# The Financial Conglomerates

An important development in the financial services industry is the formation of financial conglomerates offering a wide range of services from one source. While the potential impact of these conglomerates is huge, little evidence exists about whether synergy on such a large scale can really work in the financial services business. Can the diverse parts of these financial service conglomerates mesh and complement each other, leading to increased sales and reduced costs related to consolidation?

Some evidence suggests that it will be difficult to achieve these synergies, at least in the short run. Previous attempts to create synergy in the financial services industry have been somewhat disappointing. For the most part, life insurance sales by stock brokerage firms and mutual savings banks have not been a roaring success. Continental Insurance made little progress toward the synergy that was supposed to accrue from its Diners Club credit card operation or its consumer finance subsidiary (both units have been sold), while INA was never able to sell insurance through its Blyth Eastman Dillion subsidiary.

Of course, significant cross-selling opportunities can accrue to financial conglomerates as well as increased opportunities for mass marketing of additional services. There are also opportunities to eventually consolidate operations and utilize available computer capacity. However, it may take years to effectively achieve these synergies.

Nevertheless, the trend toward financial conglomeration is real and likely to continue in the future as witnessed by the large number of nonbank companies that have become significant factors in the financial services business.[1]

[1]Alan Gart, "The Future of the Financial Services Industry," National Association of Business Economists, Jacksonville, Florida, October 19, 1979.

The potential impact of "near-banks," such as Sears, American Express and Merrill Lynch, on the financial markets is enormous. Banks and savings and loan associations are constrained by networks of Depression-era regulations that prevent them from branching across state lines, shut the door on domestic investment banking, and sharply limit subsidiary activity. Near-banks, on the other hand, are scarcely touched by such rules because they do not accept deposits. They are less restricted as to the business functions they can perform and the business locations they can choose.

Let's look at some examples of financial conglomerates and examine their strengths, weaknesses, and likely evolution.

## Merrill Lynch

Although Merrill Lynch is best known as a retail stock brokerage firm, it performs a complete array of investment banking services. Its Capital Market Group is actively engaged in merchant banking, institutional sales, trading, arbitrage, block positioning, and underwriting.

The greatest growth at Merrill Lynch has come in its retail or consumer activities. Its money market funds and Cash Management Account (CMA) have attracted a plethora of new customers that offer the potential to become retail brokerage customers. The CMA combines a securities account, a money market fund, a VISA debit card, and access to liquidity through a credit card, or checking account arrangement via Banc One of Columbus, Ohio. The company also offers credit cards to its retail customers.

Merrill Lynch has also begun to sell insurance through its brokers in close to 500 domestic offices.

*Nonbank financial conglomerates, relatively unhindered by regulations, are expanding in size and scope. If deregulation continues, financial conglomerates that offer all financial services could emerge.*

The company has become active in selling tax shelters, commodity services and CDs (for Banc One of Columbus and Home Federal Savings and Loan of San Diego from whom they receive a commission).

The company also has an active real estate subsidiary that offers to buy and sell homes and commercial properties. All these services appear to be part of a corporate plan for Merrill to become a complete financial supermarket for investors.

## The New Sears

Sears Roebuck, in one sense, is even more of a financial supermarket than Merrill Lynch. Through Allstate, its property, casualty, and life insurance subsidiary; Dean Witter; Coldwell Banker; its ownership of the eleventh largest savings and loan association in California with $3 billion in assets and a small commercial bank in Chicago; its nearly 4000 outlets in department stores and catalog offices; a new check processing service to be offered in conjunction with credit unions; and its base of 25 million active credit card holders, Sears may well be a model of future banking concerns.

The Chicago-based Sears has a huge in-house data base on consumer credit which will become the nucleus for the carefully targeted selling of loans, money market funds, stocks, and other instruments. A recent Roper organization poll found Sears to be "viewed most favorably" by consumers who rated it against other corporations. This acceptance should offer Sears an edge over competitive financial institutions. Sears seems ready to launch an array of additional services that may include:

- The formation of a world trading company.
- The provision of retirement account opportunities for its customers.
- A debit card that could be used to endow the new money market fund accounts with savings and checking account privileges.
- A universal financial card capable of handling practically all household financial transactions.
- A move into secured and unsecured personal lending including homeowners' loans that should rival finance companies, banks, and thrifts.
- A pioneering system in two-way communications with the home through computers and telephone for financial and consumer product transactions.
- A national hookup of automated teller machines (ATMs) in Sears retail stores that could hook up to bank-like Sears merchandise credit accounts, allowing customers to draw cash, take small personal loans through prearranged lines of credit, deposit money, or make merchandise, mortgage, insurance premium, or stock purchase payments. Through agreements that Sears could make with certain banks, customers of those banks could use ATMs at Sears stores to tap their savings or checking accounts or even to pay bills.

Although the potential for cross-selling and the introduction of these new products seem quite promising, there are some potential pitfalls.[2] As the company pushes more direct selling of merchandise and financial services, notably through interactive television and home computer systems, it may steal sales from its own stores.

## American Express

The next financial services giant, American Express Company, faces a huge challenge in successfully integrating the securities firm of Shearson Loeb Rhoades, Inc., (acquired in a $1 billion stock swap) into its financial empire. This financial conglomerate with a holding company at the top is best known for its travel service and credit card business. Among its major assets are a giant-sized international bank, Warner Amex Cable Communications, Fireman's Fund Insurance, and Mitchell Beazly Ltd. (a publishing company). It has also purchased a 10 percent interest in McLeon Young Weir Ltd., a major Canadian securities firm. Shearson has also purchased Foster & Marshall, one of the largest regional brokerage firms in the Northwest, and Robinson-Humphrey, a major regional brokerage house in Atlanta.

American Express is moving beyond travel and leisure dollars to vie for a central role in the money that Americans save and invest. The company is counting on two salient aspects of its business: its reach into the affluent sector of the economy through its 13 million cardholders whom it views as nearly recession-proof and through its data processing ability and information systems. The company wishes to become an omnipresent intermediary for affluent Americans, tapping into the estimated $8 trillion of personal assets in the United States.

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[2] **Business Week**, November 16, 1981.

In addition to its credit card base of customers, American Express can also reach affluent Americans through more than 4,000 brokers in its Shearson system.

The company is presently gearing up for the first offspring of the Shearson American Express marriage, a computerized cash management service called the Financial Management Account (FMA) which permits credit card and checking withdrawals from an investment account.

Another kicker is the potential tie-in with Warner Amex Cable Communications, which would put American Express in the forefront of electronic consumer financial transactions on their television screens. The company is exploring other sophisticated interactive home services such as electronic banking and shopping and commercial services for business.

## Conclusion

The examples of Sears, Merrill Lynch, and American Express suggest what might lie ahead for the financial services industry.[3] With a loosening of regulation, financial conglomerates that offer all financial services nationwide could emerge. The current regulations separating insurance companies, banks and consumer finance and investment brokerages are fading, laying the foundation for the future. The real questions that must be answered are whether American consumers will really be attracted by one-stop shopping for all their financial needs and whether the environment is truly different today so that hybrid financial products and cross-selling across subsidiaries can really work in the 1980s. Recently, the advertising of financial services seems to encourage consumers to be selective, to pick and choose the best investment or vendor of services to fit a particular need. Also, the popularity of financial supermarkets is being tested in the marketplace. A lot of careful planning will be necessary in order for the sum of the parts to add to more than the sum of separate entities.

Banks in this country have been handicapped by both product and geographic regulatory constraints. Although the bank holding company umbrella permits some flexibility, banks (for the most part) cannot branch across state lines, underwrite corporate securities and some forms of municipal revenue bonds, or sell non-credit related insurance. On the other hand, most European banks and American financial conglomerates do not have these product or geographical limitations.

With the recent networking of nationwide ATMs and the acquisition by New York based Citicorp of a troubled California thrift institution, it is highly likely that some of the restrictive regulatory barriers may fall within the next few years. Some states and regions, such as New England, are already considering reciprocal branch banking facilities. Restrictive geographic banking regulations seem rather arbitrary and inconvenient to consumers in a modern computer and communications era where people commute from New Jersey and Connecticut to New York or from Virginia and Maryland to Washington, D.C. in order to go to work.

If some form of regional banking is permitted in the next couple of years, unlimited interstate banking would probably follow by the end of the decade. Removal of the geographic constraint would place banks in a better position in competing with financial conglomerates for the retail financial services of consumers.

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[3] For a more complete inventory of nonbanking institutions' financial services, see C. Westbrook Murphy and Thomas W. Brunner, "Will Anyone Try to Block Amexco?" **American Banker** April 23, 1981, and Harvey Rosenblum and Diane Siegel, "Competition in Financial Services: The Impact of Nonbank Entry," Federal Reserve Bank of Chicago, 1982.