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THE BRANCH AND MERGER MOVEMENT IN THE THIRD FEDERAL RESERVE DISTRICT

This article, the fifth and concluding one of a series, deals with the impact on banks and the banking structure.

THIRD DISTRICT BANKING—1954

Bank credit expanded; earnings, expenses, and profits rose.

CURRENT TRENDS

Funds for home financing seem adequate to support a high level of residential building this year.

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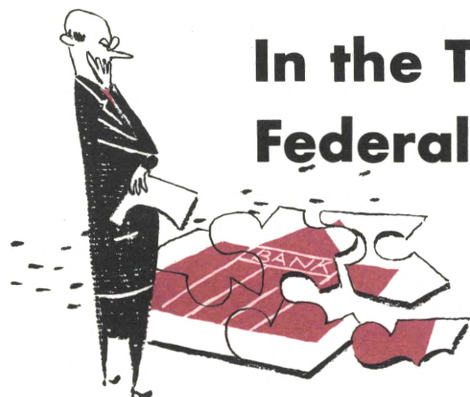
THE BRANCH AND MERGER MOVEMENT



In the Third Federal Reserve District

This is the fifth and final article in a series on bank branches and mergers. Preceding installments, published in the Business Review, *and available on request, are: August 1954, "Background"; September 1954, "Nature of the Movement"; November 1954, "The 'How' of Branches and Mergers"; and January 1955, "Motives Behind Branches and Mergers." In this article we present some of the implications for banks and the banking structure.*

PART V: IMPACT ON BANKS AND THE BANKING STRUCTURE

Although it is too early to draw definitive conclusions about the full effects of branches and mergers on the whole range of economic activity, it is possible to trace the impact, thus far at least, on that segment which relates directly to banks and the banking structure.

Impact on banks

Banks, like other enterprises, are in business to make money. The ultimate test of the success of a branch or merger, from the banker's point of view, is simply how much it increases earnings over expenses. The test is hard to apply, however, because the banker can never tell exactly how much of his profits result directly from a new branch or merger; he never knows what would have happened if he had not engaged in branch and merger activity.

One thing is clear. So many banks could not have grown so much in so short a time except through mergers. The 42 banks that engaged in mergers expanded their deposits, on the average, by more than three-fourths between December 1946 and June 1954—the period covered in our study. If you take out deposits which they acquired through mergers, however, you find that the remaining deposits rose by only about one-fourth. This was only a little more than the expansion in deposits of all banks in the Third District during the same period.

Of course the situation varied widely from bank to bank. The chart on the next page shows how mergers had a greater impact on the growth of Philadelphia banks than on banks outside of Philadelphia. In the case of some banks that absorbed, say, only one small bank during the period, acquired deposits might amount to only

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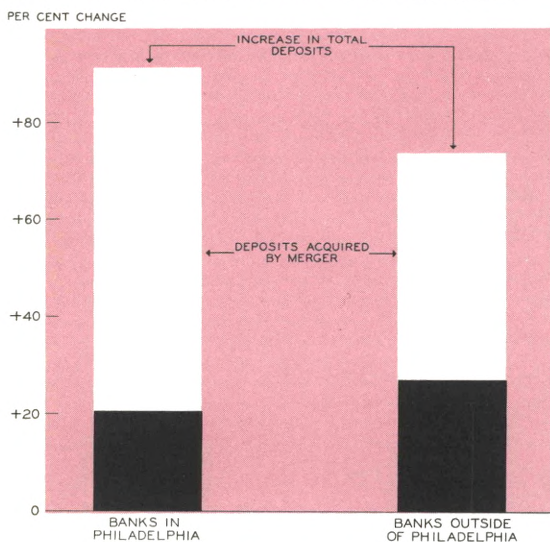
one-fifth of total deposit growth. When two banks of about the same size merged or when a bank absorbed several banks, acquired deposits might run to 80 or 90 per cent of deposit growth. In a few instances it appears that deposits would have declined had it not been for accounts acquired through merger.

These figures tell an important story for the banks involved in mergers, but they are now past history. The question that cannot be answered yet is what will happen to growth from here on. You get the general impression from bankers, however, that, thus far at least, they are pleased. Those who merged to enlarge lending capacity have been getting new large accounts. Although deposits of new branches in many cases have not yet reached the break-even point, they seem to be growing. Earnings experiences vary. They depend on premiums paid in mergers, the level of earnings of absorbed banks, and costs of new branches. But apparently on the whole they have turned out to be more favorable than expected.

HOW BANKS GROW THROUGH MERGERS



Deposits of banks which have participated in mergers rose substantially between December 1946 and June 1954. Most of the increase was because of deposits acquired through mergers.

Expenses, if anything, have been heavier than expected. They have been particularly heavy in the short run; they may also turn out to be large, although bankers may be less aware of them, in the longer run. Mergers usually are cheaper than new branches, but expenses involved in integrating two banks still can depress profits for a year or more. In addition to any premium that might be paid, the absorbing bank often incurs other expenses, such as enlarged pensions, at the time of merger. Then come expenses of making the transition to a smoothly working, efficient organization. Months of overtime may have to be paid to mesh bookkeeping methods and other procedures. At first the bank needs an extra-large staff to do this job, but once the transition is completed it often finds itself with surplus help.

Of all the problems resulting from mergers, personnel problems probably cause the most sleepless nights. They are likely to be toughest in the consolidation of two banks of about equal size. If the banks emphasized different kinds of business, as is often the case, the problem is reduced. But inevitably there is some overlapping and personnel must be reduced. Fortunately, only a few mergers are between banks of about the same size; in most mergers a larger bank absorbs a smaller bank to acquire a branch. In this case, personnel of the absorbed bank can be retained to operate the branch.

In either case, however, personnel problems may be costly—in both dollars-and-cents and in human terms. And it may take years to work some of them out. Turnover may take care of surplus employees, but turnover is not so rapid with officers. What has saved the situation more than once—and this may help to explain why mer-

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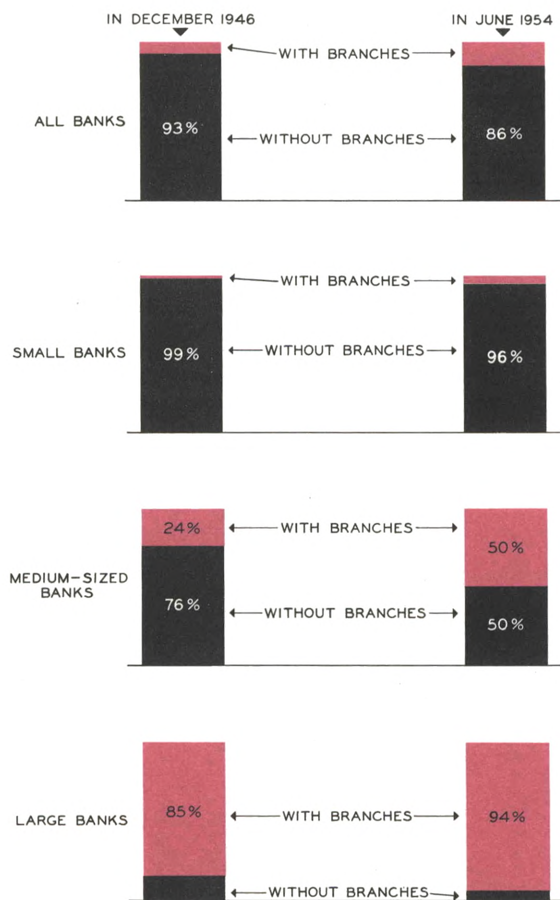
gers flourish in booms—has been an expansion of business that has absorbed surplus personnel.

Some costs of the longer-run variety show up early if banks must renovate or expand facilities they have acquired, raise salaries, and so on. There is another kind of cost, however, that may or may not show up; that is the cost of managing branches. Branches can be expensive, and one of the problems of managing branches is how to tell whether they are bringing in enough earnings to be worth while. It takes money and a cost accountant to find this out. It may also cost the bank money if it doesn't try to find out. Banks face a dilemma: the more closely they integrate operations of branches and home office the more efficient they are likely to be, but the harder it is to keep track of costs and earnings.

WHAT PROPORTION OF BANKS HAVE BRANCHES?



Although most large banks have branches and most small banks have none, more banks of all sizes now have branches.

At any rate, this is a problem which will confront an increasing number of banks. As the chart shows, most banks still have no branches; yet 80 per cent more banks now have branches than only a few years ago. The proportion of banks with branches has increased in all size groups.* Most of the branches are still being operated by large- and medium-sized banks, but small banks now have twice as large a share of all branches as they had in December 1946.

Although expenses have been heavy, some banks are beginning to experience savings through the elimination of duplication and streamlining of operations. It will take longer to benefit from some of the other gains that they look for—things like improved employee morale and more adequate provision for management succession. Ultimately, how banks make out will depend on the quality of services they perform for the public.

Impact on the banking structure

The branch and merger movement has had several important effects on the banking structure. In the first place, mergers have reduced the number of banks in operation. As the chart on the next page indicates, the number of banks in the Third District was 7 per cent lower in June 1954 than in December 1946. But mergers have not reduced

* "Large" banks are those with deposits over $100 million; "medium-sized" banks, between $10 million and $100 million; "small" banks, under $10 million.

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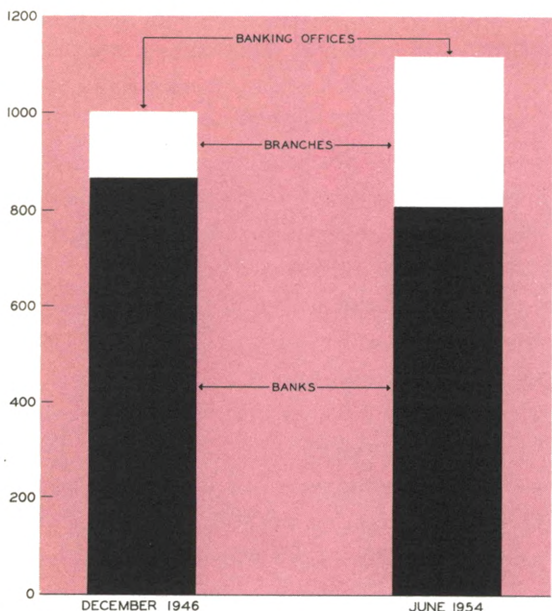
FEWER BANKS, MORE BRANCHES



Although mergers have reduced the number of banks in the Third District by 7 per cent, the number of banking offices has increased by 12 per cent.

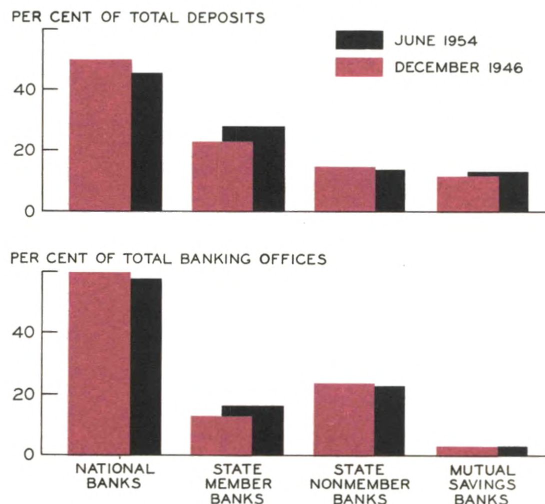
the number of banking facilities, since almost all the banks absorbed in mergers have continued to operate as branches. This, plus the establishment of more than a hundred new branches, have more than doubled the number of branches in operation. The end result is that the banking public had 12 per cent more banking offices to use at the closing date of our study than it had at the beginning.

This general picture applies to communities of all sizes throughout the district. The number of banks in large, medium, and small communities declined. The biggest drop, percentage-wise, was in Philadelphia which started out with 46 and ended with 29 banks. The number of branches, however, increased in communities of all sizes; and some towns which never had a bank now have a branch. With only a couple of exceptions, no community had fewer banking offices at the end than at the beginning of our study.

About two dozen communities which had one bank in 1946, however, no longer have a bank because it was absorbed by an out-of-town bank. And a few towns which had two banks now have only one. But since most banks absorbed in mergers remained open as branches, and since seven out of ten communities in 1946 were already one-bank towns, the over-all picture has not changed substantially.

Mergers have tended to increase the relative share of banking resources held by the large banks. In 1946, banks with deposits over $100 million represented 1 per cent of all banks in this district but held 39 per cent of the deposits. By mid-1954 they held 50 per cent. A number of forces have been at work to bring this about. but mergers are one of the more important.

SHIFTS IN CLASSES OF BANKS



Mergers have reduced the share of total deposits and banking offices held by national banks and increased the share held by State member banks.

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The branch and merger movement has also changed somewhat the distribution by class of bank—that is, among national banks, state banks that are members of the Federal Reserve System, state banks that are not members of the System, and mutual savings banks. As the chart shows, the principal result has been a shift of banking offices and deposits from the national banking system to state member banks. The shift in banking offices was because of mergers, not new branches; national banks actually increased their branches more than state banks. But state banks absorbed national banks more often than the other way around, and a couple of big transactions of this kind in Philadelphia swung a large amount of deposits over from the national to the state-bank classification.

Conclusions

The branch and merger movement is still going at full tilt. Between June 1954—the closing date of our study—and the end of February 1955, banks in the Third Federal Reserve District set up 19 more new branches and engaged in 18 more mergers. The pace, if anything, has accelerated.

What will happen from here on is anybody's guess. It is clear that the movement is not yet over. It also looks as though it is spreading more and more from the big cities to outlying areas. As the movement proceeds, bankers will want to study the matter very carefully before making decisions. And bank supervisors will want to watch it even more closely than before to see that it produces a healthy banking system which contributes to economic growth and stability.

THIRD DISTRICT BANKING—1954

Credit conditions were generally easy during 1954, as manifested in readily available reserves, lower money rates, and a slackened demand for credit in some sectors of the economy. Outstanding bank credit expanded considerably in the Third Federal Reserve District and in the country as a whole. Total earnings of the banks increased, but with growing expenses their net current earnings before income taxes changed relatively little. While taxes increased, profits on securities also were larger, helping to explain higher net profits after taxes.

Credit expansion

At the close of the year, earning assets of member banks in the Third Federal Reserve District were close to $7 billion, a record level for year-end reports. The increase of more than $400 million, the greatest in any year since World War II, was mostly in investment portfolios but included a substantial amount of loans.

THIRD DISTRICT MEMBER BANKS
(Preliminary figures)

EARNING ASSETS (Dollar amounts in millions)	Dec. 31 1954	Change in year*	
		Amount	Per cent
Loans and discounts:			
Commercial and industrial	$1,208	+ $5	
Agricultural	71	+ 8	+13%
To purchase or carry securities	136	+ 27	+25
Real estate	925	+ 92	+11
Other loans to individuals—			
Instalment	569	+ 13	+ 2
Single-payment	274	+ 30	+12
All other	90	+ 10	+13
Total loans—gross	$3,273	+$185	+ 6%
Less reserves	60	+ 5	+ 9
Total loans—net	$3,213	+$180	+ 6%
U. S. Government securities	2,812	+ 118	+ 4
State and local government securities	680	+ 155	+30
Other securities	248	— 29	—10
Total earning assets	$6,953	+$424	+ 6%

*1953 figures adjusted for mergers, changes in membership, and reclassification of loans.

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Reserve city banks accounted for more than half of the increase in earning assets, mainly because of substantial purchases of state and local government securities. Their purchases of Federal Government issues were less than those of the country banks and additions to loan portfolios were little more than one-half as large. Loan details show that both classes of banks added substantially to their real estate loans during this period of a continued boom in building. Changes in commercial and industrial loans were not large, in keeping with the readjustments in business. Moderate increases were reported in other loans, although growth in consumer instalment credit was very much less than in 1953.

Growth in deposits on a comparable basis approximated $320 million, raising the level to $8,040 million at the end of the year. Two-fifths of this increase was in the time balances of individuals and business concerns. Capital accounts moved up in about the same proportion as deposits.

Bank earnings

Total earnings of member banks in this district rose to $267 million in 1954, according to preliminary figures. The increase of $12 million over 1953, shared by reserve city and country banks, reflected chiefly the larger volume of earning assets. Record total earnings, however, were accompanied by record expenses, which increased a bit more than income. Salaries and wages were higher; interest on deposits rose, reflecting the growth in time deposits and higher rates paid in many instances; increases also were reported in other current expenses.

THIRD DISTRICT MEMBER BANKS

(Preliminary figures)

EARNINGS, EXPENSES AND PROFITS (Dollar amounts in millions)	1954	Change in year*	
		Amount	Per cent
Earnings—on U. S. Gov't securities	$54.4	— $0.2	
on other securities	19.2	+ 1.4	+ 8%
on loans	151.0	+ 8.0	+ 6
all other	42.6	+ 2.8	+ 7
Total	$267.2	+$12.0	+ 5%
Expenses—salaries and wages	$81.6	+ $5.8	+ 8%
interest on deposit	24.0	+ 2.8	+ 13
all other	60.4	+ 4.0	+ 7
Total	$166.0	+$12.6	+ 8%
Net current earnings	$101.2	— $0.6	— 1%
Recoveries, profits, and transfers from reserves	$18.8	+$11.0	+141%
Losses, charge-offs, and transfers to reserves	23.3	— .7	— 3
Taxes on net income	38.1	+ 5.5	+ 17
Net profits	$58.6	+ $5.6	+ 11%
Cash dividends declared	30.9	+ 3.8	+ 14

* 1953 figures adjusted for mergers and changes in membership.

Net current earnings before adjustments and income taxes declined slightly from 1953—the first decline since 1947. But the effect upon net profits of this small decline and of larger income taxes was more than offset, principally by profits on security sales. Losses and charge-offs, including transfers to valuation reserves, contributions to pension funds, etc., changed little from 1953.

Funds remaining for the payment of dividends or addition to undivided profits increased by $5½ million to $58 million. Dividends also increased, but accounted for little more than half of the net profits.

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CURRENT TRENDS

With the first quarter of 1955 soon to become a matter of record, there is increasing evidence that recovery is proceeding pretty much as observers forecast around the turn of the year. Most of those projections pointed to gradual gains spreading over much of 1955. Few of them anticipated the recent rapid expansion in basic steel and automobiles.

Current trends in these industries doubtless reflect among other things some hedging against the possibility of labor-management disputes in the late spring and early summer. In any event, most observers seem to feel that both the steel and automotive industries will have made their major contributions to economic recovery before the first half has ended. Should that prove to be the case, more dependence would be thrown on other lines to maintain the pace after mid-year.

The construction industry—that lent so much support to the economy while recessionary forces were affecting many other lines—is continuing at a peak level. And among the major categories of construction, residential building seems to be one of the most buoyant. The extent to which homebuilding can be counted on this year, however, depends in a large measure on the availability of funds for home financing.

We have made a spot check of the mortgage situation and the plans of homebuilders in the Third Federal Reserve District. The conclusions that may be drawn from these interviews are summarized in the following paragraphs.

Mortgage investment plans remain substantial

Lending institutions in this area expect to invest at least as much in home mortgages during 1955 as they did in 1954. Some life insurance companies already are heavily committed; others will be active participants shortly. Mutual savings institutions, commercial banks, and savings and loan associations plan to originate and purchase a substantial volume of mortgages this year. Most of them have been quite active in this field for some months. The opinion has been expressed widely that an adequate supply of funds for home financing will continue to be available on reasonable terms. Nevertheless, there are some who look for a progressive tightening in mortgage markets after mid-year, particularly if the rate of housing starts should exceed that of 1954.

Secondary mortgage markets are active

Considerable strength on an over-all basis prevails in the secondary mortgage market. The volume of transactions has not changed appreciably in recent months but there is considerably more activity than at this time last year. A development of some significance, however, may be the fact that lenders are expressing decided preferences for certain types of mortgages. Conventionals and FHA's are especially favored, and some brokers have told us there is not enough of such paper to satisfy the demand in this area.

VA 4½ per cent mortgages with a down payment of 5 per cent or more are moving in fairly substantial volume, but they are in plentiful supply in the Philadelphia market. This situation could change quickly to one of over-supply. Demand for the VA no-down-payment, 30-year mortgages appears to have slackened considerably in recent weeks. Trading in the secondary market is on a par basis for conventionals and FHA's. But discounts of from one to three points are

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appearing with some regularity on VA mortgages in which there is no equity. This is particularly true in the case of the long-term loans.

Lending terms have eased somewhat

The Housing Act of 1954 reduced the size of down payments and extended the maturity on FHA insured mortgages, with the result that this type of loan has increased in popularity in most parts of the district. Terms on conventional mortgages, too, are somewhat more lenient than in the early spring of last year. Down payments have not changed significantly, but interest rates have softened a little, chiefly on mortgages in which the borrower's equity ranges upward from 40 per cent. And savings and loan associations have liberalized their terms to permit a down payment of 25 per cent on mortgages running for 25 years. On VA's, the no-down-payment feature represents a decided easing in terms. But lately there has been considerably more insistence on at least a 5 per cent equity, particularly on those mortgages that run for the 30-year maximum.

Builders' plans reflect considerable optimism

Most builders appear to recognize the increasingly competitive nature of the market in which they operate. Nevertheless, their experience in selling houses soon after completion has continued encouraging. Homebuilders in virtually all price ranges express about the same high degree of confidence they maintained through 1954. On this basis, it seems likely that 1955 housing starts may approximate the level reached last year. In the vicinity of the larger cities of this district, improved land is becoming scarce and prices are advancing rapidly. This situation could necessitate some shift from the lower- to the medium-price ranges, although builders in nearly all sections tell us there remains a strong demand for houses selling from $10,000 to $12,000.

In this price range, a considerable volume of construction is planned for 1955 in suburban sections near Philadelphia and in the vicinity of Trenton, New Jersey. Around Reading and in the Allentown-Bethlehem area of Pennsylvania, activity is expected to be heaviest in houses selling from $13,500 to about $16,000. In suburban Wilmington, New Castle, and Newark in Delaware, more builders may be operating in the medium- to higher-price ranges this year than last.

Adequate financing is available to builders

Thus far builders have not experienced difficulty in arranging for either temporary or permanent financing on projects scheduled for 1955. Construction loans generally are available on much the same terms as prevailed last year, and commitments for mortgages on operations already under way appear to present no problems. Advance commitments covering future construction are said to be a little more difficult to arrange, and builders seem to feel that some further tightening may be expected later this year. But this situation appears to vary with the locality. There still are a few areas in this district where lenders continue to encourage builders to apply for loans on projects not yet started.

Demand for existing houses holds up

Both builders and real-estate brokers tell us the market for old houses is holding up surprisingly well in most sections. Buyer preferences lean more strongly toward suburban offerings. But there are not so many of these to choose from, so most city row houses sell fairly promptly. Prices of existing houses have continued to soften in the past year and further moderate decreases

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appear probable. The number of old houses on the market has been increasing slowly. Builders are watching this situation closely. Thus far competition with new construction has not reached noteworthy proportions and builders have not expressed serious concern over the situation.

THIRD FEDERAL RESERVE DISTRICT

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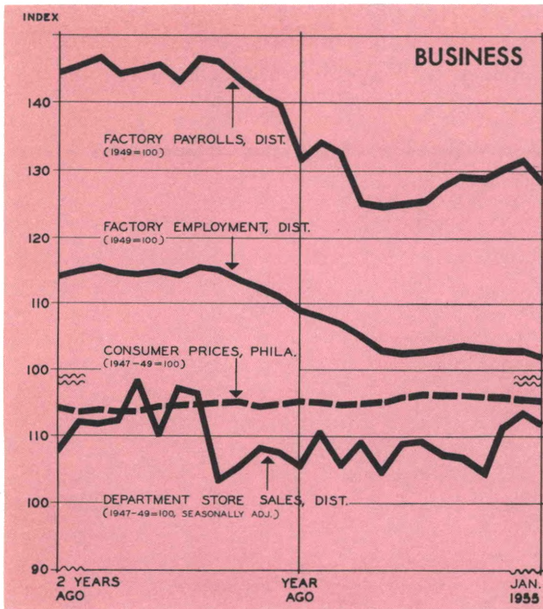
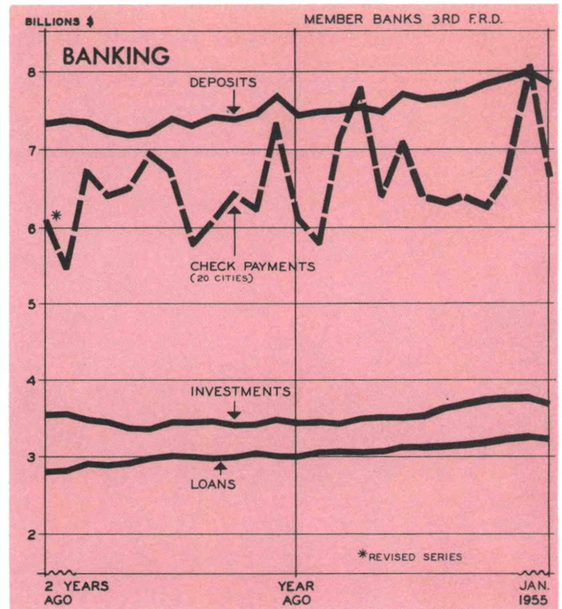
FOR THE RECORD...





SUMMARY

	Third Federal Reserve District — Per cent change			United States — Per cent change		
	January 1955 from		12 mos. 1955 from	January 1955 from		12 mos. 1955 from
	mo. ago	year ago	year ago	mo. ago	year ago	year ago
OUTPUT						
Manufacturing production	−2	−4	......	+2	+5	......
Construction contracts*	−8	+26	......	+2	+34	......
Coal mining	−6	−7	......	+3	+4	......
EMPLOYMENT AND INCOME						
Factory employment (Total)	−1	−6	......	−1	−3	......
Factory wage income	−2	−3	......	......	......	......
TRADE**						
Department store sales	−1	+5	......	+1	+10	......
Department store stocks	−2	+4	......	−1	+3	......
BANKING (All member banks)						
Deposits	−2	+5	......	−1	+6	......
Loans	−1	+7	......	−1	+6	......
Investments	−2	+7	......	0	+10	......
U.S. Govt. securities	−3	+3	......	−1	+8	......
Other	+2	+18	......	+3	+15	......
Check payments	−18†	+8†	......	−12	+6	......
PRICES						
Wholesale	......	......	......	+1	−1	......
Consumer	0‡	0‡	......	0	−1	......

*Based on 3-month moving averages.
**Adjusted for seasonal variation.
†20 Cities
‡Philadelphia

LOCAL CHANGES

	Factory* — Employment		Factory* — Payrolls		Department Store — Sales		Department Store — Stocks		Check Payments	
	Per cent change January 1955 from		Per cent change January 1955 from		Per cent change January 1955 from		Per cent change January 1955 from		Per cent change January 1955 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Allentown	−1	−7	+2	−5	......	......	......	......	−9	+17
Harrisburg	+1	−9	+3	−13	......	......	......	......	−8	+3
Lancaster	−1	−2	0	+5	−57	−4	−6	−1	−6	+11
Philadelphia	−1	−6	−2	−1	−54	+7	−3	+6	−17	+8
Reading	−1	−5	0	0	−56	+5	−4	+10	−12	+11
Scranton	−1	−4	+1	−3	−63	+3	−1	+13	−12	+9
Trenton	0	−7	0	+2	−58	+11	−8	+15	−3	+25
Wilkes-Barre	−2	−2	−5	−1	−60	+14	−1	+3	−13	+4
Wilmington	+2	−3	−2	0	−66	+6	−13	−5	−38	+5
York	−3	−10	−4	−10	−59	0	+9	+9	−5	+3

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

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