BANKS, BANKERS AND CHANGE

Remarks by

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In Thornton Wilder's "The Skin of Our Teeth," the old gypsy fortune teller derides those who would tell the future for taking the easy end of prediction. According to her, it is the past no one can read. I find great comfort in having a distinguished playwright like Thornton Wilder on my side. What has happened to the financial community in the last five years, and especially to its principal component, commercial banking, is a story no one tells well, nor will it be for some years to come. Like most history, it may have to wait until that day when economic historians can tell it like it was without anyone around who actually lived it to argue with them.

Obvious, though, is the fact that the banking industry is no longer the monolithic form it once was with all banks substantially alike except for differences of scale. There is a story told at the Grand Canyon about the little old lady who after staring spellbound at the Grand Canyon of the Colorado, turned to the park service naturalist and said, "My, something sure happened here." Like that little old lady, an observer of American banking might well mutter the same response. I dare not to stray too far from the easy course of speculating about the future, but those who might question some of the speculations about where banking may go may pause when they consider this brief recital of where banking has been in these last turbulent years.

(A) Point one -- services. No better proof of the distance some banks have come in changing the pattern of banking services can be found than in a recital of the sorts of things banks are being criticized and sometimes sued for doing. Management services, including accounting; data processing;

operating travel offices, -- these are just a few. It is no accident that in the controversy about the shape of the holding company legislation which is currently raging in Congress, the list of permissible activities is referred to as "the laundry list."

(B) Point two -- sources of funds. For many banks, credit is now a commodity to be bought and sold. These banks recognize credit is the merchandise. Again, it's no accident that expressions indicative of this fact have crept into use. Fed funds are "bought" and "sold." Euro dollars are "bought" and "sold." No one has yet started referring to negotiable CD's as "inventory" but they might just as well. These are credit sources, merchandise sources if you will, that at least in the dimensions of their present use were relatively minor five years ago.

(C) Point three -- regulatory agencies. These agencies are helping shape a new operating environment for banks, and in turn, are being reshaped by commercial banks; in fact, I would be hard put to say which reacts to which. Quite obviously, the reliance on monetary policy as the principal anti-inflation weapon in 1966, worked changes in the mutual attitudes of the Federal Reserve and commercial banks so that their relationships will never be the same again. Not the least was the discovery of Regulation Q and reliance upon it as a monetary weapon. Another result of the 1966 experience was the passage of the Interest Control Act by Congress which requires a pattern of cooperation among the regulatory agencies in setting rate ceilings which has altered the competitive relationships of financial intermediaries. Congress has also seen fit to add two new patterns of regulation, Truth in Lending, and Bank Protection Standards. And in addition, of course, it is grappling with the subject of one-bank holding companies, which comes perilously close to a review of the nature and structure of banking itself.

Without trapping myself in a detailed explanation of why these particular changes have taken place, I think it is adequate for our purposes today to point out they seem to fall into two broad categories. The first of these would be those accommodations banks have made to changes occurring in the structure and composition of their customers. These I would call reactive changes. The second category would be made up of those changes that represent genuinely innovative forays into entirely new areas of service. These I would call creative changes. Simplified, you might say that it's the difference between doing old jobs better, and creating new ones. The line between them is admittedly blurred, but the extremes are easy to isolate. For example, at one end are services which do not necessarily involve a credit relationship, like the computer oriented services. At the other end, are those credit related activities that fit within historic attitudes about the nature of banking, like the enlarging of the sources of credit and the methods of extending it. But the semantics of definition are not really very important; what is important is to note that a transformation has already taken place and will quite certainly continue indefinitely into the future. To paraphrase the axiom of physics, things and institutions in motion tend to stay in motion.

By a rather circuitous route, I have now reached the safer ground, according to Mr. Wilder, of reading the future. A whole new management discipline has grown up around the premise that by systematic projection of future operating environments, alternatives for management can be posed. It used to be the future was like the weather; everyone talked about it, but no one could do anything about it. No longer need this be true of any organization, public or private. Call it long range planning; model building; or PPBMS -- planning, programming, budgeting, management systems, this approach does pay off.

More and more institutions of all kinds are going to their own form of PPBMS. Behind this is the sober realization that to rely on the capacity of institutions to react appropriately and quickly to changes in environment may not be the way to survive, for the requirement to change and the ability to change are working in different directions. Institutions are getting bigger and more complicated which hardly can be expected to reduce their reaction time; yet the rate of evolution in the operating environment is accelerating faster and faster. Banks are not immune from these processes; nor may I add, are the regulatory agencies.

Until fairly recent times, banks tended to think of themselves as institutions not susceptible of the kind of analysis inherent in PPBMS. As service institutions, they believed that they had to follow demand rather than lead it. Attaching standards of profit accountability to departmental functions seemed impossible because demand could not be projected nor could costs be identified, or so it was said. For many banks this is now changed. The largest banks started their own inquiries as a matter of sheer necessity because of their size and complexity. For many of the others the efforts of Federal Reserve Banks and banking associations with their functional cost analysis programs, have opened their eyes to the differences in profitability of various departments.

Unfortunately, though, for many banks the time horizon of the inquiry is still much too short. It is salutary to know where you made your mistakes last year because it's just barely conceivable you may avoid making them all over again this year. The shortcoming, though, in this kind of analysis, desirable though it may be, is that your attention is confined to an analysis of the market as it exists right now, interpreted within the framework of existing departments and job relationships. This may be essential in setting annual goals, but it is of little use in shaping the institution towards the kind of place it has to be in the future.

How far in the future management sets its horizon is a fairly arbitrary judgement. Certainly it should be far enough to break out of the rigidities of the way things are now. We happen to be using twenty years, which is probably an outer limit, but this dimension will always be imprecise. Most of the changes in the political, economic, and social environment, however certain it is they will happen eventually, seldom occur on schedule. The important thing is that most of these will occur sometime during the period, with a higher order of predictability in the near term, and the bank has to be prepared to meet them.

In concentrating on the environment in today's talk, I am emphasizing a very important element of the process, for we start with a broad assumption -- banks do not exist in the vacuum. There have been times in the past when commercial banks tended to act as if they were independent of social, political, and economic changes occurring in their environments. Rightly or wrongly, the American public, which includes U.S. banks' principal customers, is demanding more and more services from its institutions regardless of their nature. This includes banks. The changes that are taking place in the U. S. have to be anticipated by banks; which is another way of saying all banks have to think about what kind of a world they'll be functioning in at some point well out in the future. Only if they can anticipate some of the possibilities in that world, can they intelligently prepare their institutions to meet the demands which will be imposed upon them by the customers of that later date. We are all aware of the phenomenon of industries that develop under our noses to meet what appears at first to be a minor and not too profitable demand for services; grow slowly and inconspicuously, and suddenly lo and behold, there's a new and dangerous competitor. The Farm Credit System and S and L's are two conspicuous examples for banking, but banking is not alone. The growth of CATV systems and private carriers within the communications industry are additional examples for those who need more convincing.

This kind of a brain-storming exercise for the shape of the U. S. economy at some distant point fortunately is going on. Major U. S. banks are conducting their own exercises; I understand the ABA is launching such an inquiry. There are a variety of symposia and think tank sessions which have already been held, each of which contributes something to our knowledge.

What are some of these areas of inquiry? And of more immediate importance, what are some of the implications for banks?

A number center about the changes computers are working in our economy. Quite obviously changes are coming in the payments mechanism. These will not affect all banks in the same way. There will be strategic locations and alliances. Where and what will these be?

An increasing share of the country's record keeping is now being done by computers. I have seen no figures on how this is distributed among bank, non-bank, and user owned computer centers. My guess would be that banks have an inherent competitive advantage over non-bank centers, which after the Adapso case banks are free to exploit in this district at least. But what will happen to the small bank whose customers request the services they have read about? Right now, the cost limitations seem to operate to preclude the small bank from this field. Is this a field they can subsequently enter when those cost considerations change? Computer designs are changing and the markets are constantly broadening, which will reduce costs. The possibility of some other kind of ownership than by a single bank should not be overlooked. I do not want to belabor the point, but failure to adequately appraise the impact of computer usage on market areas in conjunction with the location of those computers may reduce the future operating options of the smaller banks.

Bank structure is a sore subject no matter how objectively presented. It is not entirely improbable the initiative may be taken away from banks to determine their own patterns of change. Banks do exist as creatures of the law -- state and federal; with however, the right of Congress paramount over the states. This has not been exercised in any direct way since the federal tax was placed on state bank notes in the last century, but the right is a sovereign one. The Supreme Court has acknowledged in a long line of cases that the monetary power of Congress is not subject to review by the court. The dual banking system exists by the grace of Congress. To make my position explicit, I believe the competition between the two banking systems has been constructive. I do want to emphasize, though, that inconsistencies of statutes among the states which have a differential impact on the functioning of the economy can force other, and conceivably more powerful political constituencies than banking possesses to action.

Branching, modification of holding company laws, ease of c the extension of banking powers to S and L's -- how likely these ar change will be decided only partly by reference to their effect on c banks. Are there reasons outside of banking, as it is presently pr for the changes? If there are, and legislatures or Congress believ are compelling, the changes will come. I would remind you only tha was not the first choice of the AMA.

What kinds of businesses will be operating in your trade a Inherent in this question are two inquiries -- how will present cus be modified by the final year of your planning cycle? What new kind businesses can you expect? Neither of these inquiries has easy ans for those of you from agricultural areas, the track record of those have predicted the pattern of the agricultural evolution, its effec population, and the development of agri-business has been pretty goo the whole. Obviously, the largest growth area of new business is in service sector. What does this mean for country banks?

The increasing concern of this country with what some beli be a maldistribution of its human and financial resources will prod variety of responses from Congress and the states over the next dec Most of these are summed up in the phrase the rural-urban balance. in the concern is the belief that the market place as it presently f is not the most efficient distributive apparatus. Rural areas and s towns, confronted with the steady erosion of their population, are c that governments find ways to create new job opportunities to assis in holding people. They point to the normative values of the small under-utilized public investment in schools, utilities, and streets; the quality of life in rural America; the desire of many of the out migrants to remain if they had adequate employment; and of course, the congestion of the cities. In the last two at least, they find allies in the big city administrators confronted with the appalling problems of over-crowded and volatile cores in their cities.

I am not presenting this point for affirmation or rejection of any of its premises. Some of them are in the Populist tradition and are articles of faith which can not be proven or disproven. Nor am I all that sure the market place is not the preferable allocative device -- it has been proven enough times to be way ahead of whatever is in second place to cause me to pause before advocating a substitution until we are reasonably sure we have anticipated the results. Tampering with economic ecological systems can produce surprises as unpleasant as tampering with bologic balances of nature.

But be all that as it may, the next decade is going to see us experimenting with different ways to influence the movement of people and financial resources. The range of devices presently being considered is an extensive one. Tax credits for job training in rural areas, special investment credits, acceleration of already accelerated depreciation rates, and new credit devices are a few. Banks are going to be involved in at least two ways. For those banks in qualifying areas, the additional incentives for industries to settle nearby are certainly appealing, at least on balance. Banks can and should take a leadership role in the expansion of their communities when these opportunities come along, but the pattern of growth should be charted.

If new credit insititutions are spawned, the relationships with them -- and the problems they will present both in the short and the long run, have to be anticipated. A few of these proposals involve creation of new forms of federally chartered quasi-banking institutions. Urban development banks, community development banks -- something like these may very well come into existence. They represent ingenious attempts to produce a sense of community through very broad participation in a class of ownership, and thereby they may accomplish accepted social objectives at the same time they provide credit facilities to sectors of the economy which, implicitly stated, commercial banks are unable or unwilling to serve. The truth of this last contention various from zero to 100 per cent from place to place, but the prevalence of the belief is a fact with which we must reckon.

What kinds of skills will bank employees need? The technology of banking is such an important factor in any consideration of the future, that it is easy to think it is the only factor of change in the training of the new banker. In making this mistake, a new generation of buggy whip wrappers could be the result. If the scope of banking continues to expand as I believe it will, the smaller banks will be caught up in the process whether they like it or not because of competitive pressures. The emphasis will be on the ability to manage an increasingly complicated and varied enterprise. The essence of modern management is non-doctrinaire resilience -- the ability to shift resources within the enterprise quickly and easily to provide the products or services a changing market requires. This is true of public enterprises like the Federal Reserve Bank of Minneapolis where the objective is the mandate of public purpose as set by Congress, and it is true of private enterprises like banks where the objective is the equally legitimate and important one of profitability. Under the leadership of

Kenny Wales, the Minnesota Bankers Association has been conducting management schools and I applaud the effort. We made a survey of various enterprises in the Twin Cities when we were revising our own education policy to see how many businesses had formally stated their management attitude toward continuing education. There was a predictable correlation between a formal and expressed committment to continuing education and success.

In all of this there is a rich promise for career minded women -- and you may well have wondered when I would mention you. In the self conscious search for compliance with the legal mandate of the Equal Employment Opportunity Act, management is scrutinizing its own ranks and many of us do not like what we see. In addition to having been a white world, it has been a man's world. While the resentment of women against their second class role is neither as sharply felt or expressed as that of blacks, the message is coming through, at least at my bank. In any long range planning of any seriousness, the composition of the total work force, including the ranks of management must be considered.

In these rather rambling remarks, I have attempted to sketch a few of the influences which will have shaped banks twenty years from now. It is not a comprehensive list nor is it intended to be. Much less is it any kind of a blue print for the planning process. But what I hope it has been is a stimulus to urge upon your peers, if in fact your bank is not already doing it, the development of a road map to the future.