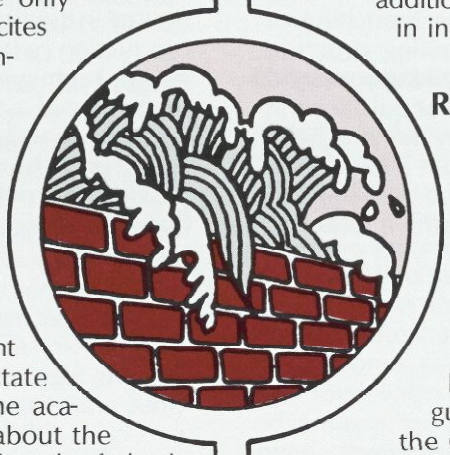
Will Bank Capital Adequacy Restrictions Slow the Development of Interstate Banking?

Earlier in this **Economic Review**, Paul Horvitz points out that the McFadden Act and the Douglas Amendment aren't the only barriers to interstate banking. He cites three additional significant constraints to interstate expansion: the need for a bank to earn a profit in a new market, internal constraints to a bank's ability to grow (for example, its need for qualified personnel), and capital adequacy constraints imposed by bank regulators.



As this article suggests, the regulatory capital adequacy constraint may slow the growth of interstate banking organizations. While some academics have expressed doubts about the value of capital adequacy constraints the federal bank regulatory agencies consider bank capital adequacy before approving bank holding company acquisitions, bank mergers and *de novo* bank branches.[1] Regulatory approval can be denied if a proposed new consolidated entity lacks sufficient capital. Therefore whether or not capital adequacy constraints are justified, they may affect the expansion rate of interstate banking. If interstate banking is legalized, then banks must have sufficient excess capital to support this growth, or they will have to raise additional capital if they wish to engage in interstate banking.

Regulatory Capital Guidelines

Until December 1981, regulatory agencies attempted to regulate the capital position of bank holding companies on the basis of informal capital standards. At that time formal guidelines were announced for three groups: one set of guidelines for FDIC-regulated banks, another guideline for banks regulated by the Office of the Comptroller of the Currency and the Federal Reserve System and the guideline for bank holding companies. While all three agencies use the organization's capital (variously defined)-to-asset ratio as the primary measure of its capital adequacy, the agencies also will take other considerations into account when analyzing a capital position.

All three sets of capital guidelines group the regulated institutions into three zones:

1) those presumed to have acceptable capital,
2) those that may be undercapitalized
3) those strongly presumed to be undercapitalized.

The FDIC measures a bank's capital adequacy by its equity capital-to-asset ratio and imposes

[1] See for example, Sam Peltzman, "Capital Investment in Commercial Banking and Its Relationship to Portfolio Regulation," **Journal of Political Economy**, 78 (January-February 1970), pp. 1-26 or Lucille S. Mayne "Impact of Federal Bank Supervision on Bank Capital," **The Bulletin** (New York University Graduate School of Business Administration, Institute of Finance), 1972, Nos. 85-86 and for counterpoint see John J. Mingo, "Regulatory Influence on Bank Capital Investment," **Journal of Finance**, 30 (September 1976) pp. 1111-1121.

Many community and smaller regional bank holding companies enjoy stronger capital positions than some larger regional and multinational companies. If regulatory guidelines on bank capital remain in place, they will affect the pace and extent of interstate expansion.

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the one guideline on all of the banks it regulates. It has established a threshold level of equity capital at 6 percent. Banks below this threshold will be required to submit an acceptable comprehensive capital plan. The FDIC also established a minimum acceptable level of equity capital at 5 percent. The FDIC will insist that banks below this level submit a plan to raise their capital promptly.

Guidelines of the Comptroller of the Currency and the Federal Reserve are more complicated. Those agencies use two measures of a bank's capital: primary capital, which consists of the bank's permanent equity capital, and total capital, which consists of its primary capital along with limited life preferred stock and subordinated debentures. Banks also are divided into three groups for the purposes of these capital guidelines: multinational banks (the 17 largest banks), regional banks (all other banks with more than $1 billion in assets), and community banks (banks with less than $1 billion in assets). The minimum primary capital-to-asset ratio is 6 percent for community banks and 5 percent for regional banks. Community and regional banks are "expected to operate above the minimum primary capital levels." Community banks whose total capital-to-asset ratio exceeds 7 percent are assigned to Zone 1, as are regional banks whose total capital ratio exceeds 6.5 percent. Community banks with total capital-to-assets between 6 percent and 7 percent and regional banks with ratios between 5.5 and 6.5 percent are assigned to Zone 2. Banks not assigned to Zones 1 or 2 are assigned to Zone 3.

Explicit capital standards have not been imposed on multinational banks. The lack of an explicit standard for multinationals does not mean, however, that the Comptroller and the Federal Reserve are unconcerned about the capital position of multinational organizations. Indeed one of the four objectives cited by the agencies for the new capital guidelines is "to address the long-term decline in capital ratios, particularly those of the multinational group."

The guidelines imposed on bank holding companies are similar to those imposed on banks by the OCC and the Federal Reserve. The guidelines are applied to the primary and total capital positions of the consolidated BHC with the BHC's primary and total capital defined in almost the exact same way as banks' primary and total capital are defined. The one significant difference is that BHC total capital includes bank subordinated debt but excludes subordinated debt issued by the BHC parent and its nonbank subsidiaries.

These guidelines can be used by banking regulators to limit a banking organzation's growth by rejecting banking organizations' merger and branching requests and by cease and desist orders. Under existing law the federal bank regulators can use their power to deny BHC and bank acquisitions' requests to prevent undercapitalized banking organizations from acquiring an existing or de novo bank. The law currently requires that the Federal Reserve approve all BHC merger applications and the federal agency regulating the surviving bank approve all bank mergers. The law requires that before such approval is given, the relevant agency must consider "the financial and managerial resources and the future prospects" of the banking organizations concerned. This gives the agencies the ability to reject the applications of banking organizations that are, in their opinion, undercapitalized.

Prior to the issuance of formal capital standards, all three agencies scrutinized the capital position of the proposed corporation when considering bank merger applications, and the Federal Reserve rejected some acquisition requests due to inadequate capital in the holding company or one of its affiliate banks. Since the new standards took effect, the Board of Governors of the Federal Reserve has rejected two applications by a holding company to acquire a bank due to the holding company's capital inadequacy. Last year the Board rejected a request that would have dropped a regional holding company's consolidated equity capital from 7.2 percent of assets to 5.8 percent of assets.[2] Furthermore, the Board noted that the company would have goodwill equal to approximately 25 percent of its equity capital.[3] The Board also rejected an application that would have reduced a bank holding company's primary capital ratio from 7.5 percent of assets to less than 6 percent.[4]

The Board also expressed concern about a regional holding company proposal which resulted

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[2] "The Central Bancorporation, Inc, "**Federal Reserve Bulletin,** (December 1982), pp. 789-792.

[3] The pace of interstate bank acquisitions could be affected if the Board does discount BHCs' capital by some fraction of its goodwill. This will be a problem because in most banking mergers the acquired organization received some premium over its book value. If the Federal Reserve does discount capital based on goodwill, then capital requirements for interstate expansion will be effectively increased.

[4] "Manufacturers Bancorp, Inc.," **Federal Reserve Bulletin**, (January 1983), pp. 46-48.

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in the holding company taking on substantial new debt, although its capital remained above the guidelines. The Board's comment on a southeastern regional BHC acquisition request was that "...although the proposal would entail significant acquisition debt, the amount of debt involved would not preclude the applicant from serving as a source of strength to its subsidiary banks.[5] The bank's total capital ratio dropped from 7.09 percent at the end of 1981 to a pro forma amount of 6.57 percent after the acquisition was consummated.

The Board has approved a bank acquisition request by a large multinational holding company. The Board said that, even though it has been concerned about "a long-term trend" toward lower capital ratios for multinationals, it "...has noted the improvements that Citicorp has made in its capital position...".[6] At the beginning of 1981, the holding company had a 3.6 percent primary capital ratio. The Board also expressed its expectation that the holding company will "continue its efforts to improve its capital position and will take such efforts into consideration in acting on applications for further expansion."

Interstate Expansion of Community Banking Organizations

The community banking organization, as defined in regulatory guidelines, can be divided into small organizations and large organizations. The small community banking organizations, those with less than $100 million in assets, constitute the overwhelming majority of banking organizations in the United States. These organizations are generally too small, however, to be a major factor in interstate banking. Most of these small organizations could double or triple in size and still have less than $100 million in assets. Most interstate banking that these organizations engage in will be transacted through offices no more than a few miles from their headquarters.

The larger community organizations generally are similar to regional and multinational banking organizations, but there is one significant difference. The larger community banking organizations have an important motivation to grow, because a bank that grows to over $1 billion in assets becomes a regional bank for capital adequacy purposes. Community banking organizations that grow into regional organizations can meet the guidelines with .5 percentage points less total capital and 1 percentage point less primary capital. If the guidelines are taken literally a holding company with assets of $950 million and the exact minimum total capital to classify as a Zone 1 community bank could finance the purchase of a $51 million bank with debt and still emerge with total capital exceeding Zone 1 guidelines as a regional holding company. A similar but less dramatic effect would occur if the guidelines were administered such that as a bank grows towards its boundary, its capital requirement would approach that of larger banks.

In 1982, Golembe Associates studied the December 1981 primary and total capital ratios of a sample of Association of Bank Holding Company members.[7] The Golembe study looked at the association's 20 largest members, 60 percent of its members who have between $3 billion and $5 billion in consolidated assets and 25 percent with less than $3 billion in assets. The results, reproduced in Table 1, show that most large community bank holding companies can support some asset growth on their existing capital.

Every percentage point a community holding company exceeds the total capital Zone 1 guidelines could support up to 14 percent asset growth.[8] Thus, some larger community organizations may be able to move up to regional bank status with little or no increase in their capital.

Large Banking Organizations' Current Capital Position

Most interstate banking that will take place if restrictions are dropped will involve regional and multinational banking organizations. These organizations can support growth with their existing capital, the earnings they retain in the future and the new capital they raise. The asset growth to be supported, however, will not consist solely of

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[5] "Ellis Banking Corporation," **Federal Reserve Bulletin**, (July 1982).
[6] "Citicorp," **Federal Reserve Bulletin**, (October 1982).

[7] See "An Analysis of the New Capital Guidelines for Bank Holding Companies," Golembe Associates, Inc., November 1982.
[8] If a banking organization is allowed to reduce its capital ratio (primary or total capital) to the minimum Zone 1 guideline, then it can grow by the amount excess capital/minimum Zone 1 capital ratio. A community bank with a 7 percent primary capital ratio could expand by a maximum of 7 percent - 6 percent/.06 =.14. This calculation of a banking organization's growth potential is for illustrative purposes and does not necessarily apply to any specific organization. Unique characteristics of individual banking organizations may affect the minimum capital ratios required for Zone 1 classification.

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Table 1. Percentage Distribution of Capital Ratios of Sampled Community Holding Companies December 31, 1981

Capital as a Percent of Assets	Primary Capital	Total Capital	
5.0 - 5.5	10	—	
5.5 - 6.0	10	—	Zone 3
6.0 - 6.5	—	—	
6.5 - 7.0	20	20	Zone 2
7.0 - 7.5	20	30	
7.5 - 8.0	10	20	
8.0 - 85	20	20	
8.5 - 9.0	—	—	
9.0 - 9.5	—	—	Zone 1
9.5 - 10.0	10	10	

_____ Federal Reserve Board primary capital ratio guidelines.
- - - - - Federal Reserve Board total capital ratio zones.
Source: Golembe Associates

interstate banking but also will come from the growth of existing business. Before we can analyze the ability of large banking organizations' capital to support interstate banking, we need to look at banking organizations' historical ability to generate capital to support their growth.

The analysis will be limited to regional and multinational bank holding companies. Independent regional banks are not analyzed because they constitute a small fraction of the regional banking organizations. There are no multinational banks that are not affiliated with a holding company. The capital position of individual banks within holding companies need not be a constraint on interstate banking because holding companies have the option of double leveraging to meet the capital needs of individual subsidiaries.[9]

Talley has examined the asset and equity growth rates of the multinations banking organizations (Table 2).[10] He shows that the growth rate of equity capital at multinationals shifted up from around 7.5 percent in 1970-1974 to around 11 percent between 1975 and 1982 but that it has otherwise remained relatively stable. The growth rate of bank assets has fluctuated widely through the past decade, however, with a maximum annual rate of 25.1 percent and a minimum rate of 1.6 percent. The equity capital to assets ratios declined from 5.15 percent in 1970 to 3.49 percent in 1974 and thereafter have fluctuated between 3.6 and 4 percent.

Capital trends for a random sample of regional banks are presented in Table 3.[11] These organizations' equity capital has been relatively constant

[9]Double leveraging can be loosely defined as bank holding company debt issues that fund holding company purchase of bank equity. The new capital standards do not stop holding company double leveraging. However, they do prevent bank capital arising from double leveraging from being used to offset a weak BHC capital position. Therefore BHCs that meet or exceed the consolidated capital standards can use double leveraging to meet the capital needs of individual subsidiaries.

[10]See "Bank Capital Trends and Financing," by Samuel Talley, a Board of Governor's staff study in February 1983.

[11]The original sample consisted of 30 organizations that were regional BHCs on December 31, 1981. The sample is selected at random with replacement, as suggested by Lapin. The sample size is reduced to 29 because one BHC, a spinoff from a nonfinancial corporation in 1980, had to be dropped. Some of the banking organizations had less than $1 billion in assets in one or more years prior to 1981 and some organizations were not organized as a holding company for the entire period.

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over the sample period, particularly since 1977. Regional holding companies have raised their capital at a rate close to their growth rate in assets over the same period.[12]

The Golembe analysis of regional and multinational holding companies' primary capital is reproduced in Table 4. Almost all the regional holding companies sampled meet or exceed the Federal Reserve's primary capital standards. Smaller regional BHCs tend to exceed the standards by a larger margin than do larger regionals. Only half of the regional holding companies with over $5 billion in assets exceed the capital standards by more than 1 percentage point, while 77 percent of the regional organizations with $3 to $5 billion in assets and 80 percent of the regionals with less than $3 billion exceed the standards by more than 1 percentage point. Every 1 percentage point of primary capital above the guidelines at regional banks could support as much as 20 percent growth if accompanied by an appropriate increase in the organization's debt capital and if the Federal Reserve allows the holding company to reduce its capital to the minimum Zone 1 guidelines.

As noted above, no guideline has been given for multinational holding companies, but the Fed and Comptroller of the Currency have expressed a desire to see improved capital positions. Even given this desire, it is highly unlikely that the Federal Reserve can force multinationals to maintain capital ratios higher than those required of regional banks. Of the multinational organizations, 37 percent have primary capital equal to or greater than that required for regional banks.

The Golembe Associates study also examined the total capital position of their sample, and those results are reproduced in Table 5.

A substantial minority of the regional banks have total capital ratios in Zones 2 or 3. This stands in sharp contrast to the finding that virtually all regional banks have adequate primary capital. For those holding companies with total capital in excess of the minimum required for Zone 1 regional organizations, every percentage point of excess total capital could support as much as 15 percent asset growth.

No total capital standards have been specified for multinational organizations. If the categories applied to regionals are also applied to multinationals, then no multinational has Zone 1 total capital and the overwhelming majority have Zone 3 total capital.

This analysis of current holding company capital positions demonstrates that smaller regional organizations are in a better position to support growth than larger organizations, and that regional organizations are in a better position than multinationals.

While no guidelines have been set for the multinationals, the Federal Reserve expressed its concern about the "long-term decline in capital ratios, particularly those of the multinational group," when it issued the standards in December 1981. Since that time banks have raised significant amounts of new capital.[13] In one case in October 1982 in which specific reference is made to a multinational's capital position, the Board noted improvements in the holding company's capital position and expressed its expectation that further improvements would be made.

This analysis also demonstrates that community and regional holding companies' primary capital positions are better relative to regulatory standards than are their total capital positions. Some regional organizations may be able to support up to 60 percent growth on existing primary capital if they increase their total capital by issuing additional subordinated debt or limited life preferred stock.

Will Capital Standards Slow the Growth of Interstate Banking?

Large banking organizations have been able to provide capital sufficient to support some growth while maintaining primary capital ratios at a relatively constant level since the mid 1970s. Some regional banking organizations may even be able to grow by as much as 15 to 23 percent on existing total capital and by as much as 60 percent on existing primary capital if they raise additional subordinated debt or limited life preferred stock. If banking organizations want to expand beyond their existing capital base, they will have to sell more subordinated debt or preferred stock and take one or more of the following measures to increase their equity

[12]The above analysis of equity capital trends ignored historical trends in total capital because the regulatory view of holding company subordinated debt has shifted through time.

[13]See "Outlook for Bank Capital" by Jane F. Nelson in the December 1982 **United States Banker**.

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Table 2. Equity Capital to Asset Ratio, Asset Growth and Capital Growth Rates for Multinational Banking Organizations

Year	Percentage Growth in Equity Capital During the Year	Percentage Growth in Total Assets During the Year	Equity Capital to Total Assets Ratio at Year-end
1970	7.9	10.9	5.15
1971	6.8	12.0	4.91
1972	8.0	19.7	4.43
1973	7.7	25.1	3.82
1974	7.9	18.2	3.49
1975	14.8[2]	1.6	3.94[2]
1976	10.2	8.5	4.00
1977	10.5	14.6	3.86
1978	11.4	14.2	3.76
1979	11.2	15.9	3.61
1980	13.0	10.5	3.69
1981	11.1	7.3	3.83
1982 (6 mos.)	11.1[3]	2.7[3]	3.98[4]

[1] Based on consolidated bank holding data.
[2] The growth of equity capital and the equity capital to total assets ratio were increased in 1975 due to an accounting change.
[3] Annualized growth rate. The growth rate for total assets between December 31, 1981 and June 30, 1982, probably was reduced to some degree by year-end "window-dressing" that increases total assets. The growth rate of total assets from June 1981 to June 1982 was 3.9 percent.
[4] Ratio is for June, 1982.

Source: Talley

Table 3. Equity Capital to Asset Ratio, Asset Growth and Capital Growth Rates of Sampled Regional BHCs

Year	Percentage Growth in Equity Capital During the Year	Percentage Growth in Total Assets During the Year	Equity Capital to Total Assets Ratio at Year-end
1975	3.7	3.8	6.2
1976	7.9	5.9	6.3
1977	6.1	11.5	6.0
1978	10.5	12.8	5.9
1979	9.5	8.7	5.9
1980	9.4	7.3	6.0
1981	11.0	11.4	6.0

Source: FDIC, Moody's

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Table 4. Percentage Distribution of Primary Capital Ratios of Sampled Companies by Class and Size of Company

Primary Capital as a Percent of Assets	Regionals: Assets Between $1b-3b	Regionals: Assets Between $3b-5b	Regionals: Assets Above $5b	Multinationals
3.0 - 3.5%	5	—	—	—
3.5 - 4.0	—	—	—	19
4.0 - 4.5	—	—	—	38
4.5 - 5.0	—	—	—	6
5.0 - 5.5	10	18	6	25
5.5 - 6.0	5	6	44	6
6.0 - 6.5	25	24	25	6
6.5 - 7.0	15	29	19	—
7.0 - 7.5	20	24	—	—
7.5 - 8.0	15	—	6	—
8.0 - 8.5	5	—	—	—

___ Federal Reserve Board primary capital ratio guidelines for "regional" holding companies.

Notes: No guidelines have been established for the multinationals.

Source: Golembe Associates

capital: raise new equity capital in the financial markets, use stock swaps to acquire other banks, increase their profitability, or cut their dividend payout ratio.

Bank organizations should face no special problems raising new debt capital. They may, however, have problems increasing their equity capital.

Assuming that banks cannot significantly increase their profitability, they will have to acquire banks through stock swaps, sell new equity or cut dividend payouts to raise new equity. Stock swaps will generally provide sufficient new equity to support the banking organization's growth. Nelson looked at banks' ability to sell new equity issues, but she did not consider dividend cuts. She notes that most bank stocks are selling below book value and that bank capital problems may affect the pace of banking organizations' growth.[14]

Common market folklore has it that corporations whose stocks are selling below book value should not issue new stock because it will dilute existing earnings. Nelson expressed this view in a recent issue of **United States Banker**. "Selling new shares below book is damaging to the issuing institution because per share earnings can be severely diluted without a dramatic improvement in profits."[15]

The arguments that companies should not dilute earnings and should not sell stock below book value are suspect. When a company

[14] Nelson, *Ibid.*

[15] Horvitz also discusses the potential for bank mergers to result in the dilution of the acquiring firm's earnings.

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Table 5. Percentage Distribution of Total Capital Ratios of Sampled Companies by Class and Size of Company

Primary Capital as a Percent of Assets		Regionals: Assets Between $1b-3b	Regionals: Assets Between $3b-5b	Regionals: Assets Above $5b	Multinationals
3.5 - 4.0%		5	—	—	13
4.0 - 4.5		—	—	—	25
	Zone 3				
4.5 - 5.0		—	—	—	25
5.0 - 5.5		5	12	—	19
5.5 - 6.0		5	12	38	13
	Zone 2				
6.0 - 6.5		20	18	13	6
6.5 - 7.0		10	24	25	—
7.0 - 7.5		30	29	19	—
	Zone 1				
7.5 - 8.0		10	6	6	—
8.0 - 8.5		10	—	—	—
8.5 - 9.0		5	—	—	—

Notes: There are no zone designations for multinationals.
Source: Golembe Associates

purchases an asset, such as another bank or a *de novo* branch, it is buying a stream of future earnings. The asset is worth purchasing if the value of the future earnings discounted at the bank's cost of capital exceeds the cost of the acquisition or in other words the asset has a positive net present value.[16] If the cost of the acquisition is greater than the discounted value of the earnings, then the project has a negative net present value and is disadvantageous to existing shareholders. Short-term dilution of earnings is not harmful to shareholders if the acquisition promises sufficient earnings in the future. The relationship of book value to market value is irrelevant to the calculation of an acquisition's net present value. Banking organizations selling below book value are doing so because they made investment and management decisions that were mistakes viewed with the 20-20 perspective of hindsight.[17] Banks cannot erase the effects of bad decisions by refusing to raise new equity to support desirable interstate growth. Indeed, bank management only compounds the cost to shareholders of prior mistakes if it refuses to fund growth that has a positive net present value.

[16] Banks' cost of capital is a weighted average of the rate paid on new debt and the market's required rate of return on a new stock issue with the weights depending on the firm's debt-to-equity ratio.

[17] This analysis of bank stocks that sell below book value applies to firms whose stock sells on organized exchanges. Because of liquidity problems, the stock price of banking organizations whose stocks have only a limited local market may not reflect the firm's true value. Thus a small bank's stock may sell below book value not because of bad management decisions but because too few investors know enough about the bank to buy its stock.

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The other way to increase a bank's capital given constant return on assets is to cut the dividend payout ratio. Dividend payout ratios can be reduced by: cutting dividends or by maintaining constant dividends while income is increasing with the bank's size. The reluctance of bank analysts to suggest that banks could solve their capital problems by reducing dividends is not very surprising. Most corporations are very reluctant to cut their dividends, and those that do, such as Consolidated Edison, sometimes find that their stock price drops sharply after the cut. Often times, however, a company cuts its dividend while it is experiencing financial difficulty. A dividend cut by a firm in this setting is taken by the financial markets as a signal that the company's management thinks it has serious problems. Thus, it is not the dividend reduction per se that causes a firm's stock price to drop, but rather the indication it provides about future prospects.

Banking managers who reduce dividends to fund profitable interstate growth are not sending the market a negative signal. On the contrary, such reductions should indicate that management views a firm's prospects as very favorable. If the financial markets agree with management, then a dividend reduction will increase the value of an organization's stock.

Banking managers who believe dividend cuts will hurt their stock price can consider the less drastic measure of holding dividends constant while income increases. This is a slow way for a firm to increase capital, but it is better than foregoing profitable investments because of capital limitations.

Banking organizations, then, can increase equity capital to support profitable interstate growth and still increase the value of their outstanding shares. There are, however, several reasons why capital adequacy guidelines may slow the growth of profitable interstate banking.

One possibility is that banking organizations will follow conventional wisdom by refusing to cut dividends, pay out ratios or sell stock at prices below book value to support desirable interstate growth. If this happens and holding company stock prices do not increase, then capital adequacy standards will slow the development of interstate banking significantly.

A related reason why interstate growth may be slowed is that the financial markets may not agree with bank managers on which interstate expansions have a positive net present value. No matter how desirable a banking organization's management believes interstate growth is, unless the financial markets agree with management's assessment the firm's stock price will drop. Therefore, some interstate expansions may be killed because the markets do not agree with management's assessments of their desirability.

Another problem that may slow the expansion of smaller banking organizations is that they may find the transaction costs of selling new equity so high that otherwise desirable mergers will become too expensive. Nelson quotes Harry Keefe, Jr., chairman of Keefe, Bruyette and Woods, as saying, "About 63 percent of all stocks are purchased by pension funds, and a company that can't reach that market is disadvantaged."[18] Keefe went on to point out that few banking organizations have sufficient trading volume to justify institutional interest. This disadvantage for smaller holding companies relative to larger organizations will be offset partially be their stronger capital position.

The fourth reason why capital guidelines may slow interstate banking growth is that they increase discount rate applied cash flows from growth. Banks, like all corporations, should discount their future cash flows by their cost of funds. Government regulation of capital/asset ratios increases banks' cost of funds if that regulation forces banks to hold more capital than they otherwise would and if equity capital is more expensive than debt.

Conclusion

Regulatory capital adequacy guidelines can affect the rate of growth in interstate banking. Banking organizations that wish to grow must have sufficient existing capital or they will need to raise additional capital. While many community and smaller regional bank holding companies appear to have excess capital, the capital position of larger regional holding companies and the multinationals seems to be weaker. Low bank stock prices may inhibit some banking organizations from selling additional equity to support growth. Banking organizations' stockholders should be willing to raise sufficient capital to support interstate growth that has a positive net present value. Regulatory capital guidelines may prevent some questionable interstate expansion, but they should not prevent expansion of profitable interstate banking.

—Larry D. Wall

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[18]Nelson, *op. cit.*, p. 47.

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