percent of State Deposits	One-Bank Holding Company: Deposits ($ Billions)	One-Bank Holding Company: Number of Organizations	One-Bank Holding Company: Percent of State Deposits	Independent Bank: Deposits ($ Billions)	Independent Bank: Number of Banks	Independent Bank: Percent of State Deposits
Colorado	$15.2	32	223	74.3	$3.4	118	16.9	$1.8	90	8.8
Kansas	$5.7	28	68	26.3	$12.9	373	59.5	$3.1	158	14.2
Missouri	$31.9	43	241	71.0	$8.7	200	19.3	$4.4	154	9.7
Nebraska	$4.8	19	49	33.5	$7.7	256	53.7	$1.8	116	12.8
New Mexico	$4.7	8	41	56.1	$3.1	33	37.0	$0.6	20	6.9
Oklahoma	$7.9	22	64	33.5	$11.9	279	49.9	$3.9	144	16.6
Wyoming	$2.5	11	58	64.9	$0.7	25	19.4	$0.6	19	15.7
Regional Total 1987	$72.7	163	744	53.0	$48.4	1,284	35.2	$16.2	701	11.8
Regional Total 1983	$47.7	99	636	39.5	$52.7	1,375	43.6	$20.3	948	16.8

SOURCE: Federal Reserve Bank of Kansas City
1988 Annual Banking Studies

Table II-5

Deposit Concentration
in Ten Largest Banking Organizations
By States Located in Tenth Federal Reserve District
1982 and 1987

	CO	KS	MO	NE	NM	OK	WY
1982:							
Deposits for 10 Largest Banks	$11,594	$2,838	$18,574	$3,368	$4,594	$8,355	$2,175
Total State Deposits	$16,419	$16,549	$31,947	$11,429	$6,629	$25,158	$3,588
10 Banks as Percent of State Deposits	70.6%	17.1%	58.1%	29.5%	69.3%	33.2%	60.6%
Number of Banks Operated by 10 Largest Banks	133	13	205	14	40	10	48
Total Number of Banks in the State	374	620	732	461	92	509	111
10 Banks as a Percent of Total	35.6%	2.1%	28.0%	3.0%	43.5%	2.0%	43.2%
1987:							
Deposits for 10 Largest Banks	$13,975	$5,612	$29,258	$5,462	$5,984	$7,352	$2,540
Total State Deposits	$20,444	$21,620	$44,926	$14,418	$8,375	$23,721	$3,798
10 Banks as Percent of State Deposits	68.4%	26.0%	65.1%	37.9%	71.4%	31.0%	66.9%
Number of Banks Operated by 10 Largest Banks	164	26	139	24	40	36	52
Total Number of Banks in the State	431	599	595	421	94	487	102
10 Banks as a Percent of Total	38.1%	4.3%	23.4%	5.7%	42.6%	7.4%	51.0%

SOURCE: Federal Reserve Bank of Kansas City banks), as compared to significantly higher numbers of subsidiaries in the other Federal Reserve District states. The ten largest banking organizations in Missouri and Colorado each control at least 65% of the states' deposits and own 23% (139) and 38% (164), respectively, of the banks operating in the states. A 1984 study by the Council for Community Development found that Kansas ranked 51st among all states and the District of Columbia in statewide concentration of commercial bank assets.

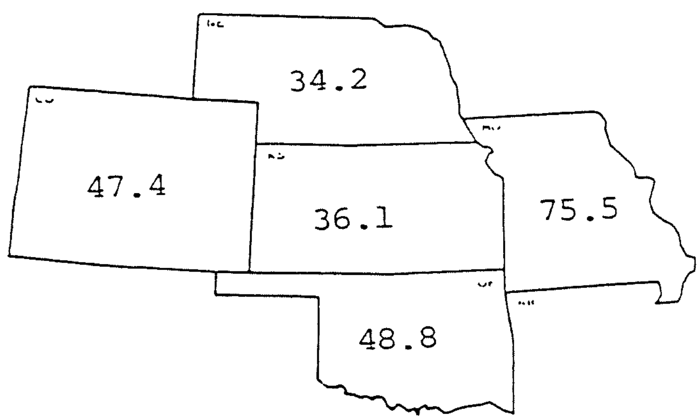
Kansas had the lowest banking concentration in the seven-state comparison area. Kansas and Nebraska were comparable with low deposit concentrations, which may reflect similarities in their banking laws. Both states are restrictive in terms of branch banking and were comparatively late in allowing multi-banking.

At year-end 1987, the Federal Reserve Bank of Kansas City reported there were 599 banks in Kansas, the average total deposits was $36 million. The Kansas average was significantly smaller than the national average of $170 million (13,701 total banks). Within the immediate five-state region, Kansas was comparable in average bank size to Nebraska, which was only slightly below Kansas, with an average size of $342 million. On the average, Missouri banks ($755 million) are twice as large as Kansas banks (Figure II-1).

Loan-to-deposit ratios for banks in Kansas (59%) were below Colorado (64%) and Missouri (76%) and slightly above

Figure II-1

Average Bank Size
in Midwest Region
(Deposits in $Millions)



Iowa, Nebraska, and Oklahoma (50.2%, 56.5%, and 55.1%, respectively). The state loan-to-deposit ratios corresponded closely with bank deposit concentration levels in the respective states where Missouri and Colorado also exhibited significantly higher deposit concentrations among their ten largest banking organizations.

Only 6.5% of assets nationally are controlled by independent banks, compared to just over 18% in Kansas. Nationally, 77% of banking assets are controlled by multi-bank holding companies, compared to 28% in Kansas. Kansas multi-bank organizations control 26% of the state's banking deposits (Table II-6).

The number of banks nationally with assets under $25 million has declined significantly from 5,863 banks in 1983 to 4,573 banks by 1987. Conversely, the number of banks with assets over $100 million increased from 1,936 to 2,717 during the same time period (Table II-7 and Figures II-2 and II-3). To a lesser degree, bank concentration has occurred in Kansas. During the same time period, while total assets did increase for banks with under $25 million (13.1 percent, just over $500 million) there was a much larger increase in total assets for banks with more than $100 million in assets (26.3 percent, almost $2.5 billion). Changes to Kansas banking laws, that became effective in 1986, creating more options for banks to branch or merge will most likely result in additional Kansas consolidation.

Table II-6

Bank Asset Summary
by Type of Ownership Structure

	Percent of Assets Controlled by			
	Multibank Holding Companies	One-Bank Holding Companies	Independent Banks	Total
Kansas	28.1%	53.6%	18.3%	100.0%
United States	77.0%	16.5%	6.5%	100.0%

SOURCE: Carner Associates and Sheshunoff

Table II-7

National and Kansas Bank Consolidation Trends
By Asset Size and Number of Banks

	Banks by Asset Size		
	Under $25 Million	$25 to $100 Million	Over $100 Million
UNITED STATES			
Assets:			
Total 1983	$83,565	$355,014	$1,903,211
Total 1987	$68,756	$330,965	$2,601,239
Percent Change	-17.72%	-6.77%	36.68%
Banks:			
Number of Banks	5,863	6,665	1,936
Number of Banks	4,573	6,411	2,717
Percent Change	-22.00%	-3.81%	40.34%
KANSAS			
Assets:			
Total 1983	$3,489	$9,234	$6,865
Total 1987	$4,018	$11,301	$9,319
Percent Change	13.17%	18.29%	26.33%
Banks:			
Number of Banks	368	224	31
Number of Banks	328	231	39
Percent Change	-12.20%	3.03%	20.51%

SOURCE: FDIC Reports 1983 and 1987

PERCENT CHANGE IN BANK NUMBERS 1983–87

KANSAS & U.S. BY BANK SIZE

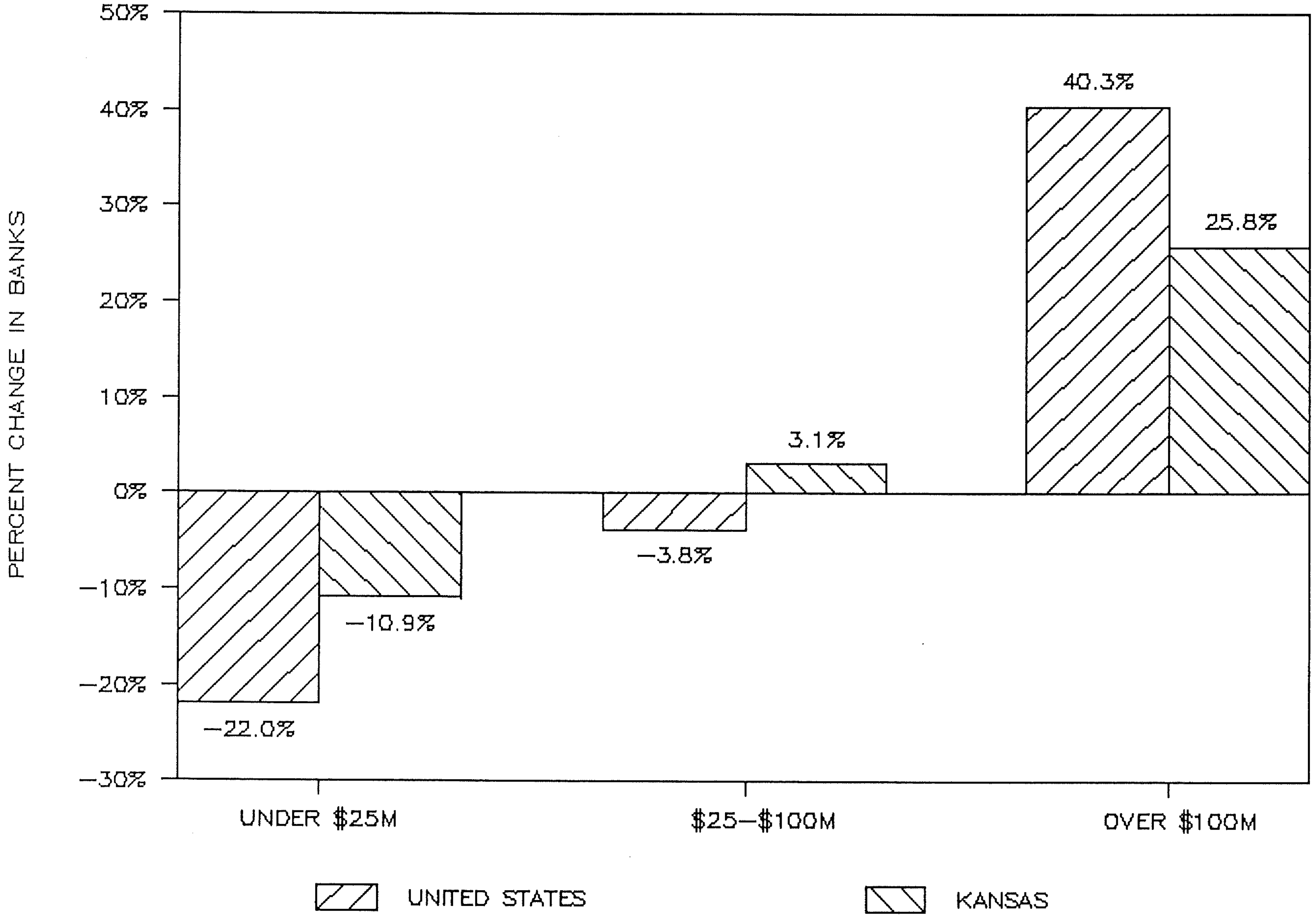


FIGURE II-2

PERCENT CHANGE IN TOTAL ASSETS 1983–87

KANSAS & U.S. BY BANK SIZE

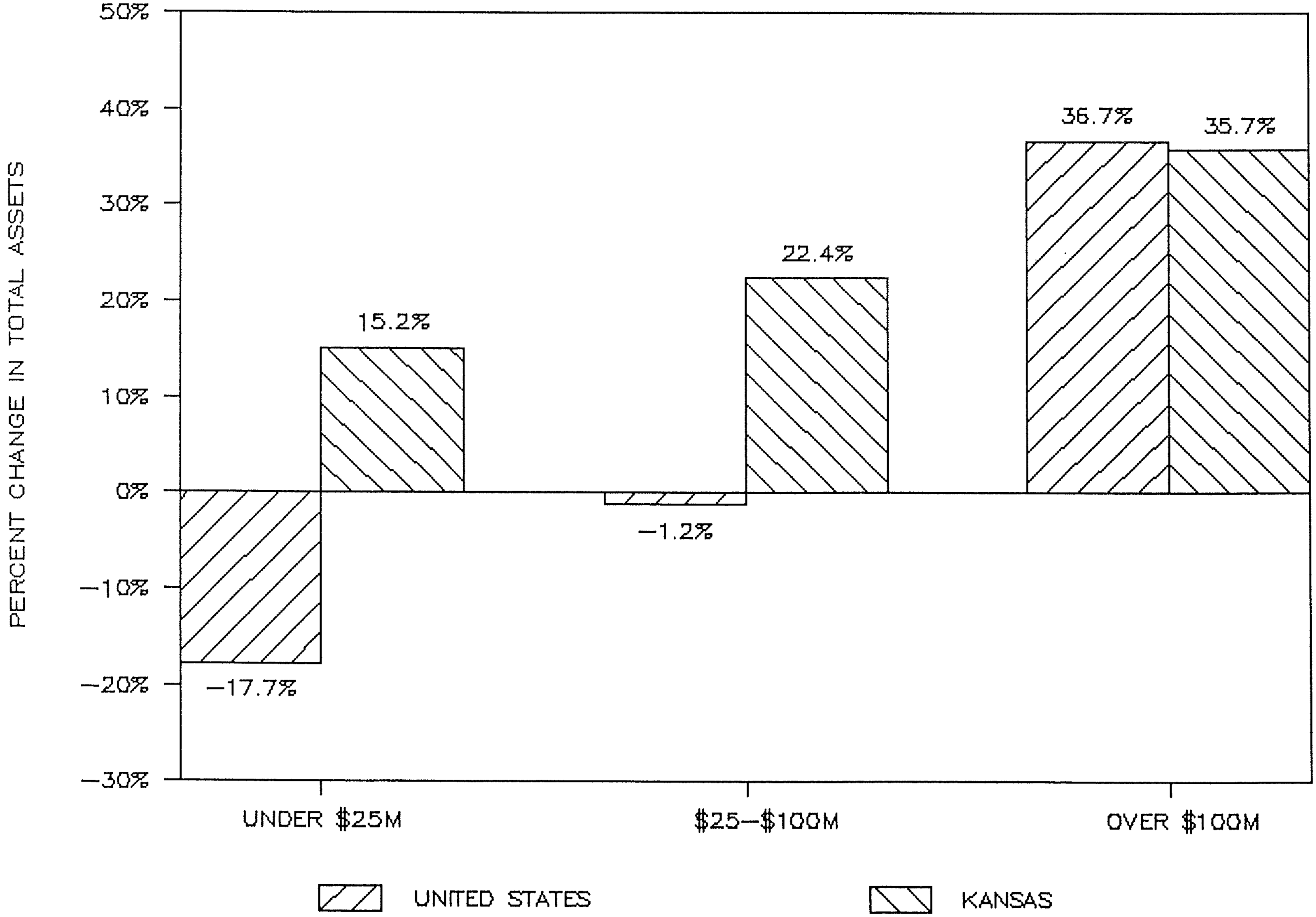


FIGURE II-3

Since July 1, 1986, the Kansas Bank Board has approved 70 bank branching requests. These include:

13 branches created due to bank mergers;

40 new branch locations approved;

10 branches as a result of bank closings; and,

7 branches from local banks leaving the community for another and then branching back to the original home community.

The seven banks that left their home community and branched back were all banks with assets below $25 million, and only one was located in a community with more than 1,000 people.

OVERVIEW OF INTRA-STATE REGIONAL STRUCTURE

For purposes of evaluating structure on an intra-state regional basis, bank deposits and other information on banks was aggregated within seven distinct regions within Kansas: north- west; south-west; north-central; south-central; north-east; east-urban; and, south-east (Figure II-4).

Banks located in the east-urban region in Johnson, Wyandotte, Douglas, and Shawnee counties were larger, had higher loan-to-deposit ratios, were more profitable, and exhibited higher returns on their assets. Banks in the north-west and south-east regions exhibited relatively low loan-to-deposit ratios and, on the average, were relatively less profitable with lower return on asset figures. The loan potential for each region was estimated using a target of a 68%

Kansas Sub-Regions

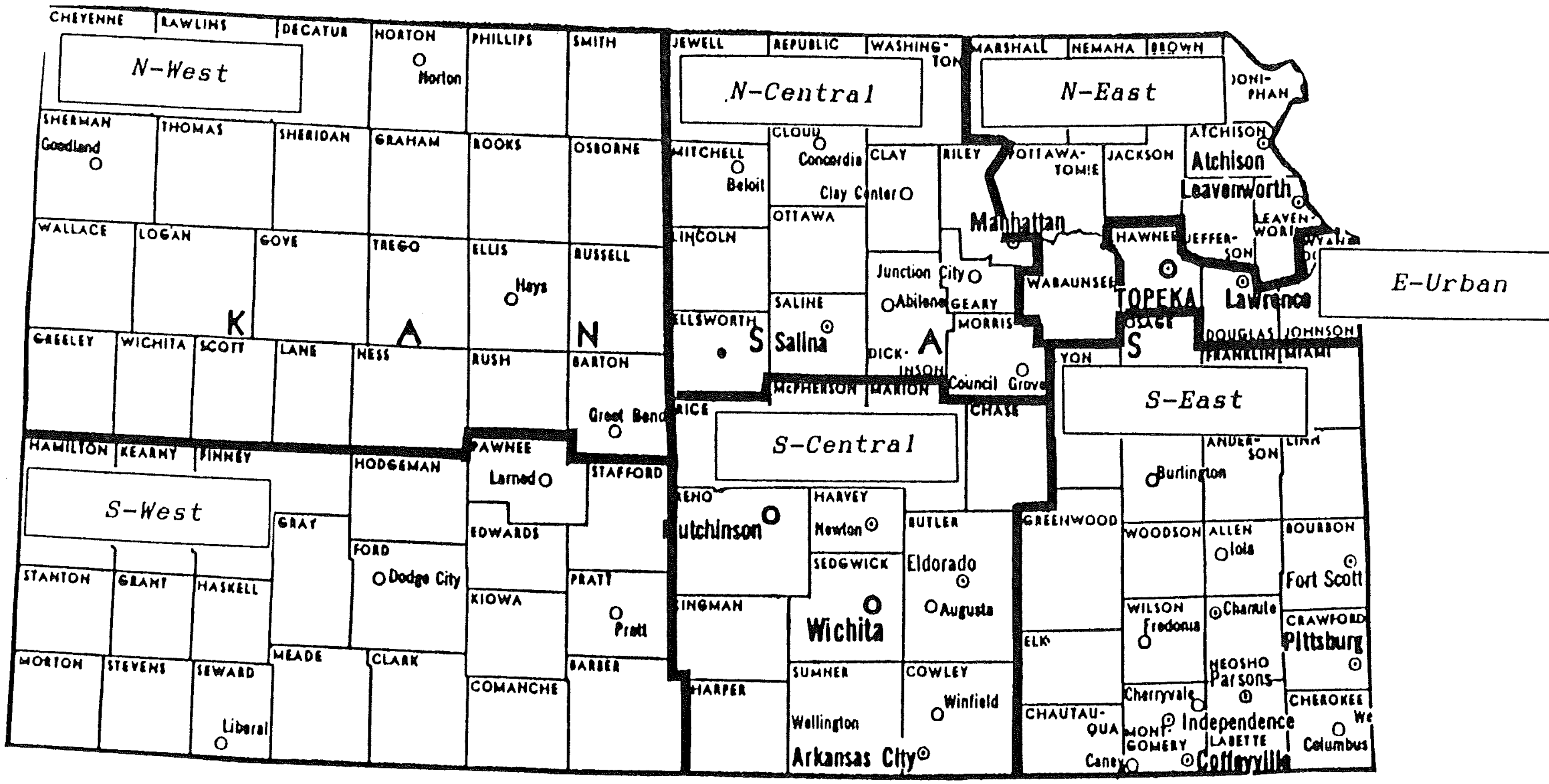


FIGURE II-4

loan-to-deposit ratio, which is approximately one-half the difference between the current Kansas average and the national average. Based on this analysis, if sufficient demand from business projects existed, there would be adequate business development capital for the state, and for the individual regions, to meet increased demands for capital (Table II-8).

MEASURES OF KANSAS BANKING COMPETITION

The Herfindahl-Hirschman Index (HHI) analysis is used to measure competition throughout the state on a county-by-county basis. HHI is a commonly accepted measure of competition used by the Federal Reserve, the Comptroller of the Currency and the US Department of Justice. HHI reflects not only the number of banks serving a defined geographic market area, but also the relative size and market dominance of each bank. Each bank's market share is squared to establish an HHI factor for each bank, and the sum of the HHI factors for each bank in the market results in the market HHI. With a range potential of .01 to 10,000, federal authorities consider a market with an HHI of 1,200 to be moderately concentrated, and an HHI of 1,800 or above is considered reflective of a highly concentrated market area.

For purposes of this study, the county was selected as the trade area for the HHI analysis. In 88 of 105 Kansas counties, the commercial bank HHI exceeds the threshold of high concentration of 1,800. Only Johnson County would be

Table II-8

Kansas Banks
Sub-Regional Analysis
Key Performance Characteristics

Region	Loan-to-Deposit Ratio	Deposit Growth Rate 86-87	Average Bank Size ($ Millions)	5-Year Average R.O.A.	Unrealized Loan Potential ($ Millions)*
N-West	46.23%	-2.01%	$25.46	0.52	$436
S-West	54.85%	2.02%	$29.31	0.76	$237
N-Central	52.19%	-1.58%	$23.58	0.62	$299
S-Central	59.94%	-1.47%	$45.13	0.76	$467
N-East	54.94%	6.77%	$19.42	0.78	$219
E-Urban	71.91%	5.02%	$85.38	0.89	$101*
S-East	46.16%	-0.39%	$25.08	0.57	$593

* The unrealized loan potential estimate is based on the assumption that banks in Kansas could achieve a 68% loan-to-deposit ratio. This is approximately one-half the difference between the current Kansas loan-to-deposit ratio and the national loan-to-deposit ratio of 79%.

** Although this region exceeds the 68% target, Douglas and Shawnee counties had a combined unrealized loan potential of $101 million.

SOURCES: Carner Associates and FDIC Computer Tapes

determined to be less than "moderately concentrated" under such an analysis (HHI under 1,200). Individual Kansas county HHI tabulations are contained in Appendix E.

There were, in 1987, 413 communities in Kansas with commercial banking services. In 306 of these, there is only one bank. The majority of these one-bank communities (275) are located in counties that contain no metropolitan areas. Within these non-metropolitan, one-bank communities (which have an average population of 825), 93% of those banks are independent, with average deposits of $13.7 million. Nearly half the banks in the state are characterized as independent and as the singular provider of commercial banking services in their communities.

PERFORMANCE OF KANSAS BANKS

An examination of bank performance is helpful in examining bank structure. Operating performance and income potentials are critically important elements in examining and forecasting structural change. The banking industry has undergone unprecedented change since the early 1980s. Deregulation on geographic expansion and entry into the financial services arena has resulted in a growing number of non-bank firms competing for a community's sources of deposits which have traditionally been the local bank's source of lending capital. Increased competition also impacts the costs banks incur in obtaining deposits, creating a major competitive challenge for all banks.

The most appropriate basis for a comparative overview of bank performance is based upon size, or "class," of bank. Historically, it has been demonstrated that aggregated analyses are more accurate when banks are grouped by size rather than other characteristics, such as geographic location or primary lending focus. In this report, performance and other data is provided using the following class categories:

> banks with assets of less than $25 million;
> banks between $25 and $50 million in assets;
> $50 to $100 million in bank assets; and,
> those bank with assets over $100 million.

Table II-9 provides an analysis of bank profitability based on bank asset size for Kansas and the Tenth Federal Reserve District.

Performance of Small Banks

Regionally, earnings among small banks (under $25 million in assets), while being positive in all but one year, declined each year from 1980 through 1986 (Figure II-5). This earnings decline can be partly attributed to economic downturns in agriculture and energy sectors.

In Kansas and the region, small banks showed some earnings recovery in 1987. A 1987 staff study by SGA determined that earnings of the group of small banks in Kansas were linked to the performance of agricultural loans, which, ultimately, were linked to net agricultural income.

Table II-9

Bank Performance Data by Bank Size
Return on Assets for Kansas Banks
and Tenth Federal Reserve District Banks*

Banks by Asset Size (in Millions)

	<$25 M		$25-$50 M		$50-$100 M		>$100 M	
Year	Kansas	10th Dis.	Kansas	10th Dis.	Kansas	10th Dis.	Kansas	10th Dis.
1980	1.32	1.49	1.35	1.48	1.22	1.36	0.91	0.96
1981	1.33	1.46	1.20	1.45	1.18	1.39	0.96	0.99
1982	1.21	1.23	1.15	1.31	1.25	1.32	0.89	0.74
1983	0.97	0.96	0.98	0.99	1.09	0.99	0.93	0.67
1984	0.52	0.49	0.73	0.69	0.71	0.83	0.86	0.55
1985	0.23	0.20	0.64	0.54	0.65	0.53	0.96	0.45
1986	-0.01	-0.02	0.45	0.31	0.70	0.26	0.88	0.27
1987	0.30	0.14	0.55	0.38	0.32	0.38	0.96	0.44

* Tenth Federal Reserve District includes Kansas, Colorado, Oklahoma, Nebraska, Wyoming, the western part of Missouri, and the northern part of New Mexico.

SOURCES: Carner Associates and FDIC Computer Tapes

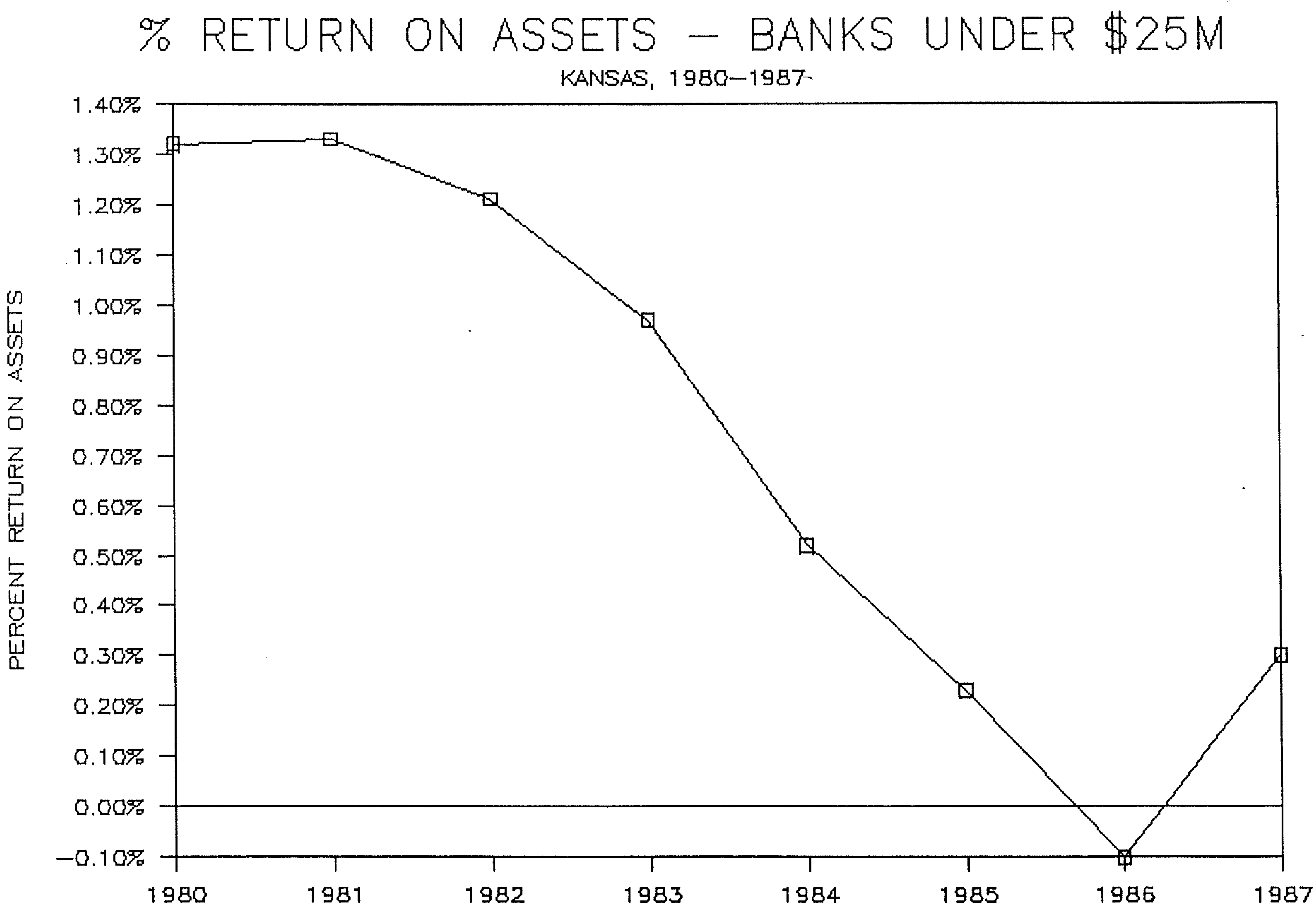

% RETURN ON ASSETS — BANKS UNDER $25M
KANSAS, 1980—1987
PERCENT RETURN ON ASSETS
1.40%
1.30%
1.20%
1.10%
1.00%
0.90%
0.80%
0.70%
0.60%
0.50%
0.40%
0.30%
0.20%
0.10%
0.00%
−0.10%
1980
1981
1982
1983
1984
1985
1986
1987

FIGURE II-5

Performance of Medium-Class Banks

As a group, banks with assets of $25 to $50 million, in both the Tenth Federal Reserve District and Kansas, displayed earnings decline comparable to the smaller banks. With the return on assets declining through 1986 then posting a slight earnings recovery in 1987 (Figure II-6).

The increase was primarily due to decreased provisions for loan losses at these banks. As with their smaller counterparts, these banks generally were unable to realize the full potential of a decrease in the net cost of funds, even though net interest margins were higher. This may be partially due to a decrease in loan volume and increasing reliance on securities investments. Net operating expense increased significantly for the group.

Also contributing to the income increase, as with smaller banks, was an apparent liquidation of a portion of the bond portfolio, suggested by uncharacteristic growth in return on that portion of their assets as well as a reduction in the net dollar value thereof.

In comparing earnings of this size (and all medium to larger bank groups) with the smaller class of banks, it is important to note that the relatively greater operating efficiencies of larger banks contribute to comparatively more favorable earnings performance (Appendix A).

Overhead expense, measured as a percentage of average assets, was 2.53% in 1987 for banks with less than $25 million

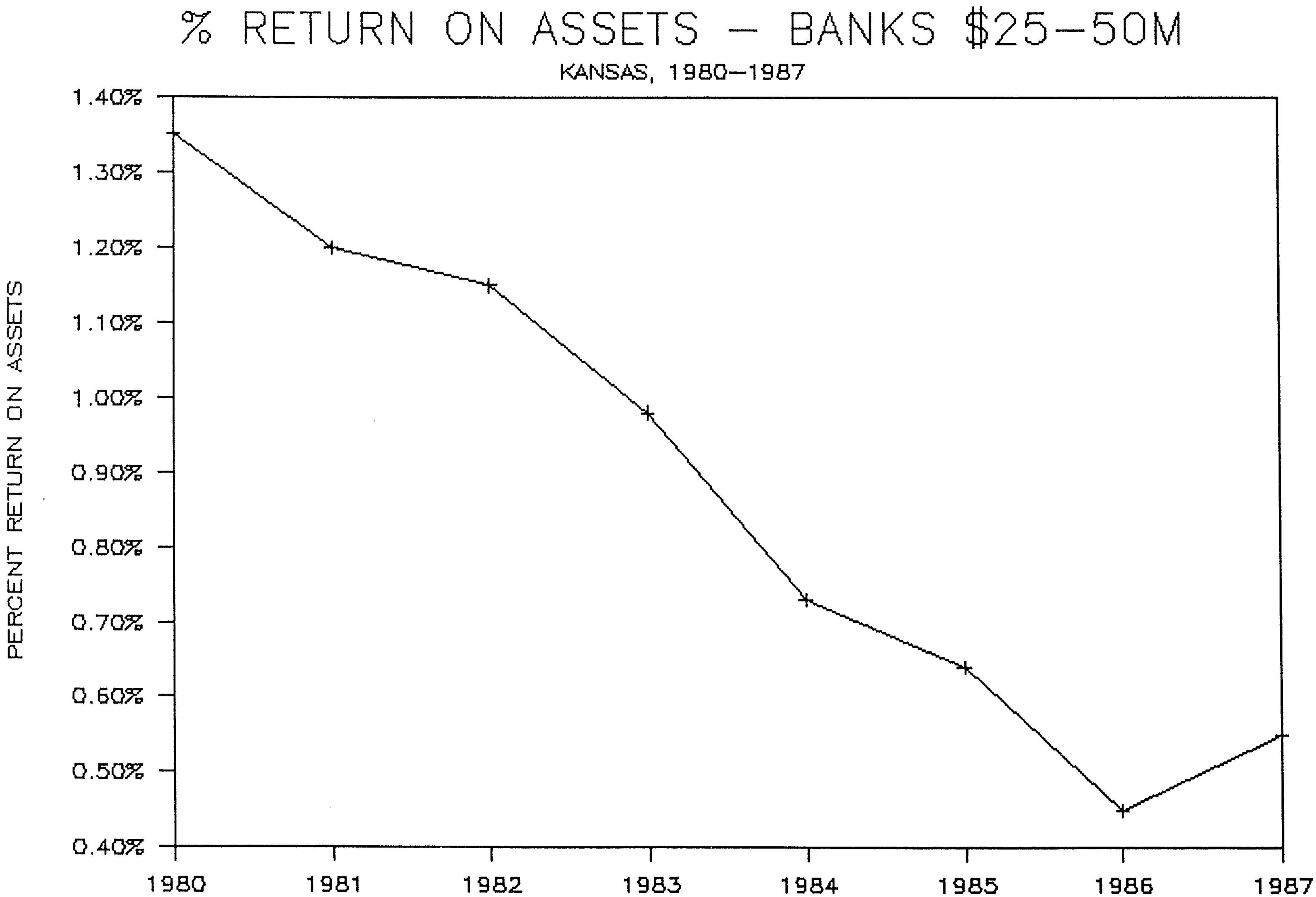

% RETURN ON ASSETS - BANKS $25-50M
KANSAS, 1980-1987
PERCENT RETURN ON ASSETS
1.40%
1.30%
1.20%
1.10%
1.00%
0.90%
0.80%
0.70%
0.60%
0.50%
0.40%
1980
1981
1982
1983
1984
1985
1986
1987

FIGURE II-6

in assets. Banks between $25 to $50 million in assets had average operating expenses of 2.17% of assets. If smaller Kansas banks could have achieved the same relative overhead expense as their counterparts in the next larger class, they would have posted a return on average assets of .66%, compared to the .30% return on assets actually realized.

Similarly, if banks in the $25 to $50 million class had achieved the same efficiencies as large banks (over $100 million), their return on assets would have averaged .98% in 1987 versus the .55% actually achieved.

Banks with assets of $50 to $100 million experienced a slight earnings increase across the Tenth Federal Reserve District in 1986 and then declined significantly in 1987 (Figure II-7). This decline in earnings from .70% in 1986 to .32% in 1987 is largely attributable to a significant increase in overhead expense. Overhead expense as a percentage of assets rose for this bank group by 18% in 1987.

Earnings Performance of Large Banks

Regional earnings among large banks remained positive yet declined in recent years, primarily because of poor performance of energy loans in oil producing states. The rapid decline in oil prices in 1986 and 1987 resulted in massive loan problems, especially for banks in Oklahoma. Earnings did improve slightly for the group in 1987 after a six-year low in 1986.

Large Kansas banks, on the other hand, have been

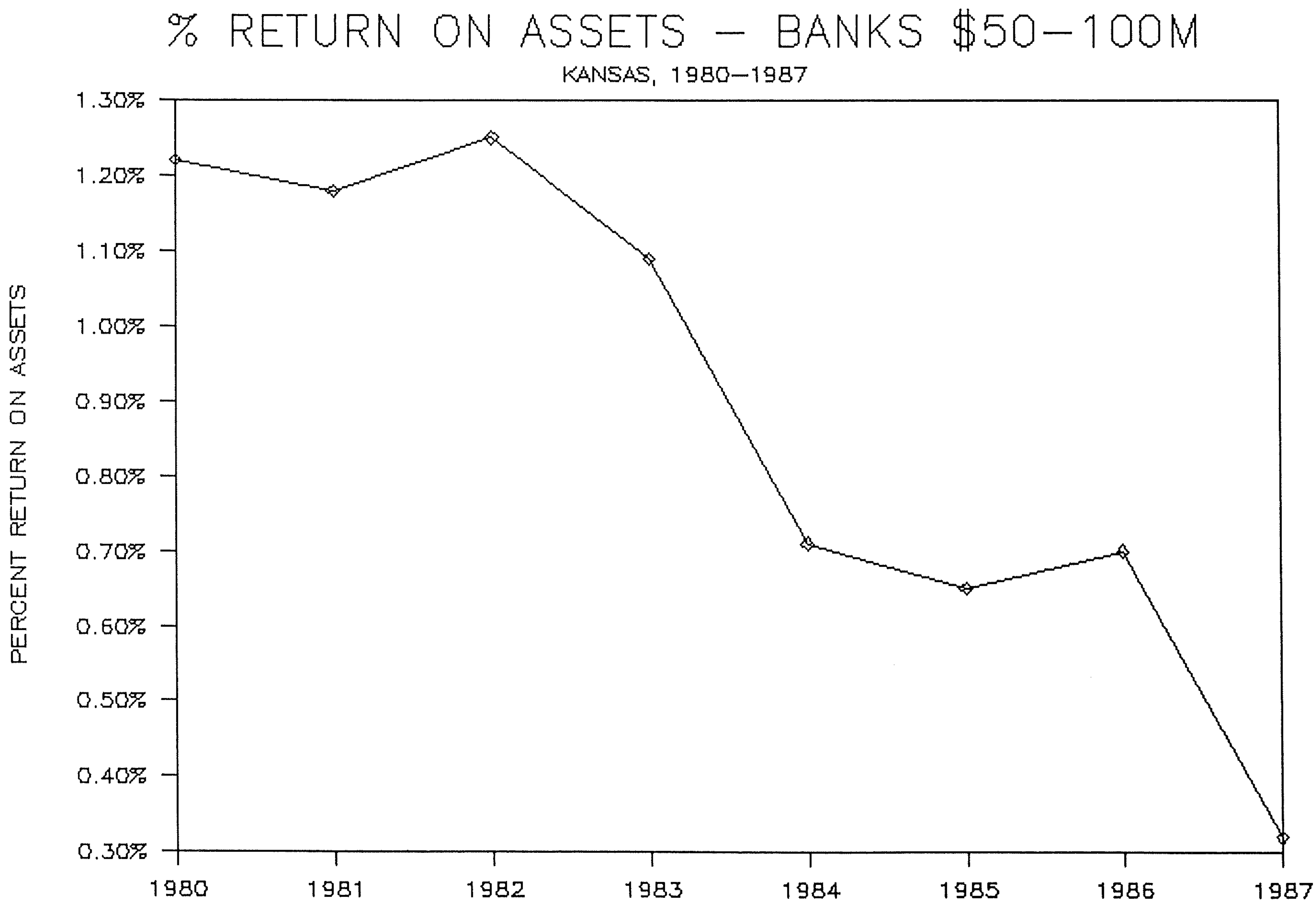

% RETURN ON ASSETS - BANKS $50-100M
KANSAS, 1980-1987
PERCENT RETURN ON ASSETS
1.30%
1.20%
1.10%
1.00%
0.90%
0.80%
0.70%
0.60%
0.50%
0.40%
0.30%
1980
1981
1982
1983
1984
1985
1986
1987

FIGURE II-7

out-performing their regional counterparts since 1982. These banks have experience consistent return on assets and reported .96% for 1987 (Figure II-8).

Large bank earnings are bolstered by consistently lower levels of operating efficiency and benefit from the ability to diversify their lending portfolio. Even though operating costs for large banks rose by eight percent in 1987 (average 1.74% of total assets) average operating costs as a percent of assets remain lower for this bank size than other classes of Kansas banks. If large banks in the state had experienced, on a percentage basis, the same levels of operating costs as the smallest class of banks, return on assets for 1987 would have been .17%, compared to the actual earnings rate of .96%.

It should also be noted that operating costs among large Kansas banks, as measured by occupancy, administrative and marketing expense as a percentage of total assets, is lower in Kansas than in other states in the Tenth Federal Reserve District.

Provisions for non-performing loans among large banks declined, both regionally and in Kansas. While net interest margins were lower across the District, they increased slightly for large Kansas banks, from 3.64% in 1986 to 3.71% in 1987.

Comparison of Earnings among all Bank Sizes

Figure II-9, displays the earnings of Kansas banks by different asset size for the 1980 to 1987 period. During the

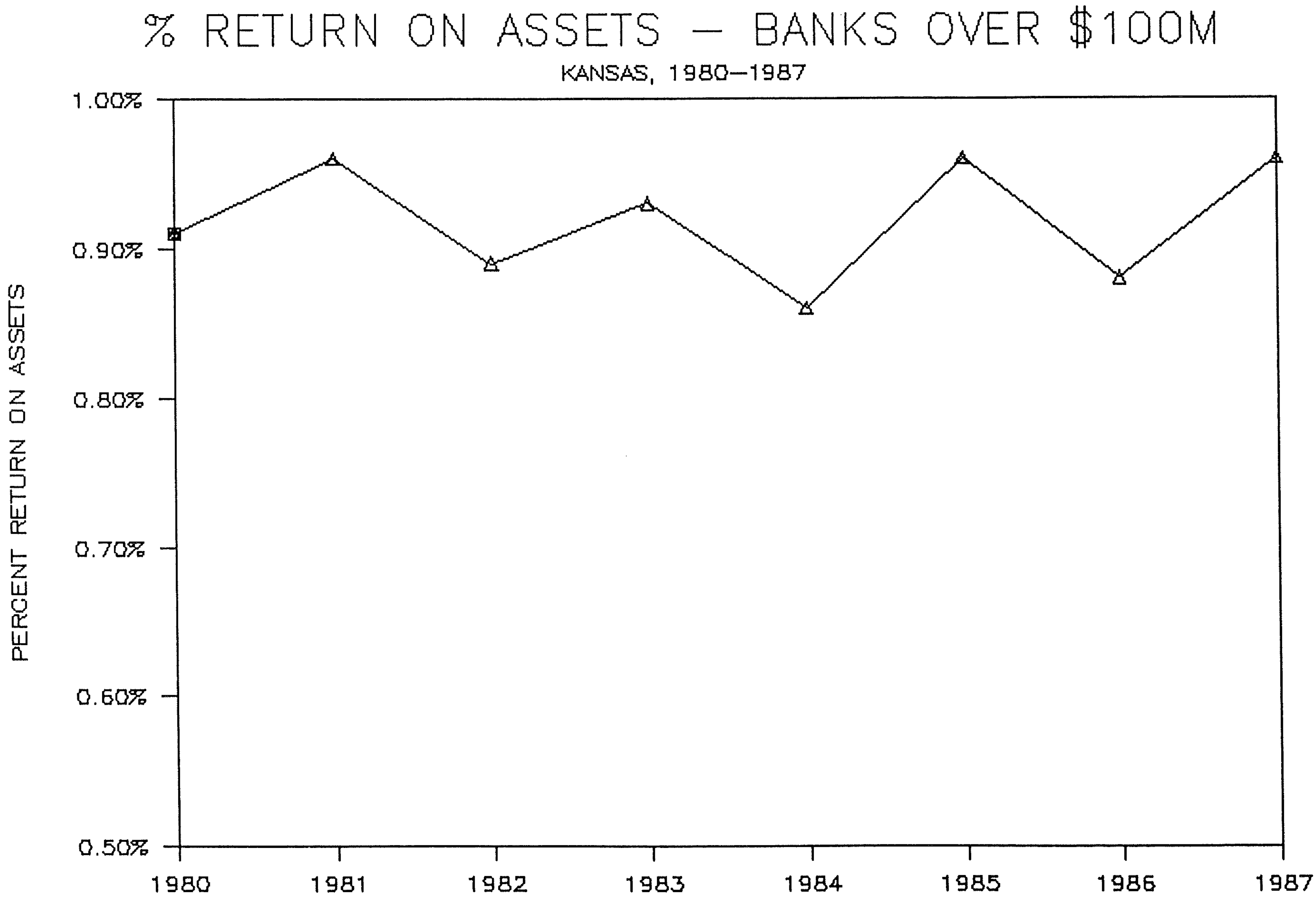

% RETURN ON ASSETS — BANKS OVER $100M
KANSAS, 1980—1987
1.00%
0.90%
0.80%
0.70%
0.60%
0.50%
PERCENT RETURN ON ASSETS
1980
1981
1982
1983
1984
1985
1986
1987

FIGURE II-8

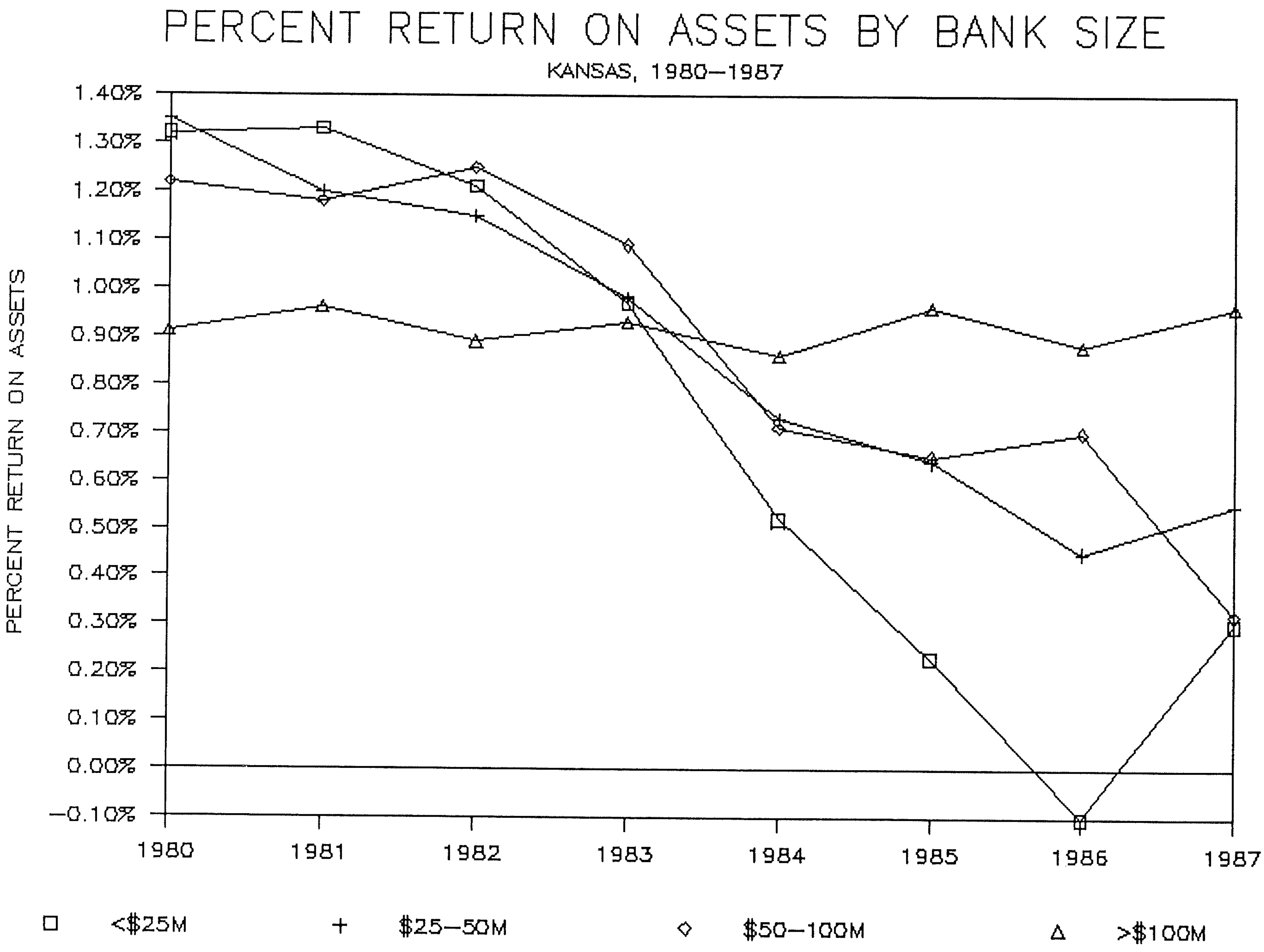

PERCENT RETURN ON ASSETS BY BANK SIZE
KANSAS, 1980–1987
PERCENT RETURN ON ASSETS
1.40%
1.30%
1.20%
1.10%
1.00%
0.90%
0.80%
0.70%
0.60%
0.50%
0.40%
0.30%
0.20%
0.10%
0.00%
–0.10%
1980
1981
1982
1983
1984
1985
1986
1987
<$25M
$25–50M
$50–100M
>$100M

FIGURE II-9

early period smaller banks were able to out-perform larger banks until the decline in both agriculture and the oil industry. After 1982, small to medium banks' earnings, while still positive, declined sharply while earnings at larger banks were consistent and greater than the smaller banks. The larger banks success during this period, when Kansas has been experiencing sustained economic growth, is partly attributable to their ability to diversify and not be dependent upon the performance of only a few local industries.

SECTION III: KANSAS BANK LENDING PATTERNS

GENERAL METHODOLOGY

The study focused on analysis of lending patterns by bank size for the year 1987. Particular focus was placed on number of banks that lend money at rates greater than the state average for both all loans and for commercial/industrial loans. Data were also reviewed for the year 1983. The similarity of the loan patterns by bank size in the two year strengthens interpretations that may be drawn from 1987 data. These two years are important because they capture periods when the Kansas economy was operating at two extreme levels. The trough of the early 1980s recession occurred in 1983 and since that time the Kansas economy has benefited from a fairly healthy expansion.

The analysis for 1987 also focused on several socio-economic variables and the relationship between bank size and lending patterns under these variables. The variables include the size of bank, simple economic indicators, competitive market environment, ownership and affiliation, operational efficiency, indicators of market economic trends, and other factors.

Bank data were compiled from balance sheet and income/expense data reported by Kansas commercial banks at year-end 1983 and 1987 to the Federal Deposit Insurance Corporation. Other source data included city and county population and population growth, employment growth, and reliance on agriculture. At the end of Section IV, SGA has introduced perspectives and opinions shared through interviews with industry representatives, or other source information, to help explain or enhance the informational value of this section.

BANK SIZE AND LENDING PATTERNS

An analysis of overall lending levels by bank size indicates that larger banks, in proportion to deposits, tend to lend more than smaller banks. The same type of analysis was used to evaluate lending patterns among various classes of Kansas banks operating under the following market conditions:

one-bank towns;
towns in counties with decreasing populations;
agriculturally-dependent towns;
Kansas towns with populations under 15,000; and,
Kansas towns with populations under 1,000.

Only the overall loan-to-deposit ratio tables are included, in all cases, commercial/industrial lending followed similar patterns by bank size. For this analysis, different bank size classifications were used, because for the most part this section deals with smaller banks. The data show relatively larger banks under the identified conditions will loan more than smaller banks. Appendix F displays these five categories by the bank size classifications previously used.

All Kansas Banks

The average loan-to-deposit ratio for banks with assets below $25 million was 50.8%, compared to 53.4%, 57.9%, and 69% for each successively larger bank class (Table. III-1). In 1983, the range was less with loan-to-deposit ratios of 56.8% for banks under $25 million in assets and banks with assets over $100 million having a 62% loan-to-deposit ratio. However, the pattern of larger banks loaning a larger relative share was consistent, in both years over 60% of the largest banks had a loan-to-deposit ratio greater than the state average.

A similar relationship in lending patterns was noted for commercial/industrial lending with larger banks experiencing higher commercial loan-to-deposit ratios. Banks in the under $25 million asset class had average commercial/industrial loan-to-deposit ratios of 10.4% as compared to 22.7% for banks in the over $100 million class (Table. III-2). There is a great deal of similarity between 1983 and 1987 commercial/industrial lending ratios. In both years, less than 15% of the smallest banks had commercial/industrial loan-to-deposit ratios above the state average. Among banks with over $100 million in assets over 55% of the banks had commercial/industrial loans above the state average.

A further review of commercial/industrial lending patterns in Kansas reveals that given the state average of 17.4%, only 139 banks (23%) out of 598 total banks loan above the state average (Figure III-1). These 139 banks are

Table III-1

Number of Banks by Asset Size Above and Below the Average Loan-to-Deposit Ratio for the State of Kansas For 1983 and 1987

1987

Number of Banks	Banks by Asset Size (in Millions) <$25M	$25M-50M	$50M-100M	>$100M	TOTAL
L/D ABOVE AVG	94	47	42	24	207
L/D BELOW AVG	234	96	46	15	391
TOTAL	328	143	88	39	598
AVG L/D BY SIZE	50.8%	53.4%	57.9%	69.0%	59.8%
Percent of Banks Above and Below State Average					
L/D ABOVE AVG	28.7%	32.9%	47.7%	61.5%	34.6%
L/D BELOW AVG	71.3%	67.1%	52.3%	38.5%	65.4%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

1983

Number of Banks	Banks by Asset Size (in Millions) <$25M	$25M-50M	$50M-100M	>$100M	TOTAL
L/D ABOVE AVG	154	72	30	20	276
L/D BELOW AVG	214	79	43	11	347
TOTAL	368	151	73	31	623
AVG L/D BY SIZE	56.8%	57.5%	58.0%	62.0%	58.7%
Percent of Banks Above and Below State Average					
L/D ABOVE AVG	41.8%	47.7%	41.1%	64.5%	44.3%
L/D BELOW AVG	58.2%	52.3%	58.9%	35.5%	55.7%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

SOURCES: Carner Associates and FDIC Computer Tapes

Table III-2

Number of Banks by Asset Size Above and Below the Average Commercial Loan-to-Deposit Ratio for the State of Kansas For 1987 and 1983

1987

Number of Banks	Banks by Asset Size (in Millions) <$25M	$25M-50M	$50M-100M	>$100M	TOTAL
COM L/D ABOVE AVG	43	32	39	22	136
COM L/D BELOW AVG	285	111	49	17	462
TOTAL	328	143	88	39	598
AVG COM L/D BY SIZE	10.4%	12.9%	18.2%	22.7%	17.4%
Percent of Banks Above and Below State Average					
COM L/D ABOVE AVG	13.1%	22.4%	44.3%	56.4%	22.7%
COM L/D BELOW AVG	86.9%	77.6%	55.7%	43.6%	77.3%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

1983

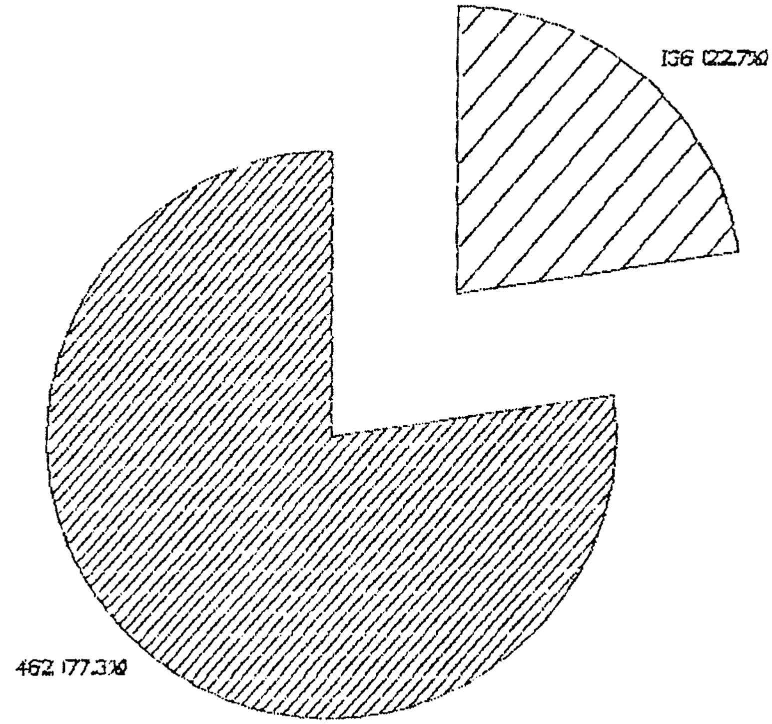
Number of Banks	Banks by Asset Size (in Millions) <$25M	$25M-50M	$50M-100M	>$100M	TOTAL
COM L/D ABOVE AVG	54	46	31	18	149
COM L/D BELOW AVG	314	105	42	13	474
TOTAL	368	151	73	31	623
AVG COM L/D BY SIZE	11.8%	15.5%	19.8%	24.9%	18.5%
Percent of Banks Above and Below State Average					
COM L/D ABOVE AVG	14.7%	30.5%	42.5%	58.1%	23.9%
COM L/D BELOW AVG	85.3%	69.5%	57.5%	41.9%	76.1%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

SOURCES: Carner Associates and FDIC Computer Tapes

FIGURE III-1

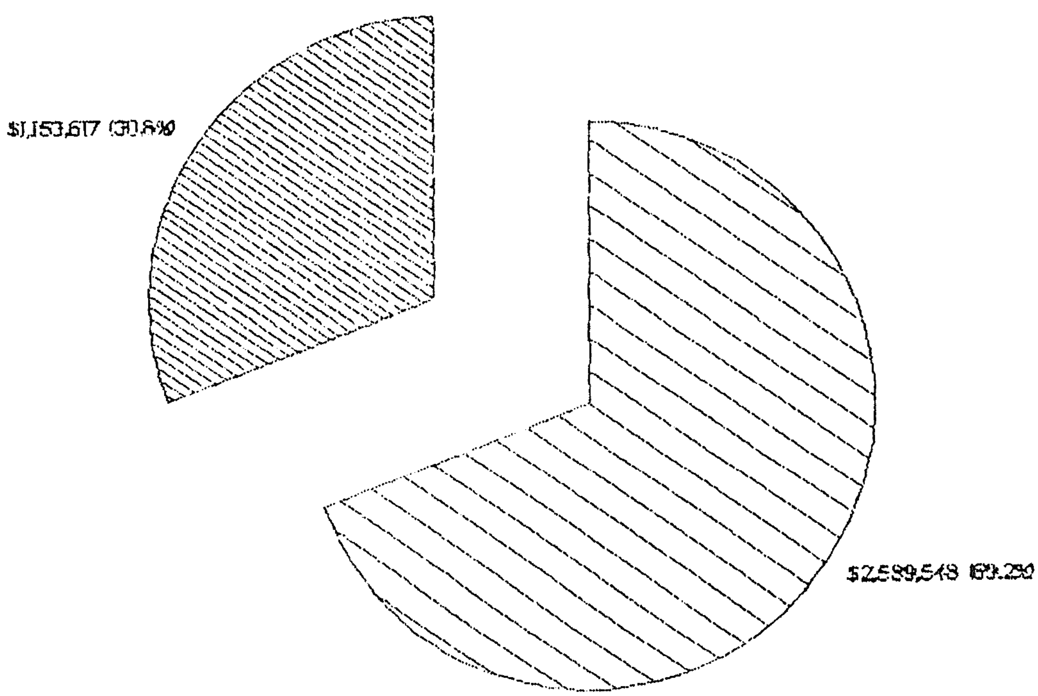
NUMBER OF BANKS ABOVE COM/IND

LOAN-TO-DEPOSIT RATIO 1987



TOTAL DOLLARS IN COM/IND LOANS

BILLIONS OF DOLLARS - 1987



responsible for almost 70% of the total commercial/industrial lending in Kansas.

One-Bank Towns

There are 306 one-bank towns which were divided into four bank size classes ranging from under $10 million to over $25 million. Banks under $10 million in assets had average loan-to-deposit ratios of 46.6%, and those with assets over $25 million had an average of 67.4% (Table III-3).

Towns In Counties With Decreasing Populations

Almost 50% (288) of Kansas banks are located in counties that have experienced a population decline between 1975 and 1983. Larger banks, faced with a declining population base still loaned more than smaller banks facing similar conditions (Table III-4).

Agriculturally-Dependent Towns

There are 254 Kansas banks located in towns that have been determined to have an above-average dependence on the agricultural economy (counties with over 15% of total personal income farm- and agriculture- based). Larger banks (above $30 million in assets) loaned 56% of their deposits as compared to 47.6% for banks in the smallest class (Table III-5).

Table III-3

Number of Banks by Asset Size Above and Below
the Average Loan-to-Deposit Ratio for the State
of Kansas Located in One-Bank Towns
1987

	Banks by Asset Size (in Millions)				
Number of Banks	<$10M	$10M-15M	$15M-25M	>$25M	TOTAL
L/D ABOVE AVG	30	23	18	20	91
L/D BELOW AVG	89	46	44	36	215
TOTAL	119	69	62	56	306
AVG L/D BY SIZE	46.6%	50.9%	50.7%	67.4%	53.9%

Percent of Banks					
L/D ABOVE AVG	25.2%	33.3%	29.0%	35.7%	29.7%
L/D BELOW AVG	74.8%	66.7%	71.0%	64.3%	70.3%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

The average loan-to-deposit ratio for one-bank towns in Kansas is 53.9%

SOURCES: Carner Associates and FDIC Computer Tapes

Table III-4

Number of Banks by Asset Size Above and Below the Average Loan-to-Deposit Ratio for Kansas Towns in Counties with Decreasing Populations
1987

	Banks by Asset Size (in Millions)				
Number of Banks	<$10M	$10M-15M	$15M-30M	>$30M	TOTAL
L/D ABOVE AVG	24	16	25	28	93
L/D BELOW AVG	68	37	43	47	195
TOTAL	92	53	68	75	288
AVG L/D BY SIZE	46.0%	47.8%	51.1%	61.5%	51.6%
Percent of Banks					
L/D ABOVE AVG	26.1%	30.2%	36.8%	37.3%	32.3%
L/D BELOW AVG	73.9%	69.8%	63.2%	62.7%	67.7%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

The average loan-to-deposit ratio for Kansas towns in counties with decreasing populations is 51.6%

SOURCES: Carner Associates and FDIC Computer Tapes

Table III-5

Number of Banks by Asset Size Above and Below the Average Loan-to-Deposit Ratio for Agriculturally-Dependent Towns in Kansas
1987

	Banks by Asset Size (in Millions)				
	<$10M	$10M-15M	$15M-30M	>$30M	TOTAL
Number of Banks					
L/D ABOVE AVG	24	20	29	29	102
L/D BELOW AVG	58	32	34	28	152
TOTAL	82	52	63	57	254
AVG L/D BY SIZE	47.6%	47.6%	52.2%	56.0%	50.8%
Percent of Banks					
L/D ABOVE AVG	29.3%	38.5%	46.0%	50.9%	40.2%
L/D BELOW AVG	70.7%	61.5%	54.0%	49.1%	59.8%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

The average loan-to-deposit ratio for agriculturally-dependent Kansas towns is 50.8%

SOURCES: Carner Associates and FDIC Computer Tapes

Kansas Towns With Populations Under 15,000

There are 487 Kansas banks located in towns with population under 15,000 and the same variations in lending patterns emerged between smaller and larger banks (Table III-6). Banks with assets above $30 million had a loan-to-deposit ratio of 56% smaller banks' loan-to-deposit ratios averaged from 47.5% to 51.4%.

Kansas Towns With Populations Under 1,000

There are 233 banks, representing approximately 40% of all 598 Kansas banks, located in towns with population below 1,000. The loan-to-deposit ratio did not increase for every successively larger bank; however, the smallest banks had loan-to-deposit ratios lower than 50% while the larger banks in these towns had ratios greater than 50% (Table III-7).

LENDING CHARACTERISTICS BY BANK OWNERSHIP CLASSIFICATIONS

An analysis by different types of bank was performed reviewing state-wide share of deposits and state-wide share of loans by various loan classifications. The bank types used were: affiliation with large multi-bank companies (ie., Fourth Financial Corporation); other multi-bank companies; one-bank holding companies; and, independent banks (Table III-8). All factors being constant, in theory, loan share would be consistent with deposit share (eg., unit banks, if controlling 35% of state-wide deposits, would extend 35% of various classes

Table III-6

Number of Banks by Asset Size Above and Below the Average Loan-to-Deposit Ratio for Kansas Towns with Populations Under 15,000
1987

	Banks by Asset Size (in Millions)				
Number of Banks	<$10M	$10M-15M	$15M-30M	>$30M	TOTAL
L/D ABOVE AVG	42	36	54	59	191
L/D BELOW AVG	91	54	73	78	296
TOTAL	133	90	127	137	487
AVG L/D BY SIZE	47.5%	49.5%	51.4%	56.0%	51.1%
Percent of Banks					
L/D ABOVE AVG	31.6%	40.0%	42.5%	43.1%	39.2%
L/D BELOW AVG	68.4%	60.0%	57.5%	56.9%	60.8%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

The average loan-to-deposit ratio for Kansas towns with populations under 15,000 is 51.1%

SOURCES: Carner Associates and FDIC Computer Tapes

Table III-7

Loan-to-Deposit and Commercial/Industrial Loan-to-Deposit Ratios for Banks by Asset Size Located in Towns with Populations Under 1000

	Kansas Banks by Asset Size Located in Towns of Less Than 1000 (in Millions)		
	<$7.5 M	$7.5-$10.0 M	$10.0-$12.5 M
Number of Banks	77	41	33
Average L/D Ratio	44.8%	47.8%	49.2%
Average Comm. L/D Ratio	7.6%	8.2%	6.8%

	$12.5-$15.0 M	$15.0-$25.0 M	>$25.0 M
Number of Banks	31	44	7
Average L/D Ratio	47.4%	51.6%	55.2%
Average Comm. L/D Ratio	9.9%	10.9%	12.5%

SOURCES: Carner Associates and FDIC Computer Tapes

Table III-8

Percent Distribution of Assets, Deposits, and Loans by Ownership Category for Kansas Banks

	Large Multibank Holding Cos.	Multibank Holding Cos.	One-Bank Holding Cos.	Independent Banks	Total
Deposits	10.0%	16.7%	55.1%	18.2%	100.0%
Assets	10.6%	17.7%	53.6%	18.1%	100.0%
Loans	9.9%	17.5%	54.8%	17.8%	100.0%
Com/Con Loans	12.3%	22.0%	51.2%	14.5%	100.0%
Farm Loans	2.4%	10.3%	62.6%	24.7%	100.0%
Consumer Loans	12.5%	26.3%	50.1%	11.1%	100.0%

NOTE: Large multibank companies includes only Fourth Financial Corporation

Year-end 1987 data

SOURCE: Carner Associates from FDIC data of loans). But these variances in lending patterns emerged:

1) Relative to deposit share, large multi-bank companies extended 2.3% more commercial, industrial, construction and land development loans and 2.5% more direct consumer loans. Large multi-bank companies had 7.6% fewer agricultural loans compared to state-wide deposit share.

2) Affiliates of other multi-bank companies extended 5.3% more commercial, industrial, construction, and land development loans; 9.6% more direct consumer loans; and, 6.4% fewer agricultural loans.

3) Relative to deposit share, affiliates of one-bank holding companies extended 3.9% fewer commercial, industrial, construction and land development loans; 5% fewer direct consumer loans; and, 7.5% more farm loans.

4) Independent unit banks, with an 18% deposit share, extended 3.7% fewer commercial, industrial, construction and land development loans; 7.1% fewer consumer loans; and, 6.5% more farm loans.

The table confirms the larger banks' tendency to work with commercial/industrial loans and the importance smaller banks play through providing farm loans. Farm loans are the only type of loans that independent banks display a greater share of state-wide deposits, even the share of consumer loans to customers is significantly below the independent banks share of total deposits. These smaller banks have been important lenders to a community's agriculture industry. However, the inability to diversify can hurt these bank's profitability and delay recovery even when the agriculture industry rebounds.

In an article discussing agricultural lending, Federal

Reserve Bank of Kansas City economists, referencing bank performance throughout the Tenth District, noted:

> Earnings at agricultural banks turned up in 1987. But earnings did not rebound at small agricultural banks like they did at medium-size agricultural banks, which hold smaller concentrations of agricultural loans. Earnings at larger banks, (both) agricultural and non-agricultural, have been generally more resilient to market shocks than earnings at small bank.[2]

The article concludes that, "The farm lending market of the future promises to be more competitive than ever. Large size and consistent earnings give commercial lenders market staying powers."

AVAILABILITY OF ADDITIONAL CAPITAL FOR LENDING

Loan-to-Deposit Ratios

Kansas loan-to-deposit ratios are low compared to many other states. At the end of 1987, the national average bank loan-to-deposit ratio is 79%, compared to 59% among Kansas banks. A county-by-county and state intra-regional analysis was prepared, comparing current loan volumes against credit that would have been extended if loan-to-deposit ratios were 68%, a target at approximately the midpoint between the Kansas and national loan-to-deposit average ratios. This analysis

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[2] Barkema, Alan and Drabenstott, Mark and Froerer, Landell; "A New Era in Farm Lending: Who Will Prosper", Economic Review: Federal Reserve Bank of Kansas City, June 1988, Volume 73, No. 6, pp. 22-38.

shows that the equivalent of more than $2.4 billion in additional loans could have been extended if the Kansas loan-to-deposit was a minimum of 68% for all banks (Appendix C for capital availability calculations for the seven Kansas sub-regions).

Commercial/Industrial Lending Rates

There is, also, a significant potential pool of capital for commercial/industrial lending. Kansas banks, in 1987, had an average commercial/industrial loan-to-deposit ratio of 17.4%, the national average was 24.3%. If state banks could lend for business purposes at the national average of 24.3%, there would be slightly more than $2.0 billion available to the business community for lending purposes.

Besides the availability of $2.4 billion and $2.0 billion, to actually lend this amount, there would have to be sufficient demand for that much additional capital as well as projects that banks determined to be of "loanable-quality." However, one conclusion supported by the data is that capital is available for more credit extension, including loans to businesses, among Kansas banks.

SECTION IV: STATE AND NATIONAL TRENDS AND ISSUES

LEGISLATIVE PROFILE

A review and analysis of legislative and regulatory trends is presented as related to the provision of capital to business enterprises within the broader perspective of the presumptive impact on financial institutions to be a major source of capital to facilitate economic growth and diversification. For comparison purposes, the study has evaluated legislative trends relating to these matters in Kansas, in surrounding states, and briefly, at the national level.

National Trends

The current policy climate pertaining to financial institutions does not seem conducive to significant further deregulation of the financial services industry. Further deregulation moves are now left primarily to the individual states, with the notable potential exception being legislation pending action in Congress pertaining to removal of federal prohibition on securities underwriting.

Interstate Banking

Since 1975, a total of 47 states have enacted some form of interstate banking statutes and 35 of them since 1985. A 1987 Federal Reserve study indicated that approximately 80% of the banks, controlling more than 90% of U. S. domestic banking assets, will be located in areas that permit some form of interstate banking.

Within the six-state region (Kansas, Iowa, Nebraska, Oklahoma, Colorado, and Missouri), Kansas and Iowa are among the few states in America without some form of interstate banking (Kansas does allow unrestricted interstate branching for savings and loan associations).

Discussions with senior federal regulators suggest that, in their opinion, interstate banking after causing a furor some years ago, is now considered a non-issue. The exception being the need for regulatory policy and procedures revisions to deal consistently with interstate banks whose areas of operation cross the jurisdictional lines of multiple regulators. Interstate banks are requesting that regulators develop uniform reporting and operating standards

Some representatives of bank regulation agencies, interviewed by SGA, consider interstate banking as positive in that it should help to increase the size of U.S. financial institutions. Larger national banks will be more favorably positioned to compete with larger international banks.

Interstate banking at a regional level is also considered positive within the context of promoting growth of banking enterprises, with a presumptive positive impact on capital financing of businesses to the benefit of regional economies. Regulatory officials have also cited the potential benefits to banking organizations of gaining entry to new markets and enhanced loan diversification opportunities.

KANSAS AND THE MIDWEST REGION

Over the last several years, the Midwest has seen a liberalization of bank structure laws governing bank holding companies, branching, and interstate banking. Nebraska, Oklahoma and Kansas statutes have been amended to allow multi-bank holding companies.

Branch banking authority varies from state to state. Colorado and Missouri prohibit branch banking statutorily, but achieved liberalization of branching restrictions by redefining bank service facilities and allowing facilities to make available all services available at the main bank location. Iowa and Nebraska allows branch banking within restricted geographic areas.

Four of the six regional states have some form of interstate banking laws which typically include some form of reciprocity requirements. Colorado and Nebraska have a national nonreciprocal trigger clause after a defined period of allowing interstate banking only among banks which have reciprocal agreements with those states. Most states also restrict de novo entry by interstate banks with the exception of Colorado which will allow such entry after July 1, 1993. The restricted de novo entry clause requires the out-of-state bank to purchase an existing bank as a method of entering the new state (Table IV-1).

Table IV-1

Comparison of Regional Interstate Banking Statutes

STATE	TYPE	ANTI-LEAPFROGGING	DE NOVO	ACQUIRE EXISTING? AGE	EFFECTIVE DATE	STATES
Colorado §§11-6.4-101 11-6.4-104	Regional Reciprocal with National Trigger	yes; by definition	on or after 7/1/93	yes; at least 5 years until 7/1/93	7/1/88	AZ, KA, NE, NM, OK, UT, WY; after 1/1/91 all states
Missouri §362.925	Regional Reciprocal	yes; by definition	no	yes	8/1/86	AR, IL, IA, KS, KY, NE, OK, TN
Nebraska §§8-901- 8-903	Regional Reciprocal with National Trigger	yes; 50% rule	no	yes; at least 5 years	1/1/90	CO, IA, KS, MN, MO, MT, ND, SD, WI, WY; after 1/1/91 all reciprocal states
Oklahoma Tit. 6, §§504-506	National Non-reciprocal	no	no	yes; at least 5 years unless charterd before act	7/1/87	all states Additional Features optional reciprocity; acquisitions of failing institutions

SOURCE: The American Bankers Association Office of the General Counsel

All states in the six-state region permit state-wide branching for savings and loan associations.

Kansas Branching Laws

A broad summary of Kansas allowances for branching includes:

> A bank located in the state can establish up to three new branches in the town in which its main office is located. A branch within 2,600 feet of the main office does not count against the limit so long as it was established prior to July 1, 1986;
>
> Any bank in the state can establish a branch located in a community in the same or in an adjacent county if that community does not have a main banking office. Banks within the county would have first priority in an application process over an applying bank from outside the county; and,
>
> Two or more banks may establish a joint branch anywhere that both banks would be eligible to individually establish a branch.

Non-Banking Powers

With deregulation at the national level, states have been confronted with efforts by banks to engage in services not closely related to traditional banking services. Each state in the region, except for Oklahoma, permits banks to sell insurance in some form. For example, Kansas allows community banks to sell insurance in towns with less than 5,000 population.

In the six-state area, Colorado and Oklahoma are the most

Table IV-2
SUMMARY OF SERVICES AUTHORIZED BY STATE LAW OR REGULATION

STATE	INSURANCE				REAL ESTATE		SECURITIES						
	Sales	Brokerage	Under-writing	Lobby leasing	Equity invest.	Sales/broker	Discount	Full service	Under-write	Mutual fund	TRAVEL	DATA PROCESS.	MGMT. CONSULT.
Colorado	X				X								
Iowa	X	X				X	X	X	X	X			
Kansas	X						X			X			
Missouri	X			X	X		X		X	X		X	
Nebraska	X	X		X			X				X	X	X
Oklahoma									X				
Regional Totals	5	2	0	2	2	1	4	1	3	3	1	2	1
State Totals	28	12	3	11	21	7	19	9	8	9	9	14	9

SOURCE: American Bankers Association Office of the General Counsel, July 1988 restrictive with regard to services banks are authorized to provide, and Missouri and Nebraska are considered relatively. liberal (Table IV-2).

KANSAS LEGISLATION PERTAINING TO FINANCIAL INSTITUTIONS AND ECONOMIC DEVELOPMENT

For purposes of this report, a chronological summary of major legislation pertaining to the structure and regulation of financial institutions and relating to economic development is provided in Table IV-3.

PRIVATE AND PUBLIC SECTOR CAPITAL PROGRAMS

Within the context of economic development initiatives, debt capital financing emerges as an important state issue. Among the three primary depository institutions including: commercial banks; savings and loans; and, credit unions, commercial banks are the major source of conventionally-financed debt capital for Kansas businesses.

Table IV-4 displays both private sector and various state-administered programs created to provide and enhance the availability of capital for Kansas businesses. Key state-administered programs include: the federally funded, Community Development Block Grants; the Kansas Development Finance Authority; Kansas Venture Capital, Inc.; the Kansas Technology Enterprise Corporation; the Pooled Money Investment Board; programs through the Kansas Public Employee Retirement System; and, Certified Development Companies. Private sector

Table IV-3

Summary of Kansas Legislation
Related to Financial Institutions and
Economic Development Matters
1983-1988

Year	Legislation
1983	- State Charter S & L Powers Expanded as a Result of Garn Act
	- Prohibited Premiums for Attracting Accounts
	- Allowed Financial Institutions to be Financial Advisor, Charge for Business Services, etc.
	- Created Kansas Industrial Finance Agency
1984	- Amendments for Trust Companies
S	- Loan Authority for Detached Facilities
S	- Bank Remote Service Units Outside of Kansas Interstate
	- State Bank Authorization to Acquire and Sell Securities
	- State Bank Investment in Bank Service Corporations
1985	- Established Farm Assistance and Counseling Program
S	- Multi-Bank Holding Companies
S	- State Chartered Savings and Loan as a Finance Subsidiary
	- Bank Capital and Stock Amendments
1986	- Creation of Kansas Inc.
S	- Branch Banking/Jo. Co. Branches
S	- Branch Banking/Failed Banks
	- Extended Time Bank Can Hold Debt Real Estate
	- Allowed Common Trust Fund with Parent Bank
	- Procedures for KCVI
1986	- Enactment of Kansas Venture Capital Company Act
	- Proposed Constitutional Amendment/Capital Formation System
	- Extended Ag Production Loan Program
1987	- Research and Development Credits
	- Local Seed Capital Pool Credits
	- KVCI Amendment/100% Kansas Businesses
S	- Statewide Branch Banking/Amended
	- Created Finance Authority/Bonds for Capital Improvement
	- Modified Kansas Venture Capital by Defining Cash Investments
S	- Saving and Loan Interstate Branching
	- S & L Allowed to Issue Time Deposits in Negotiable Form
	- CU Requirements for Loans/Investments
	- Amended CU Administrator Powers
	- Extension of Bank Tax Credit on Ag Write-Downs
	- Saving Deposit, Time Deposit, Open Account Definitions
1988	- State Chartered Banks/Bankers Banks
	- Kansas Venture Capital/Tax Credits
	- Loan Broker Regulations
	- KVCI/Equity Capital
	- Kansas Inc. Inkind Donations
	- Ag Loan Tax Credits
	- CU Authority to Establish Service Organizations
	- State Bank Security Brokerage
	- Kansas Basic Enterprise Loan Program

S - Denotes Structural Change Legislation for Financial Institutions

SOURCE: Office of the General Counsel of the American Bankers Association and the Kansas Bankers Association

Table IV-4

Existing and Potential Sources of Capital for Business Enterprises in the State of Kansas

<u>State-Administered Public and Private-Public Partnership Sources of Capital</u>

Department of Commerce - Community Development Block Grants
Kansas Development Finance Authority - Kansas Basic Enterprise Loan and Other Projects
Kansas Venture Capital Inc. - Business Development Program
Kansas Technology Enterprise Corporation
State Treasurer - Pooled Money Investment Board
Kansas Public Employees Retirement System - Business Loan Programs
Certified Development Companies

<u>Private Sector Financial Institutions and Other Sources for Debt Capital</u>

<u>Sources for Conventionally-Financed Debt Capital</u>

Kansas Banks
Kansas Savings and Loans
Kansas Credit Unions

<u>Other Private Sources of Debt Capital</u>

Midwest and National Financial Institutions
Venture Capitalist
Formal Debt Markets
Insurance Companies
Kansas Bankers' Bank
Internal Financing from Business Enterprise

<u>Programs and Policy Initiatives for Capital Availability Enhancement</u>

<u>State Public Sector-Administered Programs</u>

State-operated Small Business Loan Guarantee Program
Creation of State Loan Office to serve as clearinghouse for business loans
Expansion of State Treasury-linked deposit program for bank lending to businesses

sources include: depository institutions both within and outside the state; venture capital firms; formal debt and equity markets; insurance companies; Kansas Bankers' Banks; and, internal financing (retained earnings).

Kansas Bankers' Bank

The recently-formed (October, 1988) Kansas Bankers' Bank can serve as a mechanism to increase capital availability in the state. The Kansas Bankers' Bank is located in Wichita and currently has 36 investing banks and a total of $1.5 million in capital. Membership includes banks from all six Kansas Bankers Association districts and the asset sizes of bank members range from $5 million to $75 million. The Bankers' Bank is initially providing service to members in the areas of safe-keeping, Federal fund pooling, bank stock loans and overline help on large loans.

The Bankers' Bank concept has been used successfully in other states to deal with risk aversion by loan pooling which allows for the spreading of risk to banks located in diverse geographical areas and markets. The concept can also allow member banks to reduce their costs of data processing, customer services, and management talent. Given the relatively low return on assets observed for smaller and medium-sized Kansas banks, the Bankers' Bank could be valuable in reducing costs and increasing profitability in smaller banks. Over the long term, increased profitability could reduce risk-aversion, thus increasing loan-to-deposit ratios and making capital more available in the communities member banks serve.

State-Administered Small Business Loan Guarantee Program

A state loan guarantee program is one Legislative option for freeing-up capital for small businesses. This type state-administered programs could be helpful in increasing the availability of capital to Kansas businesses by guarantee business loans that a bank may hesitate to lend because of risks associated with making the loan.

SUMMARY OF INDUSTRY INTERVIEWS

Qualitative input was sought through interviews with a small group of bankers to give industry perspective to the issue of capital availability. Two divergent positions emerged as a result of the interviews. Some bankers indicated a lack of demand for loans among credit-worthy borrowers in their market area, adding that economic financial stress, especially in agricultural areas, created an unfavorable lending environment. Most bankers supporting this argument pointed to a need for recovery of the agricultural sector as key to creating more loan demand. Absent favorable loan demand, these bankers are said to be forced to seek other asset instruments, primarily government-backed securities, even though they typically have lower rates of return than loans.

Others interviewed felt the predominance of small unit banks results in these banks being unable to adequately serve the credit needs of their communities. As an example, a bank with assets of $10,000,000 (22% of all Kansas banks have assets below $10 million) would face a loan limit of around $120,000.

These limits would hamper the banks ability to capitalize many kinds of business enterprises. However, those interviewed cautioned that small banks are capable of lending beyond their loan limits through correspondent bank arrangements. As long as these relationships are seen as beneficial by the larger banks, it was felt loan limits, while a barrier, are not an insurmountable problem for local businesses.

It was also mentioned that many banks do not have the operating resources to invest in developing specialized industry knowledge leading to questions of the capability or willingness to lend to unfamiliar industries. In addition, smaller industries and rapidly-expanding businesses often represent greater risk than do larger or more stable enterprises or economic sectors the banks have traditionally worked with. Finally, interviewees noted that banks in communities dependent on economic sectors experiencing financial stress (such as agriculture and energy), will become more risk-averse. In this context, low profitability, as a result of not being able to diversify, could impair a bank's ability to provide loans to new and expanding enterprises when the local economy is depressed.

Those interviewed were quick to point out that their comments should not be considered critical of any bank's management or lending philosophy. Banks are seen as important to a community and a number of the problems identified center on regulatory restrictions and local economic characteristics that banks have limited ability to change, beyond developing or acquiring the expertise to work with new or expanding business and recognize growth opportunities that can benefit the community.

Belden Daniels, in a study titled Indiana Financial Markets, cited multiple studies of the operations of capital markets. His conclusions, based on his research on the problem of capital availability, include:

* viable expanding small businesses and start-up companies are unable to gain access to the formal long-term debt capital markets;

* because small and new businesses cannot find formal sources for long-term debt capital and equity, they must substitute by using short-term, high risk capital from local commercial banks or finance companies or have access to internal sources; and,

* structural and institutional factors limit the extent to which local banks can adequately provide appropriate kinds of capital to small businesses.

Daniels' conclusions suggest that small, new, innovative, or remotely-located business enterprises have a greater reliance on banks than do established, large corporations. Those businesses that depend on banks, face institutional barriers to the provision of capital in sufficient quantity. As Daniels' report notes, "When the local bank turns down a loan request, there is virtually nowhere for the small company to turn."

Referencing, once again, the 1987 Institute for Public Policy and Business Research survey of businesses in Kansas communities with populations of 10,000 to 100,000:

* 11% of responses by businesses surveyed

noted that insufficient financing had caused the firm to forego expansion;

* 15% reported a lack of available financing as a reason for not offering additional products or services; and,

* 24% identified a lack of available financing as a specific problem with expansion.

As always, in interpreting this information it is necessary to maintain an awareness that these were the responses of business owners/managers and the quality of those expansion efforts from a lenders perspective was not considered.