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Banking Structure and Banking Markets

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Growth seems to be the magic word among businessmen today. The more aggressive American firms aspire to outgrow their community, their State, the Nation, the industry and any record of their past performance. The extension of this drive is apparent in the conglomerate movement, the flow abroad of American capital and the concentrated attention of investors on firms exploiting new products and innovative processes made possible by technological progress.

Banks have not been entirely immune to this virus, especially the larger and more aggressive institutions. This is evident by their interest in the one-bank holding company, foreign branches or affiliates, and in "buying bigger footings" by the issuance of negotiable CD's and the purchase of Euro-dollars and Federal funds.

For a long time after the restructuring of banking in the 1930's banks were content to accept the confines of State laws on office locations and an elaborate harness of statutory and regulatory constraints on innovative practices. In turn, grants of quasi-monopoly power came from State legislatures in the form of home-office protection and branching limitations and from regulatory authorities in the form of limitations on entry supported by findings of "over banked" conditions when competition threatened earnings. All of this was consistent with an environment in which banks were relatively indifferent to growth objectives beyond retaining their share of a Government delineated neighborhood, city, county or State market.

In recent years more and more banks have been chafing at these restrictions. They see first hand the spectacular growth of many of their industrial and commercial customers. Looking back they realize how much more perceptive nonbank financial institutions were in occupying and developing the markets that they might have nurtured. But there is more to it than rekindled envy for the green grass on the other side of the fence so far as some banks are concerned. The realistically minded know that accelerated growth is not going to be theirs by virtue of Government fiat or sheltering policies but that to succeed they must meet the compelling force of competition for manpower and financial resources.

For example, a banking institution cannot break out of a treadmill existence without a superior management and technical cadre. It has problems like persuading a "top of his class" graduate to consider a career in an industry burdened by overlapping growth lids when the young man's alternative is moving up with an innovating concern whose growth ceiling is limited only by its resourcefulness in technological adaptations.

Or consider the difficulties faced by the planning officer in a growth-minded bank who has to identify the sources of deposits or borrowings to achieve his institution's growth in the face of continuing attrition in demand deposit balances and the steadily rising interest in equities or equity-sweetened debt. Even for banks, as we know, the question often is, where is the money coming from?

This, I take it, is a key part of your problem today. To tell your planning officer where money is and how to get it. In 1969, and perhaps for some time to come, investing or loaning the bank's money will involve a minimal promotional effort--in fact, I am often told these days that such promotional effort is mainly negative. And I am sure it is--for some kinds of loans. But there are other loans and customers whose business is more profitable and on which promotional efforts could still be concentrated even though the institution as a whole was "loaned up" or fully invested. Rather than explore these possibilities, of necessity as an amateur, I want to discuss some of the promotional possibilities of adding to your institution's resources, given the nature of our banking structure.

The banking structure of the United States is usually characterized as diffused because there are upwards of 13,500 banking organizations in the Nation. It is said to be dominated by unit banks because about 10,000 of these 13,500 organizations are unit banks. And it is asserted that it is becoming more concentrated because of merger and holding company acquisitions and because of the relatively limited growth in numbers of banks (about 400 since 1959) compared to population and economic growth.

For example, this is the way the Supreme Court of the United States characterized the Nation's banking structure in U.S. vs. The Philadelphia National Bank, in 1963:

"Commercial banking in this country is primarily unit banking. That is, control of commercial banking is diffused throughout a very large number of independent, local banks--13,460 of them in 1960--rather than concentrated in a handful of nationwide banks, as, for example, in England and Germany. There are, to be sure, in addition to the independent banks, some 10,000 branch banks; but branching, which is controlled largely by state law--and prohibited altogether by some States--enables a bank to extend itself only to state lines and often not that far. It is also the case, of course, that many banks place loans and solicit deposits outside their home area. But with these qualifications, it remains true that ours is essentially a decentralized system of community banks. Recent years, however, have witnessed a definite trend toward concentration. Thus, during the decade ending in 1960 the number of commercial banks in the United States declined by 714, despite the chartering of 887 new banks and a very substantial increase in the Nation's credit needs during the period. Of the 1,601 independent banks which thus disappeared, 1,503, with combined total resources of well over $25,000,000,000, disappeared as the result of mergers."

Most of us have unthinkingly accepted such superficial and inadequate characterizations of our banking structure because we've not considered them analytically or tested them against our own knowledge and experience. How should our banking structure be described?

While the FDIC Summary of Accounts and Deposits for 1966 shows that over 75 per cent of the country's banks are unit banks it does not follow from this one fact that "commercial banking in this country is primarily unit banking." Actually, the 10,525 unit banks had only 30 per cent of the country's bank deposits and only 31 per cent of the country's banking customers. Unit banking is even less prevalent among large banks. There are, among the 150 largest banking organizations in the country, 103 branching systems, 34 holding companies, and only 13 unit banks. These unit banks have only 8 per cent of the total deposits held by the 150 banking organizations. Thus, in any meaningful sense: i.e., in terms of aggregate resources, deposits or number of customers--U.S. banking is primarily composed of branching systems even though office locations are confined, for the most part, by State lines.

In the second place, our system may appear significantly different from that of many other countries only because of a false assumption--namely, that since there are 13,500 banking organizations there could hardly be such great disparities in size as to allow of much concentration. Few people realize how sharply the size distribution of U.S. banks is skewed by the large size of a few institutions. They are surprised to learn that 13 banks have one-fourth of the country's deposits. And even more surprised to learn that at the other end of the distribution the smallest 6,500 of the country's banks, combined, have only 5 per cent of total deposits.

These facts, however, are not inconsistent with the structure of the American economy nor do they necessarily imply a level of concentration or dispersion that should be viewed with alarm. A banking structure in which 150 institutions have 55 per cent of the country's deposits is not inappropriately geared to serve enterprises, institutions and governments of the size that account for the preponderance of the country's economic activity. And the fact that these 150 banks serve nearly half of the country's banking customers is not surprising if we bear in mind where most Americans live and work.

It is a little more difficult to rationalize the economics of the other end of the banking structure--though it can be explained and justified on other grounds. One-fourth of the country's banks have less than $2.7 million in deposits and half of our banks have deposits of less than $5.4 million. It is by no means certain banks of this size can survive and prosper in the main stream of a competitive, rapidly changing economy.

A third point about the U.S. banking structure has to do with concentration trends. The best evidence presently available indicates that banking has not shown a significant trend toward or away from greater concentration in the past 10-12 years. The shares of the market held by the largest and smallest banks have changed very little since 1957 (the earliest date as of which we have such data). For example, the largest one-tenth of one per cent of the banks had 23.1 per cent of total deposits in 1957--they have 24.3 now. The next largest .9 per cent had 28.4 in 1957 and 28.5 now.[1/]

1/ (See table on next page)

National Trends in Concentration Ratios for Total Deposits

	Share of total deposits					
	1957		1961		1967	
	Per cent	Cumulated	Per cent	Cumulated	Per cent	Cumulated
The largest banks						
Largest .1 per cent	23.1		24.5		24.3	
Next largest .9 per cent	28.4	51.5	28.1	52.6	28.5	52.8
" " 4.0 "	18.2	69.7	18.5	71.1	18.6	71.4
" " 10.0 "	12.0	81.7	11.3	82.4	11.1	82.5
The smallest banks						
Smallest 25 per cent	1.6		1.5		1.5	
Next smallest 25 per cent	3.7	5.3	3.5	5.0	3.6	5.1
" " 25 "	7.4	12.7	7.1	12.1	7.1	12.2
" " 10 "	5.6	18.3	5.4	17.5	5.3	17.5
Number of bank organizations	12,843		12,752		13,014	

Let me revert now to the relationship between banking structure--in being and in transition--and bank liability markets. It seems to me that in recent years there has been a steady diminution in the constraints that structure places on competition and growth, and this trend is continuing, structure itself is being modified by the liberalization of locational constraints. Such changes have been spectacular in some sections of the country, as, for example, along the Atlantic seaboard.

Everyone knows, I am sure, that the largest banks in the country have grown by competing in national and even world-wide asset and liability markets. And most of us realize that the inability of a bank to freely branch beyond home city, county or State has only partially restricted aggressive well-managed institutions from competing for loanable funds well beyond the boundaries of their primary service areas.

The major nonlocal sources of funds are the money and security markets where banks can borrow short, for as little as one day, or long, for as much as several years, using a considerable variety of debt or depository instruments. Many of these alternatives are not as available for the medium-sized bank as for the larger or largest banks. This is often the case, for example, when banks have gone beyond local sources by borrowing, in some form, from other banks. Obviously, the well-established correspondent practice of supplying certain services to other banks in return for investible balances is pretty much of a one-way street. These means of adding to a bank's resources involve, to a greater rather than lesser degree, increased competition in impersonal money and capital markets: their impact on local liability markets is limited.

But what can banks do to sweep up more resources that lie closer to home? How tightly do locational constraints limit the capacity of an aggressive, innovative institution to penetrate--intensively and extensively--these bank or nonbank markets?

Some part of the failure of banks to exploit such markets is traditional and imbedded in the attitudes of bankers. Reaching out beyond one's traditional "territory" to compete for customers served by others is a venturesome step and not always easily taken. A competitive behavior which at one time was considered bad taste, if not bad banking, is not easily embraced. But if a bank wants to compete aggressively, albeit fairly, in its primary service area or in an expanded service area with whom would it be competing, and how?

If we think of banks as providing a money service they compete with other banks and the Treasury's currency and coin. If we think of banks as providing a liquidity or near-money service they also compete with other banks but in this arena a large variety of nonbank competition is likewise very active. Banks in this function are competing with savings and loan associations, credit unions, short- and long-term market instruments and, in a degree, equities.

How can banks promote larger shares in these markets? Speaking first of money services, it seems to me that EDP has opened up possibilities of expanded service that have only been timidly and selectively considered. Some of the caution, no doubt, stems from the wariness of people who have found that computers have a way of not attaining their obvious potential within a predicted time period. But there is much more to it than that. Banks have not accepted the logical form of a money service implicit in computer technology, namely, the credit transfer. They continue to visualize the check tailing along behind the electronic impulse in an ever rising paper accumulation. The debit transfer (check) is outmoded by the computer; the recent English giro system installation dramatizes this fact.

Simply put, if we are going to use computers in banking we cannot avoid an ultimate breakdown in our capacity to make paper flow as fast as electronic data processing and transmission unless we have a more efficient mechanism than the check for authorizing money payments within the banking system. An arrangement compatible with EDP would be a direct instruction by the depositor to his bank directing it to credit the account of another party in that bank, or any other bank in the country. The proof of authorization would thus at all times be in possession of the paying bank. The transfer of funds and proof that the transaction has been consummated would be the contribution of the electronic gear and the essence of the bank's money service to its customers.

A credit transfer mechanism is vastly cheaper than the check, more certain, dateable, and capable of being a builder of demand deposit balances, as well as an eroder. Banks have learned that many of their services other than credit can be charged for and here is a service that has enormous possibilities for intensifying market penetration as well as extending it.

Banks have probably been somewhat myopic in resigning themselves to locational constraints in light of the opportunities inherent in transport and communication changes of recent years. An electronic credit transfer mechanism has the potential to do far more for aggressive bank merchandising over the years ahead than a far-flung string of branches. Electronic networks connecting the bank's computers with those of their largest customers, and with their customers' customers--can attract and service sizable deposits with much greater efficiency and mobility and less per-dollar cost than static street-corner plants, or community branches. Even the small personal depositor is much more reachable remotely than is often thought. Only a few banks--in fact I know of only one--promote a fairly complete banking service from remote locations, yet I know a great many people who have moved to Washington and still retain their previous banking connection's services, however remote the location. People are not adverse--given some incentive--to remote banking but bankers often seem to be.

The language "a cluster of products and services" has been used by the Supreme Court to suggest that banks' services are primarily sold in prepackaged combinations--or, to use an invidious term, as "tied in sales." My own view is that there is not nearly as much of this today as the Court implies or as is advantageous to banks or their customers. A systematic promotion of various service combinations could ensure more stability in deposits and less costly services to depositors particularly if "near money" services were a part of the package.

The competition banks face from some other intermediaries and from the market for such services has been intense for several years now. It has been held in check to some degree by interest rate ceilings. But banks, with their uniquely broad variety of services and packaging potential seem to have the competitive edge except in periods of severe monetary restraint when they have lost ground to market instruments. Promotion of "near money" services has been most difficult and the sell the hardest, yet the record again shows numerous competitive opportunities, e.g., the penetration of locations where rates are below ceilings because of ineffective competition or the further tailoring of liability instruments to customers' needs and convenience. Gains along these lines are not going to come as manna from Heaven. They will require imaginative promotional and technical skill as well as the desire to innovate banking's role and function. But if banks want to be a growth business in today's economy they can only do so by intensifying and extending their competitive effort in every direction.