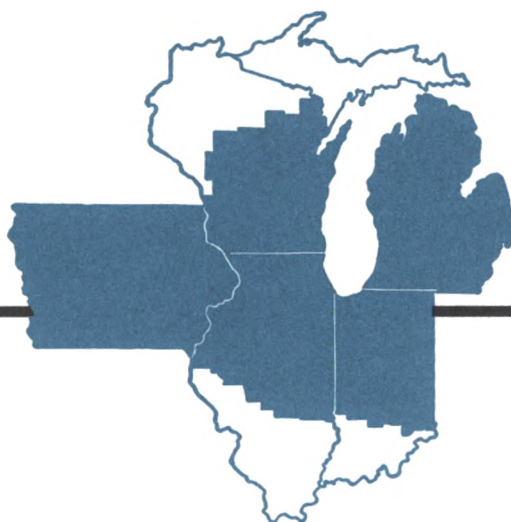


# Business Conditions

**1967 December**



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# THE Trend OF BUSINESS

Since late summer, strikes and threatened strikes in major Midwest industries have cast a veil of doubt over confident predictions that business activity would surge in the fourth quarter. Total employment and industrial production failed to rise in September and October. Retail sales remained sluggish. And unemployment rose in some areas.

October settlements of disputes in three important industries—motor vehicles, construction machinery and steel hauling—and the likelihood that other negotiations would be resolved without long walkouts opened the way to a renewed upswing. But labor peace is being bought at a high price to be paid in annual instalments for as many as three years to come. Increases in compensation of 6 percent a year, with much of the gain in current cash income, are far more than the most optimistic projections of gains in output per manhour. Wage gains far in excess of increases in productivity will be illusory.

## Price trends closely watched

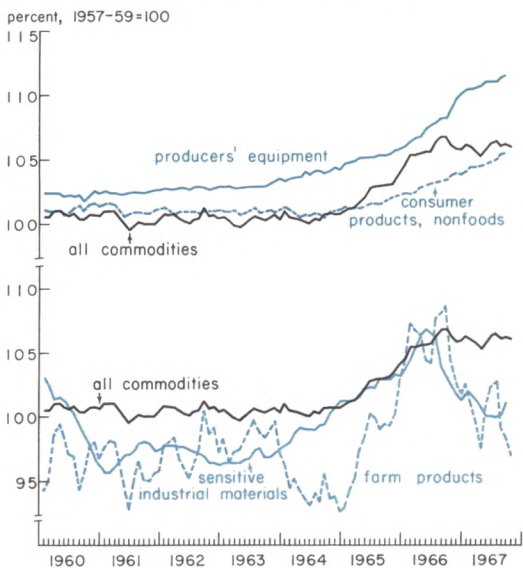
A poll of purchasing agents a year ago revealed their principal headaches to be broken delivery promises, long lead times and material shortages, in that order, with rising prices fourth. A recent survey shows rising prices as the main problem. These survey results highlight one of the paradoxes of the current situation. Most industries are operating below capacity, overtime has been

restricted and—except for the effects of strikes and defense priorities—delivery schedules have improved. But the likelihood of an accelerated rise in prices has increased.

In October, 65 percent of Chicago purchasing agents reported paying higher prices for the principal items they buy, with only 1 percent paying lower prices. Only in a few months in the spring of 1966 were larger ratios of increased prices reported.

Evidence of inflationary trends in manufacturing has been clouded for the past year

## Prices of finished goods rose as prices of materials and farm products moved to lower levels





by declines in prices for raw materials, including many farm products.

The Government's spot commodity price index was down to 95 percent of the 1957-59 average in late October. This was from 102 a year earlier and a peak of 115 in February 1966. Declines in hogs, wheat, hides, rubber, zinc, lead, steel scrap and print cloth all played a part in the downward movement of this index.

The broad wholesale price index, which includes finished and semifinished goods, was lower in September than a year earlier—but only slightly and entirely because of declines in raw materials. But machinery and equipment and consumer nondurable goods (exclusive of food) were up almost 3 percent. Consumer durable goods averaged only 1 percent higher, but appreciable increases have been announced for appliances, television and hi-fi sets, and a further increase in auto prices is widely expected.

The consumer price index, used in granting workers "cost-of-living" increases, was almost 3-percent higher in September than a year earlier, despite a 1-percent decline for food consumed at home. Food prices had risen sharply in 1966. This year housewives continue to complain about high food prices, and some foods, such as dairy products and citrus fruits, have risen further. But the main increases in the consumer price index involve commodities and services with large labor inputs. Apparel, restaurant meals and, especially, medical care have increased substantially in 1967. Rents, which had been rising about 1 percent a year in the early 1960s, increased 2 percent in the year ending in September.

Declines in prices of raw materials and agricultural products seem to have run their course for the time being. More and more, therefore, higher prices announced by

manufacturers and other suppliers of goods and services will be reflected fully in the total consumer and wholesale price indexes. In October and November, higher prices were posted for stainless steel, sulfuric acid, copper, brass and aluminum products, electrical equipment, household appliances, TV sets, rapid transit fares, newspapers and polyethylene film.

The upward price trend has clearly acquired strong momentum. But scattered price reductions for processed goods, margins of unused capacity in most industries and depressed markets for many raw materials indicate that competitive forces remain at work. Appropriate public policies can reinforce these stabilizing influences of the market place.

### **Labor shortages persist**

Estimates of total nonfarm wage and salary employment for all Seventh Federal Reserve District states—Illinois, Indiana, Iowa, Michigan and Wisconsin—and for the nation as a whole show moderate increases in recent months from the levels of a year earlier. Manufacturing employment has been somewhat lower, however, and average work-weeks in industries producing durable goods have been reduced sharply since last year.

In October 1966, 18 out of 23 major labor markets in the Seventh District were classified as having "low unemployment" with less than 3 percent of the labor force seeking work. Five centers were in the "moderate unemployment" group with unemployment rates ranging from 3 to 6 percent. Currently, 11 of the District centers are in the low unemployment group, 11 are in the moderate unemployment group and one (Kenosha) is classified as having "substantial unemployment"—more than 6 percent. Most of the Midwest centers with easier labor markets

concentrate on production of motor vehicles or farm machinery.

For the United States as a whole, a similar but less pronounced trend developed in the past year. Of 150 major labor markets, 35 percent had low unemployment in October, compared with 44 percent a year earlier.

The proportion of insured workers receiving unemployment compensation is higher than last year in all District states, but the rates generally remain well below the level for similar periods before 1965. Moreover, all District states continue to report ratios lower than the nationwide averages. Also, unemployment was increased temporarily in the early fall by indirect effects of strikes. Resumption of full-scale auto production will reduce unemployment in some centers.

Many personnel managers remain unconvinced that labor markets are easier than a year ago, and some insist that recruiting prob-

lems have become more acute. Responses to help-wanted ads have been poor, and some companies have increased use of other devices—such as ads on public conveyances, appeals for employees to aid in recruiting, and direct mail and blind telephone calls to private homes—all of which tend to seek out people working somewhere else. Married women and potential moonlighters have been attracted to jobs with hours and other conditions tailored to individual circumstances.

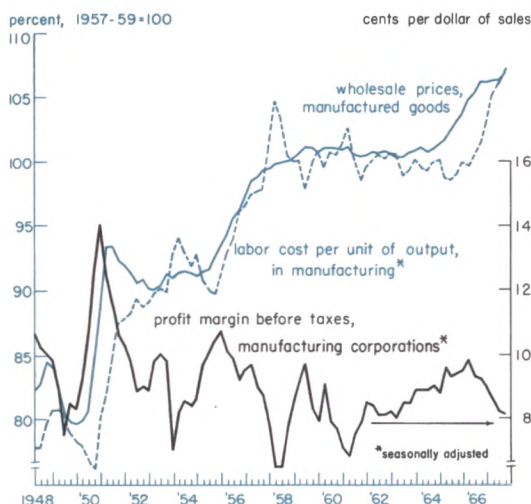
Labor shortages have been aggravated by requirements of the Armed Forces and by the large proportion of young men attending burgeoning universities. Most of these students must pursue a full-time academic program to maintain their draft-exempt status. Premium salary offers to those with advanced degrees also tend to extend schooling. The availability of labor has been further reduced by longer vacations and a trend toward early retirement encouraged by liberalization of public and private pension programs.

Demand for skilled workers—all of the building trades, the metalworking trades, engineers, computer programmers, draftsmen and other technicians—exceeds supply almost everywhere. The Department of Defense recently assigned a number of enlisted men with machinist training to the Rock Island, Illinois, arsenal after a request to the union failed to yield enough workers.

The shortage of skilled or trainable workers is compounded by the tendency of employers to hire promising applicants or to retain workers when they are not really required. Such labor hoarding is characteristic of tight labor markets.

An overall view suggests that production in the Midwest will be limited in the months ahead by labor availability rather than plant capacity and supplies of raw materials. Heavy demand for workers largely explains the rapid

### Labor costs per unit of output and prices of manufactured goods have risen sharply





rise in wages and salaries, whether collective bargaining is involved or not.

### **Capital outlays to rise**

Private surveys have indicated that business outlays on new plant and equipment will rise about 5 percent in 1968. Equipment prices and construction costs are expected to rise about the same proportion, however, so little if any real increase in purchases of plant and equipment is expected. Outlays for this year are expected to be up 2 or 3 percent from last year's record total, or slightly *less* than the increase in prices.

Surveys of plant and equipment investment intentions taken in the fall may differ appreciably from actual results because some plans are not yet complete and others may be either stepped up or slowed down as circumstances determine. Nevertheless, recent surveys confirm views Midwest equipment producers have expressed for several months: that although their new orders have revived from the slump in the first half, the uptrend has not been vigorous. Analysts for some companies foresee years of comparatively dull business before a new boom in capital expenditures develops. Underuse of capacity, reduced profits, high borrowing costs and the likelihood of a corporate tax increase—all these are cited as restraining forces.

Plant and equipment expenditures rose more than 15 percent a year in 1963-66—a sustained expansion without precedent. In 1966, these outlays amounted to 8.2 percent of output of all goods and services—up from 6.6 percent in 1963. The ratio may be about 7.9 percent in 1967 and, according to recent surveys, only slightly less in 1968.

The equipment portion of capital expenditures has held up much better in the last year than the construction portion. In 1966 and 1967, purchases of producers' durable equip-

ment (including some types not covered in plant and equipment surveys) amounted to about 7 percent of total output, a record ratio equaled only once since World War II.

Plant and equipment expenditures will be high in 1968, even if current projections are not revised upward. These outlays have shown wide fluctuations in the past and virtual stability at the crest of a boom is no mean achievement. Nevertheless, because of the importance of the production of machinery and equipment in the Seventh District—the area produces a third of the nation's total with a sixth of its population—this District will not lead the expected uptrend in the general economy in 1968 as it did in 1963-66.

### **Looking to 1968**

Projections of total economic activity for 1968 have begun to cluster in the 840 to 850 billion dollar range—up 7 to 8 percent from the 785 billion total expected for 1967. Price increases are widely expected to account for 3 percent or more of the rise in spending.

A year ago, economic forecasts ranged widely—from 750 to 800 billion dollars—and straddled actual results. The more expansive forecasts of a year ago failed to foresee the drastic inventory adjustment in the first half of 1967. The pessimists, while anticipating the inventory adjustment, expected a much greater and more extended impact on final demand than actually developed.

Economic forecasts of trends well in the future obviously must be used with caution, even when they show a high degree of uniformity. Nevertheless, policy must be formulated and implemented on the best advice available. Currently, there is widespread agreement that the coming year will see:

- Relatively full utilization of resources—especially manpower—with real gains in output limited to about 5 percent

- All major sectors of the economy—private and public—following increasing or (at worst) leveling trends
- Wage settlements in excess of productivity gains constituting both a cause and an effect of inflationary pressures
- The general price level under upward pressure and likely to rise at least 3 percent—maybe more without additional restraints
- The need for moderation of the rate of credit growth, including the Federal deficit
- Continued need for a rise in tax rates in lieu of a general (but unlikely) reduction in total Government outlays.

The record rise in the economy since early 1961—almost seven years—has been sustained despite hesitations in late 1962 and early 1967. Growth in consumer and nondefense Government outlays has continued in the face of a sharp rise in military outlays since mid-1965. In the past two and one-half years further expansion on an orderly basis has been increasingly threatened by strengthened inflationary pressures. Relieving these pressures in a manner consistent with sustained expansion and maximum possible freedom of market forces to allocate resources must be a prime national objective for 1968.

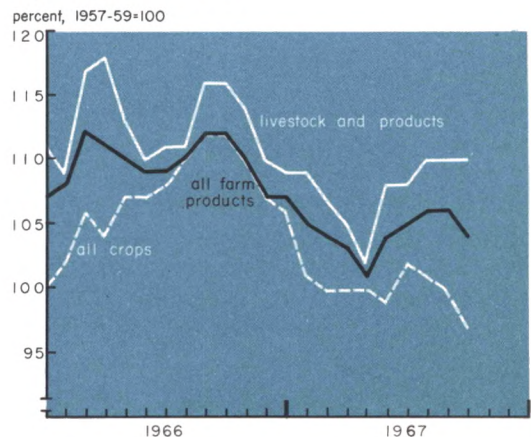
## Farm economy slows

Farm prices declined this year, dipping well below the high level reached in 1966. In October, the index of prices farmers received for all commodities stood about 6 percent below that for a year ago. Livestock prices dropped sharply, especially the price of hogs. Poultry and egg prices also averaged well below levels for the previous year. On the other hand, dairy products bolstered by higher support prices averaged near the 1966 level. Crop prices, in the early part of the year, were generally above the 1966 level, but as demand weakened and prospects for a record harvest became more certain, these too sank sharply.

Government payments to farmers declined also—about 6 percent from the 3.3 billion dollars in 1966. The combination of lower prices and reduced Government payments held gross farm income a half billion dollars short of the record 49.7 billion dollars reached last year. Higher prices for most

production items and larger purchases of these items boosted total farm costs more than a billion dollars and diminished net farm

### Farm commodity prices recover but continue below a year before . . .





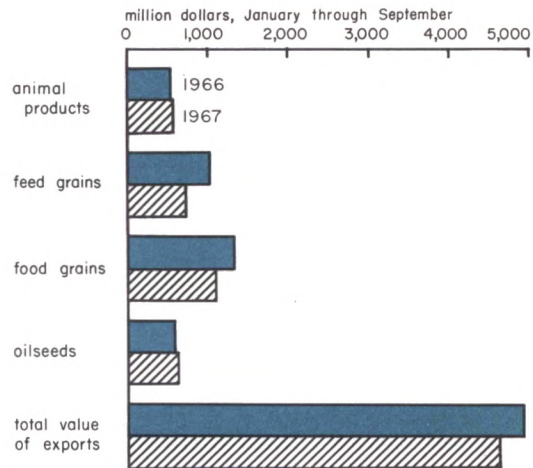
income to about 14.8 billion dollars—10 percent less than the 16.4 billion realized in 1966. Except for 1966, however, this was still the highest since the early 1950s.

A major factor in farm price and income trends has been the weakening of the export demand for U. S. products. Exports in the first three quarters totaled about 4.6 billion dollars. This was about 6 percent less than for the same period a year before and the first decline in exports in several years.

The weakening of export demand was especially important in price developments for feed grains, wheat, soybeans and other commodities dependent on foreign outlets for large parts of total sales. Feed grain exports lagged by nearly a third behind those for 1966. Foreign shipments of wheat were about a fourth lower. Soybean exports, on the other hand, exceeded the previous year's level, but by less than expected.

Domestic demand for most agricultural commodities remained strong, reflecting high levels of employment and personal income. Price changes of farm commodities dependent primarily on the domestic market were,

### Total farm exports lag behind a year ago

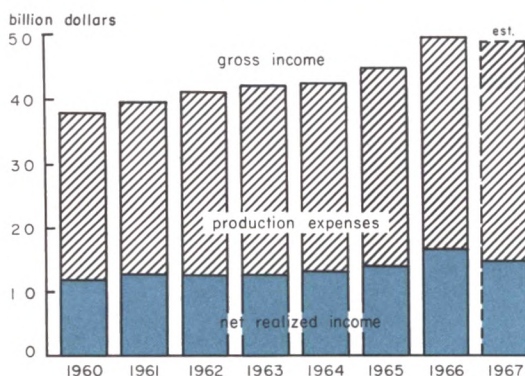


therefore, associated largely with changes in supply. The lower price levels for meat animals and poultry are prime examples. Pork supplies rose 9 percent, and supplies of beef increased about 2 percent. Similarly, broiler and turkey supplies were 4 and 12 percent higher, respectively.

Despite the decline in commodity prices and farm income, agriculture's financial balance sheet was more favorable than a year ago. Preliminary estimates indicate that the value of farmers' assets increased about 4 percent to around 281 billion dollars in 1967, and although farm debt also continued to rise rapidly, farmers' equities reached a record high—about 3 percent more than last year.

Farm borrowings, estimated at 48.6 billion dollars, rose about 4.1 billion from the 1966 level. The increase in loans outstanding secured by mortgages on farm real estate lagged behind that of other recent years, even though land prices rose further. Nonreal-estate loans, on the other hand, jumped about 2.4 billion dollars—a record increase. The

### ... causing incomes to decline



increase probably reflects a number of forces, including the cost of producing large crops, the downward drift of commodity prices and the upward drift of prices paid for equipment and supplies.

The general economic climate in which farmers will operate in 1968 is expected to be more buoyant than that of 1967. Prospective increases in economic activity, employment and wage rates point to further advances in consumer income. Advances will be substantial, even if income taxes are increased. Domestic demand is, therefore, expected to increase further, and expenditures for food are expected to increase 4 percent or more—about in line with the increase for 1967. Foreign demand for farm commodities will also probably strengthen from last year. Supplies of farm products going into 1968 are large, however, and farmers using new tech-

nologies and improved practices are likely to keep production at a high level, despite Government efforts to curtail it.

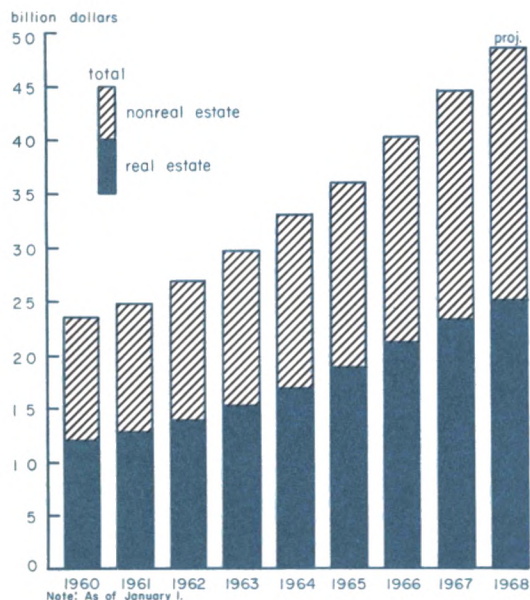
In this setting, the Department of Agriculture concluded at its annual outlook conference in November that farmers' cash receipts in 1968 probably will rise from the level of the previous year. Larger Government payments—primarily for feed grains—are expected to boost gross income past the record 50 billion dollar mark. But with the unrelenting upward movement in production expenses, total net farm income will probably be held near the 14.8 billion dollar estimate for 1967.

Livestock production is likely to be stimulated by the more favorable relationship between livestock prices and feed costs. But because of the time required to expand operations, total meat supplies may be only moderately greater than the 1967 record level.

Cattle slaughter and beef production are expected to be maintained near this year's levels. Marketings of fed cattle will probably continue larger in the first half of 1968 than in 1967, reflecting the larger number of cattle on feed last fall that will be reaching market weights after the turn of the year. Marketings of fed animals in the second half of 1968 will depend largely on the availability of feeder animals. Current estimates point to fewer cattle being available at the beginning of 1968, but some observers, recognizing the possible error in such estimates, point out that there could be enough to keep fed cattle marketings above 1967 levels for most of 1968.

Cow slaughter, which has been running well under a year ago, is expected to continue lower as beef herds are expanded and dairy herds culled less rigorously. This, with smaller calf slaughter, would probably hold total beef output near the 1967 level. As a result,

### Farm debt continues rise





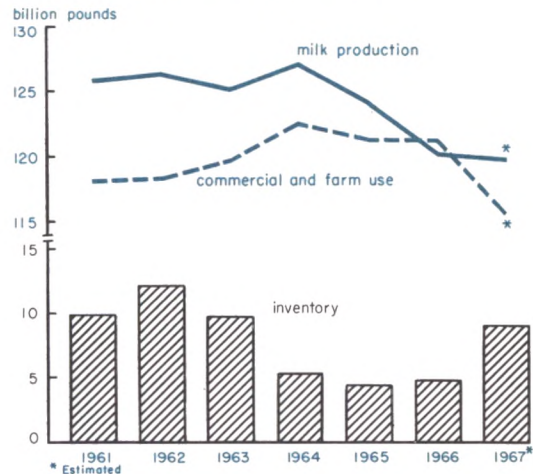
beef prices will probably average higher than this year, since the demand for beef is apt to be strengthened further by gains in population and personal income and by further increases in preference for beef over other meats.

Hog production can be expected to rise moderately as farmers respond to the currently favorable relationship between prices of hogs and corn. The level of hog marketings in 1968 is less certain, however. A Department of Agriculture survey of Corn Belt farmers in September showed a 2-percent reduction in the number of sows farrowing between June and next February. This would point to smaller hog marketings through much of 1968. But similar farrowing estimates failed to provide accurate clues to actual marketings in 1967. Furthermore, reduced production would be contrary to past experience. Producers have usually responded to sharp increases in feed grain production and lower feed prices by increasing production. Also, sow slaughter has run below year-ago levels in recent months, indicating that an expansion in production may be underway. The extent of the expansion will be reflected in increased slaughter and lower prices, especially late in the year.

The expansion in poultry production that has been underway for the past several years may slow some in 1968 because of the low returns received in 1967, especially for turkeys. Prices of turkeys were the lowest since 1961 and well under the cost of production much of the year. Although feed costs are expected to be lower in 1968, a cutback in production is indicated. This would allow prices to recover. Broiler producers, on the other hand, will probably continue increasing output in 1968, but not as rapidly as this year. Even so, 1968 prices may average a little higher than those for this year.

Milk production will total close to the 120

## Dairy product inventory rises sharply as consumption falls



billion pounds produced in 1967. Prices farmers receive for milk will average close to 1967 levels, assuming no change in Federal support of dairy prices. However, consumption of dairy products at these high prices is again expected to fall short of production. This, of course, will again make it necessary for the Commodity Credit Corporation to remove large quantities of dairy products from normal market channels to maintain prices at support levels.

The crop situation has changed dramatically from that in the fall of 1966. Faced with rapidly declining grain supplies and expecting sharply increasing demands, the Government encouraged expansion of production in 1967 through a series of program changes. Farmers responded by planting 18 million more acres to crops. This, combined with favorable weather, resulted in the largest harvest ever recorded.

Feed grain production rose nearly 18 million tons from the near-record 1966 output.

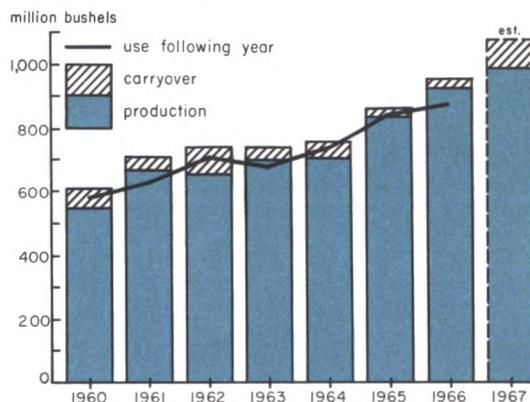
Although both domestic and foreign demand are expected to pick up from the reduced levels of the past year, total use is almost certain to fall below the 1967 crop output. The result will be the first buildup in carryover stocks since 1963.

Wheat supplies are also much higher, reflecting a record harvest, curtailed export shipments and reduced domestic use. While wheat use is expected to be more than last year, it will not be as great as the 1967 crop. Thus, the wheat carryover will also increase, reversing a seven-year decline.

Similarly, a slower rate of increase in soybean use and export, coupled with another record crop, resulted in total supplies of more than a billion bushels—far more than is expected to be needed, even allowing for some increase in demand.

Because of the resumed buildup in grain stocks and the depressing effect these supplies have had on farm prices, a number of actions

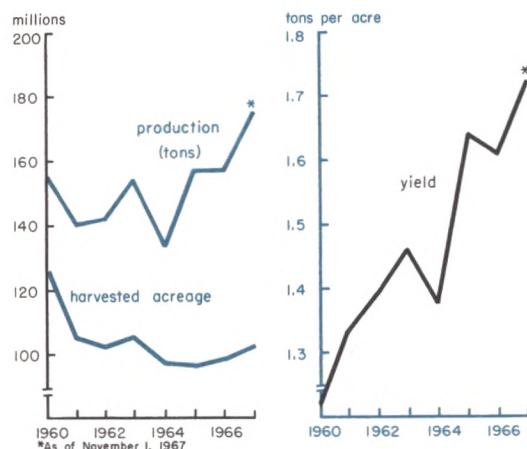
## Soybean supplies reach record levels



have been taken, or are expected to be taken, to curtail crop output in 1968. The Government's recently announced feed grain program for 1968 provides for reinstatement of the farmer's option to idle more acreage than the minimum required to participate in the program. This would probably reduce feed grain acreage 10 million acres or so. Also, the wheat program for next year reduces the national wheat allotment from 68.2 million to 59.3 million acres. With prospects of 12 to 15 million acres being withdrawn from production, crop output will probably be less next year. This is expected to allow the liquidation of grain stocks to be resumed—assuming strong domestic and foreign demand—and to allow grain prices to strengthen in the latter part of 1968. Current large supplies, however, are apt to hold grain prices substantially below the 1967 level during most of 1968.

In the longer run, the outlook for agriculture continues to be dominated by the ability of farmers to produce more than domestic and world markets can absorb at

## Expanded acreage and record yields boost feed grain production





current prices. The continuing challenge to farmers—and to the officials that formulate and administer farm programs—will be to adjust the amount of resources used in agricultural production to the amounts that will provide the output required by consumers. Achieving a desirable balance is not easy.

While rising demand and restricted production in the early 1960s culminated in sharply reduced supplies and higher prices in 1966, the boost in production in 1967 resulted in a swing to excess supplies and sharply declining prices. Hopefully, the situation in 1968 will bring a swing to greater stability.

# Bank mergers

## A study of Marion County, Indiana\*

**M**ergers—a postwar movement in all industries—have accounted for nearly 3,000 banks disappearing as separate businesses since 1945. This article describes the factors underlying postwar bank mergers in Marion County, Indiana—the Indianapolis area.

Marion County offers a striking example of the merger movement in banking. Of the 21 banks in the county in 1945, 15 were absorbed by other banks by 1960. During that time, the proportion of deposits held by the three largest Indianapolis banks grew from 67 to 96 percent.

No effort is made here to evaluate the effects of the mergers on banking competition and service in the Indianapolis area. Instead, the article describes the forces that initiated and facilitated Marion County mergers.

Information for the study—obtained from official reports, interviews with officers, directors and shareholders of banks involved in mergers and from documents pertaining to merger agreements—indicated that merger

activities of the absorbing banks reflected basic forces at work in the economy, in banking and the legal environment.

### Growth of outlying areas

The economy of Marion County changed markedly after World War II, the most notable change being the growth of outlying areas. From 1950 to 1960, the population of Indianapolis increased only 11.5 percent, compared with 78 percent for the rest of the county.

As new markets for banking services opened in outlying areas, growth-minded Indianapolis bankers wanted to tap them. And because the location of these markets precluded plans to serve them from downtown offices and because Indiana allowed countywide branch banking, bankers in the city began reaching out to the new markets through branches.

Branches could be established by setting up new offices or by acquiring existing banks for operation as branches. Acquisition of an existing bank was often the more attractive alternative, for several reasons:

- The existing bank was already a going concern, with customers, an established

\*This article is based on a study conducted by Peter W. Bacon for a doctoral dissertation at Indiana University. The study was conducted while Mr. Bacon was a research fellow at the Federal Reserve Bank of Chicago. He is now assistant professor of finance at Southern Illinois University.

location and employees familiar with the markets—all of which helped reduce the problems and expenses of setting up a branch.

- Information on the bank to be acquired provided a firm basis for estimating potential business—which reduced the uncertainties that would have accompanied an all-new branch.
- Acquisition of an existing bank eliminated a potential competitor—which boosted the share of the market that could be obtained.

The drive for branches to reach new markets was probably the most important factor underlying the merger activities of large Indianapolis banks.

### **Growth of retail banking**

Growth of markets in the outlying areas coincided with the growing interest of Indianapolis bankers in retail banking—in providing consumer credit and obtaining savings accounts and small demand deposits. Several of the large Indianapolis banks had long been “wholesalers of credit,” dealing mostly with businesses, smaller banks and wealthy individuals. But after the war, at least three important developments made it clear that the future growth of these banks depended on their reaching customers with small accounts.

One was the absorption of many Marion County businesses into national organizations and the financial needs of these companies suddenly being met by sources in other cities.<sup>1</sup> Another was the slow growth of demand deposits, which had not kept pace with economic activity. To counter this, several Indianapolis banks followed the nationwide

<sup>1</sup>The Chicago Federal Reserve Bank noted in its 1956 *Annual Report* that Indianapolis had experienced more mergers of local businesses into national companies than “almost any other big city” (page 7).

trend by aggressively seeking savings deposits. This required offices located conveniently to homes, shops and places of employment.<sup>2</sup>

Still another development was the growing importance of instalment lending that stimulated Marion County mergers. Often the best way of expanding, and in some cases initiating, consumer credit departments was by merging with other banks.

Growth in the size of companies served by Marion County banks, the increased complexity of services required by customers and the rising costs of bank operations were also factors underlying the mergers. Many bankers believed that these needs could be met most effectively by achieving rapid growth in the size of their bank and that this could be done only by merging with other banks in the area.

### **Permissiveness of regulations**

Banking is a profit-seeking business. From that standpoint, postwar mergers in Marion County can be viewed as responses of competing banks to the changing demands and unfolding opportunities of a dynamic economy. But banking is also a regulated industry, and the mergers of Marion County banks also reflected what was permissible under the statutes and regulatory policies then in effect.

Before the Bank Merger Act of 1960, the legal climate was extremely favorable for bank mergers. Under some conditions, mergers were consummated without prior review by Federal agencies. And even when the statutes gave an agency the power of approval over a merger, they did not specify the factors to be considered in the decision.

There is also substantial evidence to sug-

<sup>2</sup>Studies conducted recently by the Federal Reserve Bank of Chicago show a strong tendency for customers to use the nearest bank. This makes conveniently located offices essential to consumer-oriented banking.



gest that the discretionary standards applied by some agencies were not very restrictive. From 1950 to 1958, for example, the Comptroller of the Currency approved 731 mergers and disapproved only 35.

Furthermore, Federal antitrust laws were not used to prevent bank mergers until very recent years. Since the Supreme Court decision in *United States v Philadelphia National Bank* in 1963, mergers have been restrained partly by fear of costly law suits.

The branch banking laws of Indiana also provided a strong incentive for bank mergers. Banks could establish branches in their city and any other city in the county that was not the home office of another bank.

This law was significant for a couple of reasons. For one thing, absorbing banks were allowed to operate acquired banks as branch offices. This provided an incentive to merge that bankers would not have had if branch banking had been prohibited. For another, the "home office protection" provision of the law effectively closed six rapidly growing Marion County communities to the establishment of *de novo* branches by "outside" banks. There were only two ways an outside bank could establish branches in these towns: either by absorbing the existing bank or by waiting until another bank absorbed it. Five of the six banks protected by the home office provision were absorbed by merger.

### **The acquired banks**

But why were the stockholders and managers of 15 Marion County banks willing to give up control of their banks?

In three cases, the acquired banks had been affiliated with their acquiring banks for many years. In these cases, the mergers were simply logical extensions of existing associations undertaken to achieve the benefits already discussed.

In two other cases, it was hard to distinguish the absorbed from absorbing banks. One merger—a large retail bank and a large wholesale bank of about the same size—was undertaken so the combined banks could serve the banking needs of the entire community, instead of only segments of it. The other—also two large downtown banks—resulted from the death of the chairman of the board of one bank and the appointment of the president of the other to fill the vacancy. Other considerations in the merger included prospects for increased operating efficiencies through the introduction of data processing, more effective competition with the largest bank in the city and the use the combined bank could make of the two main offices, which were next door to each other.

The question applies more meaningfully to the elimination of small banks. In 11 years, 10 of the county's small independent banks were absorbed into larger Indianapolis banks.

### **The small acquired banks**

A failure to compete that left them behind in growth, earnings and service to the community is sometimes suggested as the reason for the absorption of many commercial banks. Most of the small banks absorbed in Marion County were operating as profitably as their absorbing banks, had above average growth rates and comparable loan-to-deposit and capital-to-deposit ratios. Nevertheless, there is much to suggest that many of them were less efficient than the larger absorbing banks—that they were profitable largely because of higher charges, lower salaries and lower occupancy expenses, all conditions that could not be continued indefinitely.

Interest rates on loans and service charges on demand deposits were above average at many of the banks. More important, the profitability ratios of these small banks did

not adequately reflect a number of prospective costs—costs the banks could not postpone much longer.

The most important of these costs were competitive salaries and fringe benefits for management. Salaries of officers in the absorbed banks were, on the average, 44 percent less than salaries paid officers of the absorbing banks. Even though many people working for themselves are satisfied with less income than they would be working for someone else, yearly incomes of several of the bank presidents were not comparable with those of even junior officers in the larger banks. And none of the ten small banks had retirement or hospitalization programs.

Most of the banks operated in obsolete, overcrowded, poorly located or otherwise inadequate facilities. Absorbing banks had to renovate or replace the offices of seven of the acquired banks.

Many operating procedures were also inadequate. Up-to-date credit files were almost nonexistent. It was reported nearly impossible to borrow from one bank when the president was not there, because “he had all the credit information in his head.” Modern methods of record keeping and even “safe-keeping” were seldom used. A former director of one bank complained, “There were no files, and paper was lying all over the place. The operations were at best confusing.” One bank operated its safe deposit facilities on a “one-key” basis, with the president holding the only key. The usual practice requires two keys, one held by the bank and the other by the customer.

Most of the small banks made no aggressive effort to attract new business, and few of their officers recalled doing any advertising. A typical comment was, “We were there and if you wanted to come in, fine.”

Directors of one bank did not consider a

sign outside the banking office necessary. The chairman of the board of a large downtown bank that eventually absorbed this small bank described driving up and down the main street of the little town looking for the bank. After stopping to ask where the bank was, he learned it was in the Masonic Hall.

These are descriptions of banks that failed to adjust to changing conditions. One can only guess how much longer they would have operated profitably. Salaries for suitable management replacements, fringe benefits for employees, and plant modernization and mechanization are all costs successful banks must pay to achieve continued growth and prosperity. Too often, they were costs that seemed to dismay owners and managers of the small Marion County banks.

### **Concentration of ownership**

The stock of the ten small absorbed banks was closely held. In only two banks did the directors, officers and their families own less than 50 percent of the outstanding shares.

This concentration of ownership facilitated mergers in two ways: 1) by allowing merger decisions to be made by small groups of people with the same interests, it increased the probability that terms could be worked out to the satisfaction of all and 2) by creating a problem of ownership succession.

In organizations with a wide distribution of stock in small lots, the decision of a small group of shareholders to dispose of their holdings is seldom important. But the situation is different in an organization with a small number of large shareholders. In such a situation, shareholders often find a merger brings them the best price for their holdings.

### **Problem of management succession**

The ages and tenures of the managers of the small absorbed banks made management



succession a problem. Five of the ten presidents were more than 65 years old, and only three were less than 60. More than half the officers were more than 60, and only 12 percent were less than 40. Of the 39 officers for whom information was available, nearly half had been with their banks more than 20 years and only five had served less than six years.

At least five of the mergers can be attributed to chief officers wanting either to retire or reduce their activities and the realization that their banks had no one to take over. The only bank that reported having tried to attract a new president was unsuccessful—primarily because of the low salary it offered.

### **Tailored mergers**

A useful distinction can be made between factors initiating a bank merger and those facilitating it. Many of the characteristics of the small absorbed banks were facilitating factors—the kind that set the stage.

Factors initiating mergers were the attractive prices and terms offered by absorbing banks. In most cases, the merger agreements were tailor-made to meet the wishes and needs of owners and managers. The terms offered usually provided increases in book value, dividends, salaries and needed pension benefits, as well as other accommodations to meet the wishes of individual shareholders.

Although book value provides only an approximation of the real value of a bank's stock, shareholders of the absorbed banks indicated that they evaluated the attractiveness of merger offers by comparing the price offered with the book value of their stock holdings. As a result of their merger decisions, they received substantial premiums over book value, either in cash or book value per share in the merged bank. For every dollar of book value they gave up, they received, on the average, \$1.56 in cash or book

value of the stock in the combined bank.

This premium was apparently far more than that paid shareholders of absorbed banks in most areas. A study of bank mergers in the Third Federal Reserve District (Philadelphia) in 1946-54, showed that shareholders of absorbed banks were typically paid \$1.05 per dollar of book value.

Owners of seven banks absorbed in exchanges of stock (as opposed to cash purchases) were also influenced in their decisions to merge by the expectation of substantial increases in dividend income. Shareholders of these banks averaged \$2.88 in cash dividends in the two years after merger for each dollar they received in the two years before merger.

To have matched the dividends their shareholders received in the combined banks, the absorbed banks would have had to increase their payouts for the two years before the mergers by 190 percent. The dividends received by stockholders of two absorbed banks in the two years after their mergers were more than the total after-tax incomes of their banks for the two years before the mergers.

Merger decisions of five banks were influenced by promises of substantial salary increases to bank officers. Immediate yearly salary increases for the leading officers of these banks ranged from \$1,500 to \$5,580—from 25 to 126 percent. The decision to merge at each of these banks was apparently influenced by these salary increases.

All the officers and employees of the absorbed banks that received employment with the absorbing banks were also brought under retirement programs. This, too, was an important factor in the decisions to merge—since most of the absorbed banks had not provided retirement benefits and most management personnel were approaching what are usually retirement ages.

Officers of three small absorbed banks operated insurance agencies that had supplemented their bank salaries before the mergers. In each case, the absorbing bank allowed the officer to retain his agency.

Officers of several banks reported that their directors were reluctant to merge because they did not want to give up the prestige and pleasure of being bank directors. Many of the board members had served 20 years or more, and strong friendships were evident within the boards. To help overcome their reluctance and avoid any loss of customers in the community, the absorbing banks established the boards of several absorbed banks as advisory boards to the directors of the acquiring banks.

Information on nine of the ten small banks absorbed showed merger decisions were influenced by provisions that officers and most of the other personnel would be retained, though this probably also indicates that absorbing banks recognized the value of keeping familiar faces in local offices.

Five mergers left former presidents of the absorbed banks as vice presidents of absorbed banks and branch managers of their previously independent banking offices. In three mergers, the presidents of the absorbed banks voluntarily retired and a senior officer of the absorbed bank was made branch manager. In another case, the president of the absorbed bank would have become chairman of the

board had he not died before the merger agreement took effect.

It appears that many officers of the small absorbed banks enjoyed the best of two worlds. They received substantial increases in salaries, nearly all became eligible for retirement benefits and insurance programs, and they were able to continue as managers of the banking offices where they had spent so many years.

### Conclusion

No two mergers were alike. But regardless of the considerations that made each different, the bank mergers in Marion County reflected basic changes in the banking environment—changes in the local economy and the distribution of economic activity, in the demand for banking services and the kind of services demanded, in the sources of funds available to banks and in the technology of banking itself.

The mergers were undertaken for the most part to put absorbing banks in stronger positions to serve their customers, to compete in new patterns of banking and to continue their growth and remain profitable. Many of the smaller banks, on the other hand, did not have the resources, including the staff and facilities, to cope with changing conditions. The same forces that led larger banks to undertake mergers made smaller banks willing candidates for absorption.

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# Business Conditions

*a review by the  
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