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George J. Kelly, Director
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ADDRESS OF M. MONROE KIMBREL

President of The American Bankers Association, before the 69th Annual Convention of the Florida Bankers Association, The Fontainebleau, Miami Beach, Saturday Morning, March 23, 1963. Mr. Kimbrel is chairman of the board, First National Bank, Thomson, Ga.

Are bankers inferior businessmen? You and I would probably answer this question with a resounding "No." And we would quickly substantiate our answer with such general proof as our growth pattern, our profit statements and the new services we have added over the years.

But apparently, not everyone would agree with this answer. Recently I was in New York and had lunch with some A.B.A. staff men, and a financial writer joined us. Somehow the question was raised, "Are bankers good businessmen?"

The writer said we did a good job of managing other people's money and giving them advice, but he did not agree that bankers are good businessmen.

He said, "While commercial banking has become one of the most competitive businesses in the world, I believe that on the whole bankers are inferior businessmen."

Naturally, we challenged his statement. But we all had to leave before we could discuss it in depth. So I asked him if he would write to me and spell out his arguments. A few days later I was surprised when I received a long letter from the writer.

After reading it, it occurred to me that this was the sort of outsider's view we should listen to and weigh carefully. I know you would not agree with everything he said. I didn't. Yet the questions he raised are challenging and stimulating--so much so that I'm going to assume the role of devil's advocate and raise some of them here today.

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First of all, let's make sure we agree that banking is a business and that commercial bankers should try to be good businessmen.

By a business I mean a private, profit-motivated operation.

Why does a business make a profit? Any business (you name it) makes a profit because it fills a need. A supermarket makes a profit because people need food; a bank makes a profit because people need banking services.

Moreover, all businesses make profits the same way. That is, a business buys or produces something at one price and sells it at a higher, or profitable, price. This applies to commercial banks as much as it does to supermarkets. What is different is that each business has its own stock in trade. Our stock in trade is the use of money.

Banks obtain the use of money in two ways: They acquire time deposits by paying interest for them; they acquire demand deposits in exchange for banking service.

Banks also sell the use of money in two ways: They provide customers with the use of money by making loans and investments; they provide customers with the use of money by transferring money ownership among them--in other words, by processing checks.

Now let's turn to the contention that, although commercial banking has become one of the most competitive businesses in the world, on the whole bankers are not very good businessmen.

Surely, no one is going to disagree seriously with the first half of this statement. I am equally sure that most bankers would disagree with the last half.

So far as competition is concerned, commercial banks not only compete strenuously with each other in acquiring their stock in trade--that is, the use of money--but also experience very substantial outside competition as well.

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Savings and loan associations, savings banks and credit unions compete head on with commercial banks for time deposits. The savings of individuals also are sought by life insurance companies and mutual funds, with both of these businesses constantly attempting to improve and broaden the wares they offer the public. Although variable annuities and monthly investment plans may be relatively new arrivals in the competitive arena, they shouldn't be ignored or discounted. They're only the latest, not the last, of the devices which nonbank institutions have been creating in their competition with commercial banks to obtain the use of money.

Competition is no less keen on the other side of the profit equation--selling the use of money. The biggest use by the general public of credit in any one area is in mortgage borrowings. Nongovernment financial institutions at the end of 1962 held a total of \$192 billion in mortgage debt. Commercial banks held less than \$34 billion. Mutual savings banks held almost as much. Life insurance companies held more than \$46 billion. Savings and loan associations held more than \$78 billion.

Now someone may say, "But how about short-term credit--the commercial banks' biggest money-earner? Aren't the commercial banks way out in front of the competition in this area?"

There's no doubt that the commercial banks still get the biggest share of the loan dollar from business, but it is equally true that our competition here, too, is mounting.

Actually, the competition is gaining ground fast. In recent years the commercial finance companies and the commercial paper dealers have steadily increased their annual portion of total business commitments.

In 1962 nonbank providers of credit put up 20 per cent of all business credit. In 1959 they put up only 8 per cent. The November 1962 issue of Burroughs Clearing House, in discussing this trend, said: "As more and more

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corporations lend to each other by purchasing commercial paper and finance each other's foreign trade by buying banker's acceptances, the proportion of corporate financial needs financed outside of banks continues to expand. This nonbanking lending has reached all-time highs both in dollar amount and as a percentage of all credit used by business."

Did I say commercial banking is one of the most competitive businesses in the world? I'm sure bankers will agree that it's difficult to think of any business that is more competitive. Certainly, commercial bankers here in Florida need no convincing on this point.

It follows that we are under special and increasing pressure to conduct our businesses just as skillfully and effectively as we possibly can. Are we doing that?

Well, how does one judge the effectiveness of a businessman?

One criterion is his familiarity with his own stock in trade. A supermarket manager, for example, may stock hundreds of items. But he knows how much it costs to put each one on the shelf for sale to customers. Thus he knows how much to mark up each item in order to realize a profit.

I use a supermarket manager as an example of a businessman at work because today's commercial bank is often referred to as "the supermarket of finance." Now let's see if the managers of these financial supermarkets are as familiar with their stock in trade as are the managers of the food supermarkets.

As we've already noted, the commercial bank's stock in trade is the use of money. Bank credit is one way a bank's customers use the money in banks. Another way is by transferring ownership of it to settle debts--by writing checks.

Bank customers certainly use an impressive amount of bank credit. At yearend 1962, some \$235 billion in commercial bank loans and investments was outstanding. Let's assume this turned over four times during the year. This is

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a mighty generous assumption in this day of the term loan, the two-year consumer loan and the 20-year mortgage loan. But let's assume bank customers made use of a total amount of \$1 trillion in commercial bank credit in 1962.

That was an important sale by commercial bankers of one part of their stock in trade. But it was not the biggest sales item. The biggest use of money by bank customers was in the transfer of its ownership by writing checks.

The A.B.A.'s excellent Centennial booklet, "How Banks Help," says, "The chances are that you are one of the nation's 57 million checking account owners and that your checks are among the 14.5 billion which flow through the banks each year. These trim pieces of paper, so commonplace, so similar, so necessary, pay more than \$4 trillion of this country's bills annually."

Two parts of this statement are exceptionally significant: the \$4 trillion figure and the words, "so necessary."

The \$4 trillion means that for bank customers the use of money by transferring its ownership is four times bigger than the use of money by borrowing it. In short, the biggest sales item in a commercial bank's stock in trade is bank checking. And it is big in more ways than one. Banks spend a good deal more time and effort processing checks than processing loan applications or managing their investment portfolios.

Paul B. Trescott, in his Centennial book, "Financing American Enterprise," says, "It is also in connection with management of checking deposits that the bulk of bank expenses are incurred. Available accounting data suggest that managing demand deposits cost the commercial banks from \$1.4 billion to \$1.6 billion in 1954. This represented about 40 per cent of their total costs."

That was eight years ago. It might be argued that since then many banks have installed electronic data-processing equipment to handle the costly

bookkeeping operations entailed in check handling. But eight years ago, the volume of checks was less than half of what it is today. And eight years from now, the volume will increase by at least another 50 per cent.

The fact is that while some of the larger banks have installed sophisticated computer-oriented systems, these systems have not as yet begun to cut check-handling costs. One reason is because these systems require multimillion-dollar expenditures before they begin to take over manual check handling. Another reason is that these systems require extensive reorientation and retraining of bank personnel.

Taking the commercial banking industry as a whole, then, it is fair to say the net effect of automation to date has been to increase, rather than reduce, check-handling expenses. No doubt some years from now, if most commercial banks, rather than only the larger ones, take full advantage of the technological advances that have been made, they will be able to cut check handling costs substantially. But until then, check handling is going to remain a heavy anchor dragging against commercial banking's progress.

And the reason, in many instances, will be the unbusinesslike methods, or lack of methods, by which bankers attempt to cover the production costs of this biggest sales item in their stock in trade. Professor Trescott says the service charges banks levy on holders of checking deposits were yielding only one-fifth of deposit management costs in 1954.

Just think of it: 20 per cent of the costs of producing the checking service--their biggest sales item--was all that the commercial banks were recovering from customers for the use of this service. You're going to say that since 1954 banks have increased their service charges, and so they have. Let's assume the banks are now recovering 40 per cent, or even 50 per cent, of the costs of managing checking accounts. In addition, we can assume that the earnings credit on demand accounts raises this recovery to a somewhat higher percentage.

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But is this really a businesslike operation? Remember the words "so necessary" that were used to describe the public's use of 14.5 billion checks annually? "So necessary" means that commercial banking is filling a real need by providing the checking service--a service, incidentally, that is now used by our economy to complete 90 per cent of all business transactions.

At this point, the average banker would quickly interject the reminder that commercial banks make most of their money out of business loans and that these loans depend on the banks' ability to attract demand deposits.

This is true, but you and I know it isn't nearly as true as it used to be. The New York University Graduate School of Business Administration recently published a deposit study. It showed that while demand deposits in the postwar period have increased at an annual average of 1.5 per cent, time deposits have grown at an average annual rate of almost 6.5 per cent.

"At these rates of growth, time deposits will constitute over half of the deposits of commercial banking by 1971," the study forecast.

So we see that demand deposits have been shrinking as a percentage of total deposits while the use of demand deposits has been increasing. This is demonstrated not only in the total of checks written but in terms of deposit turnover--or velocity. In November 1962 the Federal Reserve Bank of Chicago in its monthly bulletin said the average demand deposit account in the nation was turned over about 32 times in 1961. This represented an increase of almost one-fifth in a decade.

The Chicago central bank also said, in talking about 1961 checking activity: "Last year, individuals and businesses wrote more than 13 billion checks having a total value of about \$3.5 trillion. However, the aggregate size of the 60 million demand deposit accounts against which these checks were drawn was much smaller--\$110 billion. . . . As both the number and the dollar volume of checks have risen, the average balance per account has declined."

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Nothing could be plainer: demand deposit balances on the average are shrinking, giving the banks less funds to put to work in loans or investments, as the use of checking accounts continues to rise.

Even if we assume that it is good business to run checking accounts as a loss leader, it certainly isn't good business to continue this practice if the business can't produce a compensating profit elsewhere. The profits banks have been able to net by lending or investing funds from demand deposit balances have been shrinking simply because the cost of acquiring the use of this money has been increasing much faster than the profit derived from selling the use of this money.

Gentlemen, I think we must concede that this is not good business. It's bad business. Too many bankers--too many of us--don't know what we should know about our chief stock in trade. Actually, there are very few banks that do the sort of cost accounting on their checking operations that enables them to say with any degree of certainty: "That \$1,000 in demand deposits we took in this afternoon at 2:13 P.M. will produce so many dollars in net earnings if we lend it at such-and-such a rate."

Certainly, each bank ought to determine its own costs in acquiring the use of demand deposits. Unless each bank has this information it is at a loss to know how much it should be charging in order to earn a profit on checking services.

Charles A. Agemian, the controller general of The Chase Manhattan Bank, wrote about bank costs and profitability in a recent issue of Auditgram. Some of the things he said certainly bear repeating here:

"It is not enough for a banker to know that his profits are being squeezed; he must know where the squeeze is coming from. It is truly amazing how little some bankers know about their costs. . . . The banker must know the cost and profitability of each service. . . . The bank that competes blindly

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is the bank that does not know its costs, . . . The over-all profitability of the bank is arrived at by the sum of the contributions made by each of the components. Prudently speaking, all functions must be profitable. Loss functions should not be carried and allowed to exist because they are combined with profitable functions in the over-all earning picture."

To show that banking is viable and dynamic we like to cite the continuing growth of banking's deposits and assets from one year to the next. Deposits and assets have grown, and that is significant. However, some \$15 billion in bank deposit growth last year--just about all the deposit expansion that occurred--resulted from increases in time deposits. Since the cost of acquiring these time deposits also rose, owing to the higher ceilings on interest rates, bank earnings declined in 1962 for the industry as a whole.

It's what happens to earnings that counts. It's no secret that one reason bank earnings declined in 1962 was that bankers on the whole did not know beforehand just what the effect of added interest costs would be on the costs of acquiring time deposits. Some banks that increased savings interest rates at the beginning of 1962 lowered these rates again before the year was over. Others would probably follow suit if they could do so without embarrassment.

If we are to become profit-conscious, we must develop some realistic yardsticks--some hardheaded business practices. The question should be, "How good are profits?"

As Professor Trescott said, "Over the years 1946-1960, commercial banks averaged 8.4 per cent profit on their capital accounts, after taxes. By comparison, American manufacturing corporations over the same period recorded after-tax profits of 11.7 per cent of capital--more than one-third higher."

This is an inferior profit performance. This is another indication that we have nothing to be complacent about as we prepare for the mounting pressure of competition and service that lies ahead.

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In short, my friends, we all need to ask ourselves some hard, critical questions--and to find the answers if we don't have them.

How good are we at cost accounting? How well do we appraise the value of the services we perform? Do we pay enough attention to net profit? Do we permit ourselves to be lulled into complacency by traditions and yardsticks that are out of place in today's business environment?

So long as we recognize these problems and work at solving them, banking's future will be one of promise. After all, a good test of a successful businessman is his ability to adjust to new business conditions. Bankers have been doing this for centuries. I am convinced that our industry will continue to meet the challenge.

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