Federal Reserve Bank of Philadelphia

1968

# Business Review

May

# Philadelphia Bankers Are International Bankers

by Hugh Chairnoff

For more than a century, American bankers have engaged in international finance—that complex world where only the most sophisticated dare to tread among a wide variety of currencies and modes of conduct. In the post-World War II era American bankers have achieved pre-eminence among multi-national financial institutions just as the dollar has become the world's premier currency. Their ascendancy did not come all at once. Until the mid-fifties, most bankers were content to finance United States foreign trade. Since then, spurred by the rapid economic recovery of Western Europe and Japan, and the growing potential of Asia, Africa and Latin America, bankers have broadened their horizons considerably as the attractive opportunities in international banking and financing have become more and more apparent.

This spirit has not gone unnoticed in Philadelphia. In the postwar period, Philadelphia's bankers have woven their own growing network of worldwide financial operations. Today, Philadelphia ranks as an important center for international finance.

## INCENTIVES FOR GOING INTERNATIONAL

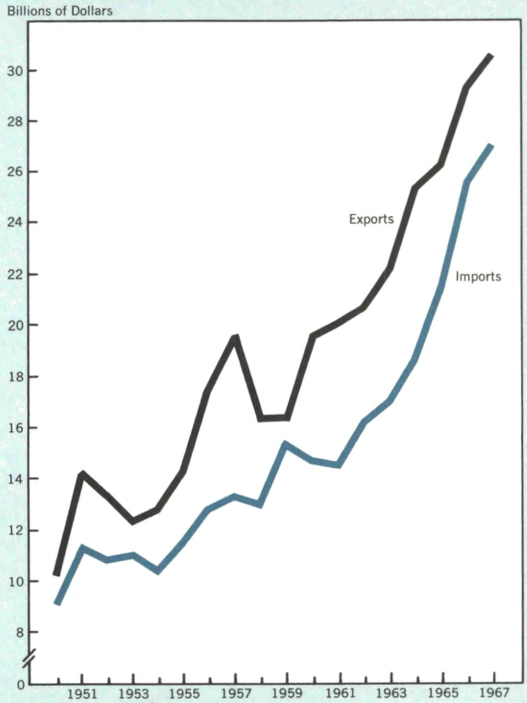
American bankers intensified their efforts in the international area for two reasons. First, many of them have come to believe that their domestic markets offer limited room for further significant growth. Expansion and development of domestic markets also have been hampered by legal restrictions on branching and merger activity. In contrast, international markets appear relatively unsaturated, though very competitive, and restrictions on overseas banking and financial activities had been relaxed over the years until the advent of foreign credit restraint programs.

### Expanding demand for international services

A second reason for going international is the seemingly limitless demand for international

**Chart 1**

**UNITED STATES MERCHANDISE EXPORTS AND IMPORTS**




Source: Department of Commerce.

**BUSINESS REVIEW** is produced in the Department of Research. Evan B. Alderfer is Editorial Consultant; Donald R. Hulmes prepared the layout and artwork. The authors will be glad to receive comments on their articles.

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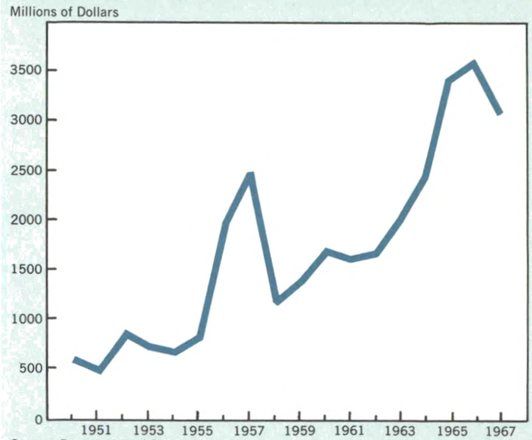
banking and financial services. U.S. exports in 1967 amounted to $31 billion while imports totaled $29 billion (See Chart 1). Private American investment abroad has been growing at an annual rate of 9.9 per cent since 1950—the cumulative investment exceeding $86 billion by the end of 1966 (See Chart 2). Moreover, overseas investment no longer is the exclusive domain of corporate giants. Medium- and small-sized businesses are finding attractive investment opportunities abroad, so that the number of customers for international financial services has increased sharply.

As international activities of American business continue to grow in intensity and scope, demand for financial services broadens. American businessmen are accustomed to the wide range of sophisticated financial services here in the United States. Such financial services, desirable for international activities as well, are not always readily available from foreign banking and financing institutions. Overseas operations require businessmen to operate among unfamiliar currencies and modes of conduct. Establishing financial policy and managing the flow of funds in an international operation are more complex tasks abroad than they are domestically.

Often, overseas money and capital markets do not approach the efficiency and diversity American businessmen take for granted in the United States. Businessmen tend to be apprehensive about mobilizing funds from overseas sources and apprehension has intensified with the installation of voluntary and involuntary credit controls. Availability of specialized types of financing or outlets for temporarily surplus funds may be less certain and more risky than in the United States. Familiar banking contacts may be useful in overcoming inadequacies of foreign markets. Foreign businessmen also have found that American banks often are able to provide financial services more quickly and efficiently.

**Chart 2**

UNITED STATES DIRECT PRIVATE INVESTMENT ABROAD




Source: Department of Commerce.

Finally, American businessmen are less familiar with prevailing economic conditions abroad. An international financial institution can provide economic intelligence to its customers in order to help reduce uncertainties associated with initiating or expanding overseas operations.

Thus, opportunities for international banking are as varied as they are complex. International financial institutions have become a necessary adjunct to the successful development of multinational business operations.

## ALTERNATIVE INTERNATIONAL ORGANIZATIONS

As American bankers have developed their international activities, their objectives have shifted as well as broadened. To accomplish their objectives a range of alternative forms of organization now is available.

The route which a banker will select in putting together an international financial organization depends on the skills and resources available to him, the nature and extent of services his customers may require, and relative profit opportunities.

Some of the alternatives currently available may be substitutes for one another. That is, a banker may choose one or the other but not both, because they essentially serve the same purposes. Others of the alternatives may complement one another, permitting a banker to satisfy objectives that other alternatives may not fulfill. None of them, however, are really mutually exclusive. So. the international structure of an American bank as it appears today reflects, in part, the stage of development of its international activities.

The simplest and most easily attainable route to international banking and finance is the *correspondent relationship* with a foreign bank. This vehicle permits an American banker to offer his customers almost immediate access to foreign banking services as well as permits him to participate in international lending transactions. At the end of June, 1967, Federal Reserve System member banks maintained working balances and so-called "link" deposits with foreign banks in excess of $200 million—up from more than $142 million in 1961 and $65 million back in 1956. Bankers throughout the country have been increasing their foreign working balances at an annual rate of more than 12 per cent over the past eleven years. And demand deposits of foreign banks in the United States totaled $1.5 billion at the end of June, 1967 or over 7 times the amount American banks have on deposit overseas. However, the correspondent relationship often does not permit the American banker to acquire a profitable stake in financing overseas loans.

*Overseas representative offices* do not transact deposit or loan business, but serve as agents for the parent bank in arranging services for customers from correspondents and negotiating participations in loans of foreign correspondents. They are used to complement the foreign correspondent network and to induce foreign businessmen and bankers to use the facilities of the parent bank when transacting business in the United States.

An American banker can enlarge his stake in financing international business operations by acquiring a minority interest in a foreign bank. Through the *affiliate bank,* international services may be more closely identified with the American bank. Potential profitability of international activity is enhanced because of increased flexibility. Also advantageous is the fact that a modest investment provides an influential stake in an existing institution.

Another way to assemble an international organization is the establishment of an *Edge Act* or "*agreement*" corporation. Organized under Section 25(a) of the Federal Reserve Act, these corporations have great flexibility in engaging in international banking and financing activities. Edge Act corporations may make equity investments in foreign banks and other types of foreign financial organizations. In addition, Edge Act corporations can establish branches overseas as well as establish headquarters in major international financial centers such as New York City. Their investment subsidiaries can make medium- and long-term credit available to businesses overseas as well as acquire an equity interest in the corporation being financed.

The most direct means of establishing an international banking organization is the *overseas branch office*. This vehicle permits the parent bank to conduct deposit and loan functions overseas under its own name. The rapid development of the Euro-dollar market, a pool of U.S. dollars deposited with banks outside of the United States including overseas branches of American banks, has provided the branch office route with further stimulus for growth. By attracting Euro-dollars, the branch acquires deposits that are not subject to Federal Reserve-imposed reserve requirements, but occasionally may be transmitted home to the parent bank for its use. The voluntary credit restraint program has increased the importance of branch offices overseas because the branch, unlike the parent bank, is not subject to the program. Thus, customers needing credit for overseas operations can be serviced through the parent's branch.

## INTERNATIONAL FINANCE IS BOOMING IN PHILADELPHIA

Until the postwar period international financial activities of American bankers were concentrated mainly in New York City, although banks in Philadelphia and Boston historically have provided specialized types of international services to a few industries. Elsewhere bankers seemed to feel that customer demand was insufficient and/or that their resources were inadequate to justify a major diversification from traditional banking functions. But the lure of rapidly growing opportunities during the 1960's induced many bankers to initiate international financial operations.

Philadelphia bankers were rather quick to develop international financial operations once opportunities seemed attractive and the need to explore new markets became apparent. Though still in the development stage, overseas loans of Philadelphia banks now rank fourth in the nation.

### Lending overseas

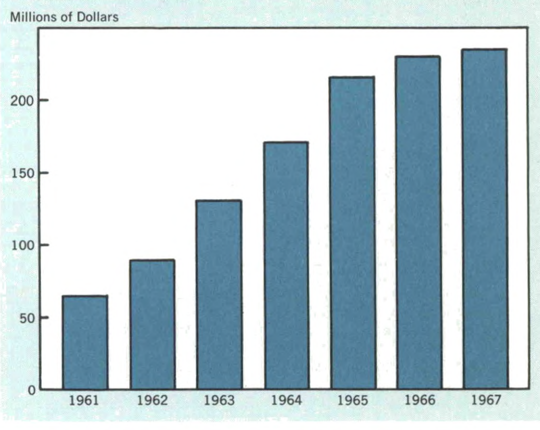
Since 1956, overseas loans made directly by Philadelphia bankers or through their Edge Act corporations have grown from less than $25 million to well over $200 million in 1967, an annual growth rate of 23 per cent. Elsewhere in the nation, these overseas loans increased from a very large base at an annual rate of 14.5 per cent during the same period. And from 1956 through 1965, overseas branches of national banks (accounting for over 90 per cent of all overseas branches and about three-fourths of the loans of all overseas branches) increased their loans at an annual rate of 21 per cent.[1] Thus, Philadelphia bankers have been able to expand their loan portfolio slightly faster than the overall growth of the market.

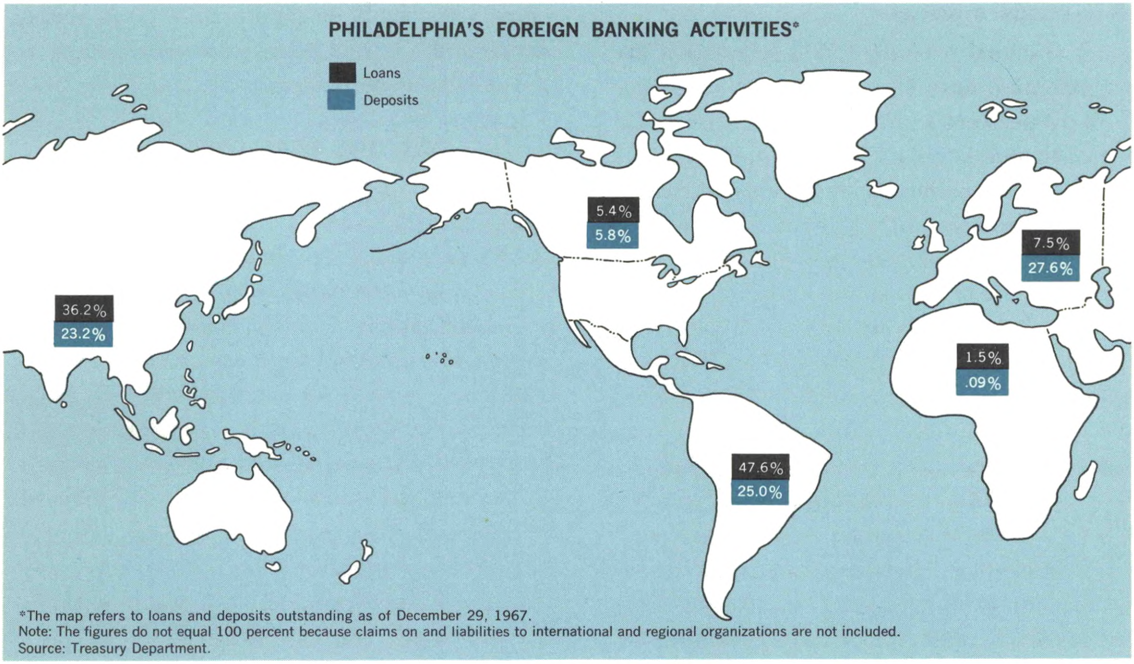
Overseas loans of Philadelphia banks had been accelerating in growth during the first half of the 1960's. From 1956 to 1961, they increased at an annual rate of 21 per cent. Since 1961, these loans have grown at an annual rate of 25 per cent. But Philadelphia banks had been expanding their overseas loans at annual rates in excess of 40 per cent during the early 1960's. In 1966 and

[1] *It is difficult to assemble complete data on international lending activities for two reasons. First, most of the information gathered is for the Voluntary Foreign Credit Restraint Program or for the Balance of Payments statistics. For these reports, foreign branches of American banks or foreign branches of their Edge Act corporations are treated as foreigners. Second, information gathered for supervisory purposes cannot be used in detail because the relatively small number of banks directly engaged in international banking presents disclosure problems. Also excluded are credits extended by foreign banks affiliated with an American bank, participations by foreign banks in loans initiated by American banks and link-type loans wherein an American banker places a deposit with a foreign bank in return for which the foreign bank makes a loan to an overseas business firm.*

**Chart 3**

PHILADELPHIA BANKS' TOTAL CLAIMS ON FOREIGNERS






1967, however, increases were limited to 8 per cent and 2.6 per cent, respectively, as the Voluntary Foreign Credit Restraint Program took its toll (See Chart 3).

Though Philadelphia bankers have preferred to make the traditional short-term type of bank loan overseas, long-term credits are far from insignificant. At the end of 1967, one-third of the overseas credits outstanding was of the long-term variety (maturity date more than one year from the date of the loan). Part of the attraction to long-term credits is the fact that Edge Act corporations are permitted to acquire equity interests in borrowers when they arise out of loan transactions. These "incentive" type loans offer enhanced profitability potential.

Short-term credits of Philadelphia bankers mainly are of two varieties. Loans to banks, official institutions, and others, account for more than half of the credits outstanding at the end of 1967 while about 42 per cent are acceptances, including dollar exchange acceptances, made for the account of foreigners. Most acceptances are essentially loans arising out of the purchase of merchandise for which an American bank substitutes its credit for the credit of the foreign business firm or its foreign bank. Because they are marketable instruments, bankers acceptances are an important source of portfolio liquidity that permit banks to minimize their non-earning cash reserves.

Philadelphia bankers have shown some preference for lending in lesser-developed parts of the world. The accompanying map shows that almost half of their total credits are to Latin America. Another 35 per cent are to Asia, though three-fourths of these credits are to Japan. Europe accounts for just 7.5 per cent of Philadelphia bankers overseas credits, Canada for 5.4 per cent, and Africa accounts for only 1.5 per cent.

### Raising funds overseas

Since 1956, total overseas liabilities, mainly deposit liabilities, have been growing at an annual rate of 20 per cent at Philadelphia banks, while the growth rate is only 7.5 per cent for bankers elsewhere in the nation. However, total liabilities of overseas branches of all national banks have increased about 20 per cent annually also.

Europe is the most important source of funds, providing almost 28 per cent of the total outstanding at the end of 1967. Latin America is a very close second, providing one-fourth of the total, while slightly more than 23 per cent of the total funds raised came from Asia, mainly Japan.

Of the liabilities outstanding at the end of 1967, about one-third was of the long-term variety. While about half of the funds raised in the major debtor areas of Latin America and Asia were long-term, funds raised in Europe, Canada, and Japan were strictly of a short-term nature. Philadelphia bankers have come to be major users of the Euro-dollar market, mobilizing these funds for extending credits throughout the world, including the United States. In fact, funds raised abroad by American banks exceeded credits made overseas by about two and one-half times at the end of 1967. In Philadelphia, total funds raised outside of the United States were almost equal to total credits made overseas.

## AND THE BEAT GOES ON

While other financial centers—especially New York—retain a commanding lead, Philadelphia bankers have made significant strides in raising Philadelphia to the position of an important center for international financial activity. Opportunities, however, are far from exhausted and their work is far from complete. They recently have begun major efforts to initiate or acquire overseas branches and affiliates that will permit them to raise and lend funds without potential harm to our international balance of payments. In this way, Philadelphia may be able to resume the very rapid growth of the pre-foreign credit restraint days in order to continue to raise their position among a fraternity that currently lends an estimated $15 billion overseas. With overseas branches under the banner of the parent bank or its Edge Act subsidiaries, Philadelphia bankers are continuing to build an international organization that offers complete and competitive services to the international business community.

*Philadelphia's stature as a center for corporate headquarters has been discussed in previous articles of the* Business Review. *They noted the relative slippage in the region's headquarters activity and the role that mergers played in this decline. Now we present a first attempt to determine the extent that other economic and social factors are related to Philadelphia's standing as a center of corporate headquarters.*

# Where Corporate Headquarters Feel at Home

**by Elizabeth P. Deutermann**[1]

Headquarters of corporations are most heavily concentrated in the same communities where other economic activity is concentrated. In other words, bigness tends to beget bigness—including corporate headquarters business.

It is obvious that metropolitan areas with more manufacturing plants, more population, and more employment house more corporate offices than do smaller towns. It also is apparent that many other social and economic factors are related to the location of headquarters. Which of these characteristics can we identify as having a strong relationship to large headquarters centers? Furthermore, do they prevail in Philadelphia?

This first attempt to answer these questions can only scratch the statistical surface. Nevertheless, it is valuable to look at what an initial cut of available data shows about a very complicated set of influences, cross-influences, and effects of random events.

**LET THE BUYER BEWARE**

Constrained by available data, we emphasize that because only the nation's ten largest metropolitan areas, in terms of population, were studied, many of the discrete community characteristics examined here measure, in part, the same features as others. This is especially true of the importance of the size of the area. Technically, we are clearly faced with a statistical problem of collinearity.

In addition, the measures of rank correlation, on which most of the discussion in the article is based, do not imply causation, as is true of any correlation analysis. Despite these limitations, the relationships, if carefully interpreted, throw some light on factors relevant to the location of corporate headquarters. For explanation of methodology employed in this study, see the Appendix to this article.

## Community characteristics and headquarters concentration

For the ten largest metropolitan areas in the country, a strong relationship exists between the number of manufacturing plants in operation and total number of headquarters with $1 million net worth or more. This can be seen in Chart 1. These metropolitan areas are ranked in descending order according to the number of companies headquartered in each area. They are similarly ranked by the number of manufacturing plants in operation. The closer the dots on the chart cluster around the diagonal line, the stronger is the relationship. This is of interest, particularly, because of the apparent association between plant size and number of headquarters in a region. For example, regions which rank highest as corporate headquarters centers also rank highest in number of small manufacturing plants. As communities

[1] *The author expresses appreciation to Henry R. Hertzfeld for the statistical undertaking on which many of the conclusions of this article are based.*

tend to become bastions of large manufacturing plants it appears that their prominence as headquarters centers drops. Chart 2, with the dots farther from the line, compared with Chart 3 illustrates this point.

Such probing suggests that areas which are prolific in giving birth to new manufacturing firms generate their own clusters of new headquarters. And as plants grow very large, with over 1,000 employees, the more likely it is that the headquarters of such firms will be housed outside the plant itself and even outside the region where manufacturing operations are performed.

Employment in service industries is next in importance, behind the number of manufacturing plants, in relationship to strong headquarters centers. That is, the more a community employs its labor force in wholesale and retail trade, transportation, public utilities, and in finance, insurance and real estate—in that order—the more one would expect the region to rank high as a headquarters center. One of the prime reasons often cited for the locational choice of a corporate

**Chart 2**

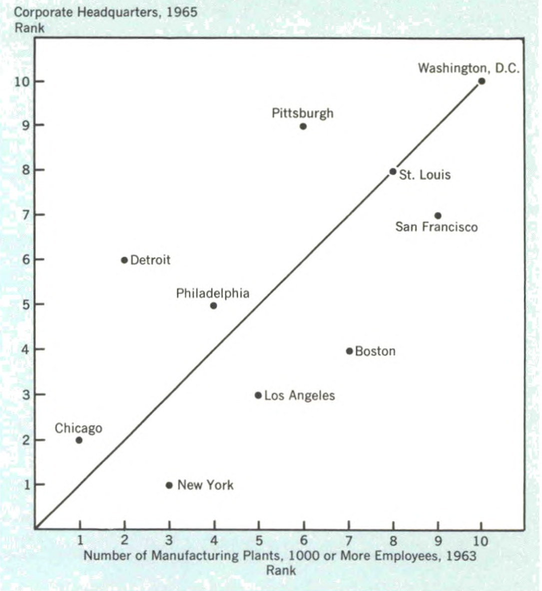



**Chart 1**

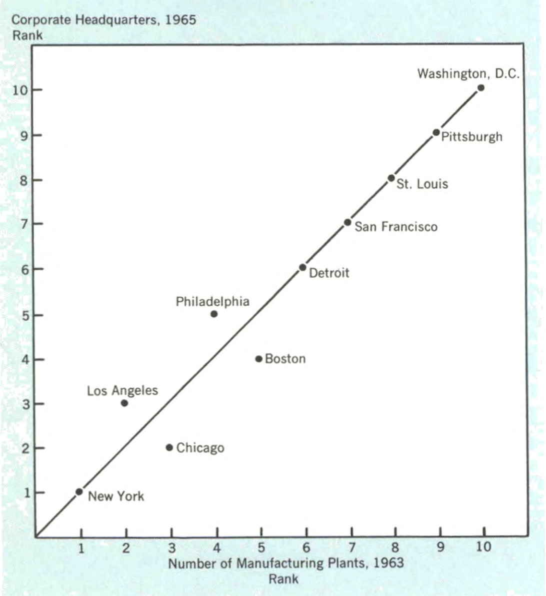
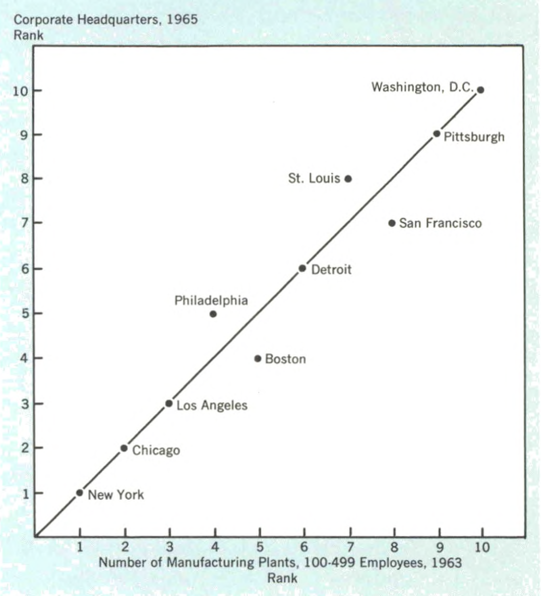



**Chart 3**



office is the ease of communication both with other corporate decision makers and with service personnel required by the head office. This claim appears to have merit.

Other factors which loom relevant to the concentration of large numbers of corporate headquarters in a region, in descending order of importance, are: opportunities for higher education, a heavy volume of research and development activity, local bank resources, and the presence of some of the nation's largest corporate headquarters.

Another factor, ranking in importance just below college personnel, merits special mention. That is the distance a community is from the country's three largest headquarters centers—New York, Chicago, and Los Angeles. Apparently, the closer any other city is to one of these three areas, the more headquarters it has.

In pointing out the above relationships between certain economic and geographic characteristics and the presence of large numbers of corporate headquarters, we should keep in mind that these associations do not imply cause and effect. For example, the prior existence of a great many headquarters in a region may stimulate growth of business services. Conversely, a community which can provide many business services may induce growth of corporate headquarters. Nevertheless, the previous discussion indicates which characteristics are more strongly associated with the location of a great many corporate offices in a region than others.

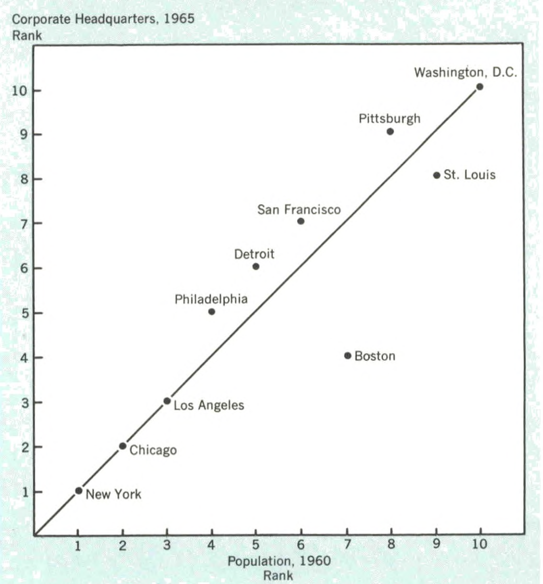
## Philadelphia's assets

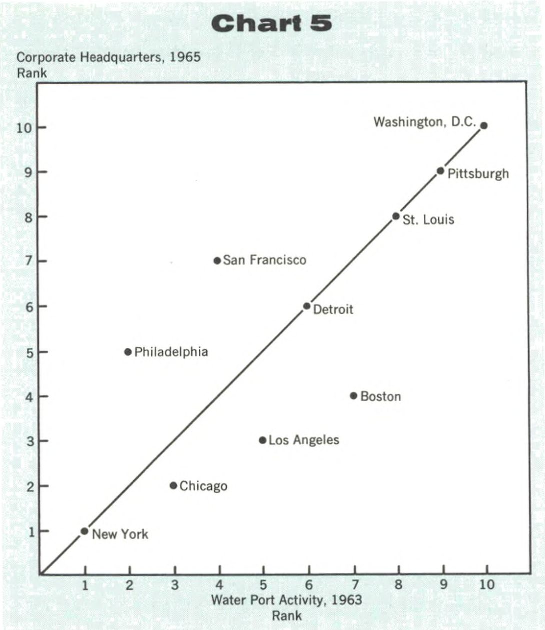
By any type of "fair share" expectation, one would look for Philadelphia to rank fourth instead of fifth in the nation as a haven for corporate offices. Nonetheless, fifth is high and indicates a strong headquarters base on which to build.

What underlies this strength? What community characteristics appear to buttress Philadelphia's fifth-place position? Sheer size of the metropolitan area is undoubtedly an asset. In 1950, 1960, and 1965 this region ranked fourth in population in the nation. Chart 4 illustrates the close relationship between the concentration of headquarters and residential population.

Similarly, the large number of manufacturing plants in Philadelphia seems to contribute to the presence of a substantial number of corporate headquarters. Furthermore, the area ranks comparatively higher in the number of small plants, with less than 500 employees, than it does in headquarters. The fact that this region does rank higher in small plants, which tend to house their own headquarters activities in the plant, than in its over-all headquarters position suggests that the existence of a great many small, and perhaps younger, manufacturing establishments help Philadelphia hold on to its fifth-place position as

**Chart 4**






a headquarters center.

Availability of skilled personnel in service industries, also, looms large as an inducement for existing headquarters to remain here as well as for headquarters on the move to find Philadelphia an attractive location. For example, this region stands higher in employees working as secretaries and accountants than it does in the number of corporations headquartered here. The case is the same with employees in transportation, utilities, trade, finance, insurance, real estate, and other services. This points to a strong white-collar region which should help bolster Philadelphia's headquarters standing.

Similarly, Philadelphia's proximity to New York appears to be beneficial with respect to the location of home offices. As mentioned, major metropolitan areas closest to the nation's three largest headquarters centers are themselves prone to be headquarters heavyweights. Among the largest population centers in the nation, Philadelphia ranks first in geographical proximity to the top headquarters city. Therefore, Philadelphia's short haul to New York appears to contribute to the region's home-office strength.

Another factor sustaining this area's headquarters position is its high level of port activity. As seen in Chart 5, Philadelphia's second-place rank suggests that the port may act as a positive force in maintaining the region's home-office stature.

One further asset cannot be overlooked. Philadelphia already is home for a substantial number of the nation's major corporate headquarters. The area ranks third among all metropolitan areas in the country as a headquarters center for giant corporations.[2] Our evidence tends to support the contention that a company's top personnel prefer to work and live in areas where large corporate headquarters abound.

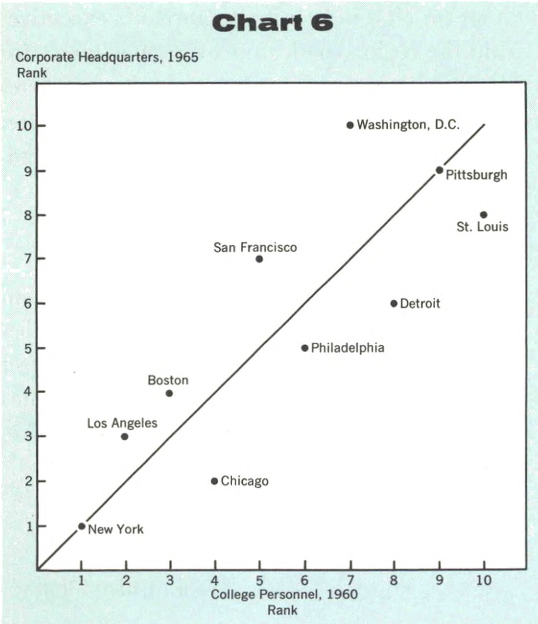
### A lag still exists

In spite of the fact that Philadelphia has numerous characteristics working in the region's favor as a headquarters metropolis, it still does not quite rank up to expectations. What identifiable factors appear to pull this region down to fifth place as a headquarters mecca?

One observed factor is the region's position as a center for higher education. For the ten largest cities in the country, the location of corporate headquarters and of colleges and universities go hand in hand. This can be seen in Chart 6. However, of the nation's ten largest metropolitan areas, Philadelphia ranks sixth in college and university personnel. This suggests that a larger community of scholars could enhance the region's headquarters position.

A larger banking center, likewise, could give a

[2] *These are the nation's 750 largest industrial and nonindustrial corporations enumerated by* Fortune *magazine.*




lift to headquarters growth. The Philadelphia region's sixth rank, among the big ten cities, in terms of bank deposits is below what one would expect. The expectation is based on the region's higher standing in the majority of other measures of city size previously discussed. Of course, the strength of the banking community may be enhanced by the strength of its headquarters activity. Nevertheless, Philadelphia's bank power ranks below its headquarters power.

Finally, we come to the "short fall" in Philadelphia's research and development enterprise. This region ranks only seventh, out of the ten regions, in research and development establishments. Undoubtedly, a chicken-and-egg problem is involved here. That is, people making decisions about where to locate corporate headquarters prefer to locate their R & D facilities close to the home office. So the prior existence of large numbers of headquarters should stimulate new R & D plants. On the other hand, R & D establishments are a breeding ground for many new companies which, by birth, automatically add headquarters to the region. In a community, such as Philadelphia, where R & D lags behind headquarters, it seems plausible that more research and development activity could generate more home-office growth.

## Conclusions

Based on measurable available information, the most important factor in the location of corporate headquarters is the size of the region. Nonetheless, other community characteristics are strongly related to the presence of a large number of home offices in a region. In Philadelphia, the overwhelming bulk of these factors appears to work to the area's advantage. Only three stand out as not working in its favor. Fortunately, changes in these three characteristics—available higher education, resources of the banking community, and the volume of research and development enterprise—all lend themselves to concerted local action. Significantly, efforts to stimulate growth of these activities are already high-priority items for Philadelphia's business and civic leadership, with action programs under way.

In spite of the results of the statistical capsule presented above, it remains highly probable that factors other than readily measurable ones are at work to inhibit Philadelphia's headquarters growth. On the one hand, concentration of headquarters in Philadelphia may be primarily due to internal company operations over which the community at large has little influence. This may not be all of the story, however. In many cases corporate decision-making may well be swayed by action of Philadelphia civic leadership. Urban renewal, for example, can permit existing headquarters to grow and expand at site. The same process may stimulate construction of prime office space sought by corporate top management.

Action of the Old Philadelphia Development Corporation to develop Independence Mall as a prestige office location could well result in a stimulating headquarters environment. Similarily, Operation Native Son, conceived and operated by the Greater Philadelphia Chamber of Commerce, may prove vital in keeping tomorrow's executives within the region, both to provide new talent for existing headquarters and to launch new firms in the region. The last is probably the easiest route for Philadelphia to follow to raise its headquarters position.

## APPENDIX

The statistical method employed in this study is one of rank correlation. It is a method of comparing the relationship between two sets of data. To determine which community characteristics are associated with the presence of headquarters in a region. to a degree not attributed solely to chance, a coefficient of rank correlation was computed. The value of the coefficient can vary between +1 (perfect relationship) and −1 (perfect inverse relationship). A value of zero indicates no relationship at all, with increasingly strong relationships as the figures approach +1 or −1.

| Characteristic | Coefficient of Rank Correlation |
|---|---|
| S.M.S.A. number of manufacturing plants, total, 1963 | .976 |
| S.M.S.A. number of manufacturing plants, 100-499 employees, 1963 | .976 |
| S.M.S.A. number of manufacturing plants, 250-499 employees, 1963 | .964 |
| S.M.S.A. population, 1950 | .952 |
| S.M.S.A. employment, total, 1965 | .927 |
| S.M.S.A. employment, wholesale and retail, 1965 | .927 |
| S.M.S.A. employment, total, 1960 | .927 |
| S.M.S.A. population, 1940 | .927 |
| S.M.S.A. employment, transportation and public utilities, 1965 | .915 |
| S.M.S.A. population, 1960 | .915 |
| S.M.S.A. number of manufacturing plants, 500 or more employees, 1963 | .903 |
| S.M.S.A. employment, finance, insurance and real estate, 1965 | .903 |
| S.M.S.A. population, 1965 | .879 |
| S.M.S.A. aggregate income, 1960 | .867 |
| S.M.S.A. service employment, total, 1965 | .855 |
| S.M.S.A. manufacturing employment, 1965 | .842 |
| S.M.S.A. college personnel, 1960 | .830 |
| Distance from New York, Chicago and Los Angeles | .830 |
| Water port tonnage, 1963 | .806 |
| S.M.S.A. accountants, 1960 | .794 |
| S.M.S.A. research and development establishments, 1963 | .770 |
| S.M.S.A. secretarial employment, 1960 | .758 |
| S.M.S.A. number of manufacturing plants, 1,000 or more employees, 1963 | .709 |
| S.M.S.A. bank deposits, 1966 | .697 |
| S.M.S.A. number of giant corporate headquarters, 1965, identified by **Fortune** magazine | .684 |

To calculate the coefficient, two sets of data are arranged in order and numbered. In this study, for example, the concentration of corporate headquarters was measured by the absolute number of headquarters in each of ten metropolitan areas in 1965. These regions were then arranged in order, with the largest concentration of headquarters in the first city and decending to the smallest concentration in the tenth city. This variable—concentration of corporate headquarters—was then separately compared with the rankings of each of many other variables that were considered even possibly relevant to the problem.

The coefficients of rank correlation can be tested for statistical significance. For a sample of ten observations, the coefficient must be greater than .650 to be significant at the 95 per cent level. Significance means that the degree of correlation observed in our limited number of cases is high enough to expect it would also exist in repeated trials.

This test of significance made it possible to identify important characteristics present in communities which tend to be large headquarters centers. Using this test, we are able to say that all of the characteristics discussed in this article are related to the location of corporate headquarters to a greater degree than would be expected on the basis of chance.

Of the 73 characteristics present in the ten largest metropolitan areas which were tested for their relationship to corporate headquarters, 25 are tabulated below. The listing is determined by two factors. They are that each coefficient of rank correlation is statistically significant, and, based on judgment, the independent variable is considered relevant to the presence of large numbers of corporate headquarters.

For 43 years the Federal Reserve Bank of Philadelphia has published an annual summary of earnings and expense ratios of Third District member banks. The most recent summary was published in April and contains ratios reflecting some of the results of bank operations in 1967.

# A Report on Bank Earnings†

While growing in absolute terms, net current earnings* of Third Distrct member banks declined in relation to capital accounts, to total assets, and to total revenues as shown in the table. These three ratios serve as approximate indexes, respectively, of return on equity investment, efficiency in use of assets, and the profit margin.**

| RATIO | 1966 | 1967 |
|---|---|---|
| Net current earnings to total capital accounts | 13.3% | 12.6% |
| Net current earnings to total assets | 1.22% | 1.14% |
| Net current earnings to total operating revenue | 24.0% | 22.0% |

**Behind the ratios**

Total operating revenue increased in 1967 as bankers increased earning assets, changed the asset distribution, and enjoyed higher gross yields on loans and investments. The shift of funds out of the more liquid, lower-yielding

*†Charles D. Soule, Technical Assistant, Bank Relations and Services Department.*

** Comparisons made on the basis of net current earnings do not reflect either capital gains and losses or the effects of income taxes.*

*** Ratios used in this report are unweighted averages of individual bank ratios.*

assets (cash and U.S. Government securities) and into less liquid but higher-yielding assets such as loans and tax-exempt securities is shown in the following table.

| Percentage of Total Assets | 1966 | 1967 |
|---|---|---|
| U.S. Government securities | 21.9% | 19.3% |
| Other securities | 13.2% | 14.0% |
| Loans | 52.2% | 54.2% |
| Cash assets | 11.3% | 10.9% |
| Real estate assets | 1.4% | 1.4% |
| Other assets | .2% | .2% |
| Total | 100.0% | 100.0% |

Gross yields on each major type of portfolio asset also rose:

| | 1966 | 1967 |
|---|---|---|
| Yield on U.S. Government securities | 3.95% | 4.27% |
| Yield on other securities | 3.42% | 3.54% |
| Yield on loans | 6.49% | 6.54% |

The average ratio of total operating revenue to total assets of 5.19 per cent last year compared with 5.06 per cent in 1966. Larger banks had significantly higher ratio values than smaller banks. (See table in next column.)

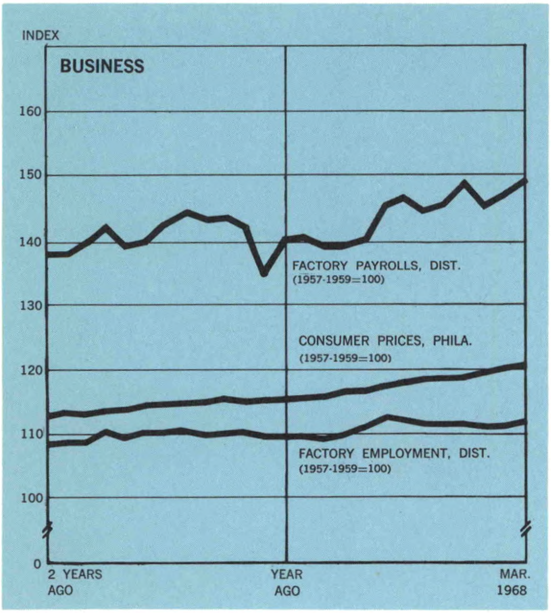
Operating expenses grew more rapidly than did operating revenues in 1967. This is reflected by an increase in the ratio of operating expenses to operating revenue from 76.0 per cent in 1966 to 78.0 per cent last year.

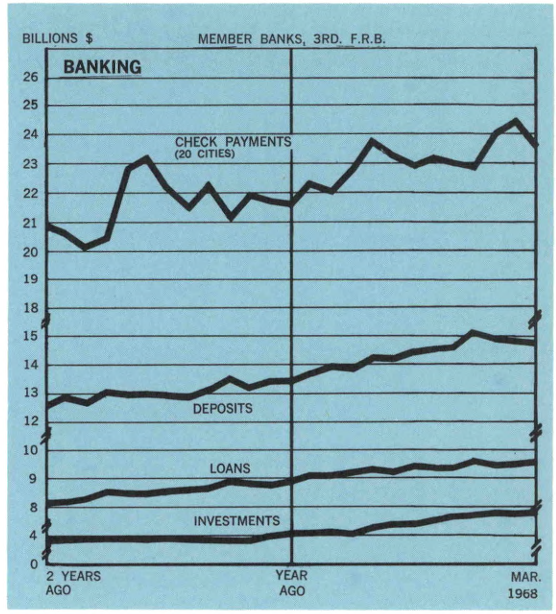
| Deposit Size | Ratio of Total Operating Revenue To Total Assets |
|---|---|
| $2,000,000 and less | 4.87% |
| $2,000,001 to $5,000,000 | 5.10% |
| $5,000,001 to $10,000,000 | 5.13% |
| $10,000,001 to $20,000,000 | 5.20% |
| $20,000,001 to $100,000,000 | 5.32% |
| Over $100,000,000 | 5.43% |

The increase in operating expenses was caused primarily by an increase in the amount of interest paid on time deposits. In 1966, interest on time deposits absorbed 36.3 cents out of each dollar of revenue, while in 1967, 38.8 cents of each revenue dollar went toward time deposit interest. Interest expense rose because the proportion of time deposits to total deposits increased from 60.0 per cent in 1966 to 61.7 per cent in 1967, and because the effective average interest rate paid on time deposits increased from 3.39 per cent in 1966 to 3.63 per cent last year.

In summary, the general trend toward higher interest rates in many sectors of the economy during 1967 seems to have had a noticeable effect on member bank earnings in the Third Federal Reserve District. Although banks enjoyed somewhat higher yields on their loan and investment portfolios in 1967 than in the previous year, they also experienced an increase in the amount of interest they had to pay in order to acquire and to hold time deposits.

# FOR THE RECORD . . .




## SUMMARY

| | Third Federal Reserve District — Per cent change: March 1968 from mo. ago | March 1968 from year ago | 3 mos. 1968 from year ago | United States — Per cent change: March 1968 from mo. ago | March 1968 from year ago | 3 mos. 1968 from year ago |
|---|---|---|---|---|---|---|
| **MANUFACTURING** | | | | | | |
| Production | ........ | ........ | ........ | + 1 | + 4 | + 3 |
| Electric power consumed | + 3 | + 8 | + 9 | ........ | ........ | ........ |
| Man-hours, total* | + 1 | + 1 | + 1 | ........ | ........ | ........ |
| Employment, total | 0 | + 2 | + 2 | ........ | ........ | ........ |
| Wage income* | + 1 | + 6 | + 6 | ........ | ........ | ........ |
| CONSTRUCTION** | +60 | +33 | +24 | +46 | +22 | +22 |
| COAL PRODUCTION | +12 | +15 | − 3 | + 9 | + 9 | 0 |
| **BANKING** | | | | | | |
| (All member banks) | | | | | | |
| Deposits | − 1 | + 9 | +11 | − 1 | + 9 | +11 |
| Loans | + 1 | + 8 | + 8 | 0 | + 7 | + 8 |
| Investments | 0 | +17 | +20 | − 1 | +13 | +16 |
| U.S. Govt. securities | − 2 | + 8 | +12 | − 4 | + 5 | + 9 |
| Other | + 3 | +27 | +29 | + 2 | +21 | +23 |
| Check payments*** | − 3† | + 9† | +11† | − 1 | +14 | +15 |
| **PRICES** | | | | | | |
| Wholesale | ........ | ........ | ........ | 0 | + 2 | + 2 |
| Consumer | 0‡ | + 5‡ | + 4‡ | 0 | + 4 | + 4 |

*Production workers only
**Value of contracts
***Adjusted for seasonal variation

†15 SMSA's
‡Philadelphia

## LOCAL CHANGES

| Standard Metropolitan Statistical Areas* | Manufacturing — Employment: Per cent change March 1968 from mo. ago | year ago | Manufacturing — Payrolls: Per cent change March 1968 from mo. ago | year ago | Banking — Check Payments**: Per cent change March 1968 from mo. ago | year ago | Banking — Total Deposits***: Per cent change March 1968 from mo. ago | year ago |
|---|---|---|---|---|---|---|---|---|
| Wilmington | − 1 | − 2 | + 3 | + 4 | − 4 | +32 | + 1 | + 9 |
| Atlantic City | ........ | ........ | ........ | ........ | + 8 | +15 | 0 | 0 |
| Trenton | − 1 | 0 | −16 | + 6 | −12 | + 4 | − 3 | + 9 |
| Altoona | − 1 | + 3 | + 1 | +14 | − 8 | + 4 | − 1 | + 7 |
| Harrisburg | 0 | 0 | − 1 | + 5 | − 6 | + 1 | + 1 | +12 |
| Johnstown | + 1 | − 2 | + 2 | − 4 | + 7 | +13 | + 1 | + 8 |
| Lancaster | 0 | 0 | + 1 | + 5 | − 1 | + 6 | + 1 | + 7 |
| Lehigh Valley | 0 | 0 | 0 | + 4 | + 7 | +14 | + 2 | +12 |
| Philadelphia | 0 | − 1 | + 1 | + 4 | − 4 | + 5 | − 2 | +10 |
| Reading | 0 | + 1 | + 2 | +12 | + 1 | +16 | −22 | −26 |
| Scranton | 0 | − 1 | 0 | +10 | − 6 | +13 | − 1 | +13 |
| Wilkes-Barre | + 1 | + 2 | + 1 | +10 | + 4 | + 7 | 0 | +13 |
| York | + 1 | 0 | + 1 | + 6 | − 1 | + 9 | 0 | + 5 |

*Not restricted to corporate limits of cities but covers areas of one or more counties.
**All commercial banks. Adjusted for seasonal variation.
***Member banks only. Last Wednesday of the month.