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BANKING'S RESPONSIBILITIES -- TO WHOM?

It is a time-honored tradition for a speaker at an event such as this to peer into the future and address his remarks to the problems he sees lurking there. I suppose this is done because an occasion like tonight's marks another threshold--another commencement, or beginning, if you please--for all of you. Because of your achievements here at Madison, of which you may be justly proud, you will view the world just a little differently--at least the world of banking. Passing across the threshold, banking will never again seem quite the same. And as the title of Patricia Griffith's novel goes, "The Future is Not What It Used To Be."

So I'm not going to be particularly timid about peering into the future. I'm not going to break the tradition. It is trite, but nevertheless true, to say that gazing into that unclear crystal ball is a necessary preliminary to rational human activity. And bankers are obviously rational humans--and I stress humans, no matter what the establishment critics say.

Unavoidably, the first steps across your new threshold call for the utterance of some cliches and some well-worn platitudes. We have, for example, all been appropriately reminded that banking's role in coming years can only grow in importance and influence. We also know that banking promises to become increasingly innovative and imaginative.

More specifically, we know there are developments both recently and in the offing that will significantly shape banking's setting for years to come. The one-bank holding company, the growing automation of check handling and funds movement, the move into bank-related activities of a wide variety--are all now underway or looming on the horizon. These and other developments promise an exciting and challenging tomorrow for all of us.

Of course, not all of the action lies ahead. Quiescience has not had banking in its grip. Far from it, for the entire postwar era--and the last decade, particularly--has seen far-reaching and profound changes in banking practices and banking strategy. Further to tread on familiar ground, who could have envisioned even a dozen years ago the role played today by "liability management" and the pursuit of nondeposit funds in contemporary commercial banking? Who could have foreseen that banks would develop as far as they have into one-stop department stores or finance? And who would have envisaged the activist part that many bankers have come to play in connection with efforts to deal with some of the most serious and persistent ills of today, especially those all around us in the bigger urban centers?

It is hardly necessary to be reminded that banking has made a pivotal contribution to the economic growth of this country. Bankers have mastered superbly the organizational and managerial techniques necessary for carrying out their depositary, fiduciary, and lending activities. And they have within their grasp the means for even greater efficiency and effectiveness in performing their economic functions.

Clearly, banking has carried--and will continue to carry--out its basic economic responsibilities to society. Clearly, banking has been able to do so and will continue to do so largely because of the existence of a free enterprise economy. Clearly, banking has been--and will continue to be--spurred by the quest for profits and the avoidance of losses. But just as clearly, banking--along with other types of business activity--will continue to be pressed hard to extend operations beyond traditional functions. Clearly, banking because of its very nature will be challenged to accept much more in the way of social responsibility.

A start has been made. Commercial bankers have made significant contributions in this area of social responsibility. More and more, bankers are being encouraged to find out how to launch and nurture new ventures by minority businessmen--how to identify--and respond with training and jobs--the talents of able and willing members of minorities that have suffered discrimination and discouragement in their efforts to join America's mainstream and become participating and productive members of society. Banking and individual bankers, I submit, have compiled a record in these respects that stands up well alongside the competition--albeit that we may have made an embarrassingly slow start and that the job still has little more than begun, when we measure accomplishment against the dimensions of the challenge.

Much has been spoken and written in recent times about the social responsibilities of business and of businessmen. Bankers have had their share--perhaps more than their share--of reminders of the burden of social responsibility that they shoulder. Now, the very term, social responsibility, has a formidable ring to it. Clearly, no one of good conscience will own up to lacking a sense of social responsibility. But, what does the term mean? Is it simply shorthand for awareness, a spirit of compassion, and a will to do good things?

Now, I am well aware that many view references to social responsibility as platitudes--empty phrases. Unfortunately, this view is often expressed within the "establishment," from within the banking community, thus giving at least some credence to the establishment's critics. I find this reaction hard to understand. Why should bankers, or other businessmen for that matter, ignore the broader social environment in their decision-making processes? They don't ignore other influences coming from governments, creditors, employees, or customers as they make their decisions. These are all inputs in the same process--factors and influences that affect, circumscribe, or constrain the decision.

The concern with social priorities is to be taken seriously. We are moving rapidly into an era of increasing public attention to the roots of social instability--a new awareness of the side effects of economic growth--a new emphasis on the quality of life. We must not discount these emerging concerns as simply fads. They are not. Our struggle against want has made good progress and our accomplishments have come closer to our goals. But our expectations have risen even faster, and human values--the qualitative aspects of life--have become more prominent.

Gabriel Hauge, Chairman of Manufacturers Hanover Trust Company, has argued that because of these new demands on corporations, firms--like some children--face the prospect of an identity crisis. In spite of the barbs thrown by some of the critics, I doubt that it has reached crisis proportions in banking, but the pressure is there. To whom are bankers responsible? Only their stockbrokers or to a wider range of constituencies as well?

Some have told us that if banks are to measure up to their social responsibilities, many of the customary precepts of prudent banking will have to be set aside on occasion in favor of practices that will afford readier and more freely available financing for ventures and projects that otherwise fail the test of prospective profitability. In other words, the credit "needs" of small firms, of minority firms, of low-cost housing of, say, college students ought to be measured with a different yardstick from that used in sizing up the credit needs of established customers such as businesses with a long record of success or, one may be tempted to say, borrowers who don't much need credit in the first place.

Now, I would be among the first to argue that hidebound adherence to some of the conventions and precepts inherited from an earlier and simpler time are rapidly becoming outmoded. If we don't discard them or at least bend them somewhat, our competitors will. It will be our loss. More and more, in other words, bankers must be prepared to adapt to new ways of doing some of their customary jobs. Competitive pressures make this all but inevitable, and every prudent banker mindful of no more than his own and his institution's well-being is going to want to remind himself that "If I don't extend credit to this man or if I don't welcome this customer's new deposit relationship with my bank, my competition will." Of course, if the business in question is not prospectively profitable, then let my competitor have it! But, if while it seems a type of proposal that wouldn't pass muster under yesterday's rules, but looks like a good thing under a more realistic, somewhat less stringent evaluation of prospects, then I'm bound to regret letting my competitor walk away with it.

Bending the rules in order to bring lending practices into line with today's conditions and with new conceptions of tomorrow's prospects is a step that often can be justified on strict grounds of lending profitability. I quite agree with the notion that by taking a long-range view of things, some proposals that may look questionable or shaky from a shorter-term point of view, will shape up as appealing outlets for bank funds. I think that it is an obligation of banking to question rules-of-thumb and precepts of sound banking practice that have been passively carried over from an earlier period, and to discard any of them than can be demonstrated to be unduly restrictive in today's setting. Often, those conventions will lead to rejection of loan proposals that in a longer-range view of things look highly promising, even from a strictly commercial standpoint.

To take an example, I am often impressed by the bearing of "neighborhood effects" upon individual ventures that bankers are appealed to for financing. In urban housing, for instance--a field high on the scale of priorities for remedial treatment--one of the crying needs is to make more use of the existing stock of housing, by suitable reconditioning and modernization of dilapidated and outmoded units that remain structurally sound and suitable for reclamation. Yet the extension of credit for residential renewal and modernization can be a risky business, to FHA if not to the lenders, when it is a matter of extending loans piecemeal. That is to say, a single home owner or owner of an apartment building may have every reason to believe that at some moderate expense he could effectively rehabilitate the structure, and that having done so he could expect a capital gain in the value of his home or apartment building sufficient to cover the debt service. But this judgment could be wholly erroneous in the face of inaction on the part of owners of adjoining and nearby properties in the same small area.

If, on the other hand, the individual property owner could arouse interest on the part of his neighbors in a broad scale rehabilitation project, the chances could be good that such a sizable program would bring results and reflect a prudent use of the credit financing it. It is, it seems to me, often likely that piecemeal improvement undertakings will fail the test of prospective profitability, whereas more ambitious projects--financed, perhaps, by consortia of commercial banks and other lenders making conventional as opposed to government-underwritten loans--could be highly productive uses of rehabilitation credit.

This example suggests that more boldness in the provision of credit for community improvement and kindred efforts to make better and more effective use of the present stock of structures in the inner-city may be what is required. Nor need the illustration stop short with residential property exclusively. What about the refashioning of community retailing and other commercial centers on a scale sufficiently broad to recast the image of the whole development, rather than on a one-at-a-time improvement basis likely to fail because of the lingering presence of substandard units in the same neighborhood?

So, it would appear, credit extended singly to a given newly-established small manufacturing or retailing enterprise may be in jeopardy if it is not clear that suitable channels exist through which distribution of the borrower's products can be secured. There may appear to be a need here for a careful look at the whole setting within which a proposed new venture expects to operate. Again, there could be a real place for cooperative lending by a group of commercial banks and perhaps other lending institutions as well.

Banks are risk-taking institutions but there are limits to how far they can go as single units. They cannot, in Hauge's terms, assume open-ended commitments for the renewal of cities or employment of entire disadvantaged groups. Cooperation among banks, other lenders, and other firms has the advantage of pooling talents, spreading costs and risks, and improving the efficiency with which we reach our social goals.

But banks can, have, and should adopt a cooperative role with governments as well. Just as there are limits to what banks and other businesses can do alone, governments have pressed against the limits of what can be accomplished through public agencies. Government has sought to provide inducements to get business participation. They have done this by way of attempting to create better markets for private activities, by way of contract subsidies, and by way of guarantees and insurance. The Small Business Administration program which provides a 90 percent Federal government guarantee on loans made by banks is an excellent case in point.

Clearly, timidity and hidebound "stand-patism" on the part of banks may prove self-defeating. Small businessmen and minority entrepreneurs, in some cases, need to be encouraged to take on more credit rather than less than they seek to obtain. Greater boldness again may be required to give viability to loans for ventures designed to deal with some of the vexatious problems confronting inner-city residents and businesses.

Now what I have called for here in terms of boldness, imagination, and concern with social goals on the part of banks appears to fly directly into the face of views such as those expressed by my old friend and celebrated economist, Milton Friedman. A few years ago he wrote, "Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible." (Capitalism and Freedom, 1962, page 133). Although I think that Friedman has put his finger on an important point, the sweep of his assertions and its confident directness gives me pause. His is perhaps a comforting view to many because it seems to relieve them of having to take into account a number of qualitative elements in their decisions. Essentially, it seems to me that the point he is making is how is the banker to be guided in the decisions he makes on the deployment of his institution's resources if it is not what serves the interests of his stockholders?

If one takes a broader view, concern with social issues is in the stockholder's interest. Banks as much as any firm continue to function by, in effect, public consent--the so-called social contract with business. Traditionally, by operating efficiently, banks have served to provide people ultimately with the means to enjoy a better life. Now the "public" wants banks to contribute more than strictly efficient economic functions. Since banks exist only because they "serve," their future, their viability, depends upon their adapting to the changing expectations of the public. Thus, if survival is assumed to serve the interests of stockholders, banks must also take into account their other constituencies--their employees, government, customers, and the public. I find, therefore, the view expressed recently (1970) by Henry Ford II to be much more congenial. "Any successful businessman has to have at least enough sense to recognize that whatever threatens the country threatens him and his family and his business."

Talking in terms of survival is probably the extreme case. Another argument can still be made easily of the consistency of so-called social concerns and the discipline of profit and loss. Essentially what I was arguing earlier is that bankers should more readily accept a longer-term horizon on their activities. Further, acceptance of greater risk under these conditions may be entirely appropriate. Where expectations of return even over the longer horizon do not compensate for significantly greater risks, cooperative efforts with other banks, firms, and government are entirely in order.

I do not see the involvement of banks in these areas as an abrogation of the incentives of risk and return and competitive pressure for inducing efficiency in the allocation of resources. I do not see the inclusion of social considerations in the decision-making process as an impossibility--it is rather a challenge. As the prestigious Committee on Economic Development points out in its recent statement on the Social Responsibilities of Business Corporations, there is a clear need to develop better methods for determining goals and evaluating performance as corporations move into uncharted social terrain. But I feel certain that these guidelines can and will be developed by innovative and imaginative bank management.

Banks and bankers can and do have a vital role to play in connection with efforts to cope with some of the deficiencies we see around us. This is because of the special expertise that commercial banking commands in sizing up alternative uses of the resources at its disposal. Bankers, in short, have a big potential as advisers and counselors to small businessmen and to members of minorities who are eager to embark on business ventures. The experience that bankers have gained in contriving imaginative financing agreements, in tapping funds available from a wide variety of sources, and in monitoring the financial results of business operations stand them in good stead as a corps of experts capable of rendering outstanding service.

In addition, as has been repeatedly stressed in recent years, the commercial banks have an opportunity to break down directly the barriers to entry that have served to fragment the labor market and impede the movement of blacks and members of other minority groups into the kinds of white collar jobs that banks have to offer. Already, impressive headway has been made by some of the nation's leading commercial banks in recruiting personnel from minority groups. So have we at the Federal Reserve Banks. It can be expected that these moves will be pursued aggressively in the future and expanded progressively until barriers to entry into banking are eliminated. Then, too, there are the programs that a number of banks have adopted to set up under their own auspices special training programs for small businessmen and would-be minority entrepreneurs. This has been done not so much as a means of smoothing entry into banking on the part of those desiring to enter the field as of acquainting would-be businessmen with the principles and concepts of sound and successful business management.

Certain activities of the sorts I have described could be regarded by captious critics as self-serving, from the viewpoint of banking as such. And, there may be something to such a charge. Obviously, men who are aided in efforts to become successful business practitioners are likely to become bank customers, availing themselves of the deposit and credit services that banks are in business to provide. Yet, this being so in no way lessens the constructiveness of such efforts. It is no more than indicative of a mutuality of interest shared by the banks and public they serve.