

business review

FEDERAL RESERVE
BANK OF
PHILADELPHIA

THE BRANCH AND MERGER MOVEMENT IN THE THIRD FEDERAL RESERVE DISTRICT

In this second article on the subject, statistics are analyzed to answer four questions: How much, when, where, and who? The figures also help to answer the \$64 question: Why?

BANKING DEVELOPMENTS — THIRD DISTRICT

Bank credit and deposits expanded over the year ended last June—a period of economic readjustment.

CURRENT TRENDS

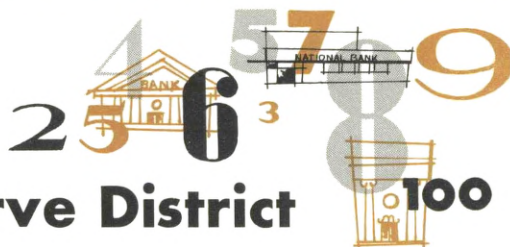
Instalment credit terms have eased somewhat, credit risks are examined more closely.

*Additional copies of this issue are available
upon request to the Department of Research,
Federal Reserve Bank of Philadelphia,
Philadelphia 1. Pa.*

THE BRANCH AND MERGER MOVEMENT

in the Third

Federal Reserve District



Last month we presented the general background for changes currently being made in the banking structure. This second article describes some basic facts about the nature of the branch and merger movement from the end of 1946 to the middle of this year.

PART II: NATURE OF THE MOVEMENT

Because they have arisen in response to human needs and because they are run by people, no two banks are exactly alike. Anyone who tends to forget this can be reminded by statistics on mergers and branches. Each bank has different problems and reacts to them in a different way. These variations show up in the figures.

Yet, a development as widespread as the current branch and merger movement must be motivated by certain common forces, and these too should be reflected in the figures. So in this article we shall try to bring some order out of statistical chaos and answer four fundamental questions: How much? When? Where? Who? Whenever the figures make it possible, we shall also try to give a partial answer to the most interesting question of all: Why?

The "typical" situation

Some of these questions are answered in a general way in the charts on pages 4 and 5, and can be summarized in a word picture of the typical situa-

tion. What follows, of course, is an over-simplification; there is no such thing as a typical case. We have, however, collected many figures on each of the 66 mergers and 118 new branches established since the end of 1946, and these statistics reveal certain concentrations, averages, and tendencies which stand out rather clearly.

In the first place, they show that for each bank participating in the branch and merger movement there are seven others that have not. And the bank which *has* participated typically has engaged in only one merger or has established only one branch.

This branch was established or merger took place probably during the past year and a half, and chances are it was in a large* city. In the case of a new branch, it was more likely to have been established in the head-office city than outside; but in the case of a merger, the likelihood is greater that the two banks were in different towns. The absorbed bank may well have been located in a town with less than 10,000 population.

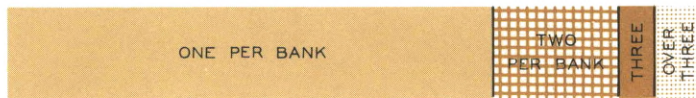
We are likely to be dealing with a bank of fairly substantial size*—perhaps with deposits of at least \$60 million. Of course, when it comes

* Throughout this article, cities are divided into four groups: Philadelphia, other large cities (population over 100,000), medium-sized cities (10,000 to 100,000), and small towns (under 10,000).

Banks are divided into three size groups: large (total deposits over \$100 million); medium (between \$10 million and \$100 million); small (under \$10 million).

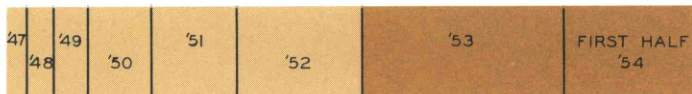
A BRIEF PICTURE OF THE BRANCH

HOW MUCH NEW BRANCHES



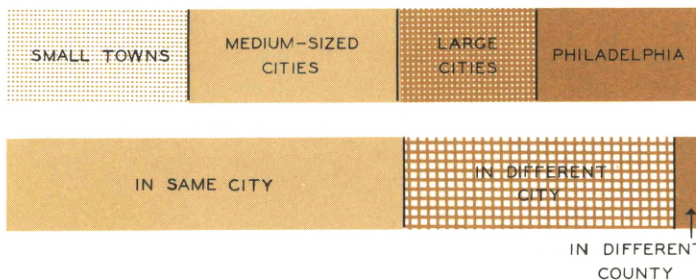
Seven out of ten banks which have established branches, have set up only one apiece.

WHEN



Banks have established as many new branches in the past year and a half as in the six preceding years.

WHERE



Almost half of the banks which have set up branches have been in Philadelphia and other large cities;

... and over half the branches have been in the same city as the head office.

WHO



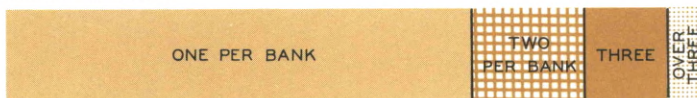
Banks with deposits over \$10 million have established three out of four of the new branches

... and state and national banks have participated about equally.



AND MERGER MOVEMENT

HOW MUCH MERGERS



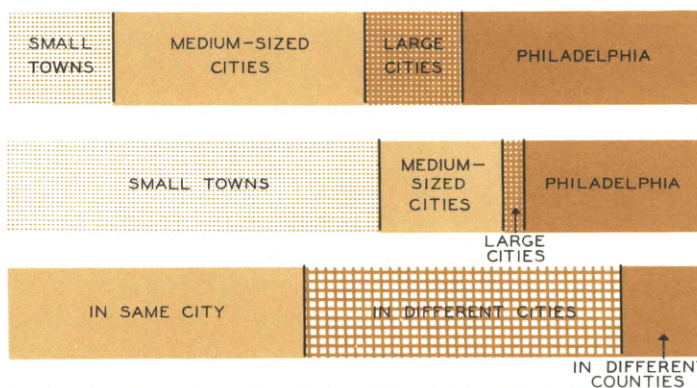
Most banks involved in mergers have absorbed only one bank apiece.

WHEN



Mergers have become increasingly numerous over the past seven and a half years.

WHERE

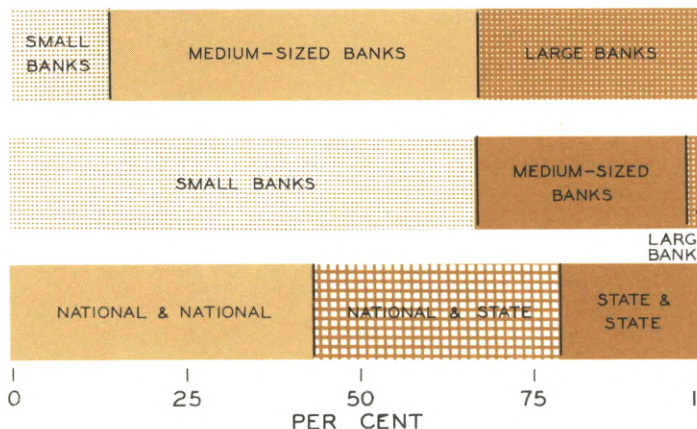


Half of the *absorbing* banks have been in Philadelphia and other large cities . . .

. . . but seven out of ten *absorbed* banks have been in small towns and medium-sized cities;

. . . the merging banks have been located in different cities more frequently than in the same city.

WHO



Absorbing banks in most cases have been large or medium-sized . . .

. . . but two out of three *absorbed* banks have been small;

. . . national banks have been involved in over three out of four mergers.

to the bank which is *absorbed* by merger, size is quite another matter; then we are talking about (roughly) a \$5 million institution.

A look at condition statements and earnings reports suggests certain other generalizations. Chances are fairly great that the absorbing bank in the typical merger had not grown so fast, since 1939, as the bank it absorbed. On the other hand, the absorbing bank frequently had relatively more of its assets in loans—particularly business loans—and had a bigger trust business. It may well have had relatively lower expenses (compared with total earnings), almost certainly had better net earnings (as a per cent of capital), and paid definitely higher dividends (as a per cent of capital). In the case of new branches, we get the same general picture by comparing banks which have established branches with all other banks.

These general conclusions are amplified, and in many cases modified, by a more careful look at the figures.

How much?

Last month we indicated that, compared with other sections of the country, banks in the Third District have been quite active in establishing new branches, and especially active in mergers. Yet, in another sense the movement does not seem so extensive. Less than 100 of the district's banks, or only about one out of eight, have absorbed other banks or set up new branches.

The relatively few banks which have been active are mainly the large banks. Almost two-thirds of the large banks have, at one time or another, absorbed another bank; and an even larger proportion of them have set up new branches. In contrast, barely 1 per cent of the small banks have absorbed other banks, and only 3 per cent have established new branches.

Moreover, most banks that *have* engaged in mergers or new-branch activity have been involved in only one merger or have established only one new branch. At the other extreme is a bank which has been party to five mergers, and another bank which has set up seven branches. Mergers have been concentrated in fewer banks than have branches; six large banks, for example, are responsible for one-third of the mergers. Most banks have used *either* mergers or new branches as a way of expanding, but over half of the large banks have used both.

When?

The branch and merger movement began picking up speed in 1951 and 1952. Activity in 1953 and the first half of this year alone was equal to the preceding six years.

The question bankers are asking themselves, of course, is whether the pace will accelerate or slow down. And in this connection, it may be significant that the smaller banks have begun to participate only recently. In the earlier years covered by our study, mergers were confined pretty largely to large and medium-sized banks and were quite sporadic. By 1951 they were becoming more frequent and numerous, and were beginning to involve small banks outside of Philadelphia. By 1953 a fairly substantial share of the mergers was being carried on among small banks. New-branch activity shows a somewhat different picture, for the smaller banks outside of Philadelphia were more active earlier. It seems that the possibilities of mergers occurred to them later.

Where?

Still, the branch and merger movement has been basically a big-city phenomenon. A third of all mergers and a fourth of the new branches have

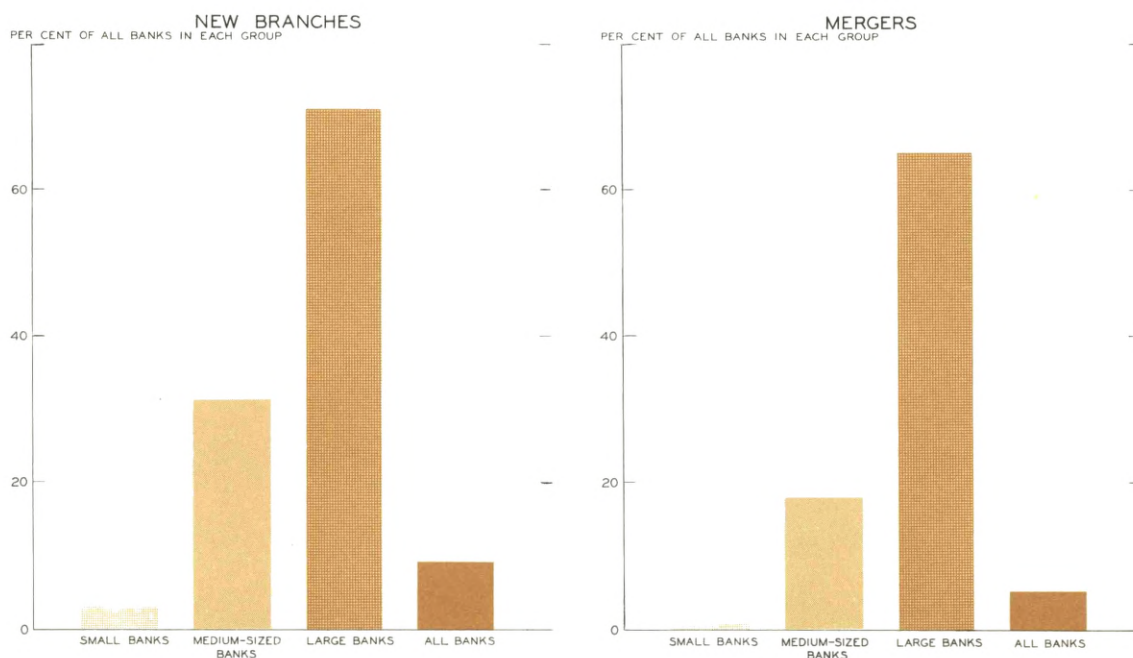
involved Philadelphia banks. Close to half of the mergers and new branches were located in the Philadelphia eight-county metropolitan area. No activity has taken place in 28 of the district's 60 counties.

When mergers are classified by size of city in which the absorbing bank is located, the picture becomes more striking. In one out of two mergers, the absorbing bank was located in a city with population over 100,000 (including Philadelphia); in one out of three it was in a city with population between 10,000 and 100,000; and in only one out of seven was it in a town of less than 10,000. If we classify mergers by the size of the town in which the *absorbed* bank is located,

however, we get quite a different picture. Over half of the absorbed banks were in towns with less than 10,000 population. New-branch activity has penetrated somewhat more into the smaller centers than have mergers. In about one out of four cases the parent bank was located in a small town.

Mergers and branches are changing the "local" nature of banking, for almost three-fifths of the mergers have been between banks in different cities and over two-fifths of the new branches have been set up outside the head-office city. The greatest impact of this development has been in the smaller towns, as is to be expected because opportunities for branching out or merging with other

WHAT PROPORTION OF ALL BANKS HAVE PARTICIPATED IN MERGERS AND NEW BRANCHES?



Most banks have not been active in the branch and merger movement. A much larger proportion of large banks than of small banks have been involved. (Chart on mergers is for absorbing banks only.)

banks in the same city become more limited the smaller the community. Philadelphia is a special case because city lines and county lines are the same. For some time, opposition to cross-county expansion has impeded establishment of branches or mergers across city lines. Yet, quite recently Philadelphia banks have merged with outside banks to the extent of one-fourth of all their mergers.

Who?

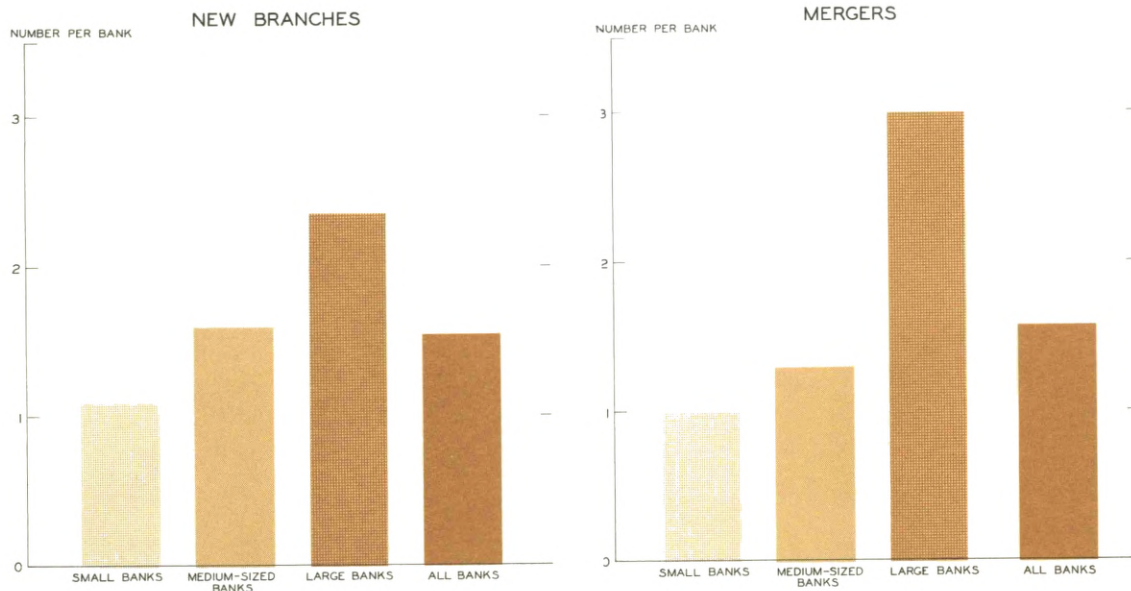
The first question almost everyone asks about the merger and branch movement is "Why?" We intend to deal with this one later; but a partial answer may come from statistics on the *kind* of bank active in the movement.

The figures show clearly that most of the banks

are fairly good sized. In a third of the mergers the absorbing bank had deposits over \$100 million; in over half, it had deposits between \$10 million and \$100 million; and in only a seventh were deposits under \$10 million. But the small group contains two-thirds of the *absorbed* banks. Banks establishing new branches are generally pretty large, too, although the smaller banks have been more active in this respect than in mergers.

Over 60 per cent of the banks in the Third District are national banks, so it is natural to expect more national than state banks to be involved in mergers and new branches. The figures bear this out. But they also show that state banks have been *relatively* more active than national banks; they were absorbing banks in 45 per cent of the mergers, and parent banks in 43 per cent of the new-branch activity. In addition, state banks ab-

HOW ACTIVE HAVE BANKS BEEN?



Of those banks which have engaged in mergers and new branches, large banks have been relatively more active than small banks. (Chart on mergers is for absorbing banks only.)

sorbed national banks more often than national absorbed state banks. The general effect has been to increase the banking resources of state banks relative to national banks, and this has been particularly true in Philadelphia.

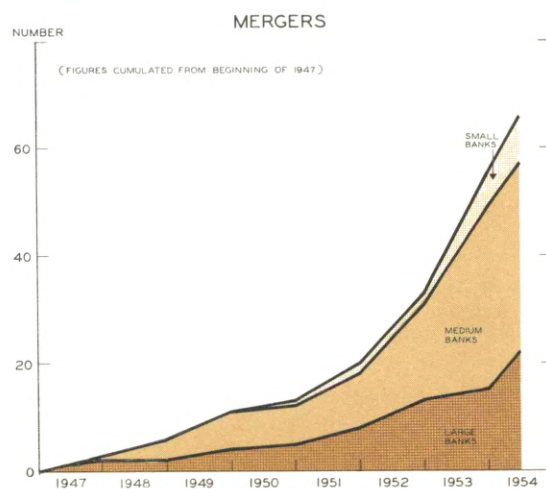
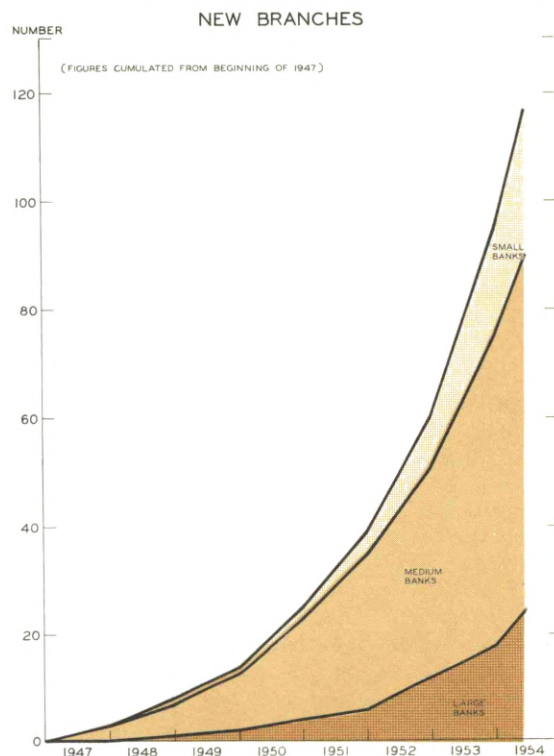
These are all, perhaps, interesting facts but when we come to some of the other characteristics of banks—especially things like growth record, branch-banking activity, the kinds of assets which they hold, and their earnings experience—we get closer to some of the motives behind the branch and merger movement.

You might start, for example, with this theory about mergers: fast-growing banks are taking over stagnant banks. But the figures show that it is not true; absorbing banks are likely to have grown less rapidly than the banks they absorb. A look at the figures by size of bank indicates that large banks in general have tended to grow less rapidly than small banks since 1939 and, of course, the larger banks are doing most of the absorbing. In mergers of smaller banks, the growth records are more nearly alike. All of which suggests that large banks are not growing so rapidly that the momentum simply carries them into other areas; rather, central city banks are getting in on the more rapid growth which smaller banks in outlying areas have been experiencing.

Banks can do this either by merging with existing banks or setting up new branches in those areas. Which method they choose depends on many things, but the result in both cases is an expansion of branch banking. The figures suggest, however, very few cases where mergers could be an attempt to acquire an established branch system of another bank; except mainly for a few fairly large institutions, most absorbed banks had no branches at time of merger.

Another theory might be that banks take over other banks for the loans they have. This does

TIMING BRANCHES AND MERGERS



Branches and mergers picked up speed in 1951 and 1952, spreading from large to small banks. (Mergers are grouped by size of absorbing bank.)

not seem to be strictly true. Certainly, mergers would be unlikely unless the absorbing bank saw prospects of profits from loans, but at time of merger the banks being absorbed have usually had a smaller proportion of their assets in loans than have the absorbing banks. Here again the difference is partly explained by the fact that the largest banks are likely to be in loans relatively more heavily than most other banks. The differences are less when two banks of about the same size are merging.

As might be expected, the composition of the loan portfolios of absorbing banks is different from that of absorbed banks—partly because of differences in size of the two institutions. Absorbing banks are quite likely to have a larger proportion of business and consumer loans, and less farm and real-estate loans. Differences in investment portfolios are not clear-cut except that the large Philadelphia banks usually have had heavier holdings of securities other than U.S. Governments than have the banks they absorbed. Trust business almost always is relatively more important in the absorbing than the absorbed bank.

These differences bring us to another theory: banks merge in order to form a more well-rounded bank. Whether this is actually a motive or not, the facts above indicate that banks actually do become more well-rounded, in the sense that the structure of the two banks is never exactly alike. But the figures suggest only a few cases where this might be a dominant reason. These are large banks of about equal size but with quite different structures—one bank having a large trust and consumer-credit business merging with another having heavy commercial-loan volume; or a bank having large consumer and real-estate loans merging with a bank with large business loans. If you examine mergers between smaller banks of about equal size, however, you find that both banks usually

have roughly the same asset pattern. Complementariness, apparently, is not important there.

In view of growth experience, you might come up with still another theory: banks absorb other banks with higher earnings. Again, it is certainly true that prospects of earnings are a motivating force, but the figures show that earnings of absorbed banks are likely to be less favorable than earnings of absorbing banks. One reason may be the higher proportion of loans in the asset structure of absorbing banks. Another may be that absorbing banks hold relatively less of their funds idle; but this is not true in mergers involving large and small banks because large banks generally have higher cash holdings (including reserves).

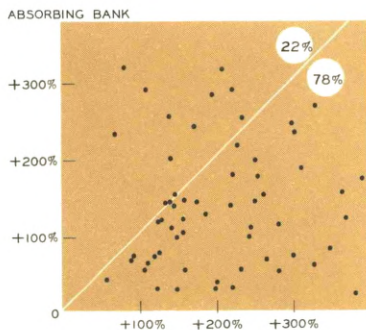
A more important reason for differences in earnings, perhaps, is expenses. If two smaller banks are merging, expenses are often about the same; but where a large bank takes over a smaller bank, expenses are likely to be relatively lower (as a percentage of total earnings) in the absorbing bank than in the absorbed bank.

Because expenses are relatively lower (as a percentage of total earnings) net current earnings of the absorbing bank are likely to be relatively higher. Partly because of this and partly because absorbing banks usually have a lower ratio of capital to so-called "risk assets," their return on capital is usually higher. And because dividend policies apparently are more liberal, dividends as a percentage of capital are still greater than those of absorbed banks.

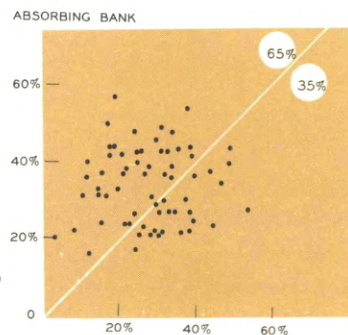
All of this has to do with mergers. It is fairly easy to analyze the characteristics of banks involved in mergers because you can simply compare one bank against another. With branches, the only possibility is to compare banks which have established branches with all banks of about the same size. When you make this comparison

HOW ABSORBING BANKS COMPARE WITH ABSORBED BANKS

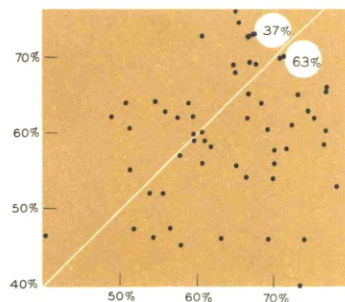
These charts show some of the differences between absorbing banks and absorbed banks. In each chart a percentage which measures a given bank characteristic is plotted on the horizontal scale for each **absorbed** bank and on the vertical scale for each **absorbing** bank. If the percentage for both banks is the same, the dot will fall on the diagonal line. If the percentage for the absorbing bank is higher than for the absorbed bank, the dot will fall above the line; if it is lower, the dot will fall below the line. The percentages in the upper right-hand corner of each chart indicate the proportion of dots falling above and below the line.



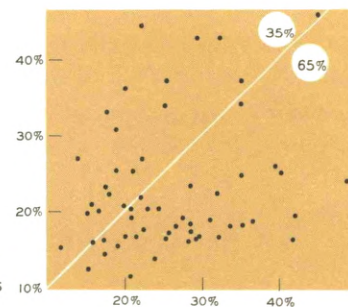
1.
Deposits of absorbing banks have grown less rapidly since 1939.



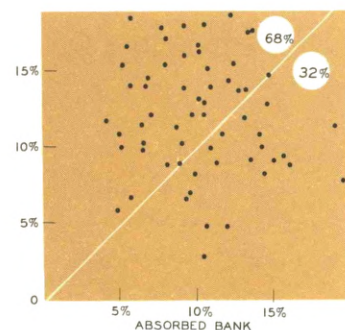
2.
Absorbing banks have a higher ratio of loans to total assets . . .



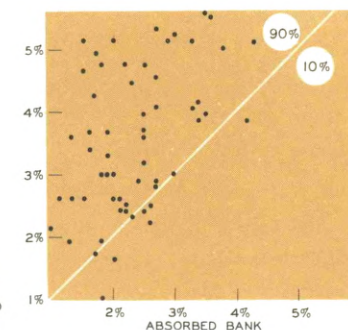
3.
. . . a lower ratio of expenses to total earnings . . .



4.
. . . a lower ratio of capital accounts to so-called "risk assets" . . .



5.
. . . a higher ratio of net current earnings to total capital accounts . . .



6.
. . . and a higher ratio of dividends to total capital accounts.

the results are not so clear-cut as with mergers but reveal the same general picture.

Conclusions

We have presented a lot of facts and figures in this article, but we have done it deliberately because so few facts have been available on the subject. One disadvantage of this approach, however, is that important points may be lost in a maze of statistics. In summary, therefore, these few main points seem to stand out:

First, the figures give some idea of the relative importance of the branch and merger movement as a banking phenomenon. And, in general, they suggest that recent developments have not been so extensive as some might think. Most banks in most areas have not participated. Of those that have, most are large banks in large centers. Small banks have participated mainly by being absorbed. Out of this comes an important question as to how much branches and mergers have affected the concentration of banking facilities. We shall look into this question later.

Second, although most banks have not been ac-

tive, yet the movement has been spreading. A question worth considering is whether mergers will become more prevalent among smaller banks.

Third, the figures shed some light on elements underlying mergers and branches. They are of limited value because there are many things that do not show up in statistics. It seems significant that, for many banks, mergers are, in a way, a defensive measure. They are a way of speeding up a lagging growth trend and expanding into growing areas. On the other hand, the figures suggest that absorbing banks have tended to make more profitable use of their funds than have absorbed banks. Their loans are a relatively greater proportion of total assets, their expenses take a smaller cut out of total earnings, and earnings are higher compared with capital. And in at least two respects, absorbed banks appear to be more conservative; they have higher capital ratios and pay out a smaller proportion of earnings as dividends. Behind these figures is management, and this is hard to measure. We shall go into this and other reasons underlying the branch and merger movement in a later article.

BANKING DEVELOPMENTS— THIRD DISTRICT

From mid-year to mid-year

Readjustment was a significant characteristic of the economy during the year ended June 30. In the field of money and credit increasing ease was manifest, reflected partly in substantial declines in bond yields and open market money rates as the

supply of funds increased and demand from some sectors declined. Reductions in reserve requirements against member bank deposits and lower discount rates at the Reserve Banks were among the contributing factors. Deposits and outstanding

credit of the member banks in the Third Federal Reserve District and nationally expanded considerably.

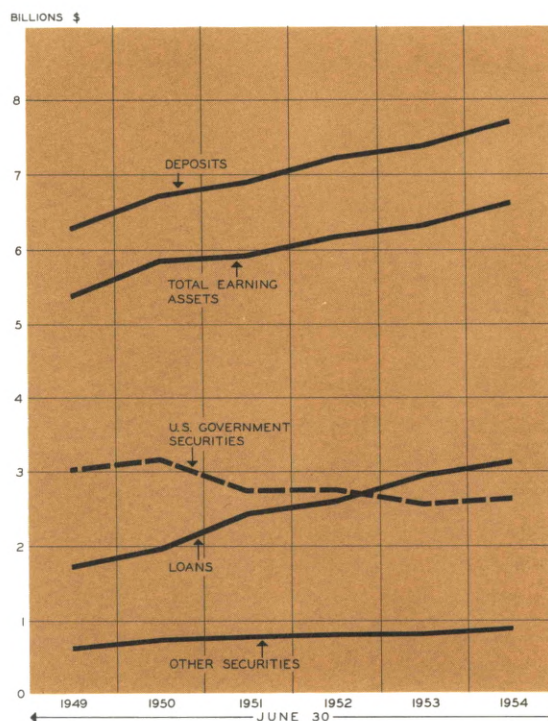
At mid-year, deposits of the member banks in this district totaled approximately \$7.7 billion. After adjustment for mergers, the figures show an increase over June 1953 of well over \$300 million—the largest for any like period since 1950. Demand deposits of individuals and business concerns changed little, but there were substantial additions to their time balances and to the balances of government—Federal, State and local.

Earning assets of Third District banks also were up more than \$300 million, or nearly 5 per cent, from June 1953 to June 1954. In the year preceding, sharply rising loans were offset to a considerable extent by reduced holdings of United States Government securities. This was not the case in the period under review. Growth in loans slowed considerably, but investment portfolios increased nearly as much, as banks purchased public obligations, both Federal and municipal. Investments in corporate securities again declined somewhat. The experience of reserve city banks, located in Philadelphia, differed from that of the country banks. Credit expansion at reserve city banks was largely in securities, both Federal Government and municipal issues, and to only a limited extent in loans. Country banks, on the other hand, added considerably to their loans but reported little change in aggregate investment portfolios.

Details of the over-all increase of \$170 million in loans to nearly \$3.2 billion reflect some of the signs of the times. Loans to commerce and industry, earlier a major factor in loan expansion, decreased in the latest twelve-month period. The decrease was not particularly large, as higher country bank figures partly offset a decline at reserve city banks. Instalment loans to consumers

MEMBER BANK LOANS

(Third Federal Reserve District)



increased, but much more moderately than a year earlier. The availability of mortgage money and the continued high level of construction resulted in an increase in real estate loans equal to or slightly larger than in the year ended June 1953. Expansion in loans to purchase or carry securities also was reported, as well as growth in agricultural paper incident to the purchase of certificates of interest in Commodity Credit Corporation loans.

Earnings reports of the member banks in this district for the first half of 1954 reflect the growth in earning assets. Preliminary figures show gross earnings of nearly \$132 million, up about \$6 million on an adjusted basis from a year earlier. As in other post-war years, increasing income on loans was the major factor in this rise.

But current expenses also continued to move upward and in about the same amount. Consequently, net current earnings before recoveries, charge-offs, and income taxes were virtually the same as in the first six months of 1953. Checking

the figures bank by bank, the number reporting a decline in net current earnings was larger than the number experiencing increases, although higher gross earnings than a year earlier were reported in the great majority of cases.

CURRENT TRENDS

The over-all pattern of late-summer economic developments seems to have strengthened the belief held by many business observers that the period of readjustment may soon be over. Productive activity and employment have continued to be stable, and although inventory reduction is still in progress the rate of liquidation has diminished somewhat. Construction, particularly in the field of home building, has maintained the fast pace set earlier this year. And consumer spending, supported by a high level of disposable income, continues to be a strong sustaining force.

Throughout this past year of business adjustment, consumers continued to increase their outlays for services but not their expenditures for goods. Consequently, keen competition soon dominated various areas of retail merchandising. In automobiles, for example, the struggle to maintain sales has been difficult since the very beginning of the 1954-model year. And in appliances and similar "big ticket" items for household use the going has been only a little less rough. White goods and television sales both have experienced some unusual fluctuations; and the demand for air conditioners, which appeared to hold such promise last season, has been extremely disappointing.

Instalment credit terms are under pressure

Because so many people buy consumer durables on the instalment plan, considerable pressure has been developing for a relaxation of financing terms. A spot check of the situation in this Federal Reserve District indicates some easing in down-payment requirements and a gradual lengthening of maturities. Terms of sale show more of a tendency to ease on automobiles than on appliances. And there is greater flexibility with respect to new cars than to used cars.

We also found variations on an area basis. There is more evidence of automobile terms being relaxed in Philadelphia and its suburbs than in a number of smaller city areas of the district. In Johnstown, York, and Harrisburg there are some signs of tightening requirements on both down payments and maturities. Major appliance dealers, irrespective of their location, still show little inclination to ease their terms of sale. While there are scattered reports to the contrary, they relate chiefly to merchants who carry appliances and similar items as a side line.

Collection experiences are mostly good

Collections on all types of instalment loans remain fairly prompt. But the finance companies and

banks mention the fact that they must work a little harder to keep payments on schedule. To be sure, this comment applies particularly to areas hardest hit by unemployment and the loss of overtime pay. Johnstown, Altoona, and Pottsville are three such areas. It seems that where delinquencies have risen they have appeared more frequently in automobile than in appliance loans. Repossessions have not become a serious problem anywhere, and in the case of automobiles they have been declining for some time.

Credit standards are higher

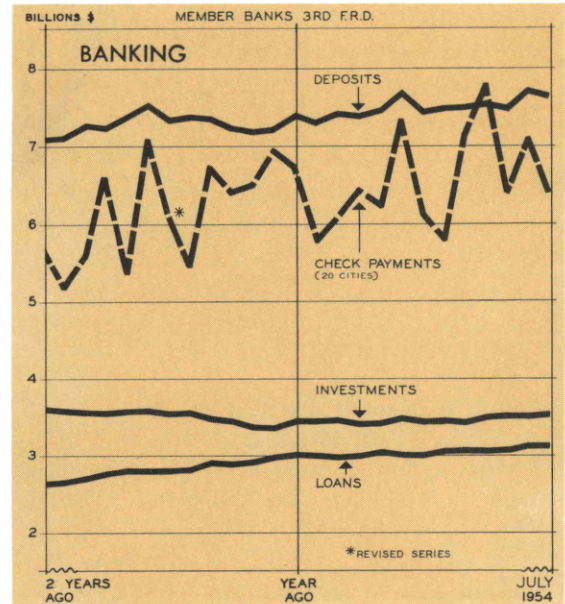
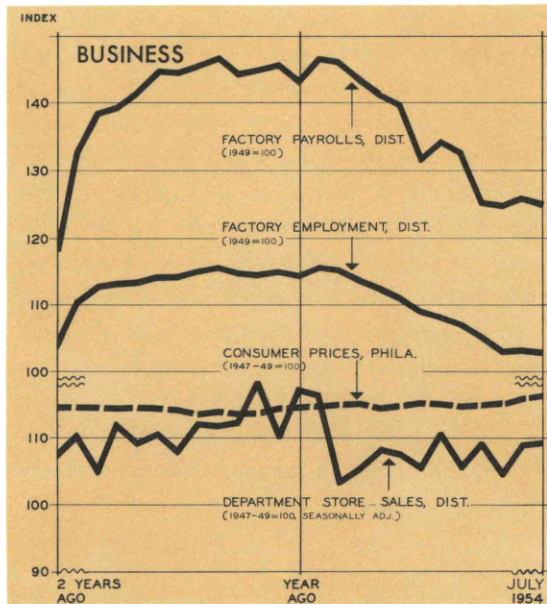
Standards used in screening applicants for installment credit are definitely higher than a year ago

in all parts of this district. Employment records are examined more carefully; earning prospects are appraised less optimistically; and the applicant's outstanding indebtedness receives a greater share of consideration. More banks and finance companies are requiring a full credit report on every individual. Frequently this results in somewhat stiffer terms being offered the less desirable credit risks. Because these lenders are "taking another look," more applications are being turned down than at any time in the recent past. Many potential delinquencies and outright defaults are thus avoided. Numerous automobile and appliance dealers are contributing their share to an improved credit picture by some careful preliminary screening before even writing a loan application.



THIRD FEDERAL RESERVE DISTRICT

FOR THE RECORD...



SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	July 1954 from		7 mos. 1954 from	July 1954 from		7 mos. 1954 from
	mo. ago	year ago	year ago	mo. ago	year ago	year ago
OUTPUT						
Manufacturing production...	-1	-15	-14	-6	-9	-9
Construction contracts*	+11	+19	+16	-3	+23	+15
Coal mining	-17	-31	-22	-10	-17	-18
EMPLOYMENT AND INCOME						
Factory employment (Total)...	-1	-10	-8	-1	-10	-7
Factory wage income	-1	-13	-11			
TRADE**						
Department store sales	0	-7	-5	0	-1	-4
Department store stocks	-1	-5		+2	-5	
BANKING (All member banks)						
Deposits	-1	+3	+3	-2	+3	+4
Loans	0	+4	+6	0	+2	+2
Investments	+1	+2	+1	+1	+4	+5
U.S. Govt. securities	+1	0	0	+1	+3	+5
Other	+1	+11	+4	+1	+9	+6
Check payments	-10†	-5†	+4†	-5	+5	+7
PRICES						
Wholesale				0	0	+1
Consumer	0†	+1†	+1†	0	0	+1

*Based on 3-month moving averages.

**Adjusted for seasonal variation.

‡20 Cities

†Philadelphia

LOCAL CHANGES	Factory*				Department Store				Check Payments		
	Employment		Payrolls		Sales		Stocks				
	Per cent change July 1954 from		Per cent change July 1954 from		Per cent change July 1954 from		Per cent change July 1954 from		Per cent change July 1954 from		
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	
Allentown . . .	+1	-11	+2	-16						-4	-5
Harrisburg . . .	0	-14	+2	-17						-5	-8
Lancaster . . .	-1	-7	-2	-8	-5	-7	-5	+3		-6	-3
Philadelphia . .	-1	-10	0	-10	-33	-7	-6	-3		-11	-1
Reading	-1	-9	-1	-14	-19	-4	-11	-9		-4	-5
Scranton	-1	-6	0	-7	-25	-6	-4	+9		-13	-9
Trenton	-1	-13	-3	-18	-22	-4	-3	-13		-7	-36
Wilkes-Barre . .	0	-10	-4	-13	-22	-10	-5	-19		-15	-11
Wilmington . . .	-2	-9	-3	-10	-23	-1	-4	-2		-16	-13
York	-3	-11	-6	-13	-7	-4	+3	-4		-14	-6

*Not restricted to corporate limits of cities but covers areas of one or more counties.