YOUR FUTURE IN BANKING

Address by

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Bank Personnel Seminar
November 28, 1967
Hickory House Motor Inn
Huron, South Dakota

The ideas I am going to share with you today are poor things, but mine own. This general disclaimer is for the protection of the South Dakota Bankers Association, its distinguished president and secretary, and the Federal Reserve Bank of Minneapolis. A disclaimer is necessary because a discussion of your future in banking is inseparable from a discussion of the future of banking -- its structure, its mechanisms, and its aspirations -- subjects about which there are as many shades of opinion in the U.S. as there are about sin. Please do not look for hidden meanings in my choice of metaphors. The apparent linking of banking and sin is no Freudian Patmanesque slip, but simply to illustrate the welter of prejudices, claims and counter-claims, in which banking is conducted today. Honest men can, and do, differ in their analyses of and prescriptions for complex situations -- especially in South Dakota this fall.

These ideas do not reflect what I consider to be the optimum model -- to the contrary, some of the constraints shaping American banking are quite distasteful to me, but they cannot be wished away. It must be remembered that we are viewing a point on a moving stream that commenced quite a ways back -- or to use still another metaphor, we are looking at a game already in process with no opportunity to call king's X so we can sort out the players and establish the rules.

If there is a single word to characterize American banking today, it is variety. The banking industry is hardly a monolithic structure.

There may have been a day when the First National Bank of Helena, Montana, and the First National Bank of New York differed principally in scale; but the difference between the First of Helena and Citibank in 1967 is almost one of essence. Functions have been added to the bank in the major urban center in bewildering succession. Even the merchandise has been altered as the search for new sources of supply and new sales packaging continues to accelerate.

What is appropriate for a bank to do within the legal limits of a corporate charter, a body of statutory proscriptions, a pattern of regulation by agencies that have been around a long time, should be easy for reasonable men to define. Certainly it presented no difficulty to Mr. Saxon, to mention one. But for the rest of us who see things less clearly, the definition of a bank becomes more and more difficult, compounded as it is by the extraordinary fertility of imagination of the current generation of bank management to be found in the first three hundred or so of American banks arranged by size.

Illustrative of the point are a number of suits pending against banks by other industrial and occupational groups whose bailiwicks have been invaded by hungry bankers. Computer service bureaus and travel agents are two that come to mind.

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Essentially these ventures into new areas have been responses to market forces spurred on by pressures to maintain and expand profit margins. In general, they have been phenomena of the money centers, with a slower reflection in banks away from these centers. And for a good reason. Scale itself has been one of the major divisive forces working to alter the essence of these 14,000 enterprises lumped together loosely and inaccurately as banks. The accommodation of a major U.S. industrial customer -- say, one of the Fortune 500 Club -- has required a complex response on a worldwide scale, of which the adjustment to the devaluation of the British pound is the most recent example. The requirements of these customers have affected the lending patterns obviously; but more importantly it has forced the large bank to develop management expertise and knowledge within the narrow context of each of these major industries. The roster of officers and their disciplines at the Chase, for example, is almost as long and complicated as the catalog for the Harvard Business School.

And the hardware of banking -- here also, capital and entrepreneurial skill have forced a cleavage between the large and the small. The computer may turn out to be the instrument that forces aggregative banking in some form. This will flow because of (a) internal requirements of cost and record control of the bank itself, and (b) the external requirements of customer demands for computer services.

I could continue. Trust services, which are becoming very sophisticated indeed at some banks in the District; portfolio management; the handicaps of geography and scale again which at the present time make it difficult for the small bank to tap sources of funds available to large banks.

My first point then, is that a gap has been created between the small bank and the large bank, caused by internal and external market forces, which will continue to widen -- a gap possessed of many more elements than scale alone -- until small banks move to narrow it. And move they must, for as bank customers even in rural America continue to become more sophisticated they are demanding types and quantities of banking services similar to those they have read about in their trade journals or heard discussed at their own association meetings.

These services require capital, scale, and innovative skill. Growth of the individual bank on a scale which keeps pace with customer growth is the most obvious answer. Other possibilities are increased reliance on correspondent banks, small intra-state bank holding companies, branch banking -- even banking consortiums which might be organized as service companies to participating banks. Certainly the efforts being made by your banking association independently and in conjunction with the MBA to provide training and information programs for smaller banks are doing much to close the training gap.

So to my second point. The pressure imposed by the marketplace for increased banking capacity requires a combination of internal growth of capital and management; and for the smaller banks of the state, a step up in aggregative banking experimentation. Otherwise the larger banks will continue to get bigger with a faster rate of growth.

Society, in its endless preoccupation with what is good and desirable, has always been concerned with the flow of money and credit, but until fairly recently the mystique surrounding American banking kept the public interest at a reasonable distance. But a generation of aggressive advertising -- "your friendly bank" ... "we're here to help you get what you want" ... "one-stop banking" ... "your full service center" -- has had its effect. Congress and legislatures now regard a bank as possessed of no more mystery than the local A & P. In fact, the suspicion is growing in some quarters of state and federal legislatures that the course of banking is too important to be determined by bankers.

Not only by their own advertising, but in part by their conduct, bankers have fueled this suspicion. Again, they have been victims of their own image -- in their efforts to stress friendship for the public, they encouraged expectations that could not be realized. Banks exist, as far as owners and management are concerned, to make a profit. Period. And only if they make a profit can they attract management and capital. Ideally, this means it must be their judgment, in the main, where and how they obtain funds, and where and for how much they loan these funds. It also means they -- or at least the creative ones -- will always be searching for new ways to make a buck.

More and more often these essentially private enterprise objectives are colliding with social goals set by legislatures and Congress -- not to mention those set by extension by regulatory agencies. So I come to my third point. National and local objectives -- social goals -- are going to alter, at an increasing rate and in significant ways, the American banking system. Examples:

.. Difficult as it is not to define a bank, the problem will be infinitely complicated by the changes proposed for S & Ls.

.. The cost of money on both sides of the equation will continue to be regulated, and my guess is the tolerances will be narrowed as the years go by.

.. U.S. based banking corporations will find their overseas operations subjected to increasing U.S. control.

More legislatures are going to grapple with such thorny problems as nonpar banking, branching, patterns of ownership, interest ceilings, regulatory machinery -- and who knows, there may be other states than North Dakota experiment with their own central bank.

But it is with the allocation of funds the major public concern will be manifest. This country is in the throes of a social revolution, the implications of which have hardly commenced to surface. Whether they be in the ghetto or in rural America, the disadvantaged -- the losers of our society -- are making themselves heard.

Charismatic industries like outdoor recreation and agriculture have their own vocal constituency. Some of these programs are even designed to redistribute population and industry. This they have in common: all of these are massive programs involving billions of dollars; all will affect the allocation of funds in the U.S. banking system. And here is the reason the public sector will have to intervene, once the determination has been made that the investment goal of a new tenement, a recreation complex, or industrial jobs in rural America, is a socially desirable one: with few exceptions, most of the situations are submarginal credit risks within the conventional banking framework -- especially when viewed competitively against the alternatives available to the banks with the requisite credit capacity. If society desires the goal, seed capital at least will have to be provided by society.

I have no idea how these demands will affect the U.S. banking system. Some certainly will be met outside. For example, I happen to think U.S. banking may be in the same relative position to the Farm Credit System and U.S. agriculture as it was a few years ago to S & Ls and residential lending. There will be primary credit programs -- current alternatives in outdoor recreation financing, plus those of the five or six bills in Congress now, are typical. There will be guaranty programs, participation programs, moral suasion, tax gimmicks -- the possibilities are endless. But they will come. Social pressures are simply too great to be contained for long -- even with the Viet Cong sitting on the safety valve.

The Fed will be at the interface, as the hep bureaucrats now put it. For us to say the Federal Reserve System cannot or should not be concerned with social goals is ridiculous. We owe our very existence to such a national objective. Look at the way the Board has been flailing about in the holding company and merger cases. Bigness, concentration of markets and ownership -- these bundled together make up the factor of competition which has been by far the most equal among the five equal factors listed in the holding company act. Right or wrong, this is a social determination -- a reflection of the national concern with the structure of the economy -- a desire to curtail growth if the price for growth is a material reduction of customer alternatives. Introspective efforts like the discount study reflect the deep concern within the System that we always be responsive to changes in the economy. And we must acknowledge the special view taken of us by our parent, the U.S. Congress. When they were looking for a place to tuck truth in lending, it is hardly an accident we were named. In the agonizing to come over the control of the electronic network that one day will not only be the courier of our credit, but the repository of all our secrets, Congress may well rely on our vaunted independence and objectivity, and add it to our list of responsibilities.

Many of you have probably been bankers longer than I. My experience after all is only two years and eight months. But my sense of excitement at being a small part of American banking has grown apace. In part this is a reflection of an enhanced awareness of what a truly significant role banking plays in the development of our country -- but more important for this inquiry is the knowledge of how dramatically it has changed just in my brief period of study. These changes are continuing with bewildering speed; and the pace will accelerate. The Ninth District no matter how remote it may seem in parts of it from the main stream -- and some of us sometimes wish it were more so -- is caught up in the process. For those who are willing to study these changes, and capitalize upon those elements that can be applied to their bank, the future is bright indeed. May I emphasize again these are changes which reflect changes in the marketplace. This is not a which comes first, the chicken or the egg, situation. Banks react to customer changes -- customers react only to banks failure to change. A broad generalization with an undoubted number of exceptions, but enough truth I hope to provoke you to think about it.

It should hardly come as a surprise that your markets are changing -- even less of a surprise is the statement you are in the service business. But perhaps more of a surprise are some of the implications your reflection upon these truisms will produce.

What kind of bank are your customers going to need ten, twenty years from now? A most relevant question to a consideration of your future, because it is that kind of a bank they will be doing business with. If it is not your bank, then don't cry about a deterioration of the good old values and customer disloyalty -- you deserted them by failing to keep pace with their needs.

This kind of self-examination is a process that can never stop because American industry, and I include agriculture as a part of American industry, is the most productive and imaginative in the world. And these are your customers. Ideally no one really can prescribe in nice detail the pattern of change for you as appropriately as you can because there are no two states, no two communities, and certainly no two banks with the same economic environment. But society will, if you don't, and here is the real spur to your self-inquiry.

But what an absorbing and exciting occupation this kind of self-examination can be. If it then becomes the basis of constructive action, it can also be rewarding in every sense of the word. There is no question at all about the bright future of banking -- nor can there be any question about your future in banking -- if you train yourself to ask, and answer, what you want that future to be.