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BANKS CAN INFLUENCE COMMUNITY GROWTH SAYS FEDERAL RESERVE BANK PRESIDENT

"An aggressive role in developing new businesses; judicious allocation of credit; due attention to management training and succession; deliberate efforts to open the bank internally and externally to the community; and attempting to stay abreast of industry developments" are among services rural bankers can offer to help revitalize their communities according to Hugh D. Galusha, Jr., who spoke at a September 2 bankers' conference sponsored by the Minneapolis Federal Reserve Bank.

Galusha, who is president of the Minneapolis Fed, spoke to bankers in Fargo, North Dakota, about the catalytic role of bankers in revitalizing rural communities, and emphasized that because banking exists for reasons that historically "were compelling in the public interest," banks have an explicit responsibility to the public they serve. This, he says, involves broadening their base of service, whether "qualitatively by adding new services, or quantitatively by the economic growth of their customers." He goes on to say that "growth and sustainable profitability of rural banks are nearly always a mirror image of the growth and prosperity of their community."

Galusha indicates that banks are in a particularly good position to be responsive to community interests because of a relatively favorable position vis-à-vis other business institutions--i.e., banking was and is "the heart of the U.S. economy, and bank credit is the lifeblood of our system." He points this out more specifically by quoting some survival figures of American businesses. The lowest annual rate of failure for non-bank firms between 1950 and 1968 was 29 per 10,000, with more than half the years above 50 per 10,000. During those 19 years there were only 94 bank failures out of a total of nearly 14,000 banks.

Galusha recognizes that banking structures, the exploration of new sources of funds, or new banking services are touchy topics with many rural bankers. He suggests they turn to bank associations, correspondent banks, and the Federal Reserve System for help. He adds that banks must be individually responsive to community needs, but that collectively all banks must reinforce each other to bring about the orderly evolution of the banking industry.

In emphasizing the need to take advantage of community resources, Galusha warns that if the rural banker "doesn't stay abreast of the political and technical changes in banking, it is a sobering fact that he, his bank, and his community will lose out."

9-28-70

THE BANKER'S ROLE IN REVITALIZING THE RURAL COMMUNITY

An Address by

Hugh D. Galusha, Jr.
President
Federal Reserve Bank of Minneapolis

at the

Member Bank Service Conference

Sponsored by

Federal Reserve Bank of Minneapolis

at Fargo, North Dakota

September 2 - 1970

THE BANKER'S ROLE IN REVITALIZING THE RURAL COMMUNITY

A topic like this presents two choices. The tempting one is to string together a few pearls of homespun wisdom, a story or two, some unkind words about the Farm Credit System, and close with a judiciously mixed denunciation of the federal government and a plea that "they" do something to save the small town and the "American way of life."

The second choice for the speaker is to share his uncertainties and convictions, his frustrations and enthusiasms, with the audience. The risk of his exposing large areas of his naivete, if not his ignorance, is considerable; along with the possibility some members of the audience may ask him into the alley afterwards. Neither one has ever been a deterrent to the Federal Reserve, so I have opted for this approach.

There are two assumptions implied in the title of this talk I would like to dispose of at the outset. The first is the assumption all rural communities are dying. There is no gainsaying many are. The Ninth Federal Reserve District is littered with the shells of abandoned or moribund towns, some of which may have had life spans of only a few years in the 1870's or 80's. The harsh fact is that historically the market place and the technical structure of natural resource industries (such as agriculture, mining, logging) have always influenced, to a major degree, where people settle and for how long. Add to that the vagaries of national policy that can shift resources in a bewildering fashion among geographic and economic areas, and small wonder there are rural communities that have withered.

But there are many rural communities that are alive and well, thank you, and advancing into the favored class of regional growth centers. This we often forget. There is a tendency to wring our hands about the rural/urban balance that ignores the dynamics of growth in this country, and the historic patterns of social change so characteristic and so much a part of our success.

Having said all that, I have to acknowledge this tendency exists - and, in fact, is growing. In part, it has been fueled by the plight of the cities; and certainly the nostalgia so many of us feel for the values, real and imagined, of rural America has been enormously stimulated by the new awareness of the age-old dangers of exceeding the critical mass in urban concentrations. It has great appeal to everyone from the commune dweller to the most conservative Southern politician. Plans to reallocate human and financial resources to special sectors of the U. S. economy by act of law are not new; many have been passed. But the scope of some of those presently under discussion is of a different, larger dimension. Most recommend the creation of new types of credit institutions; all have profound implications for rural banks.

The second implicit assumption in the title to which I object is that all rural bankers have to start doing something they haven't been doing in the past, if the rural community alleged to have been collapsing around their ears is to be shored up. Bankers, like any other minority group, suffer from the outsider's desire to fasten identity at the lowest common denominator. The same caveat made against generalization about rural communities applies here. The exhortation to bankers to sally forth and "save the community" is largely wasted, I'm afraid, for two opposite reasons: (1) for more than half the rural bankers, the message is unnecessary because neither they nor their communities are in need of help; and (2) neither history nor common sense affords any assurance the exhortation to the rest will be either heard or helpful. And this, if true, is most serious for all bankers, no matter which class they are in.

And yet, the exhortation does have special significance for banking in general and rural banks in particular -- as distinguished from paper box manufacturers, let us say. U. S. banks in their present legal form, the principal characteristics of which are restricted entry and private ownership, exist by public sufferance, because historically this form has suited the public interest. The key phrase is public interest and not private ownership. This comes hard, but history is against the disbelievers. The monetary power is a plenary or absolute power of Congress. In a succession of cases testing the validity of the right of Congress to regulate and on occasion transform American banking, the Supreme Court has reaffirmed over and over this sovereign right of Congress; a right then, that is subject to challenge only at the polls. But let me develop my case further, for it seems to me the relationship of banking and the public interest is central to this topic.

The opportunity to operate a bank is a privilege and not a right. I start with the premise that competition and internal failure prune American business generally. But -- and this is an exception to be seriously tested both for its validity and its implications -- rural banks are at least partially exempt from this discipline. There are three reasons -- (1) limited entry; (2) capital requirements; and (3) supervision.

Designed expressly for the limited but important objective of continued solvency, supervision is usually successful in maintaining minimum standards of capital and liquidity. Supervision, plus emergency credit devices like the discount window, help give banks high survival quotients. Let's take a quick look at survival rates of American business enterprises generally, and banks in particular, and test this hypothesis. The lowest annual rate of failure for non-bank firms between 1950 and 1968 was 29 per 10,000. In only four of the years did the rate drop below 40 per 10,000, with more than half the years above 50 per 10,000. But during the entire 19 years, there were only 94 bank failures in total out of nearly 14,000 banks. Now, I know many bankers whose management skills are as good as the best in industry generally, but I do not think one can argue from these statistics that the difference in survival is due to a quality of management skill uniformly distributed throughout the banking industry. Otherwise, the profit figures might be different. In only three of these years did banks show a higher return on equity than manufacturing; in twelve of the years banks were at least a full two percentage points behind.

There is competition, surely, especially as the size of the community increases. But 50 percent of U. S. banks are in one-bank towns; 77 percent are in one- and two-bank towns; and 86 percent are in less than four-bank towns. Volatility of deposits, especially time, are directly related to the size of the community and especially the number of banks. Certainly customers can and do drive elsewhere for banking services, but convenience and inertia are important considerations that tend to afford a measure of insulation for the rural bank especially.

Finally, because of the capital requirements imposed by chartering and supervisory agencies, new banks must start with financial structures adequate for their needs. And almost no bank escapes the continuing pressure from these same agencies to add to the capital structure as its business grows. The requirements may appear oppressive to the banker, but at least they assure the banker a much greater chance of avoiding the capital anemia that causes most business failures.

Banking exists as a regulated monopoly industry for reasons that historically were compelling in the public interest. It was and is the heart of the U. S. economy, and bank credit is the lifeblood of our system. Its orderly functioning has been a paramount concern. Unfortunately, in setting up patterns of regulation, our primary concern has been the safety of the depositor's money. The quality of a bank's services has been largely ignored. Except for the Merger Act and the Bank Holding Company Act, the effort is almost entirely to define what a bank can't do; with virtually no statutory measurement of what a bank should do. Small wonder there are banks that are less than fully effective in their communities.

What are some of the implications of this relatively favored position of the rural bank? Beset as you are with periodic examinations plus proscriptive regulation like rate ceilings (which a disconcerting number of rural banks privately welcome), it probably comes as a surprise to hear that someone views you as having greater freedom of choice than most in the manner you conduct your business. Reflect for a moment -- what happens to a bank that complies with the letter of the law and no more? Obviously, it may make less money or show less growth than it might have, but it doesn't go broke, nor can a group of unhappy customers or more aggressive bankers from another town move into the service vacuum -- or at least very easily.

So to the central dilemma for the public interest: having assumed its initial interest justifies restricted entry, does the public have a continuing right to test the quality and quantity of service, apart from the bare bones of solvency? I think it does, and the periodic explosions of public inquiry in legislatures and Congress, some of which have culminated in new kinds of credit institutions, are practical proof.

And this, I would urge, is the reason banking generally, and rural banks particularly, have a special interest in the question. And most importantly of all, why competent bankers, wherever located, have to be especially concerned about changing the patterns of operation of their less competent peers. Banks have a continuing requirement to justify their existence in their present form; a requirement that cannot be satisfied easily or for long -- and I submit the current inquiries into structure, laundry lists, uniform availability of credit, to mention just three points, will be the most searching and serious challenges our banking system has ever faced. No matter how differently the First National City Bank of New York and the First National Bank of Squaw Gap may view themselves, a bank is a bank is a bank to the silent majority.

Having made my case, I hope, for the question posed at the outset, what suggestions have I to offer to you?

"Revitalizing the rural community," like "service to the community," is one of those phrases that is as exasperating to pick up as a drop of mercury. Touch it, and the shining unity of the phrase disappears. In my frustration, I turned to our senior officers and posed the question in this way: suppose, for instance, banks were required to periodically renew their licenses to operate, much as radio or TV stations are required to, with a showing of public convenience, interest, or necessity? Specifically, how would they be measured?

I followed this question to them with a hasty disavowal of any advocacy for such a system. Not because I disagree with the theory; I believe that if the public is going to award a restricted operating privilege, it has a right to check up periodically to make sure that the public interest, which justified the arrangement in the first place, is still being well served. But my mind boggles at the practical problem in the judging. Regulation is inherently defensive and not creative; there may be some spectacular exceptions in our political history, but they don't come to my mind. Qualitative standards have to be individually interpreted. If they're not individually interpreted, they are no longer qualitative; if they are, reconciling the results across a country as big and complex as ours, is impossible.

Having comforted them with the assurance I wasn't really urging such a system, they set to work. One of the approaches was to develop a profile of nine rural banks considered well managed. From this and other analyses supplied me, only the broadest of guidelines emerged; certainly there were no common quantitative measurements. An aggressive role in developing new businesses; judicious allocation of credit; due attention to management training and succession; deliberate efforts to open the bank internally and externally to the community and to stay abreast of industry developments -- the list could go on, but it would contain few surprises. The striking thing about all of them was that, directly or indirectly, all were in the banker's self-interest, however construed. The only way a rural bank can increase its profitability is by broadening its base of service. Whether qualitatively by adding new services, or quantitatively by the economic growth of its customers, the base has to be increased. If the bank stands pat, as it can in a semi-monopoly position, its profitability will be affected only by the chance directions of monetary policy that may make interest differentials more attractive between municipals, participative pools, fed funds, and its few favored borrowers on the one hand, and the costs of its funds on the other. And it can stand pat only as long as the public interest leaves it alone.

Loan ratios, new sources of funds, new services, asset mix, participation in community affairs, even the rate of charitable giving -- whatever the indices used, the desire to find easy ways to measure bank performance must inevitably fall flat on its face because there is no way to equate the requirements of different communities in other than the broadest terms. If there is a common denominator, it is in the willingness of the banker to plan -- to anticipate needs -- to manage by objective -- to develop a planning, programming, budgeting and managing system -- whatever the phrase used, it stems from a desire to survive. And to survive means change must be anticipated.

It is at this point it is easy to despair. The image of rural banking unfortunately is one of "agin it." Banking structure, management training, succession of ownership, the exploration of new sources of funds or new banking services -- these are difficult subjects to talk about with many rural bankers. Yet these are subjects that won't go away. They won't go away because the public is beginning to sense their interest is involved.

But where is the rural banker to turn? It is all very well to talk about planning, but if the staff of the First National Bank of XYZ consists of the president who is also the chief stockholder, loaning officer, building officer, planning officer, and public relations man, and two tellers who share most of the rest of the chores, what can he do? A great deal, as far as sensing the demands of his community, and planning for management and ownership succession; virtually nothing on his own in the appraisal of the changing banking environment and the training of successors. Geography is his chief obstacle. But it is surmountable; the two best links in the past have been the bank associations and his correspondent banks. The efforts of associations like the Minnesota Bankers Association to establish training programs for rural bankers, and to carry banking issues to their membership through special group meetings, are remarkable. Similarly, there are those correspondent banks in the Twin Cities who have gone beyond the football tickets and free dinners that historically have been the principal adhesives in cementing the correspondent relationship, and have conducted service-oriented conferences designed to make the country bank more profitable.

To this list should be added the Federal Reserve Banks. We have a responsibility, not always acknowledged in the past, to help foster a healthy, aggressive banking system. Commercial banks happen to be the principal delivery mechanisms for monetary policy and the transfer of funds, so it seems patent, to us at any rate, that the proper discharge of our public purposes requires that we concern ourselves with the progress of commercial banks. And if this means our public objectives happen to coincide in many instances with the legitimate self-interest of bankers, that still seems a poor reason for us to hesitate.

If these outside sources are unavailable for whatever reason, the rural banker is in an exceedingly difficult quandary. If he attempts to find all the answers himself, his bank -- and his community -- will suffer for inattention. But given the acceleration of the evolution of banking, if he doesn't stay abreast of the political and technical changes in banking, it is a sobering fact that he, his bank, and his community will lose out.

In summary, these points, it seems to me, are clear:

(1) In any showdown between the public interest in banking and narrowly construed stockholder/management objectives, the public interest will win.

(2) There is no easy universal formula in our political system for regulatory judgment of the success of banks in serving the public interest. This will in a way deter the public through legislators and Congressmen from making their own assessments.

(3) Growth and sustainable profitability of rural banks are nearly always a mirror image of the growth and prosperity of their community.

(4) Banks must individually plan their own responses to market needs and continuity; collectively all banks must reinforce each other and set about the orderly evolution of the industry. It is on this last that the hope of the rural banker rests -- the hope that the leaders of the banking industry, whether large or small, recognize that they have the most to lose by the failure of their weaker brethren to plan, to train, and to serve.