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Address by R. A. Young  
Governor, Federal Reserve Board  
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BANKING CONCENTRATION

I am very happy to be here once more and to have the opportunity of discussing with you some of the developments in banking that have occurred in recent years, largely since the time I left for Washington in the autumn of 1927. The bankers of this State, a fraternity of which I shall always consider myself a member, have an unusual interest in these developments because they have been leaders in the movement to keep our banking system adjusted to the rapid changes occurring in economic and social conditions of the country. My work in Washington has given me the occasion to survey these matters from a national point of view, and I have watched the developments with keen interest and often with great admiration for the courage, skill, and rapidity with which a transformation of our banking structure has been managed.

In the financial history of this country, public policy has seldom confronted a more important parting of the ways. The decision made at this time, the route we choose to follow from hereon, will have the utmost importance for the whole commercial fabric. The smooth flow of credit and of banking service is the delicate nervous system of business, and nothing can be more important than that this machinery be kept perfectly attuned to the commercial and industrial organization which it serves.

I am confident, therefore, that much profit will result if we study the tendencies of our banking system dispassionately with an open mind and with no fixed ideas or prejudices. The Federal reserve system is trying to do just that, and in pursuit of this policy has set up a committee which is studying the whole field of group, chain, and branch banking developments. We hope that the committee's report will throw light on many perplexing matters.

The Congress of the United States is also investigating these conditions;

the Banking and Currency Committee of the House of Representatives has been holding hearings for some months on the subject and has already gathered a large body of useful information to which some of your most respected bankers of the Ninth Federal Reserve District have made important contributions. The Senate Committee also has plans for hearings.

At the outset of a discussion concerning the shifting forms of banking organization, one is prone to ask what forces are bringing them about. Two causes stand out as the most important factors: on the one hand - the large volume of bank failures that has occurred in recent years, and, on the other hand, changes in economic and social conditions, which have made a readjustment of banking organization and practice inevitable.

This country of great distances, altered in the course of a few hundred years from virgin resources to a high state of civilization and complexity of industrial organization, has flourished under a system of unit banks. Unit banking has been the natural complement of the individual initiative and enterprise which has so rapidly brought the United States to the first rank of economic powers. I cannot say too much concerning my respect for the contributions of the unit banker to this development. All my sympathies are with him. As you know, I have been one of them myself. And notwithstanding all of the rapid alteration in the environment about us in general and of the evolution of business forms in particular, the unit banker still has his place and service to perform; he will have it for a long time to come; and I, for one, can see no reason why he should not always be an important part of our banking system.

However, some unpleasant facts must be faced with respect to the appalling number of bank failures recorded in various parts of the country during recent years. This record has been so dolefully recited, and so often of late, that I hesitate to discuss it again, but it cannot be passed over altogether, since

it constitutes the background of the picture.

During the nine year period prior to June 30, 1929 about 5,000 banks closed their doors in the United States, tying up deposits in the neighborhood of one and a half billion dollars. This is at the rate of more than 500 banks per year and represents in the aggregate about one-sixth of the banks that were in existence at the beginning of the period. Altogether these failures have been rather widely dispersed, yet concentration in rural sections is clearly distinguishable. You, here in the Northwest, have suffered especially because of agricultural conditions that developed with the post-war period, and no necessity exists to rehearse before this audience the disaster involved in the closing of bank after bank in any area, the immense amount of personal hardship suffered by the individual depositor because of the loss of savings accumulated over years of toil and thrift, the lack of confidence and business stagnation which follows in the wake of wholesale bank closings.

In this history of suspensions, it is a remarkable thing that no important failures among banks in the larger cities have occurred, while in seven agricultural states 40 per cent of all the banks in existence in 1920 have failed. While the depositor in the large city banks has been amply protected, the depositor in the small country bank has suffered severely. This is not a situation which can be viewed with equanimity, but cries aloud for our best constructive thought and effort in order that it may never happen again.

In approaching the problem, I repeat, we should try to preserve an open mind. We cannot escape the fact, however, that in certain localities the unit system of banking has broken down. Whether we can repair the old or erect a new unit banking system that gives satisfactory assurance of not repeating the misfortunes of the past, that, gentlemen, is one of the serious questions to which we must try to find an answer. On the other hand, if as a result of

our investigation and thought we should conclude that practical considerations force us to some compromise with our sympathies, I hope we shall be able to face the facts with courage and the determination to make such concessions as promise fruitful results.

I turn now to other factors which I believe are forcing us just as certainly, whether we will or not, to a serious re-examination of our banking traditions. Rapidity of personal transportation, easy communication by the telephone, the spirit of the times with respect to large scale organization and the branch system in business in general have brought many differences in our habits of living and especially in the position of the small community. Progress in many lines of activity has had a serious effect on these communities and has endangered some of the institutions and characteristics, such as independence, in which we have rightly taken pride.

That a small community must be served under a unit banking system by a small bank is a self-evident fact, for such a community cannot profitably support a large one. We have today in this country about 25,000 incorporated banks, four-fifths of which are located in towns of 10,000 population or less, and the average capital of these 20,000 banks serving the smaller communities is about \$44,000. I have already recited that banks in this class contributed largely to the record of failures, 71 per cent of the failed banks having been capitalized at less than \$50,000; 88 per cent at less than \$100,000.

In many small communities the banking business is drying up so that it is becoming increasingly difficult for the small bank to make a profit, and no bank can exist for long when it is in the red. The management of such a bank is constantly under the temptation to take greater and greater risks in order to show better earnings, with the result that disaster follows in most cases.

Nowadays, the automobile takes the bank depositor to a larger town than he

used to frequent, and he goes there because there are bigger movie shows, and because there are more shops with a wider variety of goods from which he may choose in shopping. Once a patron of the larger place, nothing is more natural than that he should find it convenient to do his banking business there also, so his account is moved from the small bank to the larger one and the small banker loses deposits.

That is one aspect of the matter, there are others. In the past the small community had its local grocers, its local public utility, its local factory, but today the unit grocer is being displaced by a chain store; the utility belongs to a great holding company; and the factory has been merged with a giant organization with a head office in a metropolis. The local banker in other days did business with the grocer, the electric plant and the factory, but today the cream of that banking business is elsewhere, handled by the head office of the large company and placed with the metropolitan banks with which its treasurer does business.

So we have an entirely different economic and social pattern from that under which our unit system developed, making it necessary for the banking business to be revamped to fit the new order of things. No one is more conscious of this than the bankers themselves, and the record shows that they are embracing the opportunity to experiment with new forms in an attempt to find that system of banking best suited to the world we live in today.

Checking up statistically on what has happened so far we are surprised to find a development of such magnitude. National banks, under the liberalized branch banking provisions of the McFadden Act, and state banks, under their state codes, are, according to the latest figures, operating in the aggregate more than 3,500 branch offices, an increase of some 50 per cent in five years. Among the 800 odd banks with branches are some of our strongest institutions, since the 800 together have more than \$25,000,000,000 of loans and investments

out of a total of \$58,000,000,000 possessed by the 25,000 banks in the country.

We have known in this country for many years something of chain banking, that is two or more banks controlled by one or several identical persons, but the spectacular growth of group banking has been confined to a few brief months. You here in the Northwest, having some of the best examples of it, are quite familiar with the arrangement of associating several banks in a group through the medium of concentrating the ownership of the stock in a holding company.

The latest figures show nearly three hundred different chains or groups in the country, embracing more than 2,100 banks with total loans and investments of \$11,000,000,000. Many banks in chains and groups also have branches, so there is more than a little overlapping; and furthermore, among the banks with branches are counted all the banks, including the greatest metropolitan banks, which may have only one or a few tellers' windows in their home city. The proportion of banking resources sometimes quoted as involved in the new forms of banking organizations, therefore, exaggerates somewhat the extent of the development. Nevertheless, it has reached important aggregates, however measured, and we realize that we face a condition and not a theory.

You, bankers of this district, know precisely the whys and wherefores of this movement, and the country over, the reasons that have brought it about are much the same. An association of banking offices spread over a wide area furnishes a diversity of assets and risk that makes for stability. Head offices in large cities can contribute experienced trained banking management to the smaller offices and can give them investment and fiduciary services of unusual quality. The arrangement, whether it be a group or branch system, can cut down the overhead of the smaller office and put it more nearly on a profitable basis.

When we take stock of the situation we realize that after all, in the matter of the concentration of banking resources, this country has been in a unique position among other great commercial and industrial nations of the world. In great Britain, in France, in Germany, in Canada, and in other countries many banking offices widely dispersed and controlled from one central head office have long been the dominant system of commercial banking. At the heart of this foreign experience has been the matter of economy. In societies such as our own and those of other great countries where the generating force of business enterprise is profits, financial organizations inevitably work themselves into those forms that will keep down the costs of doing business, leaving a larger margin of profits; and under competitive conditions this results also in better and more economical service to customers and borrowers. Economy is working towards group and branch banking in this country as well, as it has worked in the countries of the old world.

As I look upon the practical situation as it confronts us, I am impressed by the indifference of economic developments to our preferences and traditional habits of doing business. Here, we have this group movement, born almost without our realization, to take care of a very difficult situation. I do not think that many persons would deny that the situation was such that something had to be done about it and something has been done, in which I see more of good than of evil.

The group system, however, also has its limitations; it is not a panacea for all of our ills, and of course we shall not find any one thing that will be. To one situation we shall have to apply one type of banking solution, to another situation, a different solution. Even the foremost exponents of the group banking plan agree that it cannot solve the problem of the smallest communities that are entitled to some sort of banking service. We know why



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under changing conditions it has become increasingly difficult for a separate bank to make a living in the smaller communities. The only way to provide banking service for such communities seems to be by establishing a branch with small overhead expense operating as part of a large bank covering a wider area than we have become accustomed to under unit banking.

I see other limitations in the group banking system. For one thing, personnel problems are bound to develop as the best men managing member banks of groups tire of taking orders. They will insist on being promoted to the head office and will either get there or find enterprising jobs elsewhere, with the result that individual members of groups will have difficulty in finding and keeping experienced and competent managers. I do not believe that a branch system would be open to quite the same limitation in this respect, since promotion lines in such systems are more obviously defined, and local branches require less responsible managers than do individual members of a group.

It is clear, however, that our experience with group banking has so far been too limited to permit us to be dogmatic. This is especially true since up to the present time the movement has been steered by competent hands, so competent indeed that they could probably make a success of banking under any type of organization. I am not sure what results would be obtained with the instrument of group banking controlled by less capable bankers, who may follow the lead of the pioneers in this field. I am inclined to believe, on the whole, that the group system will be a transitional stage during the interim, while we are working out some type of compromise between unit banking and branch banking. However, I think it will prove a very useful and instructive transitional stage and will help to overcome immediate difficulties.

My colleague on the Board, the Comptroller of the Currency, has devoted

much time and study to the matter of the effectiveness of our old banking system in its new surroundings and has on several occasions ably outlined his conclusions. As the result of these studies and his ripe experience, he has recommended to Congress that a national bank be given the right to establish branches within the natural trade area of its head office.

Had we been willing before the war to have countenanced branch banking in a limited trade area, I believe many of the unfortunate failures of the last decade might have been avoided. I might illustrate what I mean by a specific example; Aberdeen, South Dakota, which is a trade area, I suspect, for a territory 50 to 75 miles north, south, and west, and possibly 25 miles east. In the days before the war, Aberdeen banks did business with, say, 200 small banks in the town's trade area, lending them money for seasonal requirements in the fall of the year, which was always repaid. However, in 1919, because of railroad conditions and many other factors, the little bankers could not repay the Aberdeen bankers, but had to borrow during the following years more and more from them as well as from their Minneapolis and St. Paul correspondents who were leaning in turn upon the Federal reserve bank. I believe - and our hindsight is always better than our foresight - that if branch banking had been permitted in that little trade area of Aberdeen 20 years ago, many of the difficulties of recent years would have been avoided, but today that small trade area has passed and we face a new set of conditions.

Mr. Pole's recommendation proposes a trade area of much larger extent. While none of us as yet have been able to define our trade area finally, I personally concur in Mr. Pole's general recommendation. I think that the logic of events forces us to conclude that branch banking within limited areas is a reasonable concession to make to the present day conditions which must be met. Beyond this limited concession I preserve an open mind and the hope that time

and experience will help us develop the right kind of a banking system for our changing economic world.