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**FINANCIAL SERVICES IN TRANSITION:
THE EFFECTS OF NONBANK COMPETITORS**

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FEDERAL RESERVE BANK OF CHICAGO

Financial Services in Transition:
The Effects of Nonbank Competitors

by

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Prepared for

The Banking Handbook.

John Wiley & Sons, Inc.,
Richard C. Aspinwall and Robert A. Eisenbeis, eds.

*The views expressed are those of the authors and do not necessarily represent the views of the Federal Reserve Bank of Chicago or the Federal Reserve System.

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In 3/2/77

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Financial Services in Transition: The Effects of Nonbank Competitors

Harvey Rosenblum and Christine Pavel*

I. Introduction

Many magazines and newspapers have recently devoted considerable attention to the "revolution" in financial services, often citing the rise of the "nonbank bank" as well as the bank-like activities of such firms as American Express, Merrill Lynch, Prudential, and Sears. But most of the acquisitions of financial institutions and de novo expansion into financial activities by nonbanking-based firms involve extensions of interests and positions in financial services that, in many cases, go back several decades. Furthermore, the competitors in financial services include depository institutions like commercial banks, S&Ls, mutual savings banks and credit unions, as well as the four well-known nonbank competitors mentioned above and many less publicized competitors such as General Motors, J.C. Penney, and National Steel.

This paper examines in detail the extent of competition provided to depository institutions (with special emphasis on commercial banks) by nonfinancial institutions, or at least those whose primary line of business activity has not involved the offering of federally insured deposits. Section

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This paper is an update and extension of a previous monograph by Harvey Rosenblum and Diane Siegel, Competition in Financial Services: The Impact of Nonbank Entry, Staff Study 83-1, available from the Public Information Department, Federal Reserve Bank of Chicago.

II gives a background on this subject, including reviews of the early research. Section III presents and analyzes the accounting data available on the extent of competition provided by 32 companies, most of whose main interest is not (or has not been) financial. Table 1 lists the companies that were analyzed. (All tables and charts that are referred to in the text can be found in Appendix B.) The financial activities of these 32 companies are compared with the nation's 15 largest bank holding companies and with the aggregate of all federally insured commercial banks in the United States. Important balance sheet and income data for these companies are given in Appendix A. Section IV discusses the internal management and public policy implications. Finally, Section V gives the summary and conclusions.

In short, the authors find that the sheer size and number of nonbank firms with substantial nationwide financial activities are impressive. Also, the erosion of the uniqueness of demand deposits together with the increased entry into many types of lending activities by nonbank firms has made obsolete the notion that commercial banking is a distinct line of commerce. Further, there appears to be considerable circumstantial evidence that the geographic market for many financial services is now national in scope, or will soon become so.

II. Background

Although banks face many different types of competitors, they are the number one institutional lender to households and businesses. For many years, banks have had the largest share of the auto loan market as well as many other types of consumer loans. And the long-standing hegemony of banks in commercial lending is to be expected since commercial banks were chartered originally to meet the needs of business.

The preeminent market position of banks, however, is somewhat surprising when one recognizes the constraints under which they operate, particularly because many of their competitors, allegedly, are less constrained in a number of ways. Nonbank competitors, such as captive finance companies, are free to enter or exit virtually any geographic location. Further, many competitors can offer both financial and nonfinancial services and products that banks are prohibited from offering. For example, a business such as Sears can offer life insurance, money market funds, shirts, and hardware as well as retail credit at any of its more than 800 retail locations throughout the United States.¹ Apparently the ability to offer life insurance and money market funds in a department store setting, at least until 1982, did not confer a great competitive advantage upon a business enterprise; if it had, Sears would not have been alone among retailers in offering both products.²

In spite (and perhaps because) of the numerous regulatory disadvantages that banks face in comparison with their competitors, many segments of the banking business, including consumer lending, business lending, and deposit-taking, have appeared attractive to a number of firms that do not have bank charters. As a result, these firms have entered financial services through de novo expansion and through acquisitions of existing financial concerns.

Industrial- and transportation-based companies, manufacturers, and retailers have acquired insurance companies, finance companies, and leasing operations. Also, because savings and loan associations and mutual savings banks have attained the ability to offer a wide range of consumer and business loans since 1980 by virtue of federal legislation contained in the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) and the Garn-St Germain Depository Institutions Act of 1982, they have become more attractive to nondepository firms as acquisition candidates than they previously were. And commercial banks, because of their unique position in the national (and the international) payments mechanism and their entrenched incumbent position as a profitable provider of a number of financial products, have also become attractive acquisition targets to J.C. Penney, Prudential, Dreyfus and others who wish to extend or establish a delivery system for a wide range of financial products.

Although, as previously mentioned, nonbank competition in financial services is not a new phenomenon, the pace of nonbank entry has been accelerating. Most of the industrial and retailing giants that had begun to be significant financial services competitors nearly a decade ago have continued to expand their role in financial activities. In addition, these companies have been joined by many others. Nonetheless, commercial banks have managed to hold on to their market share in the provision of most financial services, having gained in some product lines while retrenching in others.

Early Research Findings

About a decade ago Citicorp released a study detailing the competitive inroads made by unregulated firms into the financial services business. This monograph, authored by Cleveland Christophe [3], provided an in-depth view of the relative importance of banks and nonfinancial firms in the extension of

consumer credit. Some of the findings were startling to many bankers, as few had recognized the importance of the competition represented by firms such as Sears and General Electric whose primary activities were nonfinancial.

Most bankers, of course, were aware of competition from other depository institutions and from consumer finance companies. Yet Sears, a firm not generally regarded at that time as a banking competitor, had more active charge accounts as of 1972 than either Master Charge or National BankAmericard (the predecessors of MasterCard and Visa). Furthermore, Sears had credit card volume and receivables to match its greater number of accounts. Its \$4.3 billion of credit card receivables at year-end 1972 were roughly 80 percent of the \$5.3 billion of installment credit on all bank credit cards. Moreover, Sears earned more money after taxes in 1972 on its financial service business than did any bank or bank holding company in the country.

Sears's prominence in financial services should not have been surprising. Sears began to provide consumer credit in 1910 to support its retail operations, while most commercial banks concentrated their lending efforts on commercial customers until the post World War II-period. It is sometimes easy to forget that commercial banks are a "Johnny-come-lately" on the consumer lending scene.³ Further, Allstate Insurance, Sears's insurance subsidiary, was formed in 1931 to sell auto insurance and long before 1972 had begun to offer a wide range of insurance products. By 1972, Sears was the largest retailer in the United States in the Fortune directory of the 50 largest retailing companies.

Though Sears and its two large national retailing rivals, Montgomery Ward and J.C. Penney, had combined consumer installment credit (\$6.9 billion) that exceeded the amount outstanding at the nation's three largest bank holding companies (BankAmerica, Citicorp, and Chase Manhattan with \$4.3 billion) by

more than 50 percent, the retailers were overshadowed by the financing arms of three large manufacturers. Through General Motors Acceptance Corporation (GMAC), General Motors had \$7.8 billion in consumer receivables at year-end 1972, more than the combined total of the three large retailers. The combination of GMAC, Ford Motor Credit Company (FMCC), and General Electric Credit Corporation (GECC) had more consumer receivables than the three retailers and three largest bank holding companies combined.

Again, the role of the manufacturers in consumer lending should not have been surprising. GMAC began making auto loans in 1919; GECC was formed in 1932; and FMCC was founded in 1959 (though Ford began making auto loans in 1928). GMAC and FMCC were largely captive finance companies in the true sense of the term; that is, they provided financing primarily to enable customers to purchase products manufactured by their parent companies or sold by their franchised distributors. GECC was a different story. Though it began as a marketing extension of General Electric's appliance division, largely financing dealer-distributor inventories and sales of General Electric products to consumers, GECC's customer orientation and profile began to change in the early 1960s when it began to extend its commercial lending and leasing business to finance products other than those made by General Electric. In 1965, GECC expanded its position in consumer financing by offering revolving charge plans to many retail dealers of electrical consumer goods. That same year, GECC began experimenting with direct consumer installment lending; by May 1972, it had expanded to 129 offices in 33 states.

In 1972, GECC accounted for less than 8 percent of General Electric's earnings; GMAC accounted for only 4.5 percent of General Motors's earnings; and FMCC, for just over 5 percent of Ford's net income. Although they were among the largest consumer installment lenders in the country, the income

derived from consumer lending was still small relative to their parent manufacturers' primary businesses. These manufacturers became creditors as a by-product of their primary manufacturing and marketing operations, but their finance operations attained a size, status, and profitability that were the envy of many banks. Indeed, it could have been argued that these three companies were the prototypes of manufacturers-turned-bankers, a move followed in later years by the once captive finance subsidiaries of such manufacturing giants as Westinghouse and Borg-Warner.

At the same time that many nonbanking firms were expanding their product lines into a wider range of lending activities, many banks began doing the same. During the late 1960s, many of the larger banks in the country formed one-bank holding companies for the purpose of expanding the range of products they could offer as well as the geographic locations at which these products could be sold. The range of products was circumscribed by the 1970 amendments to the Bank Holding Company Act and the associated regulations issued by the Federal Reserve Board. Nevertheless, bank holding companies continued their vigorous expansion activity into a number of new geographic and product markets, both by establishing de novo affiliates and the acquisition of going concerns. Indeed, in the first three full years (1972-74) that applications could be processed under Section 4(c)(8) of the Bank Holding Company Act, the Federal Reserve approved 1,806 applications involving the acquisition or formation of nonbank companies, an average of 602 per year.

Beginning in 1974, however, a number of problems confronting the banking industry began to surface: large bank failures, massive loan losses, serious questions about capital adequacy, and "affiliated REIT" difficulties. Interest in expanding product lines and geographic markets quickly waned, due in part to increased regulatory pressure from the Federal Reserve Board's "go

slow" policy. This is reflected in the decline in the number of applications to engage in nonbanking activities approved by the Federal Reserve, down to 379 in 1975 and 384 in 1976.

During 1975-1977, the emphasis in banking returned to managing the fundamentals. And as banks retrenched from their aggressive geographic and product expansion posture, many financial product and service lines were left to the nonbank competitors. The ensuing technological changes and record-breaking interest rates provided customers additional impetus to turn to other firms that were in a position to provide financial products at locations and at terms that the customers desired.

Recent Findings

It was not until 1981, following the acquisition of several very large nonbank financial service companies by other financial and nonfinancial firms, that studies of the role of nonfinancial firms in the financial sector and the public's interest in these matters began to reemerge. The combinations that caught the public's eye were the acquisition of Bache by Prudential, Shearson by American Express, Dean Witter Reynolds and Coldwell Banker by Sears, and Salomon Brothers by Phibro.

A recent article by Carol Loomis [12] provided a detailed comparison of the financial activities of Citicorp with those provided by American Express, Merrill Lynch, Prudential, and Sears. According to the criteria used by Loomis, Citicorp (consolidated international) still held the edge in assets, deposits, commercial loans, and consumer loans but was second in revenue (behind Sears); last in money market funds (it had none while the other four companies had a total of \$54.7 billion); and engaged in the second fewest number of financial activities (12), one more than Prudential but still behind Sears with 19, Merrill Lynch with 16, and American Express with 15. Among the

financial activities were several that bank holding companies are prohibited from entering: real estate development, commercial and residential real estate brokerage, executive relocation services, and the underwriting of mortgage guarantee insurance, life insurance, and casualty insurance.⁴

More recently, William F. Ford [6] has questioned whether commercial banks need to fear competition from nonbank rivals. He has argued that retailers like Sears, brokerage firms like Merrill Lynch, and insurance companies like Prudential are diversifying into new financial services because they have been doing poorly in many of their traditional product lines. He also argues that most medium and small banks need not fear Citicorp--probably the nation's most diversified banking organization with respect to product lines and geographic markets--since Citicorp's profitability in recent years has not matched that of a composite regional bank. Whether the performance records of giants like Sears, American Express, and Citicorp will improve in the future was left as an open question, but the data cited by William F. Ford should provide some comfort to smaller firms that large size and its attendant publicity do not guarantee profitable performance.

III. Competition in Financial Services: 1981-82

Overview

To explore the prevailing degree of competition between banks and nonbank companies, the financial activities of 32 major U.S.-based companies were analyzed and compared with the 15 largest bank holding companies as of year-end 1981 and 1982 by utilizing company Annual Reports and 10-K statements filed with the Securities and Exchange Commission.⁵ Additional information was obtained from recent articles that have appeared in American Banker, The Wall Street Journal, Business Week, Fortune, Moody's Bank and Finance Manual, and other current periodicals and publications believed to be reliable sources.

Companies were chosen on the basis of their being the most frequently mentioned nonbanking-based competitors of commercial banks. Several diversified financial service companies were also studied. Many other financial companies (in particular, many large insurance companies) were, for the most part, excluded because they have demonstrated little or no inclination to invade the turf of commercial banks during the last few years. Some nonfinancial companies that have begun to invade commercial banking product lines have likely been omitted simply because they have maintained a low profile and were therefore not readily identified.

Many companies could easily become bank-like entities if they were so inclined. That they have not done so to date does not mean that banks and other lenders are unaware of their potential to become a major force in commercial or consumer lending or both. Most strategic planners track developments at these companies (particularly data and information processing companies) despite the fact that the balance sheets of these potential entrants contain no deposits or loans.

In interpreting the data contained in this information base, the reader should keep in mind that accounting data have a number of shortcomings particularly when used to make economic comparisons across different companies (see Benston [1]). Moreover, many of the companies do not organize their accounting data into the same categories of assets and liabilities as that used by commercial banks. For example, unlike banks, some manufacturing-based lenders might include truck or tractor financing with auto loans. Or some foreign loans might be included with domestic loans in some categories but not in others. In such instances, ballpark estimates were often made by company employees and/or by the authors in an effort to establish some consistency in the asset, liability and income categories across companies.

No attempt was made in this paper to delineate precisely the geographic areas served by nonbanking firms. It should be kept in mind in interpreting the financial statistics provided in this paper that the competitive influence or impact of the various nonbank companies is affected by the fact that they compete in many different geographic and/or product markets not served by many of the nation's commercial banks.

Profits from Financial Activities

In 1972, there were ten companies whose earnings from financial lines of business were impressive. The financial earnings of these companies compared favorably with that of many of the largest banks and bank holding companies. These companies are shown in Table 2 (see Appendix B). During 1972 their net incomes from financial activities totaled \$666.2 million, six times greater than a decade earlier. Indeed in 1962, three of the ten companies shown had virtually no earnings from financial activities, and four of the companies had financial earnings that averaged a mere \$0.75 million. Within this group of

ten, only General Motors and Sears would have been considered significant financiers in 1962.

By year-end 1981, these ten companies had profits from financial activities totaling \$1.73 billion, more than 2.5 times the total in 1972 and a considerably greater gain than could be accounted for by inflation alone. Eight of the ten companies showed an increase in the percentage of total earnings attributable to their financial activities; only Control Data and Gulf & Western showed a decline. Interestingly, the five largest New York City bank holding companies--Citicorp, Chase Manhattan, Manufacturers Hanover, Chemical, and Morgan--earned a similar total, \$1.78 billion from their worldwide activities during 1981.⁶

To ascertain whether 1981, the yearly data studied intensively by Rosenblum and Siegel [18], was an unusual year in some way, the evidence on penetration of financial services by nonbanking firms in 1982 was used for comparison. In 1982, the earnings of these ten companies from their financial activities totaled \$2.36 billion, a 36 percent increase over 1981. Seven of the ten companies experienced an increase in their volume of financial service earnings. The nonfinancial earnings of these ten companies combined grew faster between 1981 and 1982 than did their earnings from financial services, as financial earnings amounted to 54 percent of total earnings in 1982 compared to just over 58 percent in 1981. In contrast, the nation's fifteen largest bank holding companies had combined earnings of \$3.15 billion in 1982 compared with \$3.62 billion in 1981, a 13 percent decrease. As a result, in 1982 it took the seven largest bank holding companies, ranked by earnings, to equal the financial service earnings of the ten companies shown in Table 2.

The composition of earnings from financial services is different for banks, bank holding companies, and nonbanking-based firms. For example, the

financial service earnings of Sears were dominated by its insurance activities until 1982. The same is true for ITT following the acquisition of the Hartford Insurance Group in 1970. In 1982, the Coldwell Banker and Dean Witter subsidiaries, each acquired on December 31, 1981, made significant contributions to Sears's earnings from financial services. It should be noted, however, that banks and bank holding companies cannot engage in most of the financial activities engaged in by Allstate, the Hartford Insurance Group, Coldwell Banker, or Dean Witter. Thus the earnings figures shown in Tables 2 and 3 do not necessarily signify competitive overlap or that nonbanking-based companies have been taking business away from commercial banking firms.

Companies which had 1982 profits from financial activities exceeding \$200 million are shown in Table 3. Results for 1981 are also shown. Nine of the 17 firms are bank holding companies, but of the top eleven, only three are bank holding companies. Moreover, the eight nonbanking-based companies had total 1982 earnings from financial services of \$5.53 billion compared with \$3.10 billion for the nine bank holding companies.

Nonbanking-Based Companies as Providers of Credit

If the manufacturing companies listed in Table 2 engaged solely in the financing of products manufactured by them, then one might suspect they did not compete vigorously with commercial banks. As shown in Table 4, several of the so-called captive finance companies provide credit, if not to all comers, then to a wide clientele involved in purchasing goods unrelated to their parents' products. This tendency to diversify the customer base has increased since 1972. It is clear that captive finance companies have the ability to evolve in ways not originally contemplated by the founding company. They can and oftentimes do take on a life of their own that is unrelated to their parents' operations. For example, financing of General Electric products

accounted for less than 5 percent of GECC's financing volume in 1981 and an imperceptible proportion in 1982. Over 90 percent of Borg-Warner Acceptance Corporation's income and assets result from financing other companies' products. Similarly, Westinghouse Credit serves a diverse clientele. On the other hand, several of the finance companies included in this nonbanking-based sample are much more "captive." Included in this category are GMAC, Ford Motor Credit, and IBM Credit.

Another way to look at the financial activities of the nonfinancial companies is by examining their total finance receivables. Table 5 ranks the companies by financing volume. Although some of the receivables of manufacturers such as General Motors and Ford are derived from foreign operations, Table 5 assumes that all such receivables are generated by domestic customers; consequently, the domestic receivables of bank holding companies are used for comparison.

Table 5 illustrates that banks are not the only major lenders in the United States. For example, in 1982, of the top eleven companies shown, eight are bank holding companies, one is an insurance company and broker, and two are the finance subsidiaries of automobile manufacturers. Of the next 11 companies, only five are bank holding companies. Of the 30 selected companies, 15 are bank holding companies and 15 are nonbanking-based firms; the former group had a total of \$332.5 billion in receivables in 1982 while the latter group held \$200.9 billion.

Perhaps the best way to examine the impact of nonbank entry upon banks is to look at what has happened to competition in individual product lines. Thus, the competitive thrusts made by 32 nonbank companies into various segments of consumer and business credit and into the deposit markets are examined below.

Consumer Credit

At year-end 1972, the three largest bank holding companies held less consumer installment credit than the three largest nonfood retailers which, in turn, held less consumer installment credit than three large consumer durable goods manufacturers (see Chart 1A). As is apparent in Chart 1B, these rankings have changed in a number of ways. Most notable is the dramatic gain made by bank holding companies, whether looked at on a worldwide or U.S.-only basis. Part of this gain was due to the acquisition of consumer finance companies by BankAmerica and Citicorp, but most of the increase is attributable to internal growth.

Over the 1972-82 period, the consumer installment credit held by the three large retailers grew by a factor of 2.4; that held by the three bank holding companies grew by a factor of 7.1 (worldwide); and that held by the three manufacturers grew by a factor of 4.0. Clearly, the bank holding companies experienced the highest growth rate of the three groups.

Another way to examine the impact of nonbank competition in the market for consumer credit is to rank the companies according to their consumer credit outstanding. This is shown in Table 6 for the 15 largest lenders in consumer installment and revolving credit, a measure that excludes retail mortgage credit. Of the top 15 in this group in 1982, only five are bank holding companies; within the top eight firms, only two are bank holding companies. At year-end 1982 the top ten nonbanking-based consumer installment lenders had \$86.7 billion of such loans outstanding, just double that held by the 10 largest bank holding companies in this lending category.

In the narrower field of auto loans, commercial banks have maintained their position as the leading lending group, but they have lost significant ground over the last few years to the captive finance affiliates of the auto

manufacturers. As can be seen in Table 7, commercial banks as a group have the largest market share in the auto lending product line with 46 percent of the market at year-end 1982. This share had fallen by fifteen percentage points from the peak reached only four years earlier in 1978. Over this same 1978-82 period, the share of auto loans held by the captive finance companies of General Motors, Ford, and Chrysler had increased by 13 percentage points, to 34 percent of the market. GMAC alone in 1982 held \$33.5 billion of auto loans, more than one-fourth of all auto loans outstanding and double its share of the total market just four years earlier.

By way of comparison, Bank of America was the largest auto lender among commercial banks with \$2.1 billion of auto loans at year-end 1982, about 2.3 times the total of the second largest bank in auto loans but a mere one-sixteenth the total held by GMAC. It should be recognized that Bank of America's auto loans are confined almost totally to California, while GMAC lends throughout the United States. Nevertheless, GMAC's market position as measured by loans outstanding is enormous.

At year-end 1982, according to their domestic consolidated Call Reports, the top 25 commercial banks in auto loans had \$10.5 billion of such loans on their books, and the top 100 banks had \$18.1 billion. As mentioned above, GMAC alone held \$33.5 billion, 1.6 times the amount held by the largest 100 commercial banking auto lenders. Ford Motor Credit held \$9.3 billion, about the same as that held by the 19 largest commercial banking auto lenders.⁷

Auto Loans--Permanent or Temporary Shift in Market Share?

Shifts in market share of this order of magnitude over such a short time span are somewhat unusual. But a number of diverse yet concurrent forces account for these changes in market share: a decrease in domestic car sales, liberalized bankruptcy laws, soaring cost of funds, and interest rate

volatility. This combination of factors induced the captive finance affiliates of the auto manufacturers to offer low cost auto credit, largely as a defensive measure to support their dealer networks.

Between 1978 and 1982, there was a sharp fall-off in the number of cars to be financed. Thus the volume of potential business for all auto lenders declined dramatically during this four-year period. Domestic car sales, which totaled 9.2 million units in 1978 fell monotonically to 5.7 million units in 1982, a 38 percent decline. As would be expected, the volume of loans written fell simultaneously. As can be seen in Table 8, the total of net new automobile credit extended (i.e., new loans written less paydowns and liquidations of old loans) fell from \$18.7 billion to \$4.9 billion between 1978 and 1982; furthermore, the volume of new business fell for each of the three major institutional auto lenders over this same period, with the greatest relative declines occurring at banks and credit unions, thus allowing finance companies to increase their share of the volume of net new lending.

Not all finance companies, however, increased their share. The finance company category in Table 8 includes three types of finance companies: (1) independent consumer finance companies such as Beneficial Finance, Avco Financial Services and Household Finance; (2) consumer finance affiliates of bank holding companies; and (3) the auto captive finance companies (i.e., GMAC, Ford Motor Credit and Chrysler Financial). Just as banks were decreasing their emphasis on auto lending, so too were independent and bank holding company-affiliated finance companies, thus abandoning this market to the auto captive finance companies who were forced, at least initially, to significantly increase the size and scope of their credit operations in order to support their already financially distressed dealer networks. As can be seen in Table 8, credit unions were also curtailing their auto lending

activity over the 1978-82 period. But why were all those lenders that had some choice as to whether or not they remained in auto lending choosing to exit that business line so quickly? The answer to this question is critical in assessing whether the shift in market shares is likely to be permanent or transitory.

Independent and bank-affiliated consumer finance companies had several reasons for their shift in emphasis away from auto lending. Some of these same reasons apply to banks and credit unions as well. One factor that impacted all lenders was the liberalization of the nation's personal bankruptcy laws enacted in 1978. The ease of declaring bankruptcy had an especially heavy impact on independent and bank-affiliated finance companies because they typically dealt with a clientele at the middle to higher end of the credit-risk spectrum, i.e., those with lower incomes who were forced out of the auto buying market by the steeply rising prices of autos relative to income or those who were more likely to be included among the rising level of unemployed, and therefore more likely to have a need to declare personal bankruptcy.

Another important force behind this shift in market shares, and one that affected all lenders, was the soaring cost of funds. In many states, usury ceilings did not allow the increased cost of funds to be passed forward to borrowers. Consequently, independent finance companies tended to close offices particularly in those states (such as Michigan and Arkansas) where binding usury ceilings made auto lending unprofitable. For example, in 1981 alone, Avco Financial, Household Finance and the Associates closed a combined total of 1,050 offices. This cost squeeze also affected credit unions as their deposit rates were deregulated before their lending rates were allowed to rise.

The cost squeeze imposed by the high level of funding costs was not the only problem; equally important was the sharp rise in interest rate volatility, which increased uncertainty about funding costs [19]. This can be seen in the three panels in Chart 2 which provide clear evidence that the level and volatility of rates hit modern-day records during the 1978-82 period.

But a stronger force behind the changes in market shares was the combination of this interest rate volatility with an institutional framework that was unaccustomed to dealing with rate volatility and thus had no in-place mechanisms for shifting the associated risks to those who were willing and able to bear these risks. Virtually all auto loans made were fixed-rate loans with the majority of such loans having three to four year maturities. In addition, there is no secondary market where auto loan paper can be packaged, sold or traded. Thus the originator of a fixed-rate auto loan is generally forced to hold that loan to maturity or sell the loan at a substantial discount due to lack of an efficient secondary market. If short-term interest rates and thus the cost of funds were reasonably predictable, fixed-rate auto lending could be a profitable activity even in the absence of a secondary market for auto loans. But with widely fluctuating interest rates, fixed-rate auto loans could, at times, prove to be very unprofitable unless the lender could hedge its risks to some extent by locking in a cost of funds for the same period as the auto loans being written. But this was difficult to do because deregulation of deposit-rate ceilings, which began in June 1978 with the creation of the 6-month Money Market Certificate, initially emphasized shorter-term deposits. In combination with an inverted yield curve which induced depositors to desire short-term deposits, deposit deregulation forced banks, credit unions and S&Ls to place greater reliance on short-term sources

of funds. The natural reaction was an increased desire, but not necessarily the ability, to engage in variable rate lending wherever possible.

Lenders like GMAC and Ford Motor Credit which enjoyed excellent access to national and international money and capital markets were able to raise funds having a wide range of maturities and were able to sell innovative new instruments like long-term, zero coupon bonds that allowed them to extend the weighted average maturity and duration of their liabilities to match the duration of their assets.⁸ In so doing, GMAC and Ford Motor Credit could effectively immunize themselves against changes in interest rates while still offering fixed rate auto loans, something that lenders subject to Regulation Q ceilings could not do. Many independent and bank holding company-affiliated finance companies had access to long-term capital markets and a few of them did raise long-term funds in an effort to close the duration gap between their assets and liabilities. But most found it easier, and perhaps more profitable, to change their asset mix by de-emphasizing auto lending and emphasizing second mortgage lending which provided some preferential creditor status in the event of bankruptcy and had a significantly larger average size and maturity of loan, all of which reduced overhead noninterest expense.

Because the sale of autos is so dependent on credit, the auto captive finance companies had no alternative under these circumstances except to fill the developing vacuum caused by the strategic positioning of most lenders into other product lines. Thus the gain in market share by the captive auto finance companies appears to have been a reactive rather than a proactive move. This would suggest that the shift in market shares will be reversed as interest rates decline, interest rate volatility decreases, usury ceilings are relaxed or become nonbinding, and bankruptcy laws and their enforcement become less liberal.

This could be the case, but there does not appear to be any inherent logical reason to expect that the stochastic process that determines shifts in market shares is (or should be) symmetrical. The auto captive finance companies, at least according to their published income statements, have found auto lending to be a very profitable activity. Consequently, the auto companies and dealers have found that lending at seemingly below-market rates is an excellent marketing tool. If they have been able to achieve any economies of scale or economies of scope from their increased lending activities, then the captive auto finance companies may have become the low cost producers of a fairly homogeneous product that is difficult to differentiate. If so, their increased market share may not be easily reversed.

Over the last several years, automobile-related credit has averaged between 37-38 percent of total consumer installment credit. Some of the same trends shown in auto lending are apparent for other consumer lending, as shown in Table 9. In 1978, commercial banks issued 55 percent of net new installment debt to households; finance companies accounted for only 22 percent of such debt. In 1981 these relative shares had reversed themselves; commercial banks issued only 3 percent of the net new consumer installment debt that year while finance companies accounted for 72 percent.⁹ Not all of this increased finance company share, however, was used to finance auto loans. Many noncaptive, consumer finance companies have moved away from small, unsecured cash loans toward making second mortgage loans; they held at least \$13 billion of second mortgage debt at year-end 1981 [13, p. 286]. In 1982, commercial banks bounced back in new consumer lending, increasing their market share to 33 percent in spite of a poor showing in auto loans.

That there was a fundamental change in the competitive character of the market for consumer credit in recent years can be seen by examining the

correlations of movements of changes in credit extended by various institutional lenders. Between 1945-77, the correlation between the net annual changes in consumer installment credit at finance companies and commercial banks was 0.75; that is, increases in such loans at banks tended to be accompanied by increases at finance companies and vice versa. The correlation coefficient fell to 0.27 for the 1978-82 period. The change in the correlation coefficient for net changes in auto loans was even more dramatic, falling from 0.68 during 1945-77 to -0.52 during 1978-82. The latter period clearly was not representative of the long-term trend.

The inference to be drawn from this discussion is that consumer loan markets are very fluid in the sense that the share of new loans written by any single group of lenders can change dramatically as economic conditions change. Households apparently are willing to shift from one institutional supplier to another in response to noticeable differences in price or service. In a deregulated world, old habits may be shortlived.¹⁰

Credit Cards

As of 1972, Sears held a leading position over Master Charge and National BankAmericard in the credit card business. At that time Sears's 18.5 million active accounts were almost double that of its two bank card rivals, each of which had about 10 million active accounts. As can be seen in Table 10a, Sears was also the leader in charge volume and account balances at that time.

As shown in Table 10a, by 1981 Visa had become the undisputed leader in charge volume, a very important measure of business activity in this product line because the income generated from merchants' discount fees is proportional to its charge volume. With U.S. charge volume of \$29.3 billion during the June 1980-81 period, Visa did nearly triple the volume of Sears; in

1972, Sears's volume was 43 percent greater than Visa's. Visa's and MasterCard's leading positions were augmented further in 1982.

As mentioned previously, Sears's lead in 1972 should have been expected; Sears began offering retail credit in 1910 while the two bank cards did not come into existence until the early 1960s. But since their inception, the bank cards have been very successful. Many retailers have begun accepting one or both bank cards alongside their own proprietary cards. For example, J. C. Penney began accepting Visa in 1980 and MasterCard in 1981. Montgomery Ward now accepts both bank cards. Many of the smaller regional department store chains which formerly accepted only their own credit cards have begun to accept the two bank cards as well as American Express cards. In spite of this trend, General Electric Credit offers revolving credit programs to department stores whereby it issues private label credit cards and services customer accounts. Indeed, in July 1983, General Electric Credit announced a plan to issue credit to finance the retail purchase of Apple computers. While not strictly a credit card transaction with the card being carried into the store in advance of the purchase, such sales of computer equipment at the retail level will nonetheless result in new consumer installment credit issued by a third-party, nonbanking-based company rather than a commercial bank.

The success of Visa and MasterCard vis a vis the Sears card does not necessarily imply a victory for banks over a nonbank competitor. The reason is simple; neither Visa nor MasterCard are banks. They are cooperative organizations that license a product to their members. The original members were banks, but more recently other institutions have become members as well. According to Visa's 1981 Annual Report, during 1981 "311 institutions joined Visa U.S.A. as proprietary members and another 571 joined as agent members. Many were thrift institutions--318 savings and loan associations, 28 mutual

savings banks, and 98 credit unions--who [chose] Visa as the vehicle for exercising the new consumer payment powers granted to them by Congress." Some of Visa's growth in the last few years is attributable to the popularity of Merrill Lynch's Cash Management Account, which includes a Visa card.¹¹

An alternative way to interpret the data in Table 10a is to view Visa and MasterCard together as approximating a consolidated banking system in revolving installment credit. In this context the bank cards look even stronger. In 1972, the bank cards (taken together) were slightly more successful than the Sears card by all three measures--active accounts, charge volume, and account balances. By 1981, the banks had more than double the number of active accounts of Sears, more than five times the charge volume, and about four times the account balances. The same disparity was evident in 1982.

The latter interpretation of the success of bank cards has as much validity as the first interpretation. Very few banks issue their own proprietary cards, but more banks would issue such cards if they did not have a vested interest in Visa and MasterCard.

While it is true that on a consolidated basis, the banks have surpassed Sears, American Express, and other nonbank issuers of credit cards such as department stores and petroleum companies, one should not lose sight of the fact that the two leading credit cards (as measured by customer account receivables) are Sears and American Express whose combined credit card receivables are about equal to those of the ten largest commercial banks in the credit card business. As can be seen in Table 10b, the three largest bank credit card issuers together are about equal to Sears and the volume of receivables falls off sharply as the number of included card issuers is increased.

The fewness of credit card issuers is suggestive of significant economies of scale in producing credit card services. The evolution of two major bank cards represents an efficient adaptation by the marketplace; banks generally produce products themselves when no significant economies of scale are present. When there are economies, banks purchase services or products from the Federal Reserve, large correspondents, or other suppliers who can produce the service or product more cheaply. Travelers checks, check clearing, and securities safekeeping are obvious examples. Charge cards appear to be similar in this respect. Indeed, many banks act as franchisees for the American Express (gold) card just as they do for travelers checks issued by American Express or by a few others.

Business Loans

Commercial banks are an important source of credit to all businesses, large and small. Banks have the largest share of outstanding commercial and industrial (C&I) loans in the United States. As can be seen in Table 11, the 15 largest bank holding companies held \$155.5 billion of domestic C&I loans at year-end 1982, more than triple the total held by the 32 nonbank companies covered in Table 11. Nevertheless, the importance of nonbank lenders should not be underestimated. Funds that large firms raise from banks and from the money and capital markets are used to provide loans to many smaller businesses. For smaller businesses, trade credit is the most widely used source of credit, both in terms of the percentage of firms utilizing it as a credit source [22, Table 3] and in dollar volume [4, Table 2]. Trade credit is admittedly an imperfect substitute for bank credit since it cannot be used to pay other creditors or meet employee payrolls; nevertheless, its importance cannot be ignored.

Those firms that supply trade credit have alternatives to short-term bank credit; for example, nonfinancial firms had \$48.0 billion of commercial paper outstanding at year-end 1982. In addition, nonbank financial firms had \$84.0 billion of commercial paper outstanding at that time; some (unknown) portion of this was used to provide credit to businesses.

Nonetheless, banks and bank holding companies still are the leaders in commercial lending. Among the top 10 commercial and industrial lenders, nine are bank holding companies. This can be seen in Table 12a.

With respect to commercial mortgages, banks are an important source of funds but so are insurance companies. In fact, in commercial mortgage lending, banks and bank holding companies are overshadowed by life insurance companies, but this is to be expected given the long term nature of their liabilities. In 1982, the top 15 life insurance companies had roughly \$88.0 billion in commercial mortgages, \$62.2 billion more than the 15 largest bank holding companies and 67 percent of the commercial mortgages held by the domestic offices of all insured commercial banks. The four insurance companies covered in Table 11--Prudential, Aetna Life & Casualty, Equitable Life Assurance, and American General Corp.--had \$36.4 billion of commercial mortgages outstanding at year-end 1982; this compares with \$26.5 billion of worldwide commercial mortgages held by the 15 largest bank holding companies. Indeed, the three largest of these four insurance companies in commercial mortgage lending (i.e., Prudential, Aetna, and Equitable) had more commercial mortgage loans outstanding at year-end 1982 than the 21 largest banks in commercial mortgage lending, which includes four mutual savings banks (see Table 12b).

Commercial banks do not dominate in lease financing either. As shown in Table 11, with \$15.9 billion of lease receivables, the 15 industrial-based

companies engaged in more lease financing than the 15 largest bank holding companies, or for that matter, more than the nation's more than 14,000 insured commercial banks. Also, as shown in Table 13, four out of the five top lessors in 1982 were nonbank companies. However, eight of the top 15 lessors were bank holding companies.

Nonbank companies compete with banks in other ways as well. For example, Commercial Credit Corp. (a subsidiary of Control Data), Merrill Lynch, and ITI have become approved lenders for the Small Business Administration (SBA). This has increased the competition in lending to small businesses because, prior to January 1980, SBA lending was the sole province of commercial banks.

Perhaps the most important question is not whether nonbank companies have made significant inroads into various phases of commercial lending but rather whether they are growing more rapidly in this area than banks. Since data on all nonbank lenders are not available, an attempt was made to look at how the C&I lending of nine nonbanking companies for which data were readily available--ITT, Control Data, RCA, Borg-Warner Acceptance, Chrysler Financial, Ford Motor Credit, GMAC, Gulf & Western, and General Electric Credit--has grown since 1975 in comparison with the total for all insured commercial banks (see Table 14). In 1975, these nine companies held \$14.9 billion of C&I loans or about 8.5 percent of that held by all insured commercial banks and 23.5 percent of that held by the 15 largest banks ranked by C&I loans. In 1982, these nine companies held about 7.8 percent of the total C&I loans held by all insured commercial banks and 22.9 percent of that held by the 15 largest bank C&I lenders. While these comparisons are fairly rough in the way they were constructed, they do show that banks have probably neither gained nor lost a great deal of ground in C&I lending since the mid-1970s. Based on these rather sparse data, it appears that banks have held their own in C&I lending

or at least that portion which flows through financial intermediaries. Given the volatile nature of interest rates, particularly during the 1979-82 period and the fact that business loans are variable rate or repriced frequently, it is not surprising that banks have maintained their relative share of this type of lending.

Deposits

Substitutes for bank deposits have been around as long as there has been a reasonably efficient secondary market for government and private securities. Treasury bills, repurchase agreements with banks or government bond dealers, and large negotiable CDs are (imperfect) substitutes for bank deposits, including demand deposits. A comparatively recent substitute, money market mutual funds (MMFs), grew from only a few billion dollars in assets in 1975 to over \$230 billion of assets by December 1982 when MMF assets reached their peak just prior to the introduction of the Money Market Deposit Account permitted by the Garn-St Germain Depository Institutions Act of 1982.

Table 15 shows the MMF assets of those nonbank companies included in this study, ranked by total MMF assets as of December 1, 1982 and June 29, 1983. These 10 companies accounted for about 45 percent of all MMF assets at both dates. To the extent that MMFs provide a reasonably attractive substitute to commercial bank deposits, then the combination of these 10 companies, at year-end 1982, ranked in deposit size about halfway between BankAmerica and Citicorp, the nation's two largest bank holding companies in deposits. Merrill Lynch, with MMF assets of \$50.4 billion as of December 1, 1982, was roughly comparable in size with Manufacturers Hanover and Chase Manhattan which had worldwide deposits of \$43.8 billion and \$56.9 billion, respectively, at year-end 1982.

Only two of the 10 companies listed in Table 15, Sears and Ford, were among the companies studied by Christophe a decade ago. Sears itself had only about \$0.5 billion of MMF assets in December 1982; the remaining \$11 billion of its MMF assets were obtained through the acquisition of Dean Witter Reynolds in 1981. Ford's Money Market Account is not an MMF by the usual standards as it is only available to certain salaried employees of Ford, and investments are used to purchase obligations of Ford Motor Credit.

In order to finance the loans extended to their customers, few of the nonbank companies rely to any significant extent upon deposits as a source of funds. (Even for the 10 companies shown in Table 15, MMFs are not a source of funds.) For the most part, their funds are raised in the money and capital markets at competitive rates. Consequently, the profit margins of most of these nonbank companies are not, and have never been, dependent upon the Regulation Q franchise. At year-end 1982, domestic offices of insured commercial banks had \$303.4 billion in savings accounts subject to a Q-ceiling of 5.25 percent. Alex Pollock [15] has estimated that roughly half of the 1980 profits of 31 of the 50 largest U.S. banks could be attributed to their ability to pay below-market rates on savings accounts. While estimates of this nature may overstate the importance of the Regulation Q franchise, particularly because the ability to offer deposits at Q-ceiling rates is not independent of having federal deposit insurance, the continued phase-out of Q-ceilings should enhance the market position in lending of the nonbanking-based firms.^{12,13}

In the last year competition for deposits has taken other new forms. Alliances that would have been termed unholy not long ago are commonplace now. Merrill Lynch has marketed, through its nationwide network of some 475 offices, All Savers Certificates for Bank of America, Crocker National Bank,

and two S&Ls, one in Florida and another in Washington. Merrill Lynch, the same company that once had over \$50 billion of MMF assets that purportedly compete with bank and thrift deposits, also maintains a secondary market for retail CDs issued by banks and S&Ls and has acted as a broker in the placement of retail CDs issued by many banks and thrifts, thus giving them a nationwide reach. As can be seen in Table 16, Merrill Lynch is not alone in this regard but is joined by several companies who compete directly with banks in some product lines. These include Sears/Dean Witter, Shearson/American Express, and E. F. Hutton. Together these four companies operate more than 1,300 offices throughout the United States. Even in rural locations where these companies have no physical office facilities, they are no farther than a newspaper, radio, TV, or magazine advertisement and a telephone call away. Thanks to Merrill Lynch, Sears/Dean Witter, and Bache, City Federal Savings and Loan of Elizabeth, New Jersey, now competes toe-to-toe on a nationwide basis with Bank of America for retail CDs.

The importance of the cooperative affiliations between brokers and depository institutions should not be underestimated, for it may represent one of the most significant reductions in entry barriers into the financial services business. No longer is deposit and loan growth of a de novo bank or S&L constrained by its ability to generate deposits from its local customers. To the extent that it has profitable lending opportunities, a new depository institution can engage in liability management through the sale of brokered, insured retail deposits by paying above the going market rate. The availability of federal deposit insurance should make depositors virtually indifferent to the identity of the institution they deal with. It is now conceivable that a de novo bank or S&L could develop a billion-dollar deposit base within a year or two of its opening. Furthermore, under current law the

ability to own one (and only one) S&L is not constrained by the line of commerce engaged in by the parent company or one of its affiliates; thus, a nonbank firm can establish a de novo S&L or buy an existing one and gain a significant presence in financial services in a very short time by selling insured retail deposits on a national scale through brokers. Given the expanded range of lending powers granted to S&Ls by the Garn-St Germain Depository Institutions Act of 1982, a de novo S&L could, in a very short time, resemble a large, long-established commercial bank, especially if it were to receive outside capital infusions from a well-heeled parent.

The market for funds in denominations greater than \$100,000 has been national ever since Citibank devised the negotiable certificate of deposit in 1961. The same is true for the market for large repurchase agreements. Bank-related commercial paper, also sold in a national market, amounted to some \$34.5 billion at year-end 1982. What was true a decade ago for wholesale deposit markets has now become true at the retail level--the market for deposits (and their close substitutes) is national in scope.

IV. Implications of Nonbank Competition

The competitive inroads of nonbanking-based firms in providing selected financial services that compete directly and indirectly with those offered by commercial banks provide a number of policy dilemmas to those who must formulate appropriate public economic policies and to those managers of financial institutions who must formulate appropriate strategies to maintain the profitability of their companies. By quantifying the extent of these competitive inroads, this paper has fostered a greater understanding of the identity and nature of this competition. Armed with this information, both public policymakers and managers of financial institutions can make more informed decisions in reacting to this phenomenon. Managers of financial institutions must react not only to the competition but to the current and anticipated regulatory environment as well. Accordingly, appropriate public policy, in light of the information base developed in Section III, is discussed first.

Commercial Banking: No Longer a Separate Line of Commerce

In 1963 the U.S. Supreme Court ruled in Philadelphia National Bank [23], an antitrust case, that commercial banking was a distinct line of commerce. In the eyes of the Court, commercial banks' ability to offer business loans and demand deposits together with a cluster of other financial services sets them apart from other depository and nondepository financial institutions. The Supreme Court still has not changed its mind regarding the line of commerce in banking even though, in 1983, the uniqueness of commercial banking is open to question.

The demand deposit monopoly once enjoyed by commercial banks disappeared long ago. In 1972 mutual savings banks in New England innovated with NOW

accounts which spread, in a number of different forms, outside the Northeast. By March 1980, Congress had no choice but to codify the (retail) NOW account nationwide when it passed the Depository Institutions Deregulation and Monetary Control Act (DIDMCA). More recently, Congress has permitted what amounts to small denomination, interest bearing checking accounts for households and businesses, thus giving legal sanction to the sweep account that technology and high interest rates had already brought into existence. These new accounts (the money market deposit account and the Super NOW account) may be offered by all depository institutions. The only distinguishing feature between these two accounts is with respect to the frequency of debits; four or more checks written against one of these accounts make it a transaction account subject to reserve requirements.¹⁴ Also, demand deposits and their generic equivalents are offered by a wide variety of institutions. Demand deposits have become a very small and unimportant source of funds for many banks, having become a residual of compensating balances and frictional levels of deposits that clear after preestablished presentment times. Thus, the uniqueness of demand deposits and the uniqueness of commercial banks seem to have gone the way of the V-8 engine and the vacuum tube radio.

Business loans have never been the sole province of commercial banks. As shown in Section III, banks have encountered increasing pressure from numerous nonbank lenders in meeting the credit needs of business. For many types of business loans other than short-term commercial and industrial loans, banks are not the dominant lender.

The combination of demand deposit powers together with commercial lending powers does not seem to confer much advantage to banks. Mutual savings banks already have had such powers (though somewhat more restricted) since DIDMCA,

and S&Ls obtained similar powers in October 1982. In recent years, competition has also increased in consumer lending and in taking deposits from households and other suppliers of funds. The entry of many nonfinancial firms into various segments of banking has heightened this competition.

Circumstantial evidence, therefore, suggests that commercial banking is no longer a distinct line of commerce. The franchises that constituted the main value of a commercial bank charter in 1963 when Philadelphia National Bank was decided seem to be of little value today.

Furthermore, barriers to entry into banking --legal and economic, perceived and real--seem to have diminished over the last decade. For example, one important barrier to entry that has been reduced in recent years is the information cost advantage of incumbent firms. Technological advances have made a national data base of household and business credit histories available to all interested parties at a reasonable cost. Also, competition in financial services can no longer be measured by the role of firms domiciled in a particular geographic area. Many economic entities have access to a wide range of suppliers for deposit and credit services, some of whom are hundreds or thousands of miles away. As a result, the number of potential entrants into any geographic market is very much greater than one would have thought a few years ago. Consequently, the opportunity to exercise market power seems to be severely constrained.

The bottom line of the findings in this study is that the line of commerce that was once called commercial banking has evolved into a new line of commerce, the provision of financial intermediation services, a line of commerce that may be either narrower or broader than that embodied in commercial banking, depending on the context. Technological advances and long overdue statutory and regulatory changes have blurred the distinctions between

financial intermediation services offered at the wholesale and retail levels; between intermediation services offered to businesses and households and government entities; between intermediation services offered by banks, S&Ls, and finance companies; and between intermediation services offered by old-line, traditional financial institutions like banks and S&Ls and the services offered by the finance arms of manufacturers like General Motors, General Electric, and ITT, retailers like Sears, and diversified financial conglomerates like American Express.¹⁵ These companies are capable of exploiting profitable opportunities to provide financial services when traditional suppliers fail to meet the public's needs at a reasonable price. In the long run the low cost producers will survive. The regulatory barriers that protected high cost producers have begun to be removed; it is a matter of time before a Darwinian struggle determines the new order of species in financial intermediation.

Given the above analysis, the new Justice Department guidelines seem to be anachronistic with respect to their application to the banking industry today.¹⁶ The market for many product lines seems to be national, and the existence of hundreds to thousands of competitors suggests an absence of significant scale economies, at least with present-day technology. (Exceptions are travelers checks and credit cards.) The number of potential new entrants is fairly large and seems to be increasing. Further, as shown in Table 17, the geographic scope of the financial activities of many of the larger bank holding companies covers a wide area and is almost as far-reaching as the geographic coverage of many nonbank companies.

Evolving Public Policy

In light of the fact that commercial banking no longer appears to be a distinct line of commerce, there is not likely to be a public policy response

seeking to inhibit continued entry by nonbanking firms into the various segments of what used to constitute the commercial banking business. Technological and marketplace developments over the last decade or so have simply rendered obsolete the concept that commercial banks are unique and require a set of regulations to maintain their total separateness from other parts of the financial sector. As a result, a subtle but very noticeable change in attitude on the part of many state and federal legislators and many regulatory agencies has become apparent. Prior to the passage of DIDMCA in 1980, the prevailing regulatory attitude could be characterized as "prohibit anything that is not explicitly authorized by statute." The pervading regulatory attitude that seems to be dominant in 1983 is a quite different principle: "permit except where explicitly forbidden."

Many state legislatures have gone beyond this passive acceptance of marketplace realities and have actively sought, and in many cases, enacted laws which lessen the product and geographic restrictions of banks doing business in their states. But these laws have come at a time when most of these restrictions have already been eroded. Also, the Garn-St Germain Act of 1982 authorized the money market deposit and Super NOW accounts, but as mentioned above, technology had already allowed for money fund substitutes such as sweep accounts. The broadened asset powers of the thrift institutions and increased federal chartering options provided by the Garn-St Germain Act as well as the actions of state legislatures, however, provide evidence of an underlying mood favoring increased freedom of action for all financial institutions.

Further, unless a compelling case can be made that the public is likely to be harmed by a proliferation of hybrid or mutant forms of banks, little or nothing is likely to be (or for that matter, should be) done to prevent this

evolution, particularly if these hybrid organizational forms account for only a small portion of the total financial services industry. This response, or lack of response, is appropriate because the new hybrid banks may represent a needed marketplace reaction to external environmental developments such as changing technology, shifting consumer tastes, inflation, and other developments. The stifling of experimentation with new organizational forms (particularly those funded by private capital), could prevent an evolution toward new financial enterprises that might better serve the public interest. Hence, if the private sector is willing to finance a number of small pilot programs involving new forms of competition in financial services and none of these experiments in and of themselves seem to be detrimental to the public interest, little would be gained through interference. Also, if the hybrid organizational forms are inferior to the old forms, they will go by the wayside; if the hybrid forms are superior, they will eventually be emulated and become more the standard than the exception.

The ones that may lose from this experimentation are the present-day incumbent organizations that wish to provide financial services the way they were provided several decades ago. The greatest challenge for regulators is to resist the temptation to protect the vested interests of those firms they presently regulate from firms utilizing an organizational form that provides lower cost or more convenient services to its clientele.

Managerial Implications

The most important findings from this study are that commercial banking is not a distinct line of commerce and that the combination of new entry with the repositioning of product and geographic mix by many of the larger (and smaller) incumbent firms has to result in a changed underlying economics of production and distribution for the other firms in the industry. These

findings are also the basis for the study's most fundamental managerial implication: bank managers must realize that they are providers of financial services. In the environment of the future, the title "banker" may be a misnomer in that it connotes the purveyance of a range of products endemic to an earlier period. The range of financial services offered by "bankers" in the future may be wider or narrower than at present, and if the array of products remains unchanged, it will be largely due to fortuitous circumstances.

With this basic concept of the banking firm in mind, bank managers will then need to analyze their firms in light of each bank's internal strengths and weaknesses (e.g., its customer base, location, and financial and human resources) as well as external factors such as regulation, competition, and the macro-economy. From this environmental assessment, a vision of the future organization must be developed; then a strategy can be devised to attain this goal.

Of course, there will be as many strategic "visions" as there are managers, but Bleeke and Goodrich [2], after analyzing other industries that have undergone deregulation, offer some basic ideas about the possible strategies and types of firms that could develop in the financial services industry. And indeed evidence suggests that this categorization of strategies has already begun to emerge.

The first type of firm is the national delivery company (NDC). It offers a complete line of differentiated products through a broad distribution network that has an integrated information system and uniform customer service requirements. An NDC emphasizes attractive service vs. price trade-offs and is therefore very sensitive to the need for cost controls in order to compete with low-cost firms. In its marketing campaigns an NDC stresses image. Being an NDC, however, does not guarantee profitability. They are complex to manage

and they must continuously walk a fine line between price and service. Examples of NDCs in the airlines and trucking industries are Delta Airlines and Consolidated Freightways, and examples of NDCs in the financial services industry are Citicorp, BankAmerica Corp., Manufacturers Hanover Corp., Merrill Lynch, American Express, and Sears.

The second type of firm to emerge is the low-cost, no frills producer. A firm of this type offers one, low-cost product line, or maybe a few related lines, that do not require much servicing. This provider of financial services aggressively discounts prices relative to conventional suppliers, eliminates or modifies old distribution systems, and emphasizes low cost in its advertisements. Following deregulation in the airline industry, for instance, a new tier of low-cost, no frills providers of airline services on a narrow range of routes suddenly emerged. Many of these firms, such as Peoples Express and Midway Airlines, have been profitable during a period when many of their larger NDC competitors were unprofitable. Because of their superior profit performance, the new, no frills airlines have been successful in attracting external sources of equity and debt capital [24]. Examples of low-cost producers of financial services are money market funds, discount brokers, and Dreyfus, who intends to become a no-frills provider of consumer credit.

The third type of firm is the specialty firm. It offers specialized, high quality products and services targeted at a particular group of customers. These firms depend on strong customer loyalty and emphasize information and quality service. In the airlines industry, for instance, many small, specialty carriers such as Air Wisconsin have found very profitable niches in serving small towns that were abandoned by the major carriers, and in the business terminal equipment market, firms such as Rolm and Northern Telecom

have concentrated on the segment of the market that is willing to pay the price for a high level of service. A current example of a specialty, financial services firm is J.P. Morgan & Co., which primarily serves corporations and governments. And many small and medium size banks, especially those which consider themselves to be "full service" banks, will probably emerge as specialty firms.

These banks have, as their greatest competitive strength, strong customer relationships that are primarily the result of tradition. They have always provided their customers with basic financial services such as loans and savings and transactions accounts. Arthur P. Sorter [20] terms this link the "primary relationship" and asserts that the number of these relationships "will largely determine the value of a [customer] franchise." These strong customer ties, however, may deteriorate as low-cost, no-frills providers of financial services enter the markets of the "full service" banks. Consequently, for many of these banks, the future probably holds a more limited range of products, perhaps provided over a wider geographic area. One possible exception to the reduced product range is the offering of financial services which are not booked on the balance sheet and which can be sold through franchising relationships that add to fee income with little increase in overhead cost.

Because of its strong customer relationships, a small or medium size bank could probably survive by exploiting its customer franchise and marketing the products of other financial services providers, including low cost producers. For example, as of November 1983, over 1000 banks and thrifts, many of them small, offer discount brokerage services through affiliations with such low-cost producers as Fidelity Brokerage Services and Quick & Reilly.

NDCs are using this supplier-distribution scheme as well. Brokers are marketing, through their national distribution networks, the retail CDs of many banks and thrifts across the country. Also, Merrill Lynch began offering the MMDAs of twelve depository institutions as an option with its Cash Management Account. And Kroger, a large grocery store chain, is experimenting with financial centers in Ohio, Alabama, and Texas as joint ventures with an insurance concern and with depository institutions in these areas.

Regardless of the strategy that each provider of financial services adopts, however, all firms will need to take account of a few things to compete successfully in a broader and less regulated financial environment. (For examples of how some firms are responding to this changed environment, see Table 18.)

First, the financial services industry is now "customer driven," and it is product, price, and service that matter to the customers. Changes in technology and consumer habits may make location a much less important factor in the future. Managers need to analyze their present as well as potential customer base and identify what products customers use and what related products they buy from competitors. Also, managers need to understand how customers view their firms and their competitors in terms of price, quality and services.

Firms in the financial services industry will need to be more innovative than they were in the past. This requires gaining insight into customers' needs, whether those needs be for particular products, quality services, or faster, more convenient delivery systems. Often innovation will require segmenting the market in a unique way in order to identify important customer/product segments and profitable, or potentially profitable, opportunities.

Second, with the existence of competitive pricing and the narrowing of profit margins, all firms will need to be cost conscious. Firms will, therefore, need to develop information on costs and unbundle various product lines to understand their cost components and their relative profitability and to uncover unprofitable businesses and product lines that are destined to remain so. Further, some economies of scale may be attainable due to technological advances, and some reductions in overhead costs may now be possible because of the increased acceptance of automated teller machines and banking by phone and by mail.

Third, cross-selling is very important; a checking account customer is a potential customer for brokerage services, credit cards, loans, savings accounts, etc. Cross-selling is especially important for NDCs and specialty firms because it not only increases business volume but it also strengthens customer ties. There is a benefit to the consolidation of accounts, as witnessed by the success of asset management accounts. Customers purchasing all their financial services from one supplier are probably more reluctant to switch to a competitor than are customers having only one account with a single firm. As already mentioned, however, many small, regional suppliers may have to market the products of other suppliers in order to be able to offer their customers a complete line of products.

Fourth, in planning an appropriate response to inroads made by new and existing competitors, managers of financial institutions must be mindful of possible legislative and regulatory response which oftentimes in the not so distant past amounted to preservation of the status quo. Since the passage of DIDMCA, however, the more typical regulatory response has become increasingly accommodative to experimentation.

In light of this, bank management must recognize that the regulatory rules have become increasingly flexible and the limits of the rules should constantly be tested. The present mood seems to be that all competitors should be given an opportunity to experiment and to succeed or fail, provided that failures are small, easily contained, and will not give rise to systemic failure. Such experiments or pilots with respect to new activities, new products, or new geographic markets (or some combination thereof) are likely to meet the above test if they are small relative to the size of the experimenting firm and its human and financial capital base. Under these circumstances, experiments that do not jeopardize the regulated firms are unlikely to cause systemic risk to the financial system and are, in turn, unlikely to encounter a negative regulatory or legislative response.

And finally, while drastic alterations of strategy may not be needed because a series of small adjustments have already been made in response to the changing competitive and regulatory environments, all banks will find it necessary to continually adjust their tactics and strategies in the future. The elimination of Regulation Q and the introduction of MMDA and Super NOW accounts means that funding sources are changing for all depository institutions. The entry of nonbanks, many of whom already have a national distribution system, into the credit-supplying business (and to a lesser extent, the "deposit" business) will necessitate some repositioning of focus for all banks, large and small. There is only so much business volume to go around. And with nondeposit-based firms seeking a greater proportion of the financial services business, some incumbents must shrink in relative size by spinning off unprofitable and marginally profitable products.

To summarize, there exists no single strategy that is guaranteed to provide success in dealing with competition from nonbanking-based providers of

financial services and/or other changes simultaneously taking place. It is probably easier to point out strategies that are unlikely to succeed because they were originally formulated for an external environment that has changed significantly than it is to identify a group of strategies which have a high likelihood for success irrespective of who tries to follow them.¹⁷ But what a financial services manager can learn from these failed strategies is that the changed external environment--the formidable presence of nonbank competition and a somewhat more favorable regulatory environment--should at least be the starting point for any strategy in the 1980s.

V. Summary and Conclusions

For many years, commercial banks have competed in some product lines with other depository institutions such as S&Ls, mutual savings banks, and credit unions. Recently, commercial banks have increasingly found themselves faced with many new competitors such as manufacturers, retailers, insurance companies, and diversified financial concerns. Although many of these new competitors have been encroaching on banks' turf for nearly a decade, they have continually expanded their role in financial services, and they have been joined by many other companies. As a result, by 1982, these nonbank, and even nonfinancial, firms have made significant inroads into banks' traditional lines of business.

Nonbanking-based firms have made remarkable gains in consumer lending, although banks have done quite well in the credit card area. In 1982, the top ten nonbank firms held twice the consumer installment receivables as that held by the top ten bank holding companies in this area of lending. But in consumer installment lending, market shares have been very fluid with the share of new loans made by any single supplier changing drastically with changes in the economy.

In auto lending, market shares have also been quite variable. Commercial banks are still the leading auto lender despite their loss of market share to the auto captive finance companies over the past five years. This shift is attributable to a decrease in car sales, liberalized bankruptcy laws, soaring cost of funds, and interest rate volatility. Although these factors motivated the captive finance companies of the auto manufacturers to offer below-market financing rates in an attempt to boost sluggish sales, these finance companies seem to have found auto lending to be profitable. They may have become the low cost producers in this lending area.

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Although commercial banks have lost some market share in consumer lending, banks are still the primary provider of short-term loans to businesses. In long term lending, however, commercial banks are not the leading institutional lender. Commercial mortgage lending is dominated by insurance companies, and leasing is dominated by manufacturing and leasing firms.

In the area of deposit-taking, changes have taken place as well. In 1973, money market mutual funds emerged as a close substitute for bank deposits, and while not a big threat to banks when interest rates were relatively low, money market funds became very successful when rates rose, growing from only a few billion dollars in "deposits" in 1975 to over \$230 billion by December 1982 when they reached their peak. Also, cooperative affiliations between brokers and depository institutions have developed. These affiliations could conceivably allow a de novo bank or S&L to develop a billion dollar deposit base within a year or two of its opening.

These findings lead to one very important conclusion: commercial banking is no longer a distinct line of commerce. The significant presence of many nonbank firms in consumer lending, business lending, and deposit-taking as well as the ability of S&Ls and mutual savings banks to offer a wide range of consumer and business loans has eroded the uniqueness of commercial banking. Thus, by 1983, commercial banking has evolved into a new line of commerce, the provision of financial intermediation services.

FOOTNOTES

¹In addition, Sears had 2,388 catalog outlets in the United States at year-end 1982.

²More recently, J.C. Penney began offering retail financial services on an experimental basis in five of its stores in Northern California. This pilot program began in December 1982 and was conducted jointly with First Nationwide Savings Association, a subsidiary of National Steel.

³In 1920, retailers and oil companies held almost four-fifths of consumer installment credit. At that time banks held just over 3 percent. By 1950, banks had become the largest consumer installment lender with just under 40 percent of the loans outstanding, well ahead of finance companies which held about one-fourth and retailers and oil companies which held one-fifth of consumer installment loans. For more detail, see [14, Table 2].

⁴Since the Loomis article appeared, Citicorp has acquired an S&L in California.

⁵More than 40 companies were actually analyzed, but accounting data concerning their financial activities were available on only 32 of them. Among the other firms studied were very recent entrants into financial services (Parker Pen, McMahan Valley Stores, and Krogers), potential competitors of commercial banks (Bradford National Corp., TRW, and Dun & Bradstreet), and two insurance companies that recently have expanded their range of financial services (John Hancock and Travelers).

⁶Most of the financial activities of the ten companies shown in Table 1 are carried on domestically; many of the larger bank holding companies, on the other hand, derive a significant portion of their business from foreign activities, although the portion of profits from retail foreign business is fairly small. Thus, the profits of nonbanking-based companies and the larger bank holding companies are difficult to compare directly.

⁷The auto captive finance companies have a different profit orientation than their competitors. The use of a captive finance company gives auto manufacturers an added degree of pricing and marketing freedom not enjoyed by the competition. Indeed a captive finance company could, in theory, lose money on every loan it makes provided its parent made up for such losses in added sales volume at higher average prices.

⁸No evidence is publicly available on the duration matching techniques utilized by GMAC or Ford Motor Credit. The weighted average maturities of their assets and liabilities were computed for the years 1978-82. In general, both companies tended to exhibit a weighted-average debt maturity between 4-5 years and a weighted average receivables maturity of about 2 years, leaving a maturity (not a duration) mismatch of at least 2 years. It could be argued that portfolio immunization should take place for the consolidated company rather than an individual subsidiary. In any event, GMAC and Ford Motor Credit may not have taken advantage of their ability to immunize their portfolios. Their continued profitability throughout this period suggests that they were not impacted adversely by the interest rate movements that occurred.

⁹The data are distorted somewhat by the fact that finance company subsidiaries of bank holding companies are included with finance companies. For example, in 1981, Citicorp held \$9.6 billion of consumer installment loans, \$2.2 billion, or 23 percent, of which were attributable to Citibank and Citibank (New York State); BankAmerica held \$9.7 billion of consumer installment loans, \$6.8 billion, or 78 percent, of which were attributable to Bank of America; and Mellon National Corp. held \$.9 billion of such loans, \$.83 billion, or 87 percent, of which were attributable to Mellon Bank. Further complicating interpretation of the data is the tendency of some banks to sell consumer loans to their finance company affiliate, and vice versa. However, most bank holding companies reported no interaffiliate transfers of assets in any year from 1976 to 1980 [16].

¹⁰In this context it should be noted that the post 1978 period, in particular the three-year period beginning October 6, 1979 to October 1982, has provided an unusual testing ground. One desirable characteristic of a financial firm is that it be able to survive large economic shocks--be it interest rate or regulatory changes or the combined impact of the two. The least diversified firms, S&Ls, have not done well in this regard. More diversified firms like banks, auto captive finance companies, and many diversified finance companies have done somewhat better. Diversification of product lines is neither a necessary nor a sufficient condition for survival. Rosenblum [17] has shown that with no expansion of product lines, even S&Ls could have taken steps to reduce the impact of interest rate changes on their net worth. Kane [9] has shown how improperly priced FSLIC insurance induced S&Ls not to immunize themselves against interest rate risk. Eisenmenger has argued that the real risk is political risk of unpredictable, capricious changes in the legislative and regulatory environment [5]. It appears that firms with little opportunity to diversify out of unprofitable product lines have experienced greater difficulty over the last few years than those who are less constrained. Many of the manufacturers seem to have benefited from their presence in financial services and from their competition with banks and other lenders.

¹¹Some of the comparisons between the success of the Visa, Sears and other credit cards may be overdrawn. Over the period of analysis, one could not use a Visa card in Sears nor could a Sears card have been used outside a Sears store. What is being observed is a derived demand for credit based on the relative demand for goods sold by Sears versus goods sold by merchants or other outlets that accept Visa or Mastercard. Similarly, the American Express green card is perceived by many of its users as a "travel and entertainment" card rather than a credit card since the full amount of the purchase is due and payable when the customer receives his or her bill from American Express.

¹²It could be argued that Regulation Q has hampered the ability of banks to raise funds and that removal of Q-ceilings will enhance their ability to compete for funds. However, all 15 of the bank holding companies shown in Table 4 have long had access to nondeposit funding sources not subject to Q-ceilings. It would seem that, at least for the larger bank holding companies, elimination of Q-ceilings would increase the cost of funds but not the access to funds.

¹³Offsetting this advantage to some extent is the probability that the phase-out of Q-ceilings will improve the ability of banks to immunize themselves against the earnings impacts of changes in interest rates. As shown in Rosenblum [17], by limiting the menu of maturities and interest rates that can be paid on time and savings accounts, Regulation Q has been an important barrier to immunization by banks and S&Ls and has raised tremendously the interest rate risk exposure of these depository institutions over the last few years.

¹⁴As of March 1983, noncorporate businesses as well as individuals are eligible to have money market deposit accounts; however, only individuals, certain nonprofit corporations, and governmental units are eligible to have Super NOW accounts.

¹⁵Commercial banking and investment banking are still, for the most part, separated by some Glass-Steagall provisions, but even these separations are breaking down as cooperative agency relationships eliminate the need for direct participation in underwriting.

¹⁶For a brief description of the guidelines as applied to commercial banking, see [7].

¹⁷The literature on this subject matter is extensive. For a detailed analysis of old strategies that have outlived their usefulness, see Kramer [11]. Vojta [21] provides a list of nine criteria or tactics that will be followed by the financial institution survivors. Horvitz [8] dissects the many assumptions and assertions regarding the benefits of a number of strategies. The evolution of the public policy response is traced in Kaufman, Mote and Rosenblum [10]. Many other articles (too numerous to mention) have been written on general strategy formulation and on the strategies followed by specific financial services companies.

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APPENDIX A

APPENDIX A
 Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82*
 Industrial/Communication/Transportation Based Companies

	<u>General Motors Acceptance Corp.</u>	<u>Ford Motor Credit Company</u>	<u>General Electric Credit Corp.</u> (million dollars)	<u>CIT Financial Corp. (RCA)</u>	<u>Associates¹ First Capital (Gulf & Western)</u>
<u>Consumer Loans</u>					
Mortgage	---	---	1,027	1,074	1,598
Installment, Revolving Credit	<u>35,623</u>	<u>10,542</u>	<u>4,459</u>	<u>1,534</u>	<u>1,535</u>
Total	35,623	10,542	5,486	2,608	3,133
<u>Commercial Loans</u>					
Commercial and Industrial	9,670	4,890	2,386	4,054	2,667
Mortgage	---	<u>102</u>	<u>1,059</u>	---	---
Total	9,670	4,992	3,445	4,054	2,667
Loans to Governments and Financial Institutions	---	---	---	---	---
Other Loans	---	33	---	---	---
Lease Financing	2,910	2,059	4,188	652	257
Total Finance Receivables	48,203	17,626	13,119	7,314	6,057
<u>Selected Liabilities</u>					
Deposits	---	---	---	---	---
Short-Term Debt	22,180	7,111	5,670	1,950	2,052
Long-Term Debt	17,876	5,963	3,239	2,360	2,496
<u>After-Tax Net Income</u>					
Finance Subsidiary	688	229	205	129	66
Consolidated Parent	963	(658)	1,817	223	169

*Commercial and industrial loans include construction lending; commercial mortgages exclude those purchased in the secondary markets; other loans include federal funds sold and securities purchased under resale agreements; and short-term debt includes the current portion of long-term borrowings.

¹As of 1/31/82.

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Industrial/Communication/Transportation Based Companies (Cont'd.)

	United Financial Corp. of California (National Steel)	ITT Financial Corp.	Combined Insurance ² and Finance Subsidiaries of ITT	Commercial ³ Credit Co. (Control Data)
	(million dollars)			
<u>Consumer Loans</u>				
Mortgage	5,955	733	733	716
Installment, Revolving Credit	<u>60</u>	<u>1,368</u>	<u>1,175</u>	<u>1,094</u>
Total	6,015	2,101	1,908	1,810
<u>Commercial Loans</u>				
Commercial and Industrial	---	2,689	1,769	1,301
Mortgage	---	<u>193</u>	<u>193</u>	---
Total	---	2,882	1,962	1,301
Loans to Governments and Financial Institutions	---	---	---	---
Other Loans	---	---	---	---
Lease Financing	---	218	218	1,160
Total Finance Receivables	6,015	5,201	4,088	4,271
<u>Selected Liabilities</u>				
Deposits	4,458	---	38	749
Short-Term Debt	637	2,159	1,394	1,387
Long-Term Debt	1,691	1,707	1,382	1,382
<u>After-Tax Net Income</u>				
Finance Subsidiary	7	350	72	46
Consolidated Parent	(463)	703	703	155

²Figures stated net of unearned income.

³International banking subsidiaries are not consolidated. As of December 31, 1982 they had net receivables of \$429 million and deposits of \$384 million.

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Industrial/Communication/Transportation Based Companies (Cont'd.)

	Chrysler Financial Corp.	Borg-Warner Acceptance Corp.	Westinghouse Credit Corp.	Greyhound Financial Group Subsidiaries (million dollars)	IBM Credit Corp.	IBM Corp.	Diamond Financial Holdings (Dana Corp.)	Armco Financial Services
<u>Consumer Loans</u>								
Mortgage	---	224	---	---	---	---	557	---
Installment, Revolving Credit	<u>1,666</u>	<u>204</u>	<u>63</u>	---	---	---	<u>23</u>	---
Total	1,666	428	63	---	---	---	580	---
<u>Commercial Loans</u>								
Commercial and Industrial	1,419	1,573	1,635	---	1,186	5,192	---	22
Mortgage	---	---	<u>599</u>	---	---	---	<u>83</u>	---
Total	1,419	1,573	2,234	---	1,186	5,192	83	22
Loans to Governments and Financial Institutions	---	---	---	---	---	---	---	---
Other Loans	---	171	---	---	---	---	31	---
Lease Financing	292	651	323	2,236	82	---	65	532
Total Finance Receivables	3,377	2,823	2,620	2,236	1,268	5,192	759	554
<u>Selected Liabilities</u>								
Deposits	---	---	---	---	---	---	737	---
Short-Term Debt	200	1,112	938	150	352	529	50	464
Long-Term Debt	2,376	874	1,153	1,139	508	2,851	95	245
<u>After-Tax Net Income</u>								
Finance Subsidiary	52 ⁴	37	51	48	31	---	2	(5)
Consolidated Parent	170	167	449	103	4,409	4,409	52	(345)

⁴Includes an income support payment from Chrysler of \$32 million.

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Diversified Finance Companies

	<u>American⁵ Express</u>	<u>Beneficial Corp.⁶ & Unconsolidated Subsidiaries</u>	<u>Merrill⁷ Lynch</u> (million dollars)	<u>Walter E.⁸ Heller International</u>	<u>Household⁹ International</u>
<u>Consumer Loans</u>					
Mortgage	583	2,180	412	104	1,824
Installment, Revolving Credit	<u>5,608</u>	<u>2,058</u>	<u>4,778</u>	<u>176</u>	<u>1,804</u>
Total	6,191	4,238	5,190	280	3,628
<u>Commercial Loans</u>					
Commercial and Industrial	2,057	16	615	3,302	650
Mortgage	<u>213</u>	<u>96</u>	<u>n.a.</u>	<u>891</u>	<u>---</u>
Total	2,270	112	615	4,193	650
Loans to Governments and Financial Institutions	1,988	---	---	654	---
Other Loans	512	---	5,095	---	---
Lease Financing	72	245	---	329	355
Total Finance Receivables	11,033	4,595	10,900	5,456	4,633
<u>Selected Liabilities</u>					
Deposits	6,810	224	1,005	2,280	309
Short-Term Debt	3,757	705	10,225	2,500	1,403
Long-Term Debt	1,746	3,318	757	765	3,411
<u>After-Tax Net Income</u>					
Finance Subsidiary	---	---	---	---	---
Consolidated Parent	581	(31)	309	16	125

⁵American Express International Banking Corp. is consolidated. Its total loans were \$4,474 million.

⁶Figures stated net of unearned income.

⁷Two international merchant banking subsidiaries are consolidated.

⁸American National Bank and Trust Co. of Chicago is consolidated. Its total loans outstanding were \$1,519 million at year-end 1982.

⁹Valley National Bank is consolidated.

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Diversified Finance Companies (Cont'd.)

	<u>E.F. Hutton Group</u>	<u>Transamerica Corp.</u>	Avco ¹⁰ <u>Financial Services</u>	<u>Baldwin- United</u>	<u>Lowes Corp.</u>
	(million dollars)				
<u>Consumer Loans</u>					
Mortgage	---	1,032	1,188	1,196	51
Installment, Revolving Credit	<u>1,166</u>	<u>807</u>	<u>1,133</u>	<u>73</u>	<u>936</u>
Total	1,166	1,839	2,321	1,269	987
<u>Commercial Loans</u>					
Commercial and Industrial	144	905	220	531	---
Mortgage	---	<u>1,423</u>	<u>256</u>	<u>461</u>	<u>459</u>
Total	144	2,328	476	992	459
Loans to Governments and Financial Institutions	---	---	---	---	---
Other Loans	2,674	---	---	---	---
Lease Financing	534	n.a.	244	67	---
Total Finance Receivables	4,518	4,167	3,041	2,328	1,446
<u>Selected Liabilities</u>					
Deposits	---	---	86	1,153	---
Short-Term Debt	2,995	529	536	1,429	185
Long-Term Debt	352	2,185	1,947	637	715
<u>After-Tax Net Income</u>					
Finance Subsidiary	---	---	80	---	90
Consolidated Parent	81	186	72	66	216

¹⁰As of 11/30/82.

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Insurance-Based Companies

	<u>Prudential</u>	<u>Bache Group</u>	<u>PruCapital</u> (million dollars)	<u>Prudential + Bache Group + PruCapital</u>	<u>Equitable Life Assurance</u>
<u>Consumer Loans</u>					
Mortgage	---	---	---	---	1,696
Installment, Revolving Credit	<u>4,536</u>	<u>1,351</u>	---	<u>5,887</u>	<u>2,911</u>
Total	4,536	1,351	---	5,887	4,607
<u>Commercial Loans</u>					
Commercial and Industrial	---	---	799	799	---
Mortgage	<u>14,675</u>	---	---	<u>14,675</u>	<u>9,399</u>
Total	14,675	---	799	15,474	9,399
Loans to Governments and Financial Institutions	---	---	---	---	---
Other Loans	---	2,747	---	2,747	---
Lease Financing	---	---	737	737	---
Total Finance Receivables	19,211	4,098	1,536	24,845	14,006
<u>Selected Liabilities</u>					
Deposits	---	---	---	---	---
Short-Term Debt	---	2,991	1,420	4,411	---
Long-Term Debt	135	50	185	---	414
<u>After-Tax Net Income</u>					
Finance Subsidiary	---	(30)	25	(5)	---
Consolidated Parent	2,014 ¹¹	---	---	2,014 ¹¹	584 ¹¹

¹¹Increase in surplus before dividends.

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Insurance-Based Companies (Cont'd)

	<u>Aetna Life & Casualty</u>	<u>American General Corp.</u>	<u>Credithrift Financial, Inc.</u>	<u>American General + Credithrift Financial</u>
			(million dollars)	
<u>Consumer Loans</u>				
Mortgage	---	---	481	481
Installment, Revolving Credit	<u>548</u>	<u>678</u>	<u>615</u>	<u>1,293</u>
Total	548	678	1,096	1,774
<u>Commercial Loans</u>				
Commercial and Industrial	28	---	---	---
Mortgage	<u>10,662</u>	<u>1,683</u>	---	<u>1,683</u>
Total	10,690	1,683	---	1,683
Loans to Governments and Financial Institutions	---	---	---	---
Other Loans	---	---	---	---
Lease Financing	---	---	---	---
Total Finance Receivables	11,238	2,361	1,096	3,457
<u>Selected Liabilities</u>				
Deposits	---	---	265	265
Short-Term Debt	3	173	46	219
Long-Term Debt	414	774	661	1,435
<u>After-Tax Net Income</u>				
Finance Subsidiary	---	---	24	24
Consolidated Parent	427	163	163	163

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Retail-Based Companies

	<u>Sears</u>	<u>Montgomery Ward Credit</u>	<u>J.C. Penney¹² Financial</u> (million dollars)	<u>J.C. Penney Financial¹² and J.C. Penney Co. Combined</u>
<u>Consumer Loans</u>				
Mortgage	3,103	---	---	---
Installment, Revolving Credit	<u>10,109</u>	<u>3,291</u>	<u>2,015</u>	<u>3,450</u>
Total	13,212	3,291	2,015	3,450
<u>Commercial Loans</u>				
Commercial and Industrial	603	---	2	---
Mortgage	---	---	---	---
Total	<u>603</u>	---	<u>2</u>	---
Loans to Governments and Financial Institutions	---	---	---	---
Other Loans	1,005	---	---	---
Lease Financing	---	---	---	---
Total Finance Receivables	14,820	3,291	2,017	3,450
<u>Selected Liabilities</u>				
Deposits	2,461	---	---	---
Short-Term Debt	4,153	1,286	730	730
Long-Term Debt	6,488	1,118	718	2,102
<u>After-Tax Net Income</u>				
Finance Subsidiary	---	85	50	---
Consolidated Parent	861	(75) ¹³	392	392

¹²As of 1/29/83.

¹³Montgomery Ward's operating loss.

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Bank Holding Companies

	<u>Citicorp</u>		<u>BankAmerica Corp.</u> ¹⁴		<u>Chase Manhattan Corp.</u>		<u>Manufacturers Hanover Corp.</u>	
	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>
	(million dollars)							
<u>Consumer Loans</u>								
Mortgage	10,996	9,261	10,901	10,901	1,237	1,237	1,195	1,195
Installment, Revolving Credit	16,302	11,213	10,484	9,506	3,745	3,085	2,326	2,285
Total	27,298	20,474	21,385	20,407	4,982	4,322	3,521	3,480
<u>Commercial Loans</u>								
Commercial and Industrial	48,228	18,627	36,273	17,580	35,195	11,522	24,005	12,961
Mortgage	5,660	2,915	5,158	4,402	2,237	842	1,245	880
Total	53,888	21,542	41,431	21,982	37,432	12,364	25,250	13,841
Loans to Governments and Financial Institutions	9,914	2,623	8,738	1,256	10,967	2,911	13,457	3,722
Other Loans	3,292	3,292	6,962	6,784	2,787	1,981	1,778	1,778
Lease Financing ¹⁵	1,848	1,848	1,925	1,925	237	237	3,882	3,882
Total Finance Receivables	96,240	49,779	80,441	52,354	56,405	21,815	47,888	26,703
<u>Selected Liabilities</u>								
Deposits	76,538		94,342		56,858		43,825	
Short-Term Debt	25,265		9,064		12,739		9,998	
Long-Term Debt	7,768		2,105		1,046		1,588	
<u>After-Tax Net Income</u>								
Finance Subsidiary	---		---		---		---	
Consolidated Parent	723		447		307		295	

¹⁴Figures stated net of unearned income.

¹⁵Total lease finance receivables are included under domestic receivables because of the difficulties involved in separating domestic from international leasing activity.

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Bank Holding Companies (Cont'd.)

	Continental Illinois Corp.		Chemical New York Corp.		J.P. Morgan & Company		First Interstate Bancorp	
	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>
	(million dollars)							
<u>Consumer Loans</u>								
Mortgage	866	866	1,068	1,068	73	73	2,311	2,311
Installment, Revolving Credit	<u>1,344</u>	<u>1,337</u>	<u>2,152</u>	<u>2,149</u>	<u>198</u>	<u>141</u>	<u>4,591</u>	<u>4,591</u>
Total	2,210	2,203	3,220	3,217	271	214	6,902	6,902
<u>Commercial Loans</u>								
Commercial and Industrial	21,694	13,715	20,806	14,605	18,828	6,529	10,733	9,259
Mortgage	<u>3,268</u>	<u>3,145</u>	<u>848</u>	<u>745</u>	<u>774</u>	<u>359</u>	<u>2,482</u>	<u>2,472</u>
Total	24,962	16,860	21,654	15,350	19,602	6,888	13,215	11,731
Loans to Governments and Financial Institutions	4,614	2,222	5,298	213	7,844	2,049	3,171	1,784
Other Loans	1,518	1,202	1,119	928	3,418	3,351	2,126	2,121
Lease Financing ¹⁵	1,172	1,172	1,148	1,148	328	328	999	999
Total Finance Receivables	34,476	23,659	32,439	20,856	31,463	12,830	26,413	23,537
<u>Selected Liabilities</u>								
Deposits	28,175		27,998		37,910		30,542	
Short-Term Debt	9,949		13,232		11,237		5,098	
Long-Term Debt	1,272		601		683		898	
<u>After-Tax Net Income</u>								
Finance Subsidiary	---		---		---		---	
Consolidated Parent	78		241		394		221	

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Bank Holding Companies (Cont'd.)

	<u>Security Pacific Corp.</u>		<u>Bankers Trust New York Corp.</u>		<u>First Chicago Corp.</u>		<u>Wells Fargo & Co.</u>	
	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>
	(million dollars)							
<u>Consumer Loans</u>								
Mortgage	4,912	4,912	294	294	820	820	4,319	4,319
Installment, Revolving Credit	<u>4,389</u>	<u>4,354</u>	<u>187</u>	<u>181</u>	<u>1,936</u>	<u>1,900</u>	<u>1,724</u>	<u>1,724</u>
Total	9,301	9,266	481	475	2,756	2,720	6,043	6,043
<u>Commercial Loans</u>								
Commercial and Industrial	12,052	10,051	13,073	8,766	11,476	7,694	8,422	7,436
Mortgage	<u>905</u>	<u>647</u>	<u>565</u>	<u>536</u>	<u>863</u>	<u>641</u>	<u>1,221</u>	<u>1,211</u>
Total	12,957	10,698	13,638	9,302	12,339	8,335	9,643	8,647
Loans to Governments and Financial Institutions	3,226	624	5,986	1,159	5,214	1,638	2,302	513
Other Loans	976	972	3,478	3,304	2,374	2,300	880	880
Lease Financing ¹⁵	1,465	1,465	296	296	362	362	920	920
Total Finance Receivables	27,925	23,025	23,879	14,536	23,045	15,355	19,788	17,003
<u>Selected Liabilities</u>								
Deposits	25,848		24,493		27,419		18,180	
Short-Term Debt	4,742		10,489		3,988		2,698	
Long-Term Debt	1,241		440		311		1,267	
<u>After-Tax Net Income</u>								
Finance Subsidiary	---		---		---		---	
Consolidated Parent	234		239		137		139	

SOURCE: Company Annual Reports and 10-K forms.

Estimated Gross Finance Receivables and Selected Liabilities as of 12/31/82
Bank Holding Companies (Cont'd.)

	<u>Crocker National Corp.</u>		<u>Marine</u> <u>Midland Banks, Inc.</u>		<u>Mellon National Corp.</u> ¹⁴		<u>Total Top 15</u> <u>Bank Holding Companies</u>	
	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>	<u>Worldwide</u>	<u>Domestic</u>
	(million dollars)							
<u>Consumer Loans</u>								
Mortgage	3,384	3,384	653	653	1,011	1,011	44,040	42,305
Installment, Revolving Credit	<u>1,095</u>	<u>1,095</u>	<u>2,143</u>	<u>2,127</u>	<u>907</u>	<u>907</u>	<u>53,523</u>	<u>46,595</u>
Total	4,479	4,479	2,796	2,780	1,918	1,918	97,563	88,900
<u>Commercial Loans</u>								
Commercial and Industrial	8,758	7,557	5,582	4,004	6,709	5,221	281,834	155,527
Mortgage	<u>492</u>	<u>489</u>	<u>389</u>	<u>365</u>	<u>424</u>	<u>420</u>	<u>26,531</u>	<u>20,069</u>
Total	9,250	8,046	5,971	4,369	7,133	5,641	308,365	175,596
Loans to Governments and Financial Institutions	2,499	---	3,682	1,281	1,902	768	88,814	22,763
Other Loans	132	129	255	190	917	858	32,012	30,070
Lease Financing ¹⁵	206	206	80	80	198	198	15,066	15,066
Total Finance Receivables	16,566	12,860	12,784	8,700	12,068	9,383	541,820	332,395
<u>Selected Liabilities</u>								
Deposits	18,195		15,057		12,328		537,708	
Short-Term Debt	3,425		2,084		4,629		128,637	
Long-Term Debt	210		475		493		20,398	
<u>After-Tax Net Income</u>								
Finance Subsidiary	---		---		---		---	
Consolidated Parent	72		87		134		3,748	

SOURCE: Company Annual Reports and 10-K forms.

APPENDIX B

Table 1

List of the 32 Companies Analyzed

15 Industrial/Communication/Transportation-Based Companies

Associated First Capital (Gulf & Western)
Armco Financial Services
Borg-Warner Acceptance Corp.
Chrysler Financial Corp.
CIT Financial Corp. (RCA)
Commercial Credit Co. (Control Data)
Diamond Financial Holdings (Dana)
FN Financial Corporation (National Steel)
Ford Motor Credit Company
General Electric Credit Corp.
General Motors Acceptance Corp.
Greyhound Financial Group
IBM
ITT
Westinghouse Credit Corp.

10 Diversified Financial Service Companies

American Express
Avco Financial Services
Baldwin-United Corp.
Beneficial Corp.
Walter E. Heller International
Household International
E.F. Hutton Group
Loews Corp.
Merrill Lynch
Transamerica

4 Insurance-Based Companies

Aetna Life & Casualty
American General Corp./Credithrift Financial
Equitable Life Assurance Society
Prudential (and Bache)

3 Retail-Based Companies

Montgomery Ward
J.C. Penney
Sears

Table 2
Estimated Financial Service Earnings of
Nonfinancial-Based Companies

	1962		1972		1982	
	Million dollars	Percent of total earnings	Million dollars	Percent of total earnings	Million dollars	Percent of total earnings
Borg-Warner	\$0.5	1.5%	\$6.3	10.6%	\$37	21.5%
Control Data	nil	nil	55.6	96.2	46	29.7
Ford Motor	0.4	nil	44.1	5.1	229	n.a. ¹
General Electric	8.7	3.3	41.1	7.8	205	11.3
General Motors	40.9	2.8	96.4	4.5	688	71.4
Gulf & Western	nil	nil	29.3	42.1	89	53.4
ITT	1.2	2.9	160.2	33.6	350	51.7
Marcor	nil	nil	9.0	12.4	85	n.a. ²
Sears ³	50.4	21.6	209.0	34.0	580	89.2
Westinghouse	0.9	2.0	15.2	7.6	51	11.4
	103.0		666.2		2,360	

¹Ford Motor Company had a net loss of \$658 million in 1982.

²Marcor's operating loss in 1982 was \$75 million.

³Sears' financial service earnings are stated before allocation of corporate expenses to its business groups. In 1982, such expenses were \$133 million.

SOURCE: 1962 and 1972 data from Christophe (1974), Table III, p. 10; 1981 data from company Annual Reports and 10-K forms.

Table 3
Earnings from Financial Activities, 1981 & 1982:
Manufacturers, Retailers, Diversified Finance Companies,
Insurance-Based Companies,
and Bank Holding Companies
(\$ millions)

Company	Earnings	
	1982	1981
Prudential	2,014	1,576
Citicorp	723	531
General Motors	688	365
Equitable Life Assurance	584	651
American Express	581	518
Sears	580	385
BankAmerica Corp.	447	445
Aetna Life & Casualty	427	462
J.P. Morgan & Co.	394	375
ITT	350	387
Merrill Lynch	309	203
Chase Manhattan Corp.	307	412
Manufacturers Hanover Corp.	295	252
Chemical New York Corp.	241	215
Bankers Trust New York Corp.	239	188
Security Pacific Corp.	234	206
First Interstate Bank Corp.	221	236

¹Sears' financial service earnings are stated before allocation of corporate expenses to its business groups. In 1982 and 1981, such expenses were \$133 million and \$103 million, respectively.

SOURCE: Company Annual Reports and 10-K forms, as shown in Appendix A, supra.

Table 4
Percent of Financing in Conjunction with
Sales of Parent's Products

<u>Company</u>	<u>1972</u>	<u>1981</u>	<u>1982</u>
General Electric Credit Corp.	9	5	virtually none
Borg-Warner Acceptance Corp.	not available	9	9
Westinghouse Credit Corp.	43 ¹	less than 1	less than 1
Associates/G&W	2 ²	1	1
Commercial Credit/Control Data	8 ²	11	11

¹Estimated from information in Christophe (1974), pp. 48-49. As of 1973, Westinghouse stated in its 10-K form that the percentage of its parent's products financed was a "small portion" of WCC's business.

²Data shown are for 1975, the earliest date available.

SOURCE: For 1972, Christophe (1974), except as noted. For 1981 and 1982, Annual Reports and 10-K forms.

Table 5
Total Domestic Finance Receivables
of 30 Selected Companies Having Over
\$5 Billion in Receivables: 1981 & 1982
(\$ billions)

Company	Receivables	
	1982	1981
BankAmerica Corp.	52.4	52.0
Citicorp	49.8	40.6
General Motors	48.2	45.1
Manufacturers Hanover Corp.	26.7	23.1
Prudential/Bache/PruCapital	24.8	23.0
First Interstate Bancorp	23.7	21.3
Continental Illinois Corp.	23.5	23.7
Security Pacific Corp	23.0	19.2
Chase Manhattan Corp.	21.8	21.2
Chemical New York Corp.	20.9	20.3
Ford Motor	17.6	19.5
Wells Fargo & Co.	17.0	16.1
First Chicago Corp.	15.4	14.5
Sears	14.8	13.8
Bankers Trust New York Corp.	14.5	13.0
Equitable Life Assurance	14.0	13.7
General Electric	13.1	11.1
Crocker National Corp.	12.9	12.7
J.P. Morgan & Co.	12.8	12.9
Aetna Life & Casualty	11.2	10.8
American Express	11.0	9.5
Merrill Lynch	10.9	5.1
Mellon National Corp.	9.4	8.1
Marine Midland Banks, Inc.	8.7	7.9
CIT Financial	7.3	7.2
Gulf & Western	6.1	5.9
National Steel	6.0	5.9
Walter E. Heller International	5.5	5.1
ITT	5.2	4.8
IBM	5.2	4.6

SOURCE: Company Annual Reports and 10-K forms, as shown in Appendix A, supra.

Table 6
Top 15 Consumer Installment
and Revolving Credit Lenders:*
1981 & 1982
(\$ millions)

Company	Installment and Revolving Credit	
	1982	1981
General Motors	35,623	31,077
Citicorp	11,213	9,556
Ford Motor	10,542	11,892
Sears	10,109	9,528
BankAmerica Corp.	9,506	9,703
Prudential/Bache/Prucapital	5,887	5,142
American Express	5,608	5,035
Merrill Lynch	4,778	4,725
First Interstate Bancorp	4,591	4,418
General Electric	4,459	2,792
Security Pacific Corp.	4,354	3,799
J.C. Penney	3,450	3,183
Montgomery Ward	3,291	3,623
Chase Manhattan Corp.	3,085	2,726
Equitable Life Assurance	2,911	2,692

*Data for bank holding companies are domestic loans; nonbank company data are worldwide.

SOURCE: Annual Reports and 10-K forms, as shown in Appendix A, supra.

Table 7
Domestic Automobile Loans Outstanding
as of year-end: 1978-1982

	<u>1982</u>	<u>1981</u>	<u>1980</u>	<u>1979</u>	<u>1978</u>
	(----- \$ millions -----)				
General Motors Acceptance Corp. ¹	\$ 33,520	\$ 28,545	\$ 20,298	\$ 17,526	\$ 13,519
Percent of total	26%	23%	17%	15%	13%
Ford Motor Credit Co. ²	\$ 9,321	\$ 10,450	\$ 8,977	\$ 7,678	\$ 6,527
Percent of total	7%	8%	8%	7%	6%
Chrysler Financial Corp. ³	\$ 1,665	\$ 1,948	\$ 1,742	\$ 1,472	\$ 1,728
Percent of total	1%	2%	2%	1%	2%
Total of three auto finance companies	\$ 44,506	\$ 40,943	\$ 31,017	\$ 26,676	\$ 21,774
Percent of total	34%	32%	27%	23%	21%
Commercial banks	\$ 58,851	\$ 59,181	\$ 61,536	\$ 67,367	\$ 60,510
Percent of total	45%	47%	53%	58%	60%
Other	\$ 26,870	\$ 26,307	\$ 24,285	\$ 22,319	\$ 19,363
Percent of total	21%	21%	20%	19%	19%
Total auto loans outstanding	\$130,227	\$126,431	\$116,838	\$116,362	\$101,647

¹Includes small amount of financing of other General Motors products such as trucks and tractors.

²These domestic numbers are estimates. They also include a small amount of financing of Ford's other products.

³Includes Canadian and Mexican automotive receivables.

SOURCE: *Federal Reserve Bulletin* and Annual Reports and 10-K forms.

Table 8
Automobile Credit by Holder
(\$ billions)

	Amount Outstanding			Net Change During Year			New Loans		
	1978	1981	1982	1978	1981	1982	1978	1981	1982
Commercial Banks*	60.5	58.1	58.9	10.9	- 3.5	0.8	53.0	41.6	45.3
Finance Companies	19.9	45.3	48.8	4.7	11.0	3.5	16.5	33.5	32.4
Credit Unions	<u>21.2</u>	<u>22.0</u>	<u>22.6</u>	<u>3.1</u>	<u>0.9</u>	<u>.6</u>	<u>18.5</u>	<u>18.1</u>	<u>18.3</u>
Total	101.6	125.4	130.3	18.7	8.4	4.9	88.0	93.2	96.0

*Includes both indirect paper and direct loans.

SOURCE: *Federal Reserve Bulletin*, April 1982 and April 1983, pp. A42-A43, and *Consumer Installment Credit* G.19, March 1983.

Table 9
Sources of Net New Consumer Installment Credit to Households

	1978		1981		1982	
	<u>\$ billion</u>	<u>percent</u>	<u>\$ billion</u>	<u>percent</u>	<u>\$ billion</u>	<u>percent</u>
Commercial banks	23.6	55	.6	3	4.4	33
S&Ls	*	*	1.7	9	2.3	18
Finance companies	9.4	22	13.1	72	4.5	34
Credit Unions	6.7	16	1.9	11	1.3	10
Others**	<u>3.4</u>	<u>7</u>	<u>.9</u>	<u>5</u>	<u>.6</u>	<u>5</u>
Total	43.1	100	18.2	100	13.1	100

*Less than \$0.5 billion or less than 0.5 percent.

**Includes mortgage pools, mutual savings banks, federal and related agencies, state and local governments, and other lenders. Amount of loans and percent of total is computed as a residual.

SOURCE: *Federal Reserve Bulletin*, April 1982 and April 1983, pp. A42-A43, and *Consumer Installment Credit* G.19, March 1983.

Table 10a
Consumer Credit Card Programs of Major Card Issuers

	<u>1972</u>	<u>1981</u>	<u>1982</u>
Number of Active Accounts			
at Year-End (millions)			
Sears	18.5	24.5	24.8
MasterCard	10.3	22.1	n.a.
Visa	10.0	25.8	28.0
American Express	—	10.0	n.a.
Customer Charge Volume			
(\$ billions)			
Sears	6.3	9.8	10.5
MasterCard	5.9	26.1	30.7
Visa	4.4	29.3	35.3
American Express	—	n.a.	up 17%
Total Customer Account Balances			
at Year-End (\$ billions)			
Sears	4.3	6.8	7.1
MasterCard	2.8	12.3	n.a.
Visa	2.3	15.2	17.6
American Express	—	4.2	4.7

SOURCE: 1981 and 1982 company Annual Reports supplemented by phone discussions. For 1981 and 1982, MasterCard and Visa data are U.S.-only, while Sears and American Express data are worldwide. Data for 1972 are from Christophe (1974), Chart II, p. 6.

Table 10b
Leading Issuers of Credit Cards—1982
Ranked by Customer Account Receivables
(\$ billions)

<u>Company</u>	<u>Receivables</u>
Sears	7.10
American Express	4.70
Citibank (South Dakota & Buffalo)*	3.28
Bank of America	2.77
First National Bank of Chicago	1.73
Chase Manhattan Bank	0.96
Continental Bank	0.74
Manufacturers Hanover Trust Co.	0.72
Wells Fargo Bank	0.48
Marine Midland Bank	0.47

*Citicorp, the parent of Citibank, has other credit-card-issuing subsidiaries which do not provide detailed information on credit card receivables for three heavily promoted credit cards: Diners Club, Carte Blanche, and the Choice Card.

SOURCE: For banks, domestic Call Reports, and for nonbank companies, Annual Reports.

Table 11
Business Lending by Selected Nonbanking-Based Firms and
Bank Holding Companies at Year-End 1981 & 1982
(\$ millions)

	Commercial and Industrial Loans		Commercial Mortgage Loans		Lease ¹ Financing		Total Business Lending	
	1981	1982	1981	1982	1981	1982	1981	1982
15 Industrial/ Communications/ Transportation ²	39,365	36,365	1,768	2,036	14,417	15,924	55,550	54,325
10 Diversified Financial ²	3,602	4,705	3,054	3,451	1,581	1,419	8,237	9,575
4 Insurance-Based	399	827	35,506	36,419	892	737	36,797	37,983
3 Retail-Based	606	605	—	—	—	—	606	605
	43,972	42,502	40,328	41,906	16,890	18,080	101,190	102,488
15 Largest BHCs								
Domestic	141,582	155,527	19,481	20,069	14,279	15,066	175,342	190,662
International	118,021	126,307	5,046	6,462	—	—	123,067	132,769
Total	259,603	281,834	24,527	26,531	14,279	15,066	298,409	323,431
Domestic Offices, All Insured Commercial Banks	327,101	379,566	120,333 ³	132,685 ³	13,168	13,738	460,602	525,989

¹For nonbank companies and for BHCs, includes domestic and foreign lending and may include leasing to households and government entities.

²Financing by banking and savings and loan subsidiaries has been subtracted.

³Includes all real estate loans except those secured by residential property.

SOURCE: Company Annual Reports and 10-K forms as shown in Appendix A, *supra.*, and *Federal Reserve Bulletin*, April 1982, p. A76 and April 1983, p. A74.

Table 12a
Top 10 Commercial and Industrial Lenders*
(\$ millions)

	<u>1982</u>	<u>1981</u>
Citicorp	18,627	16,442
BankAmerica Corp.	17,580	16,187
Chemical New York Corp.	14,605	14,322
Continental Illinois Corp.	13,715	12,862
Manufacturers Hanover Corp.	12,961	9,866
Chase Manhattan Corp.	11,522	10,563
Security Pacific Corp.	10,051	9,866
General Motors	9,670	10,824
First Interstate Bancorp	9,259	10,464
Bankers Trust New York Corp.	8,766	6,549

*Data for bank holding companies are domestic loans; data for General Motors are worldwide.

SOURCE: Company Annual Reports and 10-K forms, as shown in Appendix A, supra.

Table 12b
Top Commercial Mortgage Lenders*
(\$ millions)

Bank Holding Companies	Commercial Mortgage Loans	
	1982	1981
BankAmerica Corp.	4,402	4,643
Continental Illinois Corp.	3,145	3,043
Citicorp	2,915	2,635
First Interstate Bancorp	2,472	n.a.
Wells Fargo & Co.	1,221	1,165
	14,155	11,486
<u>Nonbank Companies</u>		
Prudential	14,675	14,928
Aetna Life & Casualty	10,662	10,219
Equitable Life Assurance	9,399	9,357
American General Corp.	1,683	1,002
Transamerica Corp.	1,423	1,329
	37,842	36,835
<u>Bank Holding Cos. & Nonbanks</u>		
Prudential	14,675	14,928
Aetna Life & Casualty	10,662	10,219
Equitable Life Assurance	9,399	9,357
BankAmerica Corp.	4,402	4,643
Continental Illinois Corp.	3,145	3,043
Citicorp	2,915	2,635
First Interstate Bancorp	2,472	n.a.
American General Corp.	1,683	1,002
TransAmerica Corp.	1,423	1,329
Wells Fargo & Co.	1,221	1,165

*Data for bank holding companies are domestic loans; data for nonbank companies are worldwide.

SOURCE: Annual Reports and 10-K forms, as shown in Appendix A, supra.

Table 13
Top 10 Lessors*
(\$ millions)

	<u>1982</u>	<u>1981</u>
General Electric	4,188	3,019
Manufacturers Hanover Corp.	3,882	3,601
General Motors	2,910	3,209
Greyhound	2,236	2,044
Ford Motor	2,059	2,088
BankAmerica Corp.	1,925	1,883
Citicorp	1,848	2,044
Security Pacific Corp.	1,465	1,195
Continental Illinois Corp.	1,172	1,123
Control Data	1,160	1,211

*All data shown are worldwide leases.

SOURCE: Annual Reports and 10-K forms, as shown in Appendix A, supra.

Table 14
C&I Loan Comparison:
Banks vs. Nonbanks
C&I Loans of Nine Nonbank Companies¹
as a Percent of that Held by:

	<u>All Insured Commercial Banks</u>	<u>Top 15 Banks in C&I Lending²</u>	<u>Bank Subsidiaries of 15 Largest BHCs³</u>
1975	8.5%	23.5%	23.7%
1976	9.5	28.0	28.0
1981	9.6	28.4	28.6
1982	7.8	22.9	23.1

¹The nine nonbanking companies include ITT, Control Data, RCA, Borg-Warner Acceptance, Chrysler Financial, Ford Motor Credit, GMAC, Gulf & Western, and General Electric Credit.

²Ranked by C&I loans.

³Ranked by total assets.

SOURCE: *Federal Reserve Bulletin* (various issues), and domestic Call Reports.

Table 15
Money Market Fund Assets of Selected
Nonbank Institutions
(\$ billions)

Company	Net Money Market Fund Assets	
	12/1/82	6/29/83
Merrill Lynch	50.4	33.6
Aetna Life & Casualty*	18.9	14.1
Shearson/American Express	15.5	11.7
Sears/Dean Witter	11.9	8.2
E. F. Hutton	7.7	8.1
Prudential/Bache	4.3	5.2
American General Corp.	0.4	0.3
Equitable Life Assurance	0.4	0.3
Transamerica Corp.	0.3	0.3
Ford Motor	not available	not available
Total	109.8	81.8
Total Assets of All MMFs	242.5	178.2

*On November 1, 1982, Aetna acquired 87 percent of Federated Investors, an investment management services firm. Nearly all of Aetna's money fund assets are those of Federated Investors.

SOURCE: *Donoghue's Money Fund Report*, December 6, 1982 and July 4, 1983.

Table 16
Depository Institution-Broker Relationships in the
Distribution of Insured Retail Deposits
As of August 1982

MERRILL LYNCH (475 offices)

ALL-SAVERS CERTIFICATES for 15 thrifts nationwide
 RETAIL CDs* for 20 banks and thrifts nationwide including Bank of America
 SECONDARY MARKET IN RETAIL CDs of 2 banks and 2 thrifts
 91-DAY NEGOTIABLE CDs for Great Western Federal Savings and Loan, Beverly Hills

DEAN WITTER (8 Sears stores with financial center pilot programs and 320 Dean Witter offices nationwide)

RETAIL CDs* for 2 thrifts including Allstate Federal Savings and Loan
 SECONDARY MARKET IN RETAIL CDs for City Federal Savings and Loan, New Jersey

BACHE (200 offices in 32 states)

ALL-SAVERS CERTIFICATES for City Federal Savings and Loan
 RETAIL CDs* for City Federal Savings and Loan and one S&L in Los Angeles

SHEARSON/AMERICAN EXPRESS (330 domestic offices)

ALL-SAVERS CERTIFICATES for Boston Safe-Deposit & Trust Company
 RETAIL CDs* for selected banks and thrifts

FIDELITY MANAGEMENT GROUP (29 offices in 50 states)

ALL-SAVERS CERTIFICATES for 6 banks including Security Pacific National Bank and First National Bank of Chicago

E.F. HUTTON (300 offices in 50 states)

ALL-SAVERS CERTIFICATES for 15 regional banking companies

EDWARD D. JONES & COMPANY (435 offices in 33 states)

ALL-SAVERS CERTIFICATES for Merchants Trust Company, St. Louis

MANLEY, BENNETT, McDONALD & COMPANY (10 offices in 2 states)

ALL-SAVERS CERTIFICATES for First Federal Savings & Loan, Detroit

PAINE WEBBER (240 offices)

ALL-SAVERS CERTIFICATES for 2 banks in California, including Bank of America

CHARLES SCHWAB & CO. (offices in 38 states)

ALL-SAVERS CERTIFICATES for First Nationwide Savings and Loan, San Francisco

THE VANGUARD GROUP (offices in 50 states)

ALL-SAVERS CERTIFICATES for Bradford Trust Company, Boston

*3¹/₂-, 4-, 5-year, and zero coupon certificates of deposit.

SOURCE: Various issues of *American Banker* and other general business periodicals.

Table 17
Geographic Locations of Major Financial Firms
that Provide Credit: 1981

Bank Holding Companies

	<u>States</u>	<u>Offices</u>	
		<u>Nonbanking</u>	<u>Banking*</u>
Citicorp	40 & D.C.	422	25
BankAmerica Corp.	40 & D.C.	360	38
Chase Manhattan Corp.	15 & D.C.	42	4
Manufacturers Hanover Corp.	32	471	28
Continental Illinois Corp.	14	20	28
Chemical New York Corp.	23	135	6
J.P. Morgan & Co.	6	7	5
First Interstate Bancorp	13	19	24
Security Pacific Corp.	39	427	7
Bankers Trust New York Corp.	4	2	8
First Chicago Corp.	27	23	14
Wells Fargo & Co.	16	52	6
Crocker National Corp.	6	15	5
Marine Midland Banks, Inc.	5	14	not available
Mellon National Corp.	13 & D.C.	151	11

Other Major Creditors

	<u>States</u>	<u>Offices**</u>
American Express	50	1400 Plus
American General's Credit thrift Financial	24	524
Avco Corp.	47	694
Beneficial Corp.	36	1468
Control Data's Commercial Credit	50	900
Ford Motor Credit Co.	50	200
General Electric Credit Corp.	50	480
General Motors Acceptance Corp.	50	310
G&W's Associates First Capital Corp.	50	670
Household International	47	1260
ITT	31	590
Merrill Lynch	50	475
Sears	50	1260

*These figures are exclusive of banking branches in their home states but include offices of bank subsidiaries.

**Avco Financial closed 539 offices in 1981; Beneficial has closed 576 offices since 1980, stopped making loans in 12 states, and sold its operations in Alabama and Tennessee; Household International closed 271 consumer finance offices in 1981; and the Associates consolidated 240 domestic offices in 1981.

SOURCE: Annual Reports and 10-K forms.

Table 18
Examples of How Some Firms are Responding to the Changed Environment
in the Financial Services Industry

1. Innovation

Products and Services:

- In June 1981, Prudential Insurance Company introduced a stock fund which is available to the public and is designed to provide tax advantages for upper income investors. It is distributed by Bache.
- In March 1980, Merrill Lynch & Co. tested its Equity Access Account which gives homeowners access to the equity in their homes through checks and debit cards. Now many banks, brokers and consumer finance companies are offering such home equity loans.
- First Interstate Bancorp, BankAmerica Corp. and Citicorp plan to buy state-chartered banks in South Dakota in order to enter the insurance business.
- Century 21, a nationwide real estate brokerage firm, plans to establish subsidiaries for mortgage brokerage, property insurance, and the sale of real estate limited partnerships.
- Security Pacific National Bank of Los Angeles plans a new fund, the Security Pacific Futures Fund.

Delivery Systems:

- In July 1982, Sears opened financial service centers in eight stores and as of November 1983 operated 108 such financial centers. These centers offer insurance, real estate and brokerage services, and in California, they offer Allstate Savings and Loan's products as well.
- The Kroger Company is experimenting with financial centers in Ohio, Alabama and Texas. These centers offer consumer banking and insurance products to customers at Kroger grocery stores.
- First Nationwide Savings contracted with J. C. Penney to open and operate financial service centers that offer a full range of products at five Penney stores in Northern California.
- Banc One leases space to agents of Nationwide Insurance in three Columbus, Ohio branches. The agents sell insurance products, mutual funds and annuities.

2. Reduction in Costs

- Sun Banks of Florida in Orlando acquired Flagship Banks of Miami and saved on data processing and back office operations through consolidation.
- Westinghouse Credit Corporation restructured its Financial Service group so that representatives are closer to their customers. This helped Westinghouse Credit decrease its ratio of direct expenses to net receivables.
- Citing insufficient business volume, Bank of Boston is phasing out the data processing service it provides to more than 100 correspondent banks.
- Bankers Trust is phasing out its less profitable retail operations to concentrate on the wholesale market.

3. Cross-Selling

- In June 1981, Mutual Benefit Life Insurance Co. expanded into securities brokerage through Mutual Benefit Financial Co., an in-house broker-dealer. Mutual Benefit Life sells its new service through its 1,600 insurance agents nationwide.
- American Express's insurance company, Fireman's Fund, offers an insurance and annuity plan through Shearson/American Express and Shearson/American Express offers insured money market deposit accounts through its branch system. Shearson directs the deposit to its affiliate, The Boston Safe Deposit and Trust Company.
- Prudential-Bache Securities plans to begin offering home mortgage loans as well as MMDAs and retail CDs by mail to its brokerage customers through the securities firm's Georgia bank.
- Travelers Corp. plans to offer a cash management service initially to its 10,000 independent insurance agents and later to business clients as well.

4. Legislative and Regulatory Responses

- Thirteen states have passed either full powers, reciprocal, emergency, or limited purpose interstate banking legislation as of November 1983.
- A bill was introduced in Congress to allow interstate banking in New England among states that permit the activity and to direct federal regulators to look favorably on its development.
- In October 1982, Congress passes the Garn-St Germain Depository Institution Act of 1980 which allows depository institutions, beginning in December 1980, to offer ceiling-free deposits directly competitive with money market mutual funds.
- In April 1983, the Comptroller of the Currency declared a moratorium on bank charters to nonbanks, and the chairman of the Federal Reserve Board recommended a moratorium on bank-nonbank combinations.

Source: Company Annual Reports, various issues of *American Banker* and other general business periodicals.

CONSUMER INSTALLMENT CREDIT HELD BY SELECTED LARGE BANK HOLDING COMPANIES, RETAILERS AND CONSUMER DURABLE GOODS MANUFACTURERS AT YEAR-END

Chart 1A

1972

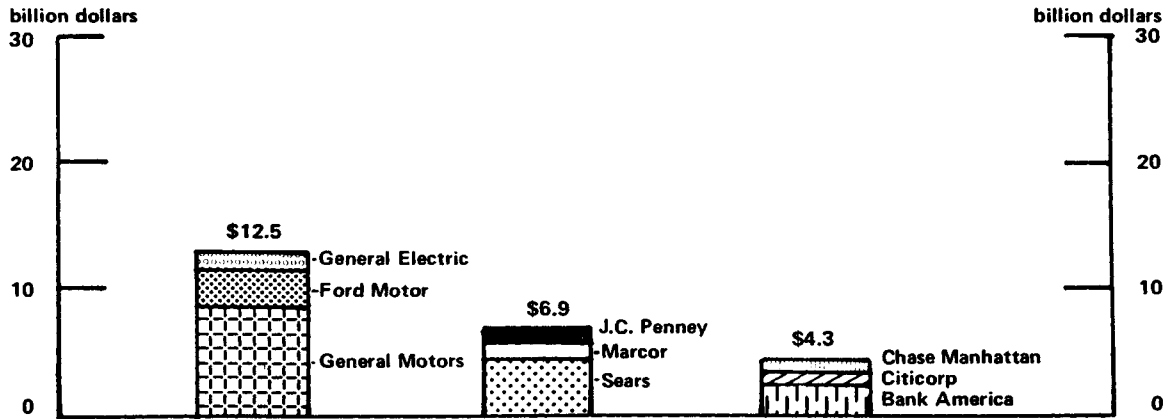
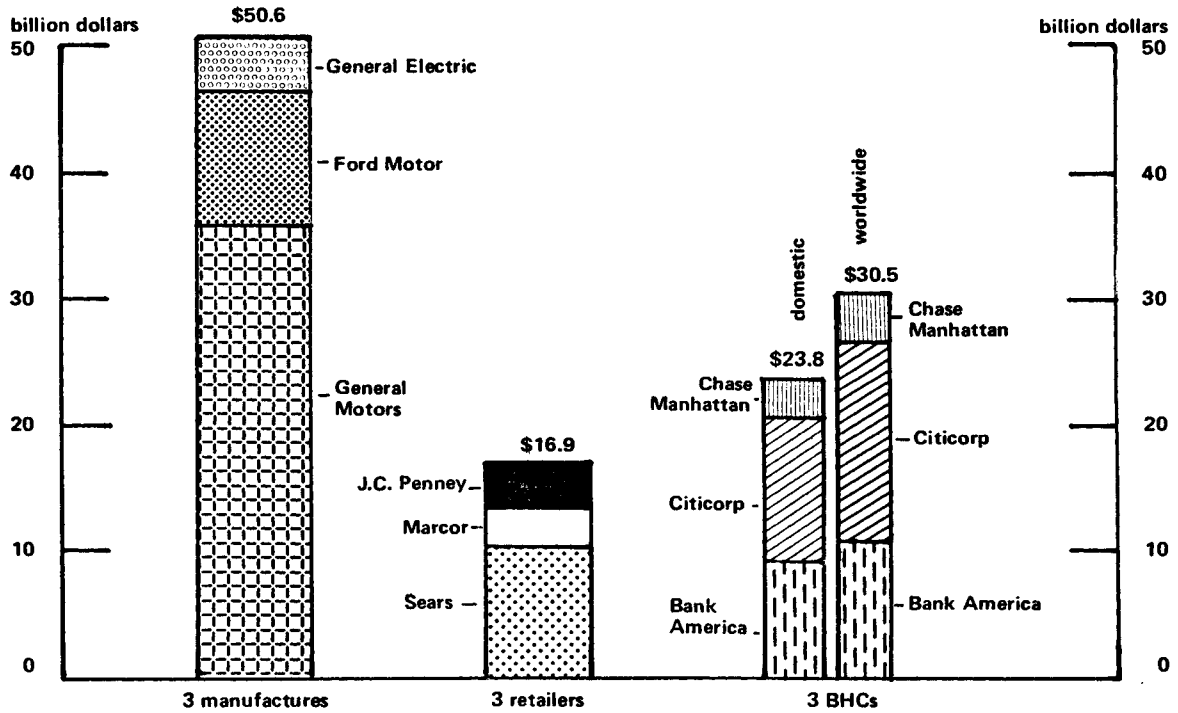


Chart 1B

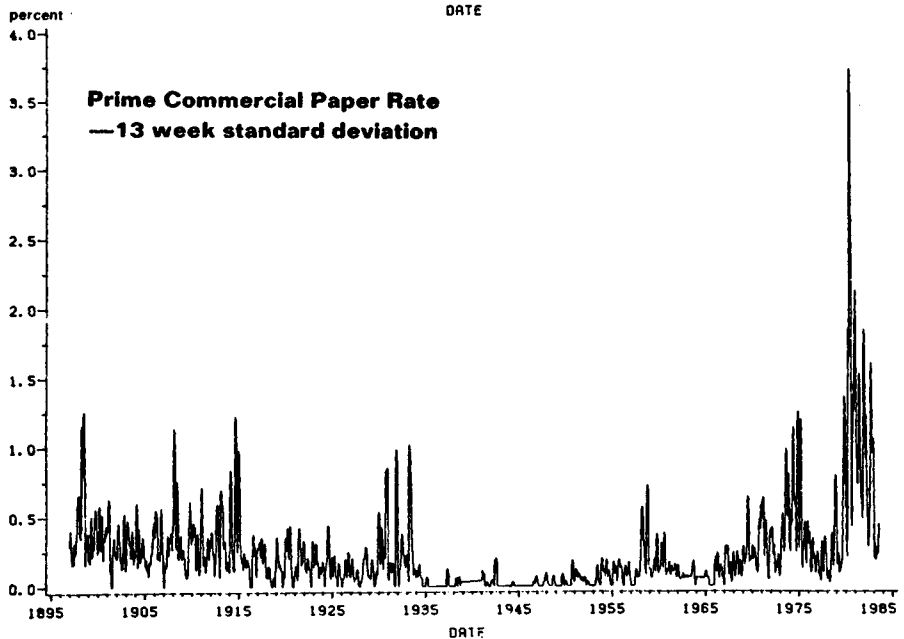
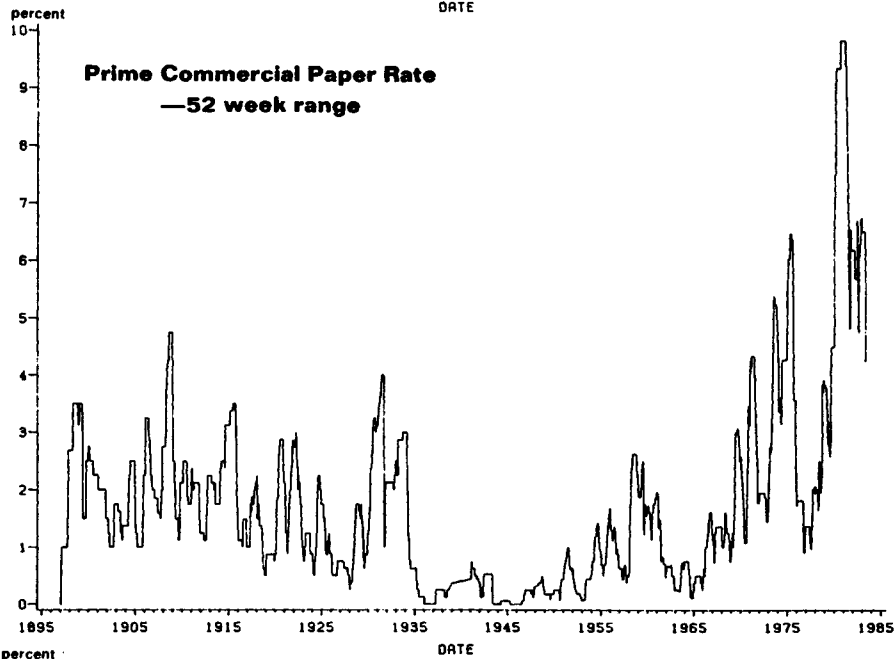
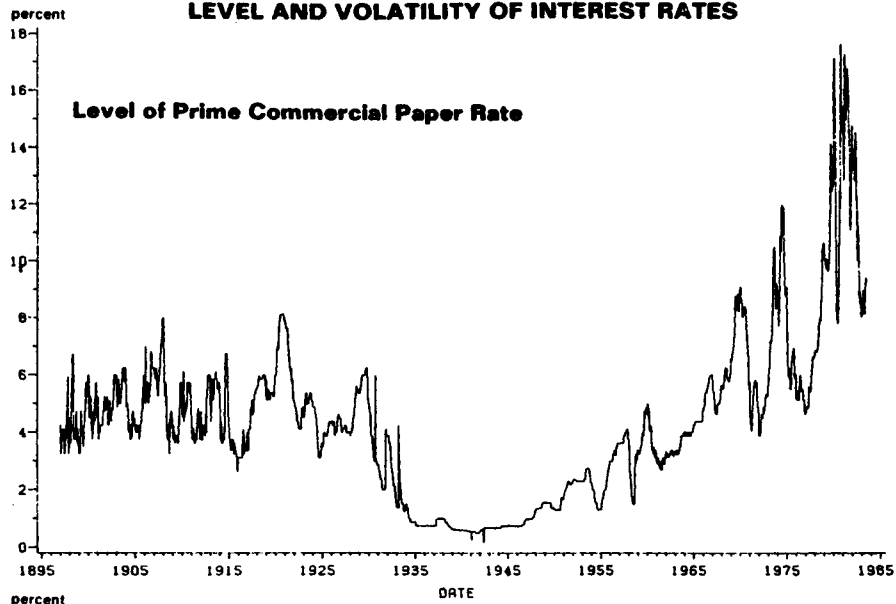
1982



SOURCE: 1972 data from Christophe (1974); 1982 data from company Annual Reports and 10-K forms, as shown in Appendix A, supra.

CHART 2

LEVEL AND VOLATILITY OF INTEREST RATES



SOURCE: Rosenblum and Strongin, *Economic Perspectives*, January/February 1983, pp. 14-15, as updated by the authors.