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THE EFFECTS OF BANK MERGERS ON FINANCIAL SERVICES
AVAILABLE TO RURAL MICHIGAN RESIDENTS

By

Wayne A. Hayenga

A THESIS

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ABSTRACT

THE EFFECTS OF BANK MERGERS ON FINANCIAL SERVICES AVAILABLE TO RURAL MICHIGAN RESIDENTS

By

Wayne A. Hayenga

Situation, Objectives, and Procedures

There have been many bank mergers in Michigan in the past decade. This situation suggested the question: How do bank mergers and consolidations affect the banking services available to rural residents? To answer this question the following specific objectives were formulated:

1. To determine how bank ownership changes affect lending, savings, and other banking services to rural residents;
2. To investigate changes in the competitive position of rural banks after merger relative to other institutions that provide farm credit;
3. To obtain a feeling of how rural residents view bank mergers in their communities;
4. To suggest appropriate changes in bank structure legislation.

The study was divided into three main parts. First, twenty-eight Michigan bank offices were surveyed during November and December, 1971. Fourteen interviews were held with city banks that acquired a rural bank between June,

1966, and January, 1970. The remaining fourteen interviews were with rural unit banks, each of which had been selected as a counterpart to one of the acquired rural branches. Questions asked in these interviews determined how the services presently available from the rural branch or independent bank differed from what was available in 1966.

The second part of the study was to poll the acquired banks's primary competitors to ascertain how the competitive relationship between the two organizations changed after the merger.

The third part of the study involved a mail survey of a knowledgeable representative from each community where the local bank had been acquired. This representative was questioned about his impressions of the community feeling toward the bank ownership change, how he thought the bank was serving the community after merger as compared to before it was acquired, and his personal feelings on the effects of the local bank's merger.

The field study results were analyzed using the Bain-Caves framework of structure, conduct, and performance. The performance criteria of equity, progressiveness, resource use efficiency, and efficiency were the main components of the analysis of rural bank performance to rural communities. It appeared bank mergers enhanced the equity in obtaining banking services because of liberalized credit standards and a broader range of loan services. The merged banks also were more progressive as evidenced by offering

more auxiliary services and a wider range of loan service plans. The resource use efficiency of the acquired banks was increased because of the higher target loan/deposit ratios. Market efficiency or awareness was also enhanced by bank mergers. It appeared that merged banks are more aligned with money market conditions than independent banks. Granted that these interpretations of equity, progressiveness, and resource use efficiency are subject to interpretation. Several of the performance variables are subjective, based upon the feelings of the people involved in the study.

An important finding was that bank mergers had little effect on competition between neighboring financial institutions. Both cooperative farm credit agency and competing bank representatives reported no significant change in the competitive relationship after the merger of of the subject banks.

Community members were often unhappy with the bank ownership change at the time of merger of the local bank into larger banking firms. However, by the time of the survey the disappointment had lessened and most communities viewed the bank mergers favorably.

A major finding with respect to Michigan agriculture is that farm operating loans are often available at lower interest rates from independent banks than from rural branches of larger banks. Independent banks frequently charge farmers less for loan funds than they charge for

other business loans. In contrast, the merged banks typically charge the same rate for farm loans as other business loans.

Implications

The major implication of the merger of rural banks for bank customers is that more services will be available to more people because of the merger. These additional services are not available without "cost," even though the charges for the services may be similar. One cost of merger may be the loss of "personalized" service that is often associated with a small firm. A second cost may be that people will have fewer banking firms from which to choose to conduct business.

A major implication for farmers is that the consolidation of a small town bank into a larger banking firm may affect farmers with different sizes of businesses differently. Because of several management practices typically followed by consolidated banks, merged banks may serve only larger farmers and issue fewer farm loans than several independent banks.

A major effect of bank mergers on other credit agencies is that a larger bank can enter a specialized market with a greater resource base and drive than a smaller bank, because it can subsidize its efforts in one market area from earnings in other markets. It is not clear which markets merged banks would enter, but a major point to

consider is that banks are not restricted to any particular market.

A major implication for regulatory agencies is that as more mergers are consummated the analysis of the effects of merger will become more difficult, and after a time banking competition for certain business may be lessened. New regulations may be necessary to insure that banking firms serve the citizens' needs. The institution and enforcement of new rules may be difficult, and the depth and quality of regulatory agencies may need to be expanded.

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Special appreciation goes to Dr. John R. Brake who walked the very narrow line of being my closest personal friend and an outstanding academic advisor during my Ph.D. program. Both my professional and personal life benefited from John's suggestions and counsel, rigorous standards, and philosophy on professionalism and personal attributes. Thanks, John.

Thanks also go to Dr. James D. Shaffer and Dr. Bruce T. Allen. I told Jim he was a "thorn-in-my side" for the last three years, but my competence as an economist and the quality of my dissertation are greater because of his suggestions. I thank him for his farsighted guidance.

Bruce was quite helpful in bringing the dissertation to its final form. He raised my spirits back to a normal level after the final exam by suggesting I worked on an important question and by asking for a copy of the dissertation.

FORWARD

"'Here's the difference it makes', I says, just to devil him. 'How do you know I like your looks?' Maybe he didn't look sore. 'Nope,' I says, 'thinking it over, I don't like your application for a loan. Take it to the other bank, only there ain't any,' I says, and I walks off on him."

--from Main Street by Sinclair Lewis

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CHAPTER I

INTRODUCTION

1.1 The Problem Setting

There has been a rapid change in the financial services demanded by rural residents in the past few years. Both farm business loans and personal consumption loans have been rapidly increasing. In addition, there is an increasing loan demand for many "service" type industries in rural areas. Demand for other financial and bank services, e.g., trust services, financial counseling, securities services, computer and international service, is becoming more evidenced in rural areas as the residents are becoming more affluent and rural businesses are becoming larger and better managed.

What is more exciting, though, is the demand for loan services, especially agricultural loans, that is projected for the future. In a projection made in 1964, Brake stated that the average Michigan farm would have six times as much credit outstanding in 1980 than it did in 1959.¹ More recently, Benson projected financial needs for large

¹John R. Brake, "Financing Michigan Farms," Research Report No. 46, (Business) Agricultural Experiment Station, Michigan State University, p. 7.

scale commercial farming operations for the Eastern Corn Belt in 1980. He summarized, "Many of the units considered in this study will require more financing, more services, and more liberal credit terms by 1980 than most farm lenders are currently offering."²

Four methods have been suggested to help meet the bank services demanded by rural communities. These include the use of (1) correspondent banking, (2) branch banking, (3) agricultural credit corporations, and (4) the Federal Reserve System discounting window. Of these four methods, branch banking has received the most support in the past.³ Proponents of branch banking argue that this method would improve services, make larger loans available, and increase total loan availability.

Since the Bank Merger Act of 1960 was enacted, there have been fifty-two bank consolidations in Michigan. Additionally, thirteen banks have been sold to other banking companies under the "voluntary sale" provision of the Michigan Banking Laws. Most of the consolidations and

²Richard A. Benson, "A Comparative Analysis of Financing Requirements of Selected Types of Farms in the Eastern Corn Belt for 1980" (unpublished Ph.D. dissertation, Michigan State University, 1970), abstract.

³For a more complete discussion, see John A. Hopkin and Thomas L. Frey, "Problems Faced by Commercial Banks of Illinois in Meeting the Financial Requirements of a Dynamic Agriculture," AERR 99, Department of Agricultural Economics, Expt. Sta. University of Illinois, April, 1969, p. 23; and Swackhamer and Doll, Financing Modern Agriculture--Banking's Problems and Changes, Federal Reserve Bank of Kansas City, 1969, pp. 55-62.

mergers have been of small rural banks being attached to larger banks in urban areas. These bank consolidations present, then, the opportunity to examine the effects of bank consolidations and mergers on banking services available to residents in rural areas.

1.2 The Problem

The rapidly increasing demand for loan funds and other banking services in rural areas, coupled with ownership changes of several rural banks, suggest the problem: How do bank mergers and consolidations affect the banking services available to rural residents?

1.3 The Objectives

The specific objectives of this study are:

1. To determine how rural bank ownership changes affect lending, savings, and other banking services to rural residents.
2. To investigate the changes in the competitive position of rural banks after merger relative to other institutions that provide farm credit.
3. To obtain a feeling of how rural residents view bank mergers in their communities.
4. To suggest appropriate changes in banking structure legislation.

1.4 The Method

To accomplish these objectives, a group of twenty-eight Michigan banks was surveyed during the fall of 1971.

Fourteen interviews were undertaken with city banks that acquired a rural bank between June, 1966, and January, 1970. The remaining fourteen interviews were with rural unit banks, each of which had been selected as a counterpart to one of the acquired rural branches. Criteria used for matching the banks included: (1) being in a similar size town, (2) being in a similar type agricultural area, and (3) having approximately the same total assets as of 1965.

The questions asked determined how the services presently available, either from the rural branch or country unit bank, differed from what was available in early 1966.⁴

Measures of service included:

- I. Number of loans and interest charged on various loan services
 - A. Real estate
 - 1. Farmland
 - 2. Residential
 - 3. Other
 - B. Farm loans
 - C. Commerical and industrial loans
 - D. Consumer loans
 - 1. Automobile (New)
 - 2. Credit cards
 - 3. Residential improvements
 - E. All other
- II. Target loan/deposit ratios of the banks
- III. Loan limits of banking office

⁴The data collected for the merged banks were only the data applicable to the rural branch.

- IV. Decision making regarding loan recipients
 - A. Time to service loan requests
 - B. Inter-financial institutions cooperation
- V. Deposit services available
- VI. Availability of "additional services"
 - A. Trust services
 - B. Credit cards
 - C. Specialized loan services
 - D. Floor planning for retailers
- VII. Change in customer structure
- VIII. Response to community changes
- IX. Ownership and management relationship to the community
 - X. For merged banks
 - A. Reason for merger
 - B. Management/continuity
- XI. Main competitors

The competitors of the merged banks were polled to see how competition between the two institutions had changed since consummation of the merger.

The merged banks represent the population of rural Michigan banks that merged during the period covered. The control banks were selected for comparison to each of the merged banks. Because of the methods used to select the banks, the assumptions for most common statistical tests were violated. As a consequence, the case study method was used to analyze each of the fourteen pairs of banks. The fourteen case studies are presented in Chapter IV. Statistical summaries are included in Chapter V, but the data do not permit valid statistical tests.

CHAPTER II

THE RURAL FINANCIAL MARKET

2.1 Introduction

The rural financial market is a complex mechanism. It encompasses several institutions which provide a multitude of functions to the residents of rural areas. The primary function of the rural financial market which affects rural residents most directly is the transfer of funds from people with "surplus" funds to people who have fund "deficits." This transfer function is aided by many auxiliary financial services such as custodial and trust services. Due to institutional constraints, boundary lines for a rural financial market cannot be drawn at the limits of a rural area. Pipelines must be available to other rural or urban areas when the rural area has surplus funds, and channels should be available from other areas when a rural community is capital deficient.

Using the above definition, it is evident that nearly all members of the rural community have a need for financial services. Nearly every member of the community has at times capital surpluses or capital deficits.

One of the serious problems that is faced in the rural financial markets is defining the relevant market area. The market definition is important because it defines the participants in the system--the buyers and the sellers of the product or products. An ideal market definition takes into account substitution possibilities in both supply and demand. The recognition of all of the participants in the system is necessary if one is to evaluate how the system performs for its members.

In many studies the market is defined by selecting, with a certain amount of arbitrariness, some existing political unit boundary line, i.e., county, township, or Standard Metropolitan Statistical Area. But in the case of the rural financial market a boundary cannot be so easily drawn. The relevant market area depends upon (1) the willingness and mobility of the individual customer to investigate and use alternative financial services and (2) the institutions offering the services needed by the individual.

A potential customer's willingness and mobility is a function of many factors, i.e., type of service needed, relationship with institution, advertising of competitors, dealer effect, friend's experiences, habit, borrower's education, etc.

The institutions serving a specific rural area vary with the area. There are many institutions offering financial services throughout Michigan, but even institutions

with similar names do not always offer the same services or always attempt to serve the same clientele.

The next two sections will provide an indication of the complexity of rural financial markets. The first section (2.1.1) will discuss the institutions that serve rural areas' financial needs. The second section (2.1.2) will deal exclusively with banks, specifically the various services they offer and the multitude of markets they serve, and will expand on the definition of the market for bank services.

2.1.1 Financial Institutions Serving Rural Areas

Many institutions serve rural areas' capital market needs. Banks, savings and loans, credit unions, loan companies, and life insurance companies are common to both rural and urban areas. They function both as depositories and lenders. In addition to these common institutions, rural areas are served by some specialized lending institutions. Production Credit Associations and Federal Land Bank Associations are farmer cooperatives that loan money to their farmer members for farm operation and farm mortgage purposes. To encourage sales, input suppliers provide financing for their products. Capital market services are also provided by individuals who borrow and loan money and by loan counselors who put those who "need" in touch with those who "have." Tax laws encourage retiring farmers who

sell land to finance the farm for the new owner. The Farmers Home Administration, a federal agency, also provides loans to farmers and rural residents who are not able to obtain funds from other conventional sources.

Rural savers have several alternatives open to them also. Several securities dealers have a network of rural offices (usually in cities of 10,000 or more) that offer a selection of debt and equity investments. Mutual funds salesmen are stationed in most rural areas. The Production Credit Association offices and some small loan company offices offer investment securities to savers in rural areas. In addition to these local rural institutions, there are numerous institutions based in larger cities that advertise saving and investment services in rural areas.

Financial transfers, the act of actually moving funds, is primarily a function of banks. Banks are the only institutions that can offer checking account services.¹ Other agencies do offer a similar service such as money order services and wire transfers of funds. Banks can also offer a multitude of other services, including safe keeping of securities, safe deposit boxes, credit card services, trust department services, and other related

¹The "Hunt Commission," a recently appointed Presidential Commission to study the financial services available in the United States, recommended that savings and loan associations and credit unions be allowed to provide checking account services.

financial services. In rural areas the bank is the most broadly based financial institution.

Banks have another important function in the rural financial market. It is the creation of money. Because of the way the rules under which banks operate are written, rural banks can expand the money supply in the rural community. This expansion mechanism is subject to regulation of the Federal Reserve Board and is a major way that the Federal Reserve Board controls the money supply.

2.1.2 The Markets for Bank Services

As stated above, a bank is the most broadly based financial institution in rural areas. Banks can offer more financial services than any other institution, but they are not required to offer a standardized package of banking services. Because a bank typically offers many services, it can be considered that each service offered is for a specific market. This market may be defined by a special clientele, a special geographic area, or a special need of a group of people (i.e., governmental unit needs). Thus a bank is a multiproduct firm serving a multitude of markets.

The multiproduct nature of rural financial markets can be shown by a hypothetical case. For example, if there are five banks located in western Michigan as depicted by Figure 2.1, each bank may serve a different geographic area for each different service offered. In the example, it can be shown how markets differ for three services: (1) personal

Lake
Michigan

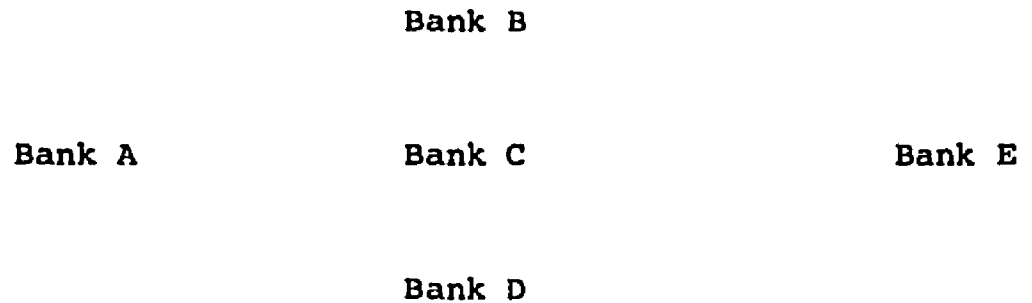


FIGURE 2.1.--Hypothetical Bank Locations.

checking and savings accounts, (2) credit card services, and (3) trust department services.

The five banks are assumed to be of different sizes and therefore may offer different services. Table 2.1 shows the differences.

If we assume that transportation is the main "cost" in getting access to service, the markets for the various

TABLE 2.1.--Services Offered by the Hypothetical Banks.

Bank	Size of Bank (Millions)	Personal Checking Service Cost	Personal Savings Account Interest Paid	Credit Card Services (Yes/No)	Trust Department (Yes/No)
A	30	Free	4-1/2%	Yes	No
B	8	\$.50/mo.	4 %	No	No
C	10	\$.50/mo.	4-1/2%	No	No
D	8	\$.50/mo.	3 %	No	No
E	70	Free	4-1/2%	Yes	Yes

services exist symmetrically around the banks. Figure 2.2 could show the potential market areas and areas of competition for each of the banks' services. Since Bank E has the only trust service available, it would be a monopolist in that market. Two banks, A and E, have credit card services available. They both have exclusive market areas around their banks but compete in the locations around Banks B, C, and D.

The personal account market, checking service and savings accounts, is complicated by the different interest rates paid on savings and charges for checking account services. As is shown above, each bank may have an exclusive service area where it will be able to service all customers (depending, of course, on the customer's willingness to travel for higher interest rates or lower checking charges). But each bank also has an area where it competes with one or more other banks for the personal accounts market.

The market territory for bank services is also expanded or contracted by the quality of service that each bank provides. If Bank E had an extremely good personal accounts service department in comparison to the other banks, it could be assumed that it would draw customers from the other banks' localities. Tying arrangements that banks commonly practice can also affect the market territory. For example, some banks offer "free" checking accounts for people who have a savings account deposit or may offer "free" safe deposit boxes for senior citizens.

Credit Card Markets: A and E — — — — —
 Trust Department Service Market: E only — + + + + +
 Personal Accounts (Checking and Savings)
 Markets: A, B, C, D, and E — — — — —

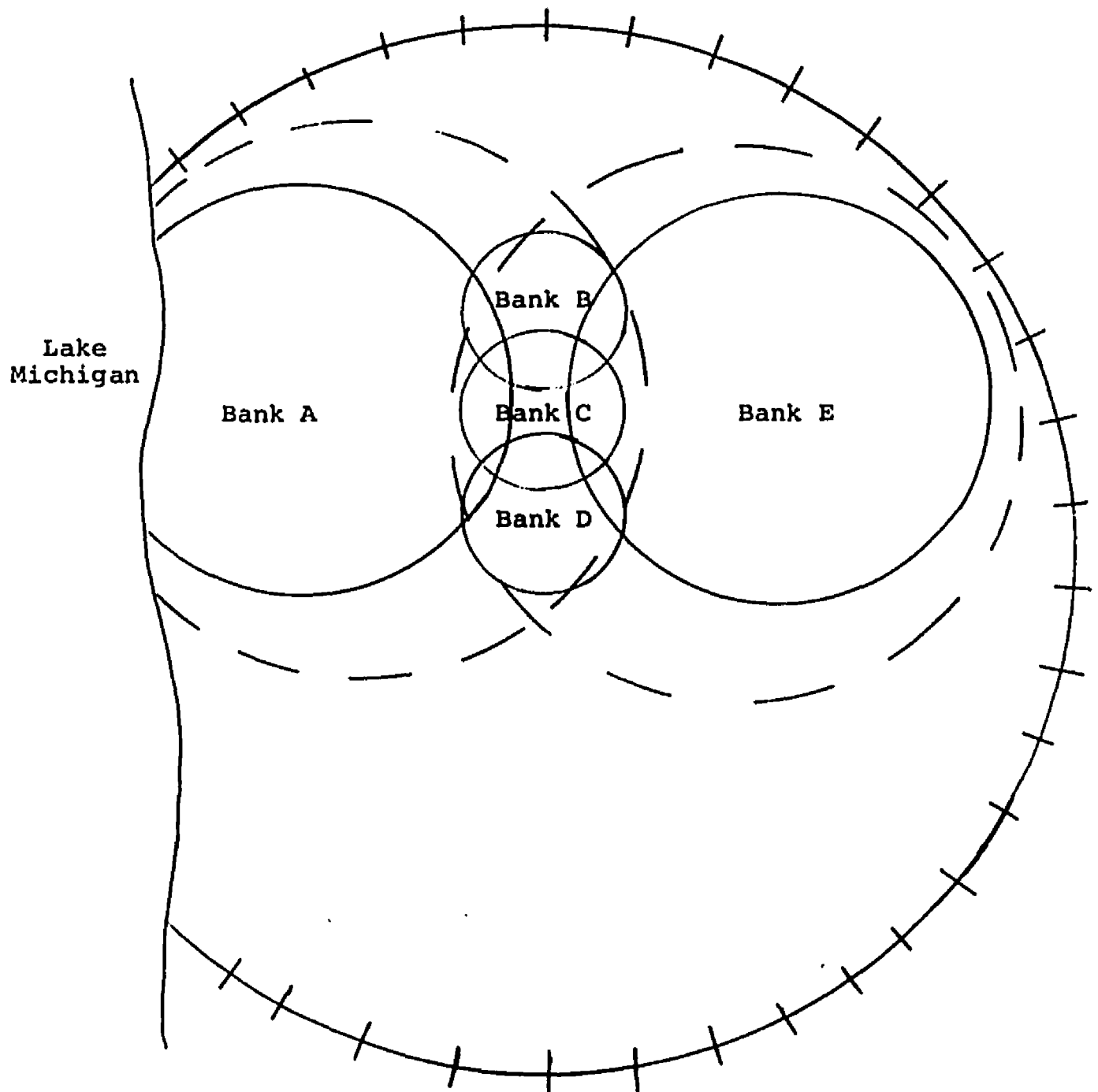


FIGURE 2.2.--Various Markets of Five Hypothetical Banks.

By tying two services together the bank tries to expand its service area further than it would by offering all services separately.

In summation of this multifirm, multiproduct market, it may be said that there is no firm definition of an individual bank's market. The final market depends upon where competitors lie, what services they offer and what they charge for these services, and the package of services that customers want when they select a bank.

The hypothetical example discussed differences in only three services offered. There can be more differentiations of various services that serve a different market. Examples of this are large loans, i.e., over \$100,000, specialized loan services due to personnel availability to service unusual loan requests, and specialized business services such as large fund transfers. Banks B and D, for example, may not be able to compete for the \$100,000 or larger lines of credit. Hence, the competition for this service would be between A, C, and E, or perhaps just A and E.

Because a bank has a different market for each service offered, the total market area for the bank is a "weighted average" of all of the markets served. The question of how to apply the weightings is one that has received much discussion from the regulatory agencies and people involved in bank location and bank merger decisions. In Michigan a recent example is the decision to allow the

Michigan National Bank in Lansing to acquire a Grand Ledge bank. The crucial element in this decision was whether the small Grand Ledge bank competed with the three larger banks in Lansing or several smaller banks in other neighboring towns. It was decided that the bank in Grand Ledge did compete more with the three larger Lansing banks than with neighboring country banks. To improve competition in Grand Ledge the Michigan National Bank was allowed to acquire the Grand Ledge bank. In this way there were three larger banks competing in Grand Ledge, rather than one small bank trying to compete with the three larger banks from Lansing.²

One of the major assumptions in this discussion of bank markets is that the market for various services exists symmetrically around the banks. In individual cases this assumption may not hold. Using the previous example, suppose an individual living in the primary market area of Bank C requests a loan from his local bank. If this request is denied, this individual may go to any of the four other area banks to make application for loan service. However, if bank mergers were to occur so that banks A, B, and C merged into one unit, and banks D and E combined, a

²The landmark court case on this point is U.S. v. Philadelphia National Bank et al. 374 U.S. 321, 358, 361 (1963). The decision states . . . (T)hat in banking the relevant geographical market is a function of each separate customer's economic scale means simply that a workable compromise [on market definition] must be found.

person refused loan service would have only one other bank to go to for loan service, rather than the four alternative sources that he had available prior to the mergers. This shows that changing bank "market" definitions as is done to justify mergers can enlarge monopolies and foreclose some banking alternatives to some individuals.

2.2 Structure, Conduct, and Performance of Financial Institutions

A useful framework for evaluating an industry and its service to its customers is the structure, conduct, performance method which has been developed by Joe Bain and Richard Caves.³ This basic framework has been expanded into an "effective competition" concept by Stephen Sosnick.⁴ This method of evaluating industry structure, conduct, and performance has commonly been used to evaluate manufacturing industries and industries with broad geographic markets but has less frequently been applied to service industries which serve localized markets. This section will present an overview of the Bain-Caves structure, conduct, performance concepts and the Sosnick effective competition

³For a more detailed description of this theoretical view, see Joe Bain, Industrial Organization (2nd ed.; New York: John Wiley and Sons, Inc., 1968) or Richard Caves, American Industry: Structure, Conduct, and Performance (2nd ed.; New York: Prentice-Hall, Inc., 1964). This discussion revolves around Richard Caves' outlook. See pp. 17, 37, 38, and 97.

⁴Stephen H. Sosnick, "Toward a Concrete Concept of Effective Competition," American Journal of Agricultural Economics, L, No. 4 (1968), 827-853.

framework and apply this theory to Michigan financial institutions with special emphasis to rural banks.

Sosnick provides a more encompassing definition of structure, conduct, and performance than do Bain and Caves. His interpretations are: structure denotes all predetermined characteristics of the game and its rules that constrain the players' choices; conduct denotes all choices or strategies that the players adopt; and performance denotes all consequences of the players choices that are, to them or others, payoffs of the game.

Caves relates industry structure to conduct and then relates conduct to performance. He states that market structure is important because it determines the conduct (behavior) of the firms in the industry, and conduct, in turn, determines the industry's performance.

The major characteristics of each aspect of the structure, conduct, performance framework are suggested by Bain. Market structure has six major characteristics: (1) concentration, (2) product differentiation, (3) barriers to entry of new firms, (4) growth rate of market demand, (5) price elasticity of market demand, and (6) ratio of fixed to variable costs in the short run.

The three major points in the analysis of market conduct are (1) policies toward setting prices, (2) policies toward setting the quality of the product, and (3) policies aimed at coercing rivals.

The four overall performance goals Caves cites are (1) efficiency, (2) full employment of resources, (3) progressiveness, and (4) equity.

The banking industry can be evaluated somewhat in this framework. Some activities of banking firms are highly competitive, while other activities are closely regulated. Lanzillotti⁴ gives an overview of the problems involved in analyzing the banking industry with the following statement:

Any attempt to evaluate the changes that have occurred in the structure of banking and banking competition must recognize at the outset that in this industry, as in certain others, competition and regulation of entry have been relied upon to serve the public side by side. Regulation plays a crucial role but most students of industrial organization and public policy, as well as many banking authorities, have argued for relying as far as possible on the forces of competition. However, in banking it has never been quite clear that competition alone is sufficient to promote the public welfare. Indeed, it is more important today in a highly charged atmosphere that we recognize competition in banking for what it is; not as a self-perpetuating system, but one that must be conscientiously supported and encouraged.

The next three sections will discuss the structure, conduct, and performance of Michigan financial institutions in general. Following this discussion, Sosnick's "effective competition" approach will be introduced prior to a history of Michigan banking structure and arguments for and against branch banking by merger.

⁴Robert F. Lanzillotti, Banking Structure in Michigan (East Lansing: MSU Business Studies, Michigan State University, 1966), pp. 3-4.

2.2.1 Structure of Rural Michigan Financial Institutions

Although the rural financial market is served by many institutions, few of them compete with any other for more than a few of the services offered, other than the depository services. Most agencies accept deposits from anyone, but loan only to selected customers.

The rural bank is probably the most broadly based financial institution. It typically provides both demand deposit services (checking accounts) and time deposit services (passbook savings and time certificates) and issues many types of loans. Types of loans available usually include farm loans, business and commercial loans, real estate loans, and consumer loans. In small rural communities there is typically only one bank, so banking competition comes from banks in nearby communities. This may appear to be monopoly power if customers are unwilling or unable to go to other communities for banking service. But, banks have only two basic services that are generally not offered by other financial institutions in most small communities. These are checking account services and small business and commercial loan services.

Banks make all types of real estate loans. Competition for housing mortgages comes from savings and loan associations, individuals, and life insurance companies. Commercial property mortgages typically come from both banks and life insurance companies. For farm property,

mortgage funds are available from banks, life insurance companies, Federal Land Bank Associations, and, under some circumstances, the Farmers Home Administration.

Farm operating loans also come from a wide variety of sources. Banks and Production Credit Associations are both common sources of funds for this purpose. Farm input suppliers are becoming increasingly important as sources of short term credit. The Farmers Home Administration also finances farm operations for farmers unable to get loans through conventional sources.

Consumer loans in rural areas come from banks, credit unions, small loan companies, and finance company subsidiaries of manufacturing companies. However, in many of the sparsely populated rural areas several companies that provide consumer loans may not be represented.

An additional consideration in the rural financial market is the "non-institutional" sources of loan funds. Individuals, local merchants, family members, and loan brokers often make loans to individuals in rural areas for many purposes. A common source of real estate financing in rural areas is the seller of the property. Land and other real estate is frequently sold by land contract. In this method the seller takes a debt instrument for a portion of the value of the property to be transferred and thus becomes a member of the local financial mechanism that serves the community.

At first glance, when there are two or more institutions serving the same needs of the community, it may appear that they compete for the business. This is not always the case. For example, banks make all types of real estate loans, but the absolute amount of real estate loans they can make is limited by the amount of their time deposits and/or their loan portfolio plan. If the local demand for real estate loans exceeds the amount they can lend, a rural bank may act as an agent for another bank (usually a city correspondent) or a life insurance company. These other institutions will supply mortgage funds to the bank's customers and pay the banks for servicing the loans. Frequently individuals who sell property on contract seek the advice of an established lender, commonly a local banker, who counsels them about the terms of the contract. So, in effect, the local lender may aid two customers by assisting in negotiating a financing agreement.

Even though several institutions offer the same general types of services, the terms of the agreements offered by each may differ substantially due to regulatory constraints or management practices of the institutions. For example, most rural banks are reluctant to make mortgage loans for more than fifteen or twenty years, whereas savings and loan associations commonly write them for twenty-five years, and life insurance companies and Federal Land Banks amortize them over forty years. Thus, if a borrower needs a very long term mortgage, a bank cannot compete.

Non-competitive behavior is also found in consumer loan service. Banks typically write consumer loans directly and also purchase consumer loan paper from commercial customers who are in retail businesses. Thus, even though a purchase is financed through the retailer, the bank is ultimately the source of loan funds. The income from the loan is shared in proportion to the risk, servicing, and funds involved in the loan.

Various parts of the structure of rural financial markets are regulated. Regulatory action limits banks and loan associations to do business only in certain cities. Once granted the right to do business within the state, life insurance companies, loan companies, and financing subsidiaries of manufacturers can go into any area in the state. Cooperative agencies, PCA's, FLBA's, and Credit Unions can establish anywhere they can get enough support to justify an office. The farmer cooperative retail financing agencies, PCA's and FLBA's divide the state up into exclusive areas.

Other financial institutions serving rural areas are also regulated in some respects. For example, savings and loan associations and credit unions are limited as to how much they can pay for savings deposits. Loan companies, savings and loan associations, and credit unions also face some regulations in the rates they can charge for loans. These regulations tend to set the common rates that are charged by competitors in the area. Lenders commonly state

they do not compete on price of loan services. Rather than make major adjustments in interest charges in the local community to attract or repel business to achieve their desired portfolio structure, they invest in non-local investment that have the terms and characteristics they desire.

2.2.2 Conduct of Rural Michigan Financial Institutions

The range of behavior of most financial institutions is regulated to some extent. Banks probably come under the strictest regulations. Ceiling rates paid on deposits are set by federal and state authorities, but banks can elect to pay less than this. The security portfolio is frequently inspected by Federal Reserve System examiners (if the bank is a system member), Federal Deposit Insurance Corporation examiners, and the State Banking Commission examiners. The chief function of these regulations is to prevent anything that would threaten the solvency of the organization or would impair the safety of the deposits, but within limits the bank officials can select the investments they desire.

Advertising and sales promotion behavior of banking firms is seldom mentioned in the literature. The purpose of advertising is twofold: (1) to get information to potential customers and (2) to attract customers from other financial institutions to do business with your institution. It seems as though many rural people are unaware

of the types of services available from the different lenders and the differences in terms available from lenders offering similar services. Thus, conduct may be improved by increasing advertising expenditures to better accomplish the goal of improved customer information.

Another measure of good conduct is the willingness of financial service organizations to "share" customers with other organizations. Do many financial institutions demand that they serve "all" of a customer's loan demands, or are they happy with just a part of a customer's business? If they are unable to serve some of the demands, do they offer the customer assistance in meeting his other needs? Are lending institutions willing to structure repayment policies to complement other lenders' repayment practices?

2.2.3 Performance of Rural Michigan Financial Institutions

Efficiency, full employment of resources, progressiveness, and equity are the four performance dimensions advanced by Richard Caves. There are some problems in the measurement of these concepts and the extension of these concepts into precise criteria, especially for a service industry such as rural banking. For example, "economic efficiency" usually means providing a product or service to the consumer in an accurate reflection of consumer preferences and real costs. But in a small multiproduct service business this may be difficult, if not impossible,

to ascertain. Nonetheless consumers are concerned about the quoted price of services. Because of their concern about quoted price of a service that may have several parts to the service, a problem arises with the trade-off of the quoted price of the service versus the quality and quantity of the service. Quoted price of a service could be lower, but a lower price may restrict the quality and quantity of service available to an individual. Prices of loan services are usually quoted as a percentage charge, such as 7 per cent for a home mortgage. But the quoted price of 7 per cent does not convey what down payment is required, how much is the loan application fee, what is the prepayment penalty, etc. Also, the quoted price does not specify the length of the loan, whether it is a fully amortized loan, or if there is a larger terminal payment, etc. Now, many of these clauses are standardized between lenders of like types; but if these clauses are not standardized, the quoted price will not reflect all of the differences without careful examination of the mortgage loan contract. So, quoted prices could probably be lowered, but the lower price may restrict the quality and quantity of the service. The total cost to the consumer from a lower quoted price may be increased in terms of cash cost to gain all of the services desired. Thus, without a detailed examination of the total services available there is little we can say about the technical efficiency of the rural financial markets.

Full use of resources in rural financial markets is also hard to evaluate. Deposits of the community are the primary resource a bank has available for use. When investing these deposits, it has several alternatives, such as (1) loans, (2) government securities, (3) municipal bonds, (4) corporate securities, and (5) holding cash. Rural banks have an obligation to "serve the community's needs" both as a depository and lender. Because of this charge, rural banks usually invest heavily in locally generated loans, so the loan/deposit ratio is a measurement of how well a bank serves the local community's loan needs. But the rural bank also has the obligation to protect the assets of its depositors and to provide liquidity to the depositors. If an extremely large amount of deposits is invested in loans, this obligation may be impaired. So a question arises: where is the maximum point of resource use efficiency? It could be envisioned as a point on a continuum with underutilization of resources on one end of the scale and with exploitation of resources on the other end of the scale. Bank management may want to overutilize the deposit resources because a higher loan/deposit ratio usually means more income to the bank. But here, too, is a question: where does proper resource utilization stop and where does exploitation of resources begin which exposes the stockholders and depositors to undue risks?

Equity as a performance dimension is generally concerned with income distribution of the participants in the

system. In the rural banking industry, increased equity may be more appropriately defined as allowing more people to have access to the services--especially loan services--that the rural bank provides. Relaxing standards to qualify for loan service or making more loan programs available would allow more people to have access to loan service from the rural banks. Thus there would be more equity in the system.

Equity can also be defined in terms of fair play. This performance feature appears to be satisfactory. Due to the regulations and legal restrictions that most of the lenders face, there is very little opportunity for major lenders to be unfair. Even though competition does not abound, there is limited competition, especially via services, and a "bad press" may cause a loss of market share of business.

Progressiveness as a performance dimension is both hard to define and hard to measure. Is it progressive to offer all new programs that come along, even though there will not be enough use of the program to justify its cost? Is it progressive to relax credit standards to serve more people if more loans are expected to default? Perhaps the question of progressiveness could be approached by asking the general question: How much and how fast do you change your terms and service criteria to meet the needs of your customers and/or potential customers, given the restrictions

that are imposed upon your organization by external sources? Of course, the answer one would expect from a question of this nature is: "We do all we can for all customers all of the time." So this would be an unsatisfactory way to measure progressiveness. Another alternative is to ask about recent changes made and about future changes planned to improve service. Answers to questions of this type should give a better measure of bank responsiveness to customer needs and progressiveness.

2.2.4 The Effective Competition Framework

Sosnick has looked extensively at industry performance and has developed an exhaustive list of criteria that must be met to have "effective competition," which is his image of a desirable state of affairs in an industry or market. The criteria developed are quite specific and are more generally applicable to a manufacturing industry than a service industry. Sosnick suggests that an industry can only be effectively competitive if it is free from twenty-five flaws. His criteria include some structure and conduct type conditions that Caves and Bain suggest, in addition to being quite specific about some performance measures. Ten of the conditions are considered undesirable both in themselves and their effects. They are: (1) unsatisfactory products, (2) underuse or overuse, (3) inefficient exchange, (4) inefficient production, (5) bad externalities,

(6) spoliation, (7) exploitation, (8) unfair tactics, (9) wasteful advertising, (10) irrationality.

Of these ten, the first seven relate to performance aspects and the last three to conduct of the firm or industry. The other fifteen flaws suggested as criteria are undesirable only because of their effects. They are:

(1) undue profits or losses, (2) inadequate research, (3) predation, (4) pre-emption, (5) tying arrangements, (6) resale price maintenance, (7) refusals to deal, (8) undesirable discrimination, (9) misallocation of risk, (10) undesirable collaboration, (11) undesirable mergers, (12) undesirable entry, (13) misinformation, (14) inefficient rules of trading, (15) misregulation.

This list, according to Sosnick, "contains every verifiable market condition that I would regard as avoidable and undesirable. I would call a market effectively competitive if, and only if, it had none of these twenty-five characteristics."

In his article Sosnick is quite specific about the values of the criterion that, when met, make that criterion a flaw to effective competition. For a service industry some of these explicit measures may need to be adjusted from those for a manufacturing industry. For example, in the rural banking industry is it wasteful advertising for a local bank to sponsor a "go to church this Sunday" advertisement? Does setting credit standards at a level

where not all community members can qualify for loan service constitute a refusal to deal? What constitutes undue profits or losses for a bank in a given community faced with its risk function? Questions of this type must be asked to develop the values that are needed for Sosnick's criteria.

Another problem with Sosnick's effective competition concept is its application from the industry level for which it was written to the individual banking markets with which this study is concerned. Given the regulations that are imposed, some of the criteria are not valid, and others must be adjusted. But for a general overview the list developed by Sosnick provides a good benchmark to look at the performance of an industry or firm.

The explicit measures of bank performance used in this study are discussed in Chapter III. In the beginning of that chapter Sosnick's criteria will be discussed more fully with respect to rural banks. Due to problems in securing data and time constraints in analyzing performance criteria, and since the objective of the study was to determine how rural bank ownership changes did affect banking services, many of Sosnick's criteria will not be covered in the field survey.

2.3 Michigan Banking Structure Regulations

Michigan banking structure regulation is currently dominated by the major provisions of the 1937 Financial

Institutions Act. This act, outgrowth of and reaction to the many bank failures of the Great Depression, placed strict limitations on banks' branching rights. Prior to 1927, National banks in Michigan could have no branches. In 1937 the McFadden Act placed national chartered banks under the same branching rules as state chartered banks. This Act allowed banks headquartered in a city of 75,000 people or more to establish branches in the same county as the main office or within twenty-five miles of the main office. In 1945, the Financial Institutions Act relaxed the branching rules to eliminate the population requirement, but it still only allowed limited branching. The effect of these bank structure laws was to allow banks in fairly large cities to establish branches in nearby rural areas, but throughout most of rural Michigan branch banking was nonexistent.

National regulations that have an effect on Michigan bank structure are the Bank Holding Company Act of 1956 and the Bank Merger Act of 1960. The Bank Holding Company Act places in the hands of the Federal Reserve Board approval or denial of setting up a bank holding company which is defined as a company holding at least 25 per cent of the voting stock of a bank. This statute requires that the following factors be investigated prior to approval of a holding company: (1) the financial history and prospects of the company; (2) quality of management; (3) convenience; (4) needs; (5) welfare of areas affected; (6) dictates of

sound banking and the public interest; (7) and the preservation of competition. This legislation was not used in Michigan until 1970, when the state passed its Bank Holding Company Act. (As of October, 1971, there was but one registered Bank Holding Company in Michigan.)

The Bank Merger Act of 1960 states that before bank mergers and acquisitions can be consummated, they must receive approval of the appropriate federal bank supervisory authorities. These are the Federal Reserve Board, Federal Deposit Insurance Corporation, and the Comptroller of the Currency. The criteria for approval are convenience, needs, various banking factors, public welfare, and competitive factors. Also, the Attorney General of the United States is required to provide an evaluation of the competitive factors involved.

As a result of these regulations Michigan has a preponderance of small banks. In the past decade there have been fifty-two mergers of banks, and there were thirteen consolidations of banks under the voluntary sale provisions of the bank consolidation laws. The regulations are constructed so that most banks can combine when there is an economic reason for the consolidation.

2.4 Prior Studies on Michigan Bank Structure

Lanzillotti has done an extensive review of the Michigan banking structure from 1945-1963.⁵ The principal

⁵Robert F. Lanzillotti, Banking Structure in Michigan (East Lansing: MSU Business Studies, Michigan State University, 1966).

objective of his study was to compile information related to the structure of banking in Michigan and to examine some of the changes that had taken place. The information used includes published call reports, census data, court records, and Federal Reserve Board survey data. He compares such things as deposit concentration ratios and number of banking offices per capita for Michigan with other states that have different types of banking structure. Lanzillotti also includes an extensive review of stockholder and loan links for Michigan banks and extensively covered the bank structure laws and court cases that have affected bank mergers and consolidations. Some of his conclusions that have relevance to this study are:

1. Through 1945-1963, Michigan had a 30 per cent greater increase in total banking offices than respective averages for limited branching states, unit banking states, and the U.S. total.
2. An aspect of this movement is the replacement movement (i.e., one bank for another) that has been taking place. The importance of this aspect depends upon the nature of the replaced and replacing banks and the alternative sources of banking in the given and adjacent communities.
3. Deposit concentration ratios are extremely high in several of the Michigan Standard Metropolitan Areas, but it is unclear how this has affected the viability and vigor of banking competition.
4. Efficiency of operations does not appear to be largely a function of bank size, so it is not clear what size a bank should be in relation to the market served.
5. In order to ascertain what the impact of structural changes means in terms of banking competition, it is necessary to examine individual bank markets and submarkets within the state.

In a more recent study the Joint Senate-House Bank Study Committee of the Michigan Legislature evaluated state bank structure in 1969. Some findings of interest reported are population per banking office for each county, number of banks per county, and the rate of return for banks of different sizes in Michigan. As could be expected for a state with as diverse a land use pattern as Michigan, population per bank office per county varies tremendously. But, on an average there is one bank per 6,100 people compared to one per 6,300 for the U.S. An unexpected finding is that the net income after taxes as a per cent of total assets was higher for smaller banks than for larger banks. The after tax income (as a per cent of capital accounts) was 9.07 per cent for banks under \$5 million (deposit size), increased to 9.87 per cent for \$10 to \$25 million banks, and then dropped to 9.01 per cent for \$25 to \$100 million banks. The report recommended changes in the bank structure laws to allow bank holding companies to be established.

2.5 Alternative Bank Structures

The effect of the rules and regulations on bank structure in rural areas in Michigan has been to foster the establishment of a preponderance of small unit banks. Usually there is one bank per small town. In fact, there are only nine towns of under 5,000 people with more than one bank or banking office. The smallness of these banks is indicated by the fact that, out of the 332 banks in

Michigan as of December 31, 1970, 197 had less than \$20,000,000 in deposits, and 120 had less than \$10,000,000 in deposits. Most of these small banks are in rural areas. The second most common type of bank organization in rural communities is that of a branch of a bank headquartered in a larger nearby city. As of December 31, 1970, there were no bank holding companies represented in rural areas.

There are some other quasi-legal mechanisms for interrelated bank ownership and control, but all of these are legally covered by the three structures mentioned above. They include employee pension funds of one bank owning stock in another banking company, trust accounts of one bank holding stock in another bank, or limited partnerships holding stock in banking firms.

There are advantages and disadvantages to each type of ownership structure. The unit bank is frequently criticized for being "too small" to be efficient and of good service. For example, the loan limit for one-third of Michigan banks is less than \$50,000. This amount is often not adequate to finance a medium-sized rural business or a large farm. The banks often do not have specialized loan officers and may not have such services as a consumer loan department.

The local unit bank is also prone to the risk of a given community. Adverse economic conditions in a small area where a bank had most of its loans outstanding could

cause insolvency of the banking company. Local economic conditions and financing needs could fluctuate greatly so the bank would not be able to satisfy community loan demands during part of the year but would have excess loanable funds available during another part of the year.

The most often cited advantage of unit banking is that the management (and usually ownership) of the bank is local and sensitive to local problems and needs. It is purported that this local character of the organization responds more to local problems and helps the local community develop.

In an attempt to circumvent some of the disadvantages of being small, some rural banks have developed strong "correspondent" relationships with larger city banks. The larger bank is, in effect, the country bank's bank. In return for the deposits which the country bank keeps with the city bank (for which, by law, no interest can be paid), the city bank provides services to the country bank. These services may include providing specialized loan expertise, trust services, overloan assistance, other banking services, and specialized consulting for the rural bank. This action has not silenced critics of unit banks or proponents of branch banking. They hold that the correspondent relationships leave much to be desired in terms of customer service. The "partnership" relationship between the bankers depends upon many factors, and frequently, if this does not mutually

benefit the bankers, the rural customer needing the services of a city bank does not receive it through his local bank.

A series of arguments that support branch banking (generally meaning the consolidation of existing unit banks) over unit banking include: (1) the loan size available to a single customer would be greatly increased, (2) the risk of defaults due to localized conditions would be reduced, (3) more banking services could be provided because of the larger deposit base, and (4) there would be more flexibility in transferring funds from surplus fund areas to deficit fund areas.⁶ All of these arguments are, in effect, true. But whether they become advantages or disadvantages to the customers and community depends upon the bank management. And management of branch offices are frequently criticized for being unsympathetic to community needs because they channel funds into external investments rather than local investments!

Bank ownership by a bank holding company has a limited advantage over either of the other types of bank ownership styles. As defined above, a bank holding company is a corporation that controls 25 per cent or more of the voting stock in a bank. This amount of ownership generally gives the holding company control of a bank. Typically, a bank holding company initially owns one fairly large bank

⁶See Hopkin and Frey and Swackhamer and Doll for an expanded discussion.

and then acquires other smaller banks. Each of the banks is a separate entity. This type of ownership structure does not increase loan limits or reduce risk by spreading loans for each bank over a larger geographic area. The parent company with all of the affiliates may be large enough to amass some specialized management talent for the member banks and to provide some central management services for the member banks. But, in actuality, all a bank holding company usually does is to increase the use of the correspondent relationship more than is usually done under separate ownership.

2.6 Reasons for Bank Mergers

Many reasons have been given for bank mergers. Smith⁷ summarizes many of the reasons presented in various studies in the following lists:

From the standpoint of the acquired banks mergers are desirable because of:

1. failure to provide successor management, generally alleged to be due to the inability and/or unwillingness to pay sufficient salaries to attract capable managers;
2. attractive prices offered for the stock of the solicited bank which the owners find difficult or unwise to refuse due to the limited market for the

⁷David L. Smith, Economist Fed. Res. Bank of Cleveland, "Characteristics of merging Banks" (paper presented at the Fifth Annual meeting of the Appalachian Finance Assoc., Syracuse, N.Y., April 26, 1969). Also see Currency, Annual Report for 1964 (Washington, D.C.: Government Printing Office, 1955), pp. 9-10.

stock of many small banks and the consequent market undervaluation of the shares;

3. high operating costs and low profits resulting from inefficiencies and/or the inability to provide adequate banking services;
4. the inability of many small banks to meet the borrowing needs of a community due to low lending limits.

From the standpoint of the acquiring banks mergers are desirable because of :

1. the need or desire to grow in size and obtain additional banking offices in adjoining areas in order to better serve existing customers and obtain additional customers;
2. the need for larger lending limits and additional deposits to loan;
3. the desire to improve (or recoup) their position due to relatively slow growth;
4. the desire for greater profits.

2.6.1 Management Succession

Lack of successive management as a reason for merger is explored in depth by Smith. He expands on alternatives that banks experiencing management voids can explore. Options here include (1) hire new management at the going price, (2) merge (as permitted by Michigan law), (3) become an affiliate of a bank holding company (if permitted by law), or (4) liquidate. Smith does not suggest another alternative, which is for the stockholders to sell their stock to other individuals who will either manage the operation or will hire capable management. Since Michigan law (in the period relevant to this study) did not permit holding

company affiliations, the merger alternative permitted was often the most attractive alternative to bank ownership groups. Smith found that merger usually promised capital gains for stockholders as well as salary increases and pension benefits for the bank's employees. He contrasts this to the problem of attracting new management, probably at higher salaries than had been paid, with no assurance of increased profits.

2.6.2 Lending Limits

The other reason often cited for mergers, that of increasing lending limits, is also assailed by Smith. The small banks acquired are usually merged into larger banks (which often try to obtain more than one small bank) and are then operated as a branch of the larger bank. Smith contends that this is a round about, cumbersome, and expensive way to increase lending limits.

2.6.3 Profit Motive

After discounting management succession and increased lending limits, the primary reason for mergers is that the stockholders of the acquired banks receive what they consider to be a good price for their stock. Or, it can be assumed that the acquiring banks place a higher value on the stock than the original owners, possibly because the new owner/management will increase earnings of the bank by fuller use of resources.

2.6.4 Economies of Scale

Economies of scale that are available from larger operations is often one of the acquiring bank's stated reasons for a bank merger. There have been numerous studies on scale economies in banking operations involving various banking structures and bank sizes. In a study of banks in the Tenth Federal Reserve District (Kansas City) Lyle Gramley⁸ states that he could not reach any definite conclusions. His difficulty resulted from lack of data and was a consequence of the nature of the problem. He states that there is some improvement in efficiency (lower costs) for larger banks. These lower costs are made possible by larger scale operations and greater efficiency in labor utilization. But the real question that arises is: Do the large banks serve the same customers as small banks? Gramley believes the answer to this question is no. Loans at larger banks are substantially larger (to corporate borrowers), and the relative number of individuals to business customers is smaller than for small banks. Therefore, economies of scale studies are misleading because adjustments in customer structure have not been considered.

2.6.5 Increased Services

That a larger banking firm can offer a wider range of services to its customers is also a reason for bank

⁸Lyle Gramley, "A Study of Scale Economies in Banking," Research Department, Federal Reserve Bank of Kansas City, November, 1962.

merger. Services here include more savings and checking account alternatives, trust services, different types of mortgages, bank credit cards, and specialized loan services. A larger banking firm can offer these services because it has a broader customer base over which to spread the fixed costs of entering into an activity.

It has usually been found that larger banks do offer more services. But a question arising for a rural community is whether the people want or need these additional services and are willing to pay the additional costs of these services. In many cases the people who benefit from the additional services available may not pay the total cost of the additional service. This may happen due to the way the bank's pricing policies are established where the total customer base may pay for the additional costs of services used by only a few.

Additional questions that should be asked before offering specific services include: (1) Do people need low down payment plans for home mortgages? (2) Do people need a trust department? (3) Do people need bank credit cards available from the local bank? Having these services available has a cost. Not having these services available also has a cost for those wanting and needing the services. The costs should include the cash cost of the new service and/or the general increase in costs of the banking service if additional costs are not totally allocated to the

customers using the new services. How these costs are to be paid and/or how they should be computed is an interesting question.

2.6.6 Management Sensitivity

An argument against bank mergers is that the allegiance of bank management is no longer primarily to the people of the community in which the bank office is located. Consequently, many people feel that rural communities may lose out on potential development if the local financial institution does not actively support new projects. There is no way to truly measure this variable. Proxy measurements could include loan/deposit ratios for each branch office. But banks do not usually keep these types of records; even if they did, could one determine that a loan made through a given branch office actually benefited the local community? It is possible to find out where bank officers and board members live, but is their allegiance always to the community in which they reside? Community affairs involvement of bank management personnel could be another variable used to measure community allegiance involvement. But this may not be relevant because (1) the management person may not be the central power figure in bank decision making or (2) the management person may disassociate his business values from his personal feelings in operating the bank.

2.6.7 Profits vs. Community Service

There may be a direct trade-off between short run profits and community service for the owners of a bank. This trade-off often tends toward short run profits in the case of a bank that has recently changed ownership. The reason lies in the ways that banks are commonly sold and financed. If a new group purchases a bank (or controlling interest) for cash, they frequently borrow as much as 75 to 85 per cent of the purchase price against the stock purchased. This debt is commonly financed over a five or seven year period. A large cash flow is required to service this loan for the first few years of operation under new ownership. High return loans (and high risk loans) are typically industrial mortgages and lower quality tax-exempt municipals. By the time management has enough high return loans to generate a large cash flow to service the debt, there may be few funds available to serve the local loan demand. Therefore, community service may suffer, especially in the short run. This cash flow need may be the same if the bank is purchased by another banking firm or an individual. Most bank purchasers realize that a large amount of "external" investments reduce the deposit growth from within the community. But the trade-off between long term growth and short run profits for debt service often leans toward short run profits.

2.6.8 Movement of Funds

A positive benefit of bank mergers is that a bank with several offices can move funds from a surplus area to a deficit area. The ability to do that is undisputable for banks with offices covering a diverse business area. But for many limited bank branching systems (such as Michigan has) the whole area that is served by the bank may have similar fund needs.

Larger banks do, though, often have the ability to enter into arrangements to adjust their flows of funds in an area more easily than smaller banks. The larger size "packages" of loans that they have available may allow them more options to discount them. They are usually able to get the necessary resources to deal in the Federal Funds market more easily than smaller banks. When larger banks are "long" on funds, they may be able to find higher yielding investments from non-local markets. A necessary question that must be asked about movement of funds is: How does one determine what sector has surplus funds and what sector has a fund deficit? To answer this question requires more insight than we currently possess.

2.6.9 Management Quality

"Larger banks can afford to pay management higher salaries, and thus are able to attract a higher level of competence in managers." This statement is frequently found as a supporting statement for bank mergers. The 1971

Michigan Bankers Association Salary survey shows that this is true in Michigan. For 17 banks with assets under \$5,000,000 the chief active officer was paid a median salary of \$12,600; the second man was paid \$8,000. In 50 banks with assets between \$25,000,000 and \$50,000,000, median salaries were \$31,000 for a chief active officer, \$18,000 for a senior vice president, and \$9,500 for a branch office manager. If salary levels are an indication of management ability, the 50 larger banks (35 of which had between 1 and 5 branches) would have better management than the 19 smaller banks (17 of which had no branches).

Bank funded management training programs were also more available from the larger banks. In the \$15-25 million size banks, all of the banks compensated employees for tuition spent for educational programs. Also, most paid for travel and living expenses and allowed the employee time off with pay for the schooling. Alternatively, less than half of the small banks paid the employees' tuition for educational programs, and only one-third allowed time off and paid expenses for schools.

2.7 Decisions on Bank Ownership Changes⁹

The existing stockholders of the bank that is for sale make most effective decisions on bank ownership changes.

⁹This section gives a brief overview on how decisions to sell banks are made, the regulatory decisions when banks are purchased by an existing banking firm, and some of the constraints that bank purchasers may face. Much of the

They select, usually through the Boards of Directors of the bank, the best offer they can receive for the sale of their stock. The sale terms can involve (1) cash, (2) a securities trade (either equity or debt securities of the company making the offer), (3) employment opportunities for selling stockholders, (4) directorships in the acquiring bank, or (5) combinations of the above items. Frequently the best offer to the selling stockholders is from an existing banking company. If the selling stockholders select the offer from an existing bank, the sale (merger) comes under the control of the appropriate regulatory agencies.

In Michigan, the State Financial Institutions Bureau is the initial regulatory agency for merger approval for State banks; the Comptroller of the Currency is the initial governing body for National banks. After approval by the initial regulatory agency, all merger applications go to the District Federal Reserve Bank and the Federal Deposit Insurance Corporation. The final regulatory agency with which bank mergers must be cleared is the Anti-Trust Division of the U.S. Department of Justice.

The decision criteria to allow mergers are generally the same among all regulatory agencies that screen merger applications. However, the weightings of each criterion

material in this section comes from a conference with Graeme M. Black, retired Deputy Comm. of Banking, State Financial Institutions Bureau. Interpretations are those of the author and have not been cleared with Mr. Black.

differ, depending upon the function that the reviewing body serves. The decision criteria and the information gathered are on (1) successive management in the bank about to be acquired, (2) banking competition in the area, (3) capital adequacy of the resulting bank, (4) potential profitability of the resulting bank, and (5) the increase in loan limit of the resulting bank.

The main criterion used by the State Financial Institutions Bureau and the Comptroller of the Currency, agencies whose primary responsibility is to provide adequate financial service to the State, is management succession in the bank being acquired. Frequently rural banks are (or consider themselves to be) too small to be able to afford the salaries required to have a "manager-in-training" before the existing chief executive retires. If they are too small for that, they also consider themselves too small to pay high enough salaries to compete for new management personnel after the chief executive retires. Because of this lack of management talent, many small banks seek out a buyer for the organization, and this may be an existing bank that has in-depth management ability.

The second criterion that the Comptroller of the Currency and the State Financial Institutions Bureau look at is the competition in the area for financial services. This standard is rather loosely applied by these two regulatory agencies because of the various definitions of the

"relevant market" and the character of the competing banks in a region. Both of these agencies generally realize that one healthy large bank can and usually does provide better service than a small failing organization. But, because the Anti-trust Division of the U.S. Justice Department looks closely at the competition factor, even for small banks in rural areas, the initial approval reports are written by the State Financial Institutions Bureau and Comptroller of the Currency to show that both competition and service would be improved.¹⁰

The last three criteria--capital adequacy, potential profitability, and increased loan limits of the resulting bank--are met, under most circumstances when two banks merge, unless one of the organizations was extremely unhealthy. The relation of deposits to capital in the resulting bank can fall, but this is usually negligible unless the bank selling out is fairly large (in relation to the resulting bank) and/or has an extremely unfavorable capital ratio. Profit potential of the resulting bank is usually increased. There are many specific banking activities that have scale economies which could significantly reduce costs; and there are few reasons to think that income would go down,

¹⁰The State Financial Institutions Bureau and the Comptroller of the Currency use several definitions of the "relevant market" to show improved competition. They do this by varying the relevant geographic area, showing different competitors of comparable sizes, and by showing a lack of services available from some of the smaller banks involved in the merger application.

especially if the acquiring organization has better management. The loan limits of the resulting bank must increase. Loan limits are a function of capital plus surplus; and since these two accounts are added for the two banks, it must increase.

The Federal Reserve Board's primary criterion is availability of financial services, which is usually met because of the assumption that larger organizations can provide a wider range of services than a small organization. The Federal Deposit Insurance Corporation tends to focus on safety of the deposits. Since practically all banks now are members of the FDIC, there is really no question about them keeping their deposits as safe after merger. Neither of these agencies has ever denied a merger application in Michigan.

2.8 Chapter Summary

This chapter presented the theoretical framework in which rural bank performance will be analyzed. The basic industrial organization framework of structure-conduct-performance, supplemented with some of Sosnick's ideas, was used. Because of the nature of the rural banking industry, some modifications of this framework as commonly applied are necessary. Rural banking structure is closely regulated. Bank office location and the ownership arrangements are closely regulated by the state. Certain conduct of the rural banks is also regulated by law. Performance

is regulated only to the extent of being sure the rural banks make safe investments.

Rural Michigan has a preponderance of small unit banks. In recent years some of these have consolidated and some of them have been acquired with the intent of operating them as branches of larger banks in nearby cities. Another alternative bank ownership structure, the Bank Holding Company, has also been used in some states. There are advantages and disadvantages to all types of ownership structure.

The Michigan bank structure laws have allowed for bank mergers since 1960. The merger rule has been used often in the last ten years. Reasons for mergers and for merger regulation have been presented from several points of view.

The final section of this chapter explains how decisions regarding bank ownership changes are made. One point to remember is that the benefits of merger occur to the bank's owners first, and any benefits to the community it serves may be incidental.

Chapter III will discuss Sosnick's twenty-five criteria for effective competition with special reference to the rural banking industry. After the general discussion the criteria selected for study in the field survey will be presented.

CHAPTER III

MEASURES OF RURAL BANK PERFORMANCE

3.1 Introduction

Performance measures for banks have been defined in many fashions. Up to now most literature on bank performance has been flush with numerical ratios. The reason is that there is an abundance of secondary data available from the Federal Reserve System, the Federal Deposit Insurance Corporation, and state financial institutions bureaus. Because these data are available only in aggregations for large numbers or classes of banks, it is quite common to define a ratio of something as a performance measure. Examples of these ratios are: (1) loans to deposits, (2) profits to assets, (3) capital to assets, (4) rate of return on capital, and (5) rate of growth of deposits. These performance measures are then subjected to statistical tests to see if differences exist.

Performance measures of this type are quite useful. They give an indication of aggregate bank performance which can be used by policy makers in making rule changes to see where bank performance can be enhanced. Ratios are also used by individual bankers as a basis for comparing their

individual operation with an average of other operations. However, measures of bank performance as perceived by individuals are different. An individual may not care about the ratios commonly accepted by economists for measuring bank performance. But, he is extremely interested in the services available to him personally. And this is perhaps more important in a rural area where a person may have to drive ten miles or more to find an alternative bank than in an urban area where several nearby alternatives exist.

An individual thinks his bank is "good" if his loan request is granted, if it pays high interest rates on his savings account, if it is open for business when he wants it open, etc. Bank performance as rated by an individual is "bad" if he has to go out of his way to obtain service, if the bank has few open hours, if his loan request is refused or not acted upon for several days, or if the bank makes errors in his accounts. This chapter will discuss measures of rural bank performance as it relates to individuals and small communities. Sosnick's twenty-five flaws to effective competition will be the focal point of the discussion in the first part of the chapter. Only the major aspects of rural banking will be covered in this discussion. Some of the factors are pertinent to several flaws but will only be discussed under the major element. The second part of the chapter will discuss in more depth

the factors which formed the basis for the questions used in the field survey. This section will be structured according to the Bain-Caves framework with performance dimensions of efficiency, resource employment, progressiveness, and equity as they apply to individual customers served by rural banks.

3.2 Effective Competition in Rural Banks

Sosnick has identified twenty-five flaws that keep a market from being effectively competitive. From the definition of the market in the previous chapter and the regulations that rural banks must obey, it is evident that there is not a great deal of competition in some rural communities. In industries such as this, Sosnick's criteria provide a comprehensive listing of conditions that can be used to evaluate the service the industry provides.

He begins his list of undesirable market characteristics with ten conditions that are undesirable both in themselves and in their effects.

Unsatisfactory products.--Unsatisfactory products from rural banks could include loans that are not structured according to the repayment ability of the customer, loans that are of insufficient size to meet the customer's goals, loans that have a "high" interest rate, and a reluctance on the part of the bank to make certain types of loans. Also included here would be savings program that pay "low"

interest rates, frequent errors in accounting, and a lack of sufficient deposit and savings programs to fill the local needs. Unsatisfactory products would also include unavailability of services that would be desirable to the members of the rural community.

Underuse or overuse.--This flaw could most appropriately apply to the use of deposits the local bank controls. Large amounts of cash and government securities and a low loan/deposit ratio would indicate underuse of deposits for local community loan use. An extremely high loan/deposit ratio may lead to liquidity problems and be dangerous for bank depositors and stockholders.

Inefficient exchange.--Sosnick includes in this flaw giving buyers no opportunity to choose less costly alternatives, and imposing price ceilings and floors that create queues or surpluses. These factors are evident in rural banking. Regulation Q establishes maximum rates that can be paid on savings accounts. Not allowing buyers (borrowers) to choose less costly alternatives is common also because of the practice of offering "standard" programs that may have more features than the customers would choose if they could structure programs for themselves. Also, many types of loans are written at standard prices. An adjustment in loan prices would be desirable for different situations.

Inefficient production.--The most obvious case of inefficient production from rural banks to the borrowing

community would be to under utilize the deposits available for loans to the local community. This could come about because the loanable funds were disbursed in other than local loans or because the bank's portfolio plan was conservative in regard to making loans. Another area of inefficient production would be unavailability of services that are desired by the local community, thus forcing local people to travel to other communities to find the desired services.

Bad externalities.--"Inflicting costs or denying benefits when the persons could, with mutual advantage, contract out of the situation if negotiations were feasible" is Sosnik's concept of bad externalities. Because of a rural bank's position as a "middleman" between savers and borrowers and because of the rules, regulations, and examinations that the bank must face, it is frequently asserted that a bank cannot negotiate in some instances. If this is true, then bad externalities do exist because the lack of negotiations may deny services to some community members.

Spoliation.--Needlessly exhausting a self-renewing resource is spoliation. If rural bank deposits are generated primarily from the local community, investing an inordinate amount of community generated deposits in non-local investments would constitute spoliation. This is because non-local investments would not generate future deposits for the community to use as future sources of loan funds.

Exploitation.--In the rural banking industry overuse of deposits for loan funds would be the most obvious case of exploitation. Investing an injudicious amount of funds in loans may cause liquidity problems which would, in turn, injure depositors and stockholders. Exploitation would also be a factor when a local bank paid extremely low interest rates on savings accounts to people who may not have access to alternative savings programs. A bank making many non-local investments of deposits that were community generated could also be considered guilty of exploitation.

Unfair tactics.--Malicious interference with competitors or suppliers and fraud against customers are examples of unfair tactics. Because banks are multiproduct firms, they can subsidize certain parts of their business to make inroads into a competitor's business. An example of this may be a bank writing home mortgage loans at a favorable rate to restrict a saving and loan association's growth. If successful, the bank could emerge as the dominant home mortgage loan firm in the community and then return to charging normal rates for mortgage service. Because of the regulations that banks face, fraud does not appear to be a problem. However, a lack of understanding of the specifics of the agreements and bank policies on the part of some customers may lead to serious misunderstandings.

Wasteful advertising.--Advertising that is false, misleading, or valueless to its audience is called wasteful

by Sosnick. The question of the "value" of all advertising comes up frequently. Is it wasteful for a rural bank to sponsor community service type advertisements? Questions of this type must be answered before judgments of advertising value can be answered.

Irrationality.--Self-defeating choices by buyers or sellers constitute irrationality. To answer the question of whether or not this exists one needs to know more information about the utility function of the participants in the system. On the surface it appears that at times there may be some irrationality in the industry, but upon closer inspection there is often justification for the actions. An example of this is a bank that makes many non-local loans. In the long run this would be expected to restrict deposit growth, but in the short run the return on these investments may be higher.

The other fifteen flaws that Sosnick cites are conditions considered undesirable because of their effects. These conditions are:

Undue profits or losses.--Sosnick states that he does not know how to identify unjustified profits. Because of the entry rules to banking and the regulations on interest paid and types of investments used, there appears to be little evidence of undue profits in rural banking. (See Section 2.4 for average profit figures in Michigan banking.)

Inadequate research.--Individual rural banks do not generally have anyone whose job is a "researcher." However,

bankers' associations, city correspondent banks, the Federal Reserve System, and the Comptroller of the Currency usually have research staffs that do studies on banking. The research done by these agencies appears, however, to be directed more toward bank operations and macro results of banking actions than toward better servicing individual customers. Even if the research is the proper type, there is the question of the dissemination of the research results so as to benefit rural banks and rural bank customers.

Predation.--Pricing a product below the per unit cost to injure a competitor is predation. A similar problem occurs when one financial institution gives an extremely favorable rate to attract customers from a competitor; when the competitor quits serving this type of client, the original price cutter goes back to normal rates. (See unfair tactics section.)

Pre-emption.--This may be found in rural banking when a country bank insists on being the only source of loan funds to a borrower and is not willing to share the customer's loan needs. This could be harmful to the customer if his bank is unable to meet his total financial needs.

Tying arrangements.--Tying arrangements do exist in rural banking. Examples of this are "free" checking accounts when you have a savings account deposit of a certain size, "free" safety deposit boxes for time deposit holders, etc.

Resale price maintenance.--Prices of loan service are not set by a specific group or ruling, but are influenced directly by the major money markets. A rural bank has the option of investing funds in local investments or in the major money market alternatives. Thus the price of rural loan service is highly influenced by the major money market interest rates. Resale price maintenance is found in deposit acquisition because of Regulation Q, which cites the maximum interest rates that banks can pay for deposits.

Refusals to deal.--This flaw may be found where a bank establishes credit standards that are too "high" to allow many people to have access to the bank's loan service.

Undesirable discrimination.--There is probably some undesirable discrimination in the rural banking industry because of the examination of loans by the regulators. A person is refused a loan if his credit worthiness is adjudged poor, rather than being given a loan at a high interest cost to compensate for the higher risk shown by his poor credit standing.

Misallocation of risk.--This flaw is probably prevalent in the industry because of the "quality" standards that are established to qualify for loan service. Also, due to the rules and regulations, bank owners may not be exposed to as much risk as their returns might suggest that they face if there were freedom to enter the banking business.

Undesirable collaboration.--This flaw may exist in some cases because of the attitude of some rural bankers not to "infringe" on another bank's territory or to "steal" customers from neighboring bankers. This type of action sets up a non-competitive relationship between some rural banks.

Undesirable mergers.--Sosnick decries mergers that reduce the number of competitors to less than three, except for those that reduce costs. Since bank mergers have to be approved by the regulatory agencies, the flaw of undesirable mergers should not be present if regulations are properly made and enforced.

Undesirable entry.--Because entry into banking is regulated, this should not be a flaw.

Misinformation.--Misinformation probably exists in the rural banking industry as much or more than in most rural industries. Many citizens do not understand how their local banks function and the regulations they face. Also, many individuals are unsophisticated in financial dealings and do not know what options are available to them. Although the feeling appears to be diminishing, some residents are reluctant to provide their lenders with the necessary financial information so they can be given financial counseling.

Inefficient rules of trading.--Rules that fail to maximize the traders collective gain from trade in the

market are a flaw in Sosnick's framework. These would include Regulation Q interest rates, refusals to deal, and some of the other flaws mentioned before.

Misregulation.--Undoubtedly there are some regulations that foster inefficiency in certain aspects of rural banking. But operating inefficiencies may be offset by the gains in depositor safety by some of the regulations.

The list of twenty-five flaws contains what Sosnick considers every verifiable market condition that is available and undesirable. Some of them are structural elements, some conduct elements, and some performance elements in the Bain-Caves framework. The advantage of an exhaustive list like Sosnick's is that it gives specific identification to the flaws, whereas the Bain-Caves framework points only in the general direction of the major flaws. The specific identification of flaws is a problem because of the differences in markets to which this framework is applied. Also, Sosnick holds an "all or none" philosophy. A market is effectively competitive if, and only if, it has none of their characteristics. Because of the various objectives for the rural banking industry, some of these "flaws" exist. Nonetheless, this grouping of criteria is a good point of reference for the broader Bain-Caves framework.

3.3 Rural Bank Performance Dimensions Selected for the Field Survey

This section will discuss the performance dimensions covered in the field survey. They will be discussed within

the Bain-Caves framework, using the performance criteria of efficiency, employment of resources, progressiveness, and equity as they apply to small communities and individual customers served by rural banks. Because of the regulations that rural banks face and the problems in securing data, and because the objectives of the study were to look primarily at the differences in services available through rural banks after merger, information pertaining to many of the flaws suggested by Sosnick was not collected in the field study.

The nine variables selected as performance dimensions are:

1. Deposit and savings programs available
2. Interest rates paid on savings
3. Types of and charges for loan services available
4. Loan/deposit ratios
5. Services available to local public institutions
6. Loan limits
7. Auxiliary services
8. Changes in response to community needs
9. Decision making on loan requests

Some of these performance variables are subjective, based upon the feelings of people involved in the study: the bankers, local citizens, competitors, and the author. Other measures will be ratios and studies that are objective and for which objective answers can be obtained.

3.3.1 Deposit and Savings Programs

One central Michigan bank (not involved or included in this study) advertises "14 different checking plans available." This suggests that customers use, when offered, different checking account services. Checking accounts differ in (1) statement date and frequency, (2) service charge structure, (3) type of forms provided, and (4) time lag in crediting deposits, along with some other ways. Banks with computerized accounts have the ability to change many variables to suit the various services. Charges for the services may be competitive with neighboring banks, be set independently, or may be established on some basis such as the customers' demands for service.

Savings programs also have differences in interest rates paid, computation of rates, date interest is paid, how many cost-free transactions are allowed, and when withdrawals can be made without loss of interest earned.

A greater selection of deposit and savings programs may represent improvements in equity and progressiveness and fuller use of potential deposits in the rural community. If more programs are available, more members of the community could have their deposit and bank savings needs met at the local bank. These expanded programs would give more access to the local people who had some unusual needs. If one considers potential community deposits as the major resource available for use by the local bank, enhancing

the number of deposit and savings programs may increase the amounts of deposits in these accounts. Then the local bank could use these greater deposits in its investment program. The individual in the community may consider it a mark of progressiveness for his local bank to offer the same programs offered by larger banks located in the cities.

3.3.2 Interest Rates Paid on Savings

"Regulation Q" is the Federal Reserve System regulation that establishes the maximum rates banks can pay on deposits. There are reasons why banks may not want to pay the maximum amount allowed, or why they don't want to offer all of the savings plans that are allowed. These reasons include (1) being "long" on deposits in relation to the amount of investment alternatives, (2) not needing to pay high interest rates to attract deposits, and (3) not being willing or able to service different interest rates and conditions of the accounts. The third reason can be a problem if calculations are done by hand, but it is not a valid reason for banks with computerized records and accounts.

The same arguments can be used in regard to paying high interest rates on savings accounts as were used in the previous discussion of offering a large selection of deposit and savings programs. Two of the reasons for not paying high interest rates on savings--(1) being long on deposits and (2) not needing to pay high interest rates to

attract deposits--may demonstrate a lack of bank management push to find suitable investment opportunities, especially when one considers that a bank has open to it many investment alternatives which are not open to small investors. Thus, it would be a measure of progressiveness, increased equity, and greater use of community deposit potential to pay the highest interest rates allowed on savings plans.

3.3.3 Types of Charges for Loan Services Available

Loan service is a very important performance dimension for individuals in rural communities. Variables of importance in loan service include (1) the purposes for which loans are made, (2) collateral necessary to qualify for loan service, and (3) the repayment terms available. These variables and the interest charge for loan service are of prime importance to individuals needing such service.

Another concern is the timeliness with which loan service is granted. The lead time required between the loan application and the decision to grant or refuse the loan service is also important to the person seeking a loan. The lending agency does need time to investigate the borrower's credit references and the fund use, but an undue amount of time required by some agencies for these inquiries may render the loan service requested useless.

When assisting customers who are financing home mortgages, banks have the option of affiliating with the

Federal Housing Authority (FHA) and/or a mortgage guarantee insurance company, such as the Mortgage Guarantee Insurance Corporation (MGIC). By establishing a relationship with an agency of this type a bank may offer what is commonly known as a "low down payment plan" for real estate loans. Typically these loans have a 10 per cent down payment for qualified buyers. This compares to a required 20 per cent to 30 per cent down payment on conventional mortgage loans.

There is a cost to affiliate with these plans. It is not a direct cash cost, but the time involved to establish the relationship is incurred by the bank prior to writing any loans under these plans. Additional time must also be spent by the bank loan staff to meet the necessary paperwork requirements for each loan. The main benefit of the plan for the borrower is that a lower down payment is required. The cost to the buyer is a higher interest rate and/or a higher cost for obtaining the loan.

Having several loan service plans available increases the equity of the banking system in a local community. It could be expected that many more people would qualify for real estate loan service if the down payment requirements for such service were reduced from 30 per cent to 10 per cent. Thus, when a bank is affiliated with a low down payment plan more people have access to real estate loans.

More people can also have access to loan service if the purposes for which loans are granted are expanded, or if the collateral requirements are relaxed. In taking these actions, though, the bank management must be careful not to overlook its obligation to the depositors to invest the funds in "safe" investments.

By granting loan funds for use in more enterprises (on consumption items) resource use efficiency may be enhanced, since such action would increase the flow of money to elements of the local economy that are short of funds. This change in the flow of funds may benefit many in rural communities.

Loan pricing in a local community can have a large effect on the flow of funds. If, for example, real estate loans were written at 9 per cent interest rather than 7 per cent interest (given the same down payment requirement and repayment time), some individuals may be denied use of the real estate loan service because the payments to service the loan would be more than they could afford. But a trade-off here is that loan funds that are not used in one area, i.e., real estate, can be made available for other types of loans. How loans should be priced to enhance a bank's performance for a community may not be consistent from community to community. But good bank performance for a local community may include some measure of loan pricing that would enhance community development. Because of the

lack of information about loan pricing that would stimulate local development, it is not possible to develop a criterion that would be "good." Even though this criterion cannot be developed, it is interesting to notice if the banks offer favorable rates on any types of loans, as compared to other rates commonly charged.

3.3.4 Loan/Deposit Ratio

A bank's loan/deposit ratio is a measure of "how much mileage"--in terms of loans-- a bank's customers receive from the deposits held by the bank. However, it is a rough measure and assumes several things. If deposits are locally generated and most loans are granted in the community, it is a fairly good measure of how well a bank serves the community loan needs. With a given amount of deposits, a bank with a higher loan/deposit ratio usually indicates that more of a community's loan needs are met than would be met by a bank with a lower loan/deposit ratio, given similar loan demands. Of course, this assumes that the loans are made to community members, which is not always the case.

The statement above cannot be viewed in a static framework. The more loans granted in the community, the more deposits that would be generated for the bank. This would increase the bank's loaning capacity, which may in turn have the effect of lowering the loan/deposit ratio for a time until more loans can be made.

Also, when several banks' loan/deposit ratios are compared it is usually assumed that they all have similar deposit supply functions and loan demand functions. This is not always the case. There are many factors, especially in rural communities, that can affect either the deposits or loan demands that confront an individual bank.

Good performance in terms of a loan/deposit ratio for most country banks may be in the 65 per cent range if there are no unusual circumstances in the community. Ratios above this for smaller banks may cause liquidity problems at times. Ratios below this may indicate that the bank has extremely high credit standards or does not have sufficient loan programs available to meet the needs of the local community. A lower loan/deposit ratio may also indicate that the bank management is conservative and is extremely careful to avoid potential liquidity problems.

Good performance as perceived by the borrowing members of the community would be indicated by a higher loan/deposit ratio. To the saving members of the community, on the other hand, good performance would be indicated by slightly lower loan/deposit ratios to help insure the bank's solvency and deposit safety. For the owners of the bank a high loan/deposit ratio would suggest good performance because higher loan/deposit ratios are typically associated with a high return on the bank capital--but the loan/deposit ratio should not be so high that liquidity problems develop.

3.3.5 Services to Local Public Institutions

Local public agencies, local governmental districts, school districts, etc., have special financial needs. In addition to the normal business requirements of demand deposit service, they have needs for special services. These special needs include a depository for large sums of money after a tax collection and frequently a loan for operating funds prior to tax collections. Some public agencies also desire to have the bank accept payment for taxes and other bills, keep records, and do other types of financial work. This type of public service work can be beneficial to the bank, the governmental agency, and the community members. The bank benefits because it has the deposits of the governmental agency, while the agency benefits because often the bank can do the work at less expense than would be required of the agency. The community members benefit because many of them can conveniently pay assessments at a place where they normally transact business.

3.3.6 Loan Limit

The maximum loan available to an individual or corporate borrower from a Michigan bank is set by statute at 10 per cent of the paid-in, unimpaired capital and surplus of the bank.¹ This restriction prohibits one-third

¹State chartered banks can loan a maximum of 20 per cent of capital and surplus if approved by a two-thirds vote of the board of directors.

of the state's banks from making a loan in excess of \$50,000 and keeps one-sixth of the banks from making a loan greater than \$25,000. Most of the banks that face these limits are located in rural areas where there are few alternative financing sources. Having a local bank of adequate size to service all loan needs is desirable from the point of view of a rural businessman. Many small town businessmen lack the contacts necessary for access to financing sources in larger cities; so, in effect, their business size may be limited by the loan limit of their local bank. From the point of view of the local businessmen, local bank performance may be increased by having larger size loans available. But, from the point of view of others in the community wanting loan services, making larger loans available to the business sector may restrict the supply of loanable funds for other purposes.

A rural bank may expand its lending limit through the use of a city correspondent bank. In this type of an arrangement, the city bank will assist the country bank with both funds and service for large or highly specialized loans. A city bank benefits from providing this service in that it usually holds deposits of the country bank and it has another investment source. If a satisfactory correspondent relationship can be maintained by the country bank, the low loan limit problem may be alleviated. In this way those bank customers with larger fund needs can be served

without any question of restricting funds to the bank's other customers.

3.3.7 Auxiliary Services

To facilitate the primary function of financial transfers many banks offer a series of additional services. Some of these auxiliary services make the transfer function more convenient for the bank's customers or help to make the financial transfer process less costly. If the bank has a large enough customer base using the services, then they are generally profitable for the bank also. Three of these facilitating functions are bank credit card service, trust services, and retail inventory financing (floor-planning).

Credit card services are usually "mail in" functions. Application blanks are given to or mailed to potential customers, and a credit check is made upon their return. If credit is approved for the customer, a charge plate is mailed to the customer for his use. After the customer has used the charge card, bills are sent and payment is usually received by mail. Some sales time is usually required to convince retailers to accept charge cards. After this, most of the necessary work is a normal banking function.

It is an advantage to credit card users to have the service available locally: users and potential users can more easily inquire about the service; in the case of an

error or problem, a correction or solution may be more easily obtained at the local bank by phone call or visit than at a distant bank by long distance phone call or letter. From a merchant's point of view, it is also desirable to have the service available locally: they can receive immediate credit for credit card sales rather than wait for clearing operations at distant banks. In summary, it is positive performance to have credit card services available from a local bank. More people have access to the service. By having rapid credit to the participating merchants' accounts it may give them some additional capital.

Trust services are also a facilitating function that often aids in the transfer of funds. The transfer function that a trust department aids in is not usually the rapid transfer but a transfer which may take place over many years. In the process, a custodian is needed to be responsible for the funds while they are in the process of transfer. Trust services are for both business and personal use. The amount of business use, or potential use, in small towns would be difficult to determine. On the average, an individual's use of trust services may occur only a few times per lifetime. If trust services were provided by rural banks, the services might be more readily used by the residents than they would be if the people had to travel to a city and deal with strangers. So, having trust services available locally would allow the rural residents greater access to the service.

Another banking service that is useful both to a bank's retail merchant customers and to the community members who purchase merchandise from the retailers is floor-planning. This is an inventory financing plan that is primarily a service to the merchant. As a merchant takes delivery of inventory the bank finances the merchandise and takes a security agreement on it. When the merchant sells the merchandise to the consumer, he will act as the bank's agent and transfer the bank loan to the consumer. This is desirable for the consumer because it is an extremely convenient source of a loan. It is desirable for the merchant because it facilitates the sales of his products and because the bank usually pays a fee for writing the consumer loans. (The service fee is also necessary because the merchant must usually take some of the risks of bad loans.) It is desirable for the bank because it may attract loan customers who would not otherwise use the bank. This service is not without hazards, though, for the customer, the merchant, and the bank. The customer may obtain a loan from the merchant that would not be made by a professional lender and may then have difficulty repaying it. In these cases the merchant is responsible for repayments to the bank and may face losses in repossessing and collecting for the bank's loan. The bank faces the risk that the merchant's guarantee for the loan is not "good" and that the inventory financed will remain as good collateral.

Improved rural bank performance would indicate that this service be available. It would make loans more accessible to some community members, and it may enable local businessmen to compete more effectively with larger business firms that have internal financing programs.

3.3.8 Changes in Response to Community Needs

Performance criteria should include not only what a banking firm is doing now, but how often and how soon it changes its service in response to community changes. Questions to approach this criterion may include: (1) Does the bank act as an innovator in providing new services to the community, (2) does the bank respond to community demand for the services, or (3) does the bank attempt to foreclose the potential demand for a service? Positive bank performance as perceived by the community would probably be somewhere between (1) and (2) above. Not all new services are a benefit to the community. But a progressive bank should be a "leader" and change methods and provide new services with the changing needs of the community. It should not be a follower and wait until there is a substantial vocal demand for different types of services.

Measurement of a bank's change in response to community needs is difficult. Measures of how soon a bank started a service are possible. But was the service provided because the bank saw other banks profitably offering

this service? Or did the bank lose customers to other institutions that offered the service? Or did the bank deliberately not offer a service to encourage some customers to do their banking elsewhere? It would be difficult to obtain objective answers to questions of this type. Measures of progressiveness may better come from answers to questions about services mentioned in previous sections of this chapter.

3.3.9 Decision Making on Loan Requests

The person or persons who grant or deny loan requests in a rural bank have a powerful influence on individual financial growth and on community development. The decision maker may be the department head in a bank, the president, the board of directors, or one member of the board of directors. It is often difficult to determine who is the decision maker, and, after that, it is just as hard to determine the primary objectives of the decision maker. Identifying these objectives may give insight into the equity of the system by showing who has access to the benefits of the local bank.

The bank's objectives may include (1) being a safe depository for funds, (2) serving the community's loan needs, and (3) being profitable for the stockholders. These objectives are not always compatible, so a question arises as to the weighting of the objectives which would maximize performance. For small accounts, being a safe

depository is accomplished usually by the bank being insured by the Federal Deposit Insurance Corporation. Being profitable for the stockholders is a goal that is assumed away by many because of the feeling that the owners will change management if returns are unsatisfactory. But this may not be the case. If returns to bank capital are not attractive, the bank may not be able to attract capital for future expansion, which may lead to weaker bank service in the future. Positive performance for a rural bank would be to put stress on serving the community's loan needs but not at great expense of the other objectives.

3.4 Chapter Summary

This chapter has presented the performance dimensions that will be used to evaluate rural banks in terms of performance to community members. The major performance criteria were also discussed in Sosnick's framework of twenty-five flaws to effective competition.

So far the primary performance criteria discussed were concerned about the availability of services. It must be recognized that service availability is only one dimension of bank performance--another is service quality. And service quality may be more important in some instances than service availability. Consider how costly it would be to a person, for example, if a bank had a trust department, but the trust officers were incompetent and lost much of the account's capital because of bad management. How useful is it to

have a wide choice of deposit and savings programs if the bank makes numerous errors in accounting? There are many questions of service quality that can be raised, but for this study service quality was assumed to be equal from all banks.

The next chapter will present the results of the field study by means of a case study approach. It will describe the differences between the paired banks and will present reasons why some of these differences exist.

CHAPTER IV

THE FIELD STUDY - CASE STUDIES

4.1 Introduction

The field study was conducted from November, 1971, to January, 1972. It consisted of personal interviews with twenty-eight bankers, a mail survey of citizens living in the communities of fourteen merged banks, and a phone survey of several competitors of the merged banks. This chapter presents (1) the process used to select the respondents, (2) the primary area of questioning, and (3) the resulting case analyses.

4.2 The Banks

The major part of the data collecting aspect of the study was a field survey to interview representatives from twenty-eight banks. Fourteen of these banks were rural banks (as of December 31, 1965) that had since merged into larger banking operations. These banks were selected from all Michigan banks that had merged between January 1, 1966, and December 31, 1969. The selection criteria for these banks included (1) being in a town of under 2500 population (1960 census), (2) being in an agricultural area, and

(3) being at least ten miles away from a major metropolitan area. These criteria produced the population of rural Michigan banks that merged during the five-year period.

The fourteen selected banks were then paired with banks that were still independent rural banks at the time of the interviews (November-December, 1971). The pairing criteria included (1) being in a similar size town, (2) being a similar size bank as of 1965, and (3) being in a similar type agricultural area. These pairings were made with information from the Michigan Bank Directory¹ and with the assistance of several members of the Farm Management Extension Staff from the Department of Agricultural Economics.²

The main bevy of questions to these twenty-eight banks centered on how their operations had changed from December 31, 1965, (pre-merger) to December 31, 1970 (post-merger). This latter period was approximately one year after the last merger was effected, so it was expected that the major changes in bank operations would have occurred under the new ownership. (See Appendix A for questionnaire used.)

The major part of the financial data came from Reports of Condition which all banks are required to file

¹Michigan Bank Directory is published by Polk's World Bank Directory, R. L. Polk and Co., Nashville, Tennessee. It is distributed annually by the Michigan National Bank, Lansing, Michigan.

²Myron Kelsey and Ralph Hepp.

with the regulatory authorities at the close of business each year. This report has a breakdown of assets, liabilities, and capital structure, all of which is public information. In addition, there is a detailed breakdown of loan types and volume outstanding of each type; this is not public information but was supplied by all the independent banks banks and eight of the merged banks. The reason for this low response from merged banks was that after the merger former Reports of Condition were packed away and were not readily accessible.

Non-financial data were asked from the officers of the banks. For the merged banks the interviews included one of the following: Chief Executive Officer, the rural branch manager, or an officer responsible for the bank's branch operations. The knowledge of current operations by the officer interviewed was usually extensive; or if he did not know the answers to the questions, he generally asked another officer for assistance. However, the knowledge the interviewee had about past management practices varied considerably. As a result, responses to these questions were often "best estimates," and some respondents were unable or unwilling even to give estimates to some questions about past management practices.

Information from independent banks was obtained from the Chief Executive Officer. In all instances this person was employed by the bank for the whole time period in question. The information received from these

respondents was readily available, and estimates for unrecorded information can be considered fairly accurate.

4.3 The Competitors

The second data gathering aspect of the study included a phone interview of officers in financial institutions which competed with the merged banks. These competitors were selected by asking the merged banks for the names of competing financial institutions in the area. Unfortunately some of the banks were not able to list any direct competitors that were active in their primary business area. When this was the case, nearby banks or savings and loan associations were polled. In all instances, whether listed as competitors or not, Production Credit Association and Federal Land Bank Association representatives in the subject bank's business area were questioned.

It was planned to ask these respondents about relative changes in "market share" between the two organizations after merger. This question was not understood by the interviewees, so the questions were changed to ask about numbers of customers "picked up from" or "lost to" the banks immediately after merger. These representatives from competitive institutions were also asked if there was any change immediately after merger, if the change was still evident, or if the prior customer pattern had been re-established. In some cases the competitors were also asked about the community's general feeling toward the bank after merger.

The quality of the responses varied tremendously. Some of the representatives of the institutions questioned were new employees of the organization; as a result they could only pass on hearsay evidence and impressions gained from other members of the organization. Others were long term employees and gave accurate data to questions. All in all, it was believed most of the respondents gave accurate answers to the questions posed.

4.4 The Representative Citizens

A mail survey from some "representative citizens" was the last part of the field work. The County Extension Director where banks had merged was asked to suggest a person to interview--a knowledgeable citizen in the area who was not associated as an employee or stockholder of the bank. This citizen was asked to describe "the image of the bank among townspeople." Specific questions asked of the respondent included (1) how he thought the local people liked the bank ownership change, both immediately after the bank merger and at the current time; (2) what loan services were receiving more or less consideration under new ownership; (3) if people were more aware of banking services now than before; and (4) what changes were noticed in the bank's advertising. In addition to the structured questions about community feeling and knowledge, he was asked an open-ended question about his personal feeling toward the bank ownership change. (See Appendix B for questionnaire used.)

Of the fourteen questionnaires mailed in December, 1971, thirteen responses were returned and twelve were usable. The quality of these responses is indeterminate. It is known that some respondents did have a financial interest in the bank's past ownership and that others benefited from the bank management change. Hence, little can be said about the objectivity of individual responses.

4.5 Case Studies

The major findings of each pairing of a merged bank with its independent counterpart are presented in this chapter. The basic outline used in each of the case studies presented is:

- I. Previous ownership situation
 - A. Reason for merger
 - B. Financial considerations
 - C. Management continuity
- II. Service changes in the merged bank
- III. Comparison with the independent bank
- IV. Competitor's response
- V. Community acceptance

The case studies are headed with the major community economic activity. These headings indicate the type of banking services needed by the community. The fourteen headings are:

- 1. A bank in a fruit/recreation area
- 2. A bank in a fruit/recreation area
- 3. A bank in a general farming/recreation area

4. A bank in a general farming/livestock area
5. A bank in a general farming/livestock area
6. A bank in a livestock/crop farming area
7. A bank in a marginal farming/semi-urban area
8. A bank in a general farming/livestock area
9. A bank in a livestock farming area
10. A bank in a fruit farming area
11. A bank in a crop farming area
12. A bank in a general farming area
13. A bank in a crop farming/livestock area
14. A bank in a general farming area

4.5.1 A Bank in a Fruit/Recreation Area

The subject bank was family owned and managed. After the extended illness and death of the family head, the remaining family members sold the business to a larger banking firm in a nearby city. The family had been courting the city bank for years as a possible future owner of the bank and had used the acquiring bank as its primary city correspondent. Financial considerations of the merger included maintaining the widow of the former manager as an officer until she reached retirement age and electing her to the Board of Directors of the bank.

After merger the service changes of the subject bank included a liberalized lending policy. Conventional real estate loan policy changed from making loans of 60 per cent of the value of property to making loans up to 80 per cent of the value of the property. Also, under new ownership, a government sponsored plan became available so down

payments on real estate loans could be as low as 10 per cent. Maximum loan available from the branch manager was changed to \$20,000, as compared with a maximum loan of \$13,000 from the previous bank Chief Executive Officer. The target loan/deposit ratio of the subject bank increased from 58 per cent under previous ownership to 74 per cent under policies of present management. Interest rates paid on savings deposits were less than maximum Regulation Q rates in 1965, but they reached maximum Regulation Q rates under current ownership.

Services introduced under the new management included complete trust services, floor planning for retail customers, credit card services, and computerized accounts. The previous bank ownership offered none of these. The most rapidly increasing loan category in number of customers under the new ownership was real estate loans, followed by consumer loans.

As a comparison, the control bank has not had any lending policy change in the last five years. Its conventional real estate loan policy has been to loan 75 per cent of appraised value; it has been at this same rate for the last five years. In both 1965 and 1970 the control bank paid maximum Regulation Q interest rates. One of the rather unusual factors about the control bank was its large loan demand. In 1965 the loan/deposit ratio was 80 per cent. Management considered this too high, but maintained it to serve their customers. The target loan/deposit ratio was

set at 65 per cent, a figure management considered more workable for a five million dollar bank.

Fewer services were available from the control bank than from the subject bank office. Trust department services were not available, nor were the accounts computerized. However, floor planning and credit card services were available.

Interest charges on farm operating loans differed substantially between the subject and the control bank. The subject bank charged 8-1/2 per cent for farm loans, long-term real estate loans, and commercial and industrial loans. The control bank only charged 7 per cent on farm loans but did charge 8-1/2 per cent for real estate and commercial and industrial loans. For automobile loans the subject bank charged 6 per cent add-on; the control bank charged 7 per cent add-on. For short term residential improvement loans the subject bank charged 6 per cent add-on, and the control bank charged 8-1/2 per cent annual interest. The subject bank had longer hours; it was opened forty-two and one-half hours per week vs. the control bank's thirty-three and one-half hours. Both banks were open one evening a week, and neither of them was open on Saturday.

A vice president of the subject bank reported community acceptance of the merger to be quite good, especially from commercial customers. If anything, though, he suggested that the positive attitudes toward the bank might

have been for "non-banking" reasons. He suggested the reasons included the fact that new subject bank management had funded many community projects, e.g., public park and several smaller community projects. This was something that previous management and ownership of the country bank did not do.

The representative citizen responded that community acceptance of the bank merger was favorable at the time of the merger and remained that way. He stated that the current bank ownership stressed real estate loans and commercial loans more than past bank ownership did. The representative citizen also stated he thought the people were now much more aware of the range of services available from the local bank than they had been of those available before merger, even though he had not noticed any major change in bank advertising. His general comment about the merger was: "This has been a benefit to the community by the additional services available and the [increased] size of the bank for loans." The only concern the representative citizen had was that he "would like to see the bank record deposits at the main office (where the bookkeeping is done) the same day deposits are made in the rural branch, instead of recording them one day later as current arrangements do now."

Two competitors of the bank were interviewed. One competitor, a bank officer in the nearby town, said that

his bank gained window customers because of the merger. The main reason that people gave for changing banks was the subject bank's delay in recording deposits. However, the competing banker said that the subject bank was now able to do a better job of servicing loans than the past ownership and had taken away some of the loan customers his bank had previously served. However, due to an uncomfortably high loan/deposit ratio at his bank, he was glad that the neighboring bank was able to service some of the loan requests. The area Federal Land Bank representative who was interviewed said he had not noticed any major change in the farm real estate mortgage activity of the bank under the new ownership. He stated neither bank ownership group was active in making long-term farm real estate loans.

A performance summary of Case Analysis 4.5.1 is presented in Table 4.1.

4.5.2 A Bank in a Fruit/Recreation Area

This bank consolidation may not be viewed as a true merger. Five executives from a larger bank forty miles away invested in the subject bank several years ago. In early 1969 they merged the subject bank into the larger bank they also controlled. Due to common ownership of the two banks, a close relationship existed prior to merger. The city bank was the primary correspondent for the country bank and, in this role, supplied many services and most of

TABLE 4.1.--Performance Summary of Case Analysis 4.5.1, A
Bank Located in a Fruit/Recreation Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	58	74	84	84
Loan Interest Rates:				
a) Real estate (%)	XXX	8-1/2	XXX	8-1/2
b) Farm operating (%)	XXX	8-1/2	XXX	7
c) Consumer (add-on %)	XXX	6	XXX	7
Maximum per cent of value loaned for conventional real estate loans:	60	80	75	75
Are low down payment real estate loan plans available?	XXX	Yes	XXX	No
How have credit requirements changed from five years ago? ¹	XXX	L	XXX	S
What are the loan limits of				
a) Bank office manager	XXX	20	XXX	5
b) Bank (legal limit)	XXX	600	XXX	64
Are maximum Regulation Q rates paid on savings accounts?	No	Yes	Yes	Yes
How do your checking charges compare to your competitors? ²	XXX	C	XXX	C
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	Yes
c) Computerized accounts	XXX	Yes	XXX	No
d) Floor planning	XXX	Yes	XXX	Yes
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

the management expertise and technical help. Because of the prior close association the merger caused little effect in the community.

The primary reason for the merger was that the subject bank was short of capital. At the time of the merger the subject bank had a 72 per cent loan/deposit ratio and was unable to meet the local loan demand with deposits generated from the rural area. Up until the merger the city correspondent bank (merging partner) sent out loan funds to the rural community through loan sharing arrangements. Finally, though, it was decided it would be easier to serve the rural community by merging the two banks. Another reason for the merger was that a new building was necessary, so additional capital was needed for this.

The subject bank was unwilling to furnish financial statements; however, information about the services available was obtained. Under the new ownership arrangement the subject bank did liberalize the terms of its loan policy. Conventional real estate loans down payment requirements decreased from 50 per cent in 1965 to 35 per cent in 1970. In addition, the subject bank began offering a 10 per cent down payment plan for real estate loans. The target loan/deposit ratio was 75 per cent in 1965, but because of the larger deposit base, this was decreased to a more workable 65 per cent. In 1965 the subject bank did not pay maximum Regulation Q rates on savings accounts, whereas maximum Regulation Q rates were paid after the

merger. There was no substantial change in service charges. New services provided by the subject bank included trust services, floor planning, credit cards, and computerized accounts. The major loan portfolio change was an increase in real estate loans. Also since this bank office has merged, commercial and industrial loans are receiving much more attention from the new bank management than they did previously.

Current interest charges on new loans from the subject were slightly lower than the control bank. For example, mortgages were 8 per cent in the subject bank vs. 8-1/2 per cent in the control bank; commercial and industrial loans were 8-1/2 per cent in the subject bank vs. 9-1/2 per cent in the control bank; automobile loans were 5 per cent add-on in the subject bank and 7 per cent add-on in the control bank. The only category where interest rates were not lower in the subject bank was for farm loans. The subject bank charged 8 per cent, whereas the control bank charged only 7 per cent. The branch manager of the subject bank had loan approval authority of \$10,000; the control bank senior officer was authorized to go to only \$1,500 without loan committee or board approval.

The subject bank was open thirty-seven hours per week and the control bank thirty-two and one-half hours. Neither bank was open on Saturday, but both of them were open one evening per week. Both banks had comfortable

facilities. The control bank had recently been remodeled, and the subject bank had new facilities.

Management responsibility and sensitivity to the subject bank area was hard to evaluate. Six former board members remained on the board of the merged operation. However, the primary allegiance of these men may have been to the city in which the larger bank was located.

The Chief Executive of the subject bank stated that he believed the people in the local community liked the new operation. Additional capital had allowed a liberalized loan policy, a new building was available, and interest rates on loans had not changed significantly. Employees and personnel in the office remained basically the same.

The representative citizen in the subject bank area did not respond. Because of the population sparseness in the area competing financial institutions were practically nonexistent. The nearest banking institution was eighteen miles away. The Federal Land Bank representative contacted responded that the subject bank was not very active in making farm real estate loans, but this was unchanged from previous management policy. He also stated farmers were happier with the bank following the merger than they had been before because the larger farm operating loans were available.

A performance summary of Case Analysis 4.5.2 is presented in Table 4.2.

TABLE 4.2.--Performance Summary of Case Analysis 4.5.2, A
Bank Located in a Fruit/Recreation Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	75	65	70	65
Loan Interest Rates:				
a) Real estate (%)	XXX	8	XXX	8-1/2
b) Farm operating (%)	XXX	8	XXX	7
c) Consumer (add-on %)	XXX	5	XXX	7
Maximum per cent of value loaned for conventional real estate loans:	50	65	66	75
Are low down payment real estate loan plans available?	XXX	Yes	XXX	Yes
How have credit requirements changed from five years ago? ¹	XXX	L	XXX	S
What are the loan limits of				
a) Bank office manager	XXX	10	XXX	1.5
b) Bank (legal limit)	XXX	140	XXX	83
Are maximum Regulation Q rates paid on savings accounts?	No	Yes	No	No
How do your checking charges compare to your competitors? ²	XXX	C	XXX	C
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	Yes
c) Computerized accounts	XXX	Yes	XXX	No
d) Floor planning	XXX	Yes	XXX	Yes
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

4.5.3 A Bank in a General Farming/ Recreation Area

The subject bank was owned and controlled by three brothers. One of the brothers was the Chief Executive Officer of the bank; the other brothers were retail merchants in nearby communities. Because the manager of the bank wanted to "semi-retire," the family controlling the bank negotiated a merger with a larger bank in a nearby city. Financial considerations of the merger were not known, but the previous Chief Executive Officer was retained to manage the banking office as a branch of the acquiring bank.

The bank branch office was very independent of the parent bank. It maintained its own securities portfolio and purchased municipal bonds for its portfolio. It did all of its accounting internally and processed and serviced most of the loan requests that arose from the subject community. Since the present manager wished to semi-retire, he sent large and/or unusual loan requests to the main office for servicing. An unusual aspect of the merger was that all of the directors of the country bank were elected to the board of the merged operation.

Banking service considerations that were changed included the real estate loan policy. Previously, conventional real estate loans were written for 66 per cent of the value of the property. Under the new policies, conventional mortgages were written for 75 per cent of the

value of the real estate. In addition, a 10 per cent down payment plan was made available from the subject. Credit standards for approving loans were not changed.

Target loan/deposit ratios were increased. Under previous management the target loan/deposit ratio was 50 per cent; this was increased to 65 per cent from new management. Savings account interest rates were below maximum Regulation Q interest rates in 1965 and continued to be below maximum Regulation Q rates under present ownership.

In number of loans serviced the greatest change was in real estate mortgages; the second greatest change was in consumer loans. For this bank, the increase in number of consumer loans was not as great as it had been for many other banks in the study. This is because the members of the controlling family utilized the bank resources to finance sales from their retail businesses. By doing this they were able to write a lot of consumer loans for the bank.

Interest rates on real estate loans and consumer loans were the same from both the subject and control bank. Real estate loan rates were 7-3/4 per cent; farm loans were 7 per cent; commercial and industrial loans were 8 per cent; and consumer loans were 5-1/2 per cent add-on. For residential improvement loans the subject bank's interest rate was 6 per cent add-on. The control bank did not write separate residential improvement loans but attached this type of loan to a conventional real estate loan.

New services available in the subject bank included trust department services, floor planning, credit card services, and computerized accounts. None of these services were available from the control bank. The subject bank was open for business thrity-five hours per week; the control bank was open thirty-three hours. Both banks were open on Saturday, but neither was open during an evening. Both banks had very pleasant facilities.

Two competitors of the subject bank were interviewed. The area Production Credit Association representative responded that his organization had "picked up a lot of business" from the subject bank because it had "lost its agricultural orientation" under the new ownership. Also, he stated that his association was doing all of the loan services for customers previously shared. The Federal Land Bank representative when asked about the subject bank's activities in farm real estate mortgages stated that the bank was making fewer farm real estate loans. But since the subject bank didn't do much farm mortgage business before, there was little effect on the FLBA business. There were no other banks in the area close enough to compete with any of the major services the subject bank offered.

The representative citizen felt that the community feeling toward the bank immediately after the ownership changed was unfavorable. At the time of the mail survey, though, community feeling toward the new ownership has

improved from what it had been immediately following the merger. He stated that the bank was not stressing any loans service more after merger than before, but since the merger it had been less active in real estate loans. He further responded he had not noticed any change in the bank's advertising or in the awareness of community members to availability of services from the bank, as compared with services available under previous ownership. The respondent's personal feelings were that he did not like the ownership change because "the Board of Directors is forty miles away and the man in charge of the branch does not have control over the loans issued at the bank." He did not see any advantage to the merger and stated that farmers, of which he was one, were still using other means of finance.

A performance summary of Case Analysis 4.5.3 is presented in Table 4.3.

4.5.4 A Bank in a General Farming/ Livestock Area

Lack of upcoming management talent was the primary reason given for the merger of a four million dollar bank in a small village with a \$45 million bank in a city ten miles away. The former Chief Executive Officer was sixty-three years old at the time of the merger and wished to semi-retire. The former CEO and his wife, who was also employed at the bank, were the primary owners. Terms of the merger agreement included employment contracts for both the former Chief Executive and his wife until they reached

TABLE 4.3.--Performance Summary of Case Analysis 4.5.3, A
Bank Located in a General Farming/Recreation Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	50	65	60	65
Loan Interest Rates:				
a) Real estate (%)	XXX	7-3/4	XXX	7-3/4
b) Farm operating (%)	XXX	7	XXX	7
c) Consumer (add-on %)	XXX	5-1/2	XXX	5-1/2
Maximum per cent of value loaned for conventional real estate loans:	66	75	70	75
Are low down payment real estate loan plans available?	XXX	Yes	XXX	No
How have credit requirements changed from five years ago? ¹	XXX	S	XXX	S
What are the loan limits of				
a) Bank office manager	XXX	15	XXX	40
b) Bank (legal limit)	XXX	240	XXX	80
Are maximum Regulation Q rates paid on savings accounts?	No	No	No	No
How do your checking charges compare to your competitors? ²	XXX	H	XXX	L
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	No
c) Computerized accounts	XXX	Yes	XXX	No
d) Floor planning	XXX	Yes	XXX	No
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

retirement age and agreement that the man would be elected to the Board of Directors. Even though this couple was still employed at the branch office, the new management group assigned a newly hired executive to the office to assume management responsibilities so the former owner could semi-retire.

Bank loan criteria became more liberal after the ownership changed. Conventional real estate mortgage policy changed from requiring a 30 per cent down payment under previous management to a 20 per cent down payment under new management. In addition, a low down payment loan plan was made available. The loan/deposit ratio under the previous ownership was at a very conservative 40 per cent; under new management it increased to 55 per cent. Maximum Regulation Q interest rates were not paid on deposits under previous ownership, but top rates were paid under the new ownership. Trust services, floor planning services, credit card services, and computerized accounts began to be offered through the branch office.

The greatest increase in customers for a loan service was in real estate loans. The magnitude of other loan service changes through this office was not ascertainable because only records of consumer loans of less than \$1500 were kept.

Target loan/deposit ratio for the control bank was a constant 60 per cent. It did not pay maximum Regulation Q

interest rates on deposits in 1965, but it did in 1970. Consumer loans and real estate loans were reported as the most rapidly growing loan categories. The control bank's conventional real estate loan policy was to make loans of 65 per cent of the value of the property in both 1965 and 1970. It did not have a low down payment plan for real estate loans nor did it have a trust department or make credit card services available. However, floor planning service for retail customers was available.

Interest charges on loan services between the two banks were practically the same. Both banks charged 8 per cent on real estate loans and commercial and industrial loans, and both were 6 per cent add-on on auto loans. Residential improvement loans were 5-1/2 per cent add-on from the subject bank and 6 per cent add-on from the control bank. Farm operating loans were 8 per cent from the subject bank, whereas the control bank charged only 7 per cent.

The competitors of the subject bank, the Production Credit Association, the Federal Land Bank, and a neighboring bank were interviewed. The competing bank reported that since the merger they had acquired some window customers from the merged bank because of their longer hours. They did not, however, notice any appreciable change in number of loan customers. The Production Credit Association representative stated the subject bank was no longer interested in expanding farm loans. However, he also reported the

bank did hold good, solid loan accounts, and their association had not been able to attract highly desirable customers away from the bank.

The Federal Land Bank respondent said he had not noticed any change in the farm real estate lending activities of the subject bank. He commented that the subject bank did not have a farm loan representative, and as a result it only serviced very solid farm loans. He stated that the subject bank had been looking for a farm loan representative and inquired if someone from the FLB office would be interested in working as a farm loan service representative for the bank. He also reported that the general attitude of FBLA-borrowers who banked with the subject bank was positive.

The representative citizen stated that his impression of the community attitude toward the change in ownership was unfavorable immediately following the ownership change. However, this feeling had changed to a highly favorable current attitude. He gave one of the strongest positive reactions from any representative citizen contacted about the bank ownership change. He reported the current bank ownership was servicing consumer loans, commercial loans, and real estate loan customers much better than the past ownership had. He also stated people in the community were now somewhat more aware of the range of services available from the bank than they had been five years ago. This

increased awareness may have come about through more advertising for new accounts and advertising credit card services. He reported the current bank ownership had improved service to business type customers. At first he did not personally favor the ownership change, but at the time of the mail survey he liked it. "I feel the personnel have a better understanding of business. I can now make night deposits, a service that wasn't available before. As far as the general public goes, I don't feel it's affected them very much one way or the other."

A performance summary of Case Analysis 4.5.4 is presented in Table 4.4.

4.5.5 A Bank in a General Farming/ Livestock Area

Lack of upcoming management talent was given as the reason the subject bank decided to merge with a larger city bank. The operating manager/primary owner was sixty-nine years old at the time of merger and considered his bank too small to justify a "high" salary for a new management person. So, through a stock transfer the subject bank was merged with a city bank fourteen miles away. There was no transfer of operating management to the new organization. The previous manager retired immediately after the merger was consummated but was elected to a Director's position on the consolidated bank board. Both of the other "junior level management" employees also left after the merger.

TABLE 4.4.--Performance Summary of Case Analysis 4.5.4, A
Bank Located in a General Farming/Livestock Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	40	55	60	60
Loan Interest Rates:				
a) Real estate (%)	XXX	8	XXX	8
b) Farm operating (%)	XXX	8	XXX	7
c) Consumer (add-on %)	XXX	6	XXX	6
Maximum per cent of value loaned for conventional real estate loans:	70	80	65	65
Are low down payment real estate loan plans available?	XXX	Yes	XXX	No
How have credit requirements changed from five years ago? ¹	XXX	L	XXX	S
What are the loan limits of				
a) Bank office manager	XXX	2	XXX	5
b) Bank (legal limit)	XXX	1500	XXX	62
Are maximum Regulation Q rates paid on savings accounts?	No	Yes	No	Yes
How do your checking charges compare to your competitors? ²	XXX	C	XXX	C
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	No
c) Computerized accounts	XXX	Yes	XXX	Yes
d) Floor planning	XXX	Yes	XXX	Yes
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

Services available from the subject bank changed substantially. Requirements for loan service were liberalized. Conventional real estate loan policy in 1965 was to grant loans of up to 55 per cent of the value of real estate, whereas the post-merger limit was 75 per cent. In addition, a 10 per cent down payment plan was made available. The loan/deposit target ratio under past ownership was 50 per cent; current ownership had a target loan/deposit ratio of 65 per cent. Maximum Regulation Q interest rates formerly were not paid on deposits but were introduced under current ownership. A previously unavailable trust department was added, along with floor planning service for retail customers, credit card services, and computerized accounting. Following the ownership change, real estate loans were the bank's most rapidly growing category of loans, followed closely by consumer loans. Positive increases were made in both commercial and industrial loans and in farm operating loans.

These service indicators contrast with the control bank which reported no change in lending policy for the last five years. Real estate loan policy was and continues to be to loan no more than 65 per cent of the value of the real estate. A low down payment loan plan was not available. Loan/deposit target ratios remained at a constant 60 per cent. Five years ago, the control bank did not pay maximum Regulation Q interest rates on savings accounts, but it did by the time of the study. The control bank Executive Officer

stated that consumer loans had been the most rapidly growing line with real estate loans also increasing. He responded that both commercial and industrial loans and farming operating loans had been fairly constant over the last five years.

Loan granting authority for the branch manager of the subject bank and the manager of the control bank were both at \$5,000. Interest rate differences between the two banking offices were slight. Both banks charged 8 per cent for commercial and industrial loans, 6 per cent add-on for consumer auto loans and 6 per cent add-on for residential improvement loans. Differences were in the real estate loans where the subject bank charged 7-3/4 per cent and the control bank charged 8 per cent. This difference was reversed in the farm operating loan category, where the subject bank charged 8 per cent and the control bank only 7 per cent. Operating time of the subject bank was thirty-five hours per week; the control bank was open thirty-eight hours per week. Neither bank was open on Saturday, but both of them were open one evening per week.

A representative from the Production Credit Association stated that there was no change in the responsiveness of this banking office to farm credit needs in the area. He reported his association picked up a few loans in the area but there was nothing unusual about the amount of loans that they picked up or lost to the subject bank. However, the Federal Land Bank representative stated the

subject bank had increased its farm lending activity both in production loans and in farm real estate in the area. Two savings and loan associations from the area were also surveyed. Both reported that they were not near enough to the subject banking office to be able to give a comparison of the competitive effects of the ownership change on the subject bank's home mortgage activity.

The president of the acquiring bank reported that community acceptance of new ownership of the bank was favorable. He said at first the community was rather unhappy that they had lost their own local bank, but he reported that current management was doing a better job of banking and helping the community than past management and ownership. He believed the former management team was old and "not at all aggressive." The new management group, as a result of their aggressiveness and the additional services available to customers, had tripled loan volume through the branch the last five years.

The new ownership group also built a new, comfortable, serviceable building. The president also stated that their bank permitted the branch office to be more independent than many branch banking systems allow. The branch office had its own credit files and its own records and only sent the main office a daily summary of activity. He reported having a capable branch manager who was able to take care of most operational problems.

The representative citizen also reported highly favorable community reaction to the bank ownership change both immediately after the change and at the time of the study. He said the current bank ownership was pushing farm loans, real estate loans, and consumer loans more than past management had. He also stated that due to increased advertising of bank services the people were now much more aware of what services were available through the banking office than they had been previously.

He reported that larger loans were now made available and stated that types of loans which the past management did not even consider, such as mobile home loans, were now made. He also said that the new management made more loans available to young people. Savings depositors were happy because higher interest rates on savings accounts were paid and because time certificates were now available.

According to the representative citizen, since the ownership change many people from the community had resumed doing banking business in the local community rather than at other cities. In general, he said, "I feel it is much better."

A performance summary of Case Analysis 4.5 is presented in Table 4.5.

4.5.6 A Bank in a Livestock/Crop Farming Area

The subject country bank stock was widely held when it merged with a nearby city bank. The primary reason given

TABLE 4.5.--Performance Summary of Case Analysis 4.5.5, A
Bank Located in a General Farming/Livestock Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	50	65	60	60
Loan Interest Rates:				
a) Real estate (%)	XXX	7-3/4	XXX	8
b) Farm operating (%)	XXX	8	XXX	7
c) Consumer (add-on %)	XXX	6	XXX	6
Maximum per cent of value loaned for conventional real estate loans:	55	75	65	65
Are low down payment real estate loan plans available?	XXX	Yes	XXX	No
How have credit requirements changed from five years ago? ¹	XXX	L	XXX	S
What are the loan limits of				
a) Bank office manager	XXX	5	XXX	5
b) Bank (legal limit)	XXX	400	XXX	62
Are maximum Regulation Q rates paid on savings accounts?	No	Yes	No	Yes
How do your checking charges compare to your competitors? ²	XXX	C	XXX	C
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	No
c) Computerized accounts	XXX	Yes	XXX	Yes
d) Floor planning	XXX	Yes	XXX	Yes
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

for the merger was the lack of upcoming management talent. Shortly after the merger the ex-president retired. Management continuity was maintained, though, because new bank owners kept an Advisory Board which consisted of the former Board of Directors in the area. However, none of the actual directors from the acquired bank were elected to the Board of Directors of the combined operation.

The president of the combined bank operation stated that there had been no substantial lending policy change. Conventional real estate loan policy, which had previously been to make loans of up to 75 per cent of the value of the property, was increased to 80 per cent. In addition, a low down payment plan was made available from the combined bank. Target loan/deposit ratios increased from 65 per cent to 72 per cent. Maximum Regulation Q interest rates were paid under both ownership structures.

Checking account charges were reduced greatly. In fact, the new ownership advertised free checking account service and also offered trust services, floor planning for its retail customers, credit cards, and computerized accounts. The officer reported that since the merger the consumer loans had been the most rapidly growing loan type, with real estate loans following. There was no change in number of farm loan and commercial and industrial loan customers.

These factors compared to that of the control bank which also stated that its lending policies had not changed the last five years. Its conventional real estate loan policy was at 75 per cent both in 1965 and in 1970. However, the control bank did not have a low down payment plan available for real estate loans.

The target loan/deposit ratio of the control bank was 65 per cent in 1965 and remained at 65 per cent in 1970. It paid maximum Regulation Q interest rates on its savings accounts in both years. The control bank did not have a trust department, did not offer credit cards, and did not have computerized accounting. It did do floor planning for retail customers. Consumer loans had been the most rapidly growing loan category the last five years, with real estate loans being a close second.

Interest charges on various types of loans from both banks were about the same. Both charged 8 per cent for real estate loans and for farm loans and 6 per cent add-on for auto loans and for residential improvement loans. The only difference was that the subject bank charged 8-1/2 per cent for commercial and industrial loans, whereas the control bank only charged 8 per cent for this type of loan.

Both banks were open approximately the same hours. The subject bank was open thirty-two hours per week, the control bank thirty-four hours per week. Neither bank was open on Saturday, but both banks were open one evening per week.

Competitors stated that the subject bank had decreased its involvement in agricultural operating loans since the merger. The Production Credit Association representative said the current ownership was not as farm-oriented as the past ownership. He noted they did go after more of the higher interest rate loans and tried to get farmers in the area to use consumer loan services to buy pickup trucks and small machinery items. He stated that since the ownership changed, the local PCA had had many more requests for operating loans and had picked up many customers the subject bank previously served. He also indicated that the subject bank had hired a farm loan representative, but after twelve or thirteen months the employee had left because he did not feel higher level bank management had a real interest in farm operating loans. The Federal Land Bank competitor said he had not noticed any change in the subject bank's farm real estate lending activity since the merger.

Two officers from a competing bank located in the same town as the subject bank's headquarters related an interesting situation. Shortly after the merger was announced, these two men made a concentrated effort to solicit customers for their bank from the business area of the acquired bank. They reported finding 60 to 70 per cent of the acquired bank's customers willing to change banks when the merger occurred. However, when the merger was effected only a few customers actually switched from the

subject bank to the competitor. The competitor gained a major customer that was still with their bank, but most of the smaller commercial accounts that did business with their bank had since returned to doing business with their original banking office. The competitor thought the reason was convenience, since both banks gave similar type services.

Another competing banker stated that the subject bank was one of the strongest and finest competitors in the area. He reported the subject bank was first in innovation and change and foremost in providing quality banking service.

The subject bank president reported community relations after the first six months were good and the new organization was well accepted. He said there was some difficulty for the community in getting used to the change in operations since all records were kept in the main office, deposits were posted one day after deposit, and many of the "unusual services" were only provided in the headquarters office. He stated that these changes were made slowly as to prevent customer alienation.

The representative citizen stated that immediately after the ownership change the community feeling was indifferent. However, the current feeling toward the change was highly favorable. He reported the new bank ownership was stressing commercial loans, consumer loans, and real estate loans more. Further, he said that due to increased advertising the community was now somewhat more aware of

the banking services available. More types of savings accounts were available, and more bank involvement in community service activities was reported. The representative citizen felt that since the change in ownership the bank provided more services for its customers and that the community appeared to be pleased with changes. He had not heard anyone indicate a desire to return to the former situation.

A performance summary of Case Analysis 4.5.6 is presented in Table 4.6.

4.5.7 A Bank in a Marginal Farming/ Semi-Urban Area

The subject bank's need for additional capital was given as the primary reason for the merger. The bank president stated that the former operation was too small to service the community loan needs. Another reason for the merger was a lack of upcoming management talent. The bank previously had only one management employee, and he retired soon after the merger. There were no former board members elected to the consolidated bank board. Bank/community relationships were maintained because four members of the acquiring bank board had close ties to the subject community.

Under new ownership the subject bank reported that it had liberalized its lending policies. Conventional real estate loan policies increased from a maximum of 66 per cent to 70 per cent of the value of the property. In addition,

TABLE 4.6.--Performance Summary of Case Analysis 4.5.6, A
Bank Located in a Livestock/Crop Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	65	72	65	65
Loan Interest Rates:				
a) Real estate (%)	XXX	8	XXX	8
b) Farm operating (%)	XXX	8	XXX	8
c) Consumer (add-on %)	XXX	6	XXX	6
Maximum per cent of value loaned for conventional real estate loans:	75	80	75	75
Are low down payment real estate loan plans available?	XXX	Yes	XXX	No
How have credit requirements changed from five years ago? ¹	XXX	S	XXX	S
What are the loan limits of				
a) Bank office manager	XXX	25	XXX	N.A.
b) Bank (legal limit)	XXX	760	XXX	65
Are maximum Regulation Q rates paid on savings accounts?	Yes	Yes	Yes	Yes
How do your checking charges compare to your competitors? ²	XXX	L	XXX	C
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	No
c) Computerized accounts	XXX	Yes	XXX	No
d) Floor planning	XXX	Yes	XXX	Yes
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

a low down payment plan was made available. The loan/deposit target was at 70 per cent, whereas under previous ownership it had been 60 per cent. Maximum Regulation Q interest rates were not previously paid on savings, but after the merger maximum rates were paid on both savings accounts and time certificates. Checking account charges were somewhat higher than those of competing banks in the area. A trust department, floor planning for retail customers, credit card services, and computerized accounts were available. The greatest loan number increase was for real estate loans; the second greatest increase was consumer loans. Farm loan and commercial and industrial loan customer numbers remained steady.

The control bank reported no change in lending policies the last five years. Maximum conventional real estate loan policies in the control bank were 66 per cent of the value of the property and were constant the last five years. A low down payment plan was not available. Target loan/deposit ratios for the control bank were slightly less than 60 per cent. The control bank paid maximum Regulation Q interest rates on savings in 1965 but did not pay them in 1970. Its checking account charges were comparable to other banks in the area. Trust services, floor planning for retail customers, credit cards, or computerized accounting were not available. The control bank also reported real estate and consumer loan customers as

the most rapidly increasing for the bank. Commercial and industrial loans and farm loans remained steady.

Interest rate differences between the subject and the control bank were evidenced in farm loans, commercial and industrial loans and consumer loans. The subject bank charged 8 per cent for both farm loans and commercial-industrial loans, whereas the control bank charged only 7 per cent. Both banks charged 8 per cent for real estate loans and 7 per cent for residential improvement loans. Consumer loan interest rates were 6 per cent add-on in the subject bank and 5 per cent add-on in the control bank. The loan limit of the subject bank branch manager was \$10,000, whereas in the control bank the loan limit of the Chief Executive Officer was \$30,000. The subject bank was open thirty-eight and one-half hours per week; the control bank was open thirty-six hours per week. Both banks were open on Saturday. The subject bank was open on Friday evening, but the control bank was not. The subject bank facilities are very comfortable; the control bank facilities are extremely old and uncomfortable.

Two competitors of the subject bank were interviewed. The Production Credit Association official said farm loan activity of the subject bank remained basically the same after merger. He also stated there was not much commercial farming in the area so a change would be hard to perceive. The Federal Land Bank representative reported

his office did not see any change in the subject bank's aggressiveness regarding farm real estate mortgages in the area.

The representative citizen in this area did not respond, but responses on community acceptance of the bank merger were asked of the competitors surveyed. Both said their clients who were customers of the subject bank were quite happy with the change. Also, they thought the community liked the new services the acquiring bank made available. The president of the combined operation stated that at first there was resentment that the bank was no longer locally owned. He also noted the first manager was a disappointing experience; however, he reported community acceptance had improved since a new manager was hired.

A performance summary of Case Analysis 4.5.7 is presented in Table 4.7.

4.5.8 A Bank in a General Farming/ Livestock Area

The primary reason given for the merger was lack of upcoming management talent. The president of the acquired bank retired within one year, and the cashier retired within three years after the merger. Both of these gentlemen were on the acquired bank's board and were elected to the board of directors of the acquiring firm.

The subject bank and the control bank with which it was compared were quite similar in many of their operations.

TABLE 4.7.--Performance Summary of Case Analysis 4.5.7, A Bank Located in a Marginal Farming/Semi-Urban Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	60	70	60	60
Loan Interest Rates:				
a) Real estate (%)	XXX	8	XXX	8
b) Farm operating (%)	XXX	8	XXX	7
c) Consumer (add-on %)	XXX	6	XXX	5
Maximum per cent of value loaned for conventional real estate loans:	66	70	66	66
Are low down payment real estate loan plans available?	XXX	Yes	XXX	No
How have credit requirements changed from five years ago? ¹	XXX	L	XXX	S
What are the loan limits of				
a) Bank office manager	XXX	10	XXX	30
b) Bank (legal limit)	XXX	300	XXX	60
Are maximum Regulation Q rates paid on savings accounts?	No	Yes	Yes	No
How do your checking charges compare to your competitors? ²	XXX	H	XXX	C
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	No
c) Computerized accounts	XXX	Yes	XXX	No
d) Floor planning	XXX	Yes	XXX	No
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

The control bank changed management but not ownership in 1966, so it was operated under different circumstances in 1970 than in 1965. Both banks reported loan requirements were somewhat more liberal than five years ago. Five years ago the subject bank's conventional real estate mortgage policy was to make loans up to 55 per cent of the value of the property; under new management and control, this was increased to 70 per cent. The control bank's conventional real estate loan policy in 1965 was to loan up to 60 per cent; this, too, was increased to 70 per cent. Both banks had low down payment plans available for real estate loans.

The subject bank's target loan/deposit ratio was 65 per cent in 1965. This had been increased to 70 per cent in 1970. For the control bank the target loan/deposit ratio was 45 per cent in 1965 but had been increased to 65 per cent. Both banks had paid maximum Regulation Q interest rates on savings accounts over the last five years. The subject bank reported its checking account charges to be comparable to those of its competitors. However, the control bank reported checking service charges to be higher than other area banks.

In the subject bank a wider range of services was available. Trust services, floor planning for retail customers, and credit card services were available, and accounts were computerized. Neither trust services nor credit cards were available in the control bank, although

it did do floor planning for retail customers and did have computerized accounts.

Both banks responded that real estate loans and consumer loans were the fastest and second fastest growing loan services in their respective operations. Both banks also reported that commercial and industrial loans and farm operating loan demand was steady the last five years. Interest rates on loans were nearly the same also. Both the subject bank and control bank charged 8 per cent for real estate loans, farm operating loans, and commercial and industrial loans. Both banks charged 6 per cent add-on for consumer loans. The only difference in reported interest rates was that residential improvement loans were 7 per cent add-on from the subject bank and 6-1/2 per cent add-on from the control bank.

A substantial difference was reported in the number of hours the banks were open per week. The subject bank was open forty-one hours per week versus thirty-two and one-half hours for the control bank. Both banks were open on Saturday; the subject bank was open on Friday evening, but the control bank was not.

Three competitors of the subject bank were surveyed. The Production Credit Association representative from the area stated the subject bank was getting quite active in farm operating loans, especially since the subject bank had opened another branch near an industrial city. He suggested the subject bank channeled deposits from the industrial

area to the agricultural area. He stated that many of the PCA members who did business with the subject bank liked the broad range of services available after the merger. The area Federal Land Bank representative did not notice any major change in the subject bank's farm lending activity. He thought that this might have been because of the type of community in which the subject bank was located: a strong ethnic group that borrowed very little except from family members for farm real estate loans.

A competing banker was also interviewed. He stated he did not notice much difference in the subject bank's operations after the merger. The number of customers gained from the subject bank area was normal as was the number of customers lost to the subject bank.

Community acceptance of the ownership change had been quite good. The current president of the subject bank stated that the ownership change was well-received from the beginning. He said there was not any radical change of policies or operations when the ownership change was effected. The community was aware of a close association of the two banks prior to merger, such as some common officers and directors. This factor helped the new banking group to be aware of local community relations and problems.

The representative citizen responded that the community feeling toward the bank was favorable immediately after the ownership change and remained that way. He stated the new bank ownership was pushing all types of

loans more than the past ownership. He also suggested people were now somewhat more aware of the range of services available from the bank than they had been before. He attributed this to an increase in newspaper and radio advertising. He reported that the new ownership had improved service to many groups of customers by making more types of loans and taking higher risk loans. His personal feelings were: "I was a stockholder for about twenty-five years when the bank was run locally. I knew more about how it was run and used to feel more a part of it. But, I can see where there are advantages to being part of a larger bank; they are in a position to make larger loans to farmers and other businesses which seems to be the trend nowadays. They seem to take a lot more chances on loans than the local bank did, but with property (values) going up all the time, they seem to come out all right. These high risk loans seem to be where the money is."

A performance summary of Case Analysis 4.5.8 is presented in Table 4.8.

4.5.9 A Bank in a Livestock Area

According to the president of the merged bank, the merger came about because the majority stockholders wanted to withdraw their capital from the banking business. Before merger the subject bank was very small, with slightly over \$2 million of total assets. The merged operation combined the subject bank office with three other fairly

TABLE 4.8.--Performance Summary of Case Analysis 4.5.8, A
Bank Located in a General Farming/Livestock Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	65	70	45	65
Loan Interest Rates:				
a) Real estate (%)	XXX	8	XXX	8
b) Farm operating (%)	XXX	8	XXX	8
c) Consumer (add-on %)	XXX	6	XXX	6
Maximum per cent of value loaned for conventional real estate loans:	55	70	60	70
Are low down payment real estate loan plans available?	XXX	Yes	XXX	Yes
How have credit requirements changed from five years ago? ¹	XXX	L	XXX	L
What are the loan limits of				
a) Bank office manager	XXX	10	XXX	9
b) Bank (legal limit)	XXX	300	XXX	90
Are maximum Regulation Q rates paid on savings accounts?	Yes	Yes	Yes	Yes
How do your checking charges compare to your competitors? ²	XXX	C	XXX	H
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	No
c) Computerized accounts	XXX	Yes	XXX	Yes
d) Floor planning	XXX	Yes	XXX	Yes
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

small country banks. After the merger all of the junior management employees of the subject bank quit so a new manager was hired. To give continuity of service, the new manager was assisted by an advisory committee made up of several former directors of the country bank. The advisory committee was discontinued after two years because the members were reluctant to accept the new ownership's methods.

The subject bank branch office was independently operated. It had its own bookkeeping system and credit files. The manager was given much responsibility. He had authority to make loans as large as any other bank officer without consulting the loan committee.

Both the new ownership of the subject bank and the control bank have liberalized their loan policies over the last five years. The conventional real estate loan policy for both banks in 1965 was to lend up to 60 per cent of the value of real estate. For the subject bank this increased to 75 per cent; for the control bank this increased to 66 per cent. Neither bank had a low down payment plan available for real estate loans. The subject bank's loan/deposit ratio remained at 63 per cent from 1965 to 1970; the control bank's loan/deposit policy increased from 56 per cent in 1965 to 70 per cent in 1970.

Both banks paid maximum Regulation Q interest rates on deposits in both 1965 and 1970. They also both reported their checking account charges were comparable to those charged by other area banks. Neither bank had trust

services, computerized accounts, or credit cards to offer its customers. The subject bank had floor planning services for its retail customers but the control bank did not.

The most rapidly growing loan service for both banks was installment credit. Commercial and industrial loans were the second fastest growing for the subject bank. Interest rates charged by the two banks were 8 per cent for farm operating loans, 8 per cent for commercial and industrial loans, and 6 per cent add-on for residential improvement loans. Differences were in real estate loans where the subject bank charged 8-1/2 per cent and the control bank charged 8 per cent; and in consumer loans where the subject bank charged 6 per cent add-on and the control bank 5-1/2 per cent add-on. The subject bank was open thirty-three hours per week, whereas the control bank was open thirty-nine hours per week. Both offices were open on Saturday. The control bank was open one evening, but the subject bank was not.

Competitors interviewed included the subject bank's area Production Credit Association representative and a Federal Land Bank fieldman. The Production Credit Association representative reported the subject bank had been taking some farm customers from the Association. He stated the reason was that the bank was handy for the area farmers to use for banking services. He also said that after the merger the bank had substantially increased the size of available farm operating loans. The Federal Land Bank

representative responded that he also noticed a positive change in the attitude of the subject bank in making farm loans. He noted the subject bank was much more competitive on short term real estate loans than before. He also said that the bank made many more large farm operating loans to their Association members now than prior to merger.

The representative citizen did not respond. The community feeling, according to the President of the acquiring bank, was favorable. The people in the community liked the change, he said, and he had never heard any adverse feelings about the change. He did note that for a short period of time some management problems at the acquired office caused some dissatisfaction. It took some time to find a capable new manager, but after the new manager was established in the position, community acceptance was very good.

A performance summary of Case Analysis 4.5.9 is presented in Table 4.9.

4.5.10 A Bank in a Fruit
Farming Area

The merger of the subject bank with a nearby city bank was consummated after the former president died. Another member of the family controlling the bank came in to assume bank management. But due to problems stemming from a large amount of low quality and overdue outstanding loans, the controlling family was forced to find some management assistance. Rather than hire a new manager and write off

TABLE 4.9.--Performance Summary of Case Analysis 4.5.9, A Bank Located in a Livestock Farming Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	63	63	56	70
Loan Interest Rates:				
a) Real estate (%)	XXX	8-1/2	XXX	8
b) Farm operating (%)	XXX	8	XXX	8
c) Consumer (add-on %)	XXX	6	XXX	5-1/2
Maximum per cent of value loaned for conventional real estate loans:	60	75	60	66
Are low down payment real estate loan plans available?	XXX	No	XXX	No
How have credit requirements changed from five years ago? ¹	XXX	L	XXX	L
What are the loan limits of				
a) Bank office manager	XXX	5	XXX	41
b) Bank (legal limit)	XXX	260	XXX	82
Are maximum Regulation Q rates paid on savings accounts?	Yes	Yes	Yes	Yes
How do your checking charges compare to your competitors? ²	XXX	C	XXX	C
Does the bank offer				
a) Trust department	XXX	No	XXX	No
b) Credit cards	XXX	No	XXX	No
c) Computerized accounts	XXX	No	XXX	No
d) Floor planning	XXX	Yes	XXX	No
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

their "bad" loans, they sold their stock to a nearby city bank. Management continuity was provided by one employee who remained with the organization. No former board members were elected to the acquiring bank's board.

Service changes from the new ownership group included more conservative loan criteria. However, other services were expanded. Conventional real estate loan policy was changed to loan up to 80 per cent of the value of the property. A 10 per cent down payment plan was also made available. Target loan/deposit ratios as of 1965 for the subject bank are not known, but the 1970 target loan/deposit ratio was 63 per cent. Rates comparable to other area banks were charged on checking accounts. It was not known whether the bank paid maximum Regulation Q interest rates on savings accounts in 1965, but maximum rates were paid on savings in 1970.

As a comparison, the control bank's lending policy did not change from 1965 to 1970. In both years it made conventional real estate loans of up to 60 per cent of the value of the property. The target loan/deposit ratio of the subject bank increased from 55 in 1965 to 60 per cent in 1970. Maximum Regulation Q interest rates were paid on savings accounts in both periods, and checking service charges were comparable to other area banks.

Services available from the subject bank included trust services, floor planning for its retail accounts,

credit card services, and computerized accounts. The control bank did not have any of these services available. Both banks reported that the greatest change in loan services in the past five years had been for consumer loans. In fact, before merger the subject bank did not have any consumer loans. The remaining three loan types available from the subject bank had all decreased in numbers since merger. This was expected because of the extremely liberal loan policy of past management.

The subject and control banks charged similar interest rates for real estate loans ($7\frac{3}{4}$ per cent) and for farm operating loans (7 per cent). Commercial and industrial loan customers were charged 8 per cent interest at the subject bank and $7\frac{3}{4}$ per cent at the control bank. Both banks charged $5\frac{1}{2}$ per cent add-on for consumer loans. Residential improvement loans were $5\frac{1}{2}$ per cent from the subject bank and 5 per cent add-on from the control bank. The control bank was open forty-three hours per week including Saturday and one evening per week. The subject bank was open thirty-eight hours per week and was not open on Saturday or during any evening.

Competitors of the subject bank included a Production Credit Association representative, a Federal Land Bank Association representative, a local Savings and Loan Association representative, and another banker in the area. The local Production Credit Association representative

stated his association had more inquiries about loans from area farmers since the ownership change but had not gained any substantial number of new customers at the expense of the subject bank.

The Federal Land Bank representative stated that under past management the subject bank was extremely farm oriented, but it lost this orientation when it changed ownership. He thought that the present management was less sympathetic with farmers' problems than past ownership had been. He agreed with the subject bank Vice President, who stated that the old manager made many marginal farm operating loans which new ownership was not interested in making or renewing. The Federal Land Bank representative stated that the bank competed for some residential loans. For these loans the new bank ownership was much more aggressive now than former ownership had been.

A competing banker, whose basic orientation was agricultural, responded that his bank had gained many agriculture and agri-business loans from the subject bank's service area after the merger. He stated that the subject bank now prefers to take care of the downtown merchants and does a much better job for them than the previous ownership. He stated the new ownership brought in many new banking services for area residents and provided a broader range of home mortgage services. Except for farm operators, he thought service was greatly improved over what it was before.

The savings and loan association manager stated that he did not notice any major change in the bank's residential real estate loan activity. He did say his association was able to pick up some savings accounts from the subject area since the ownership change, but they had lost many more savers to the bank than they had gained.

Community acceptance of the ownership change was not favorable. The Vice President stated that soon after merger there was a lot of resentment to the ownership change. He reported some of the resentment had subsided; but because of the changed orientation away from agriculture and because the bank was more selective in approving loan requests, some resentment remained. The representative citizen's response was basically the same. He reported that community feeling was highly unfavorable immediately after the ownership change. He stated that the community impression of the ownership change is still unfavorable but has improved since the merger was effected. He thought the bank was pushing consumer loans but was extremely restrictive on farm loans. Even though the bank used more radio advertising since the ownership change, he thought the community was less aware of the services available from the bank now than they were under the past ownership.

A performance summary of Case Analysis 4.5.10 is presented in Table 4.10.

TABLE 4.10.--Performance Summary of Case Analysis 4.5.10,
A Bank Located in a Fruit Farming Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	N.A.	63	55	60
Loan Interest Rates:				
a) Real estate (%)	XXX	7-3/4	XXX	7-3/4
b) Farm operating (%)	XXX	7	XXX	7
c) Consumer (add-on %)	XXX	5-1/2	XXX	5-1/2
Maximum per cent of value loaned for conventional real estate loans:	N.A.	80	60	60
Are low down payment real estate loan plans available?	XXX	Yes	XXX	No
How have credit requirements changed from five years ago? ¹	XXX	C	XXX	S
What are the loan limits of				
a) Bank office manager	XXX	100	XXX	40
b) Bank (legal limit)	XXX	550	XXX	110
Are maximum Regulation Q rates paid on savings accounts?	N.A.	Yes	Yes	Yes
How do your checking charges compare to your competitors? ²	XXX	C	XXX	C
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	No
c) Computerized accounts	XXX	Yes	XXX	No
d) Floor planning	XXX	Yes	XXX	No
e) Saturday or evening hours	XXX	No	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

4.5.11 A Bank in a Crop
Farming Area

The reason for the subject bank's merger was lack of upcoming management talent. Because the previous owners of the subject bank thought they were unable to afford additional management talent to overlap with the present manager, a sale of the stock was negotiated. The present branch manager, who was a major owner of the bank, was strongly in favor of the merger because of the pension arrangements available to him from the acquiring bank.

Management continuity was provided by the ex-Chief Executive Officer who remained with the bank for four years until he retired. Five of the seven directors from the previous board remained on the board of directors of the combined banking firm.

Loan granting requirements had not changed substantially since the ownership change. Conventional real estate loan policy in 1965 was to make loans up to 60 per cent of the value of the property. This was increased to 75 per cent under current ownership. Also, a low down payment plan for real estate loans was available from the new operating group.

The control bank had a management change in 1964. The vice president of the comparison bank stated that their loan criteria had also become more conservative since 1965. In 1965 its conventional real estate loan policy was to loan up to 70 per cent of the value of the property, and it

remained at that rate in 1970. A low down payment plan was available.

The target loan/deposit ratio of the subject bank in 1965 was 60 per cent. This was increased to 72 per cent in 1970 as compared with a 70 per cent target loan/deposit ratio in both years for the control bank. Both banks paid maximum Regulation Q interest rates on savings accounts in both 1965 and 1970. The control bank's checking account charges were lower than their competitor's. The subject bank's checking account charges were comparable to their competitors.

Services available from the subject bank included full trust services, whereas the control bank only had limited trust services. The subject bank offered credit card services, but the control bank did not. Both banks offered floor planning for retail customers and had computerized accounts.

The subject bank reported no increases in any type of loan serviced by their bank after merger. The only difference in loan service mentioned was that fewer farm loans were outstanding. The reason for this was attributed to fewer farmers in the area. The control bank, however, reported that it had large increases in numbers of consumer loans, and a substantial increase also in real estate loans serviced. For the control bank, numbers of farm operating loans and commercial and industrial loans did not change

from 1965 to 1970. Interest rates were generally higher at the subject bank than at the control bank. For farm operating loans the subject bank charged 8 per cent and the control bank 7-1/2 per cent. For commercial and industrial loans the subject bank charged 8-1/2 per cent; the control bank charged 8-1/4 per cent. Consumer loans were 6 per cent add-on in the subject bank, 5-1/2 per cent add-on in the control bank. On residential improvement loans the subject bank charged 7 per cent add-on while the control bank charged 6 per cent add-on. Interest rates for real estate loans were the same at both banks, 8 per cent. The subject bank was open forty-two hours per week, while the control bank was only open thirty hours per week. Neither bank was open on Saturday, but both banks were open one evening per week.

Three of the subject bank's competitors were interviewed. The Production Credit Association fieldman stated the merger created no major effect on farm loan service to the area. The PCA had picked up some loan customers from the bank but had also lost some loan customers to the bank. The Federal Land Bank representative stated the subject bank had very little money to lend for long term real estate mortgages for farm lands. In fact, he reported that the bank sent most of its requests for long term farm real estate mortgage service to his association. He thought the bank did a good job of servicing farm operating loans

and said many of his customers had operating loans from the bank. A nearby savings and loan association manager responded that the subject bank did less residential real estate lending since the merger. However, he was unable to tell if it was because less property was being sold or transferred in the area or if the bank did not service the demand. He did state his association was obtaining more savings accounts from the subject area than they had in the past and attributed this to the higher interest rates on savings accounts that the savings and loan was able to pay.

Community acceptance, according to the branch manager, was fairly good. He commented that the branch office was very independent. In fact, the subject bank office paid higher rates on savings accounts than did the other offices in the parent company. He also stated that few other services or personnel had changed, so most bank customers noticed little difference. The major change was that after merger the bank went to computerized accounts with central clearing. This caused some unhappiness because of clearing delays and problems of getting acquainted with the computerized system methods.

The representative citizen responded that immediately after the ownership change the community impression toward the new ownership was unfavorable. However, by the time of the study the feeling was favorable. He stated that the current bank ownership was pushing commercial and

industrial loans, consumer loans, and real estate loans more than the past ownership. He thought people of the community were much more aware of the range of services available now than before, and he attributed this to heavy radio and newspaper advertising. His personal feeling was that the change was good because of the additional bank services available. He thought these additional services were due to the larger financial base. He also reported the bank was involved in more community activities. The only negative response the representative citizen noted was that the bookkeeping was done at the main office. This practice prevented deposits from being immediately credited to the accounts; rather, this was not done until the day after deposit. He also said many of the people in the community found it difficult to understand the new computerized bookkeeping system.

A performance summary of Case Analysis 4.5.11 is presented in Table 4.11.

4.5.12 A Bank in a General Farming Area

The subject bank office was merged into a nearby city bank two years after the death of the former owner. For those two years the former owner's widow acted as the Chief Executive Officer. Because she was having serious problems with the management of the firm, she effected a merger with the city bank. Prior to the merger there were many inter-bank dealings and relationships between the two banks. Merger conditions included that the widow would be

TABLE 4.11.--Performance Summary of Case Analysis 4.5.11,
A Bank Located in a Crop Farming Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	60	72	70	70
Loan Interest Rates:				
a) Real estate (%)	XXX	8	XXX	8
b) Farm operating (%)	XXX	8	XXX	8
c) Consumer (add-on %)	XXX	6	XXX	5-1/2
Maximum per cent of value loaned for conventional real estate loans:	60	75	70	70
Are low down payment real estate loan plans available?	XXX	Yes	XXX	Yes
How have credit requirements changed from five years ago? ¹	XXX	S	XXX	C
What are the loan limits of				
a) Bank office manager	XXX	N.A.	XXX	N.A.
b) Bank (legal limit)	XXX	300	XXX	90
Are maximum Regulation Q rates paid on savings accounts?	Yes	Yes	Yes	Yes
How do your checking charges compare to your competitors? ²	XXX	C	XXX	L
Does the bank offer				
a) Trust department	XXX	Yes	XXX	Yes
b) Credit cards	XXX	Yes	XXX	Yes
c) Computerized accounts	XXX	Yes	XXX	No
d) Floor planning	XXX	Yes	XXX	Yes
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

employed as a Vice President of the bank until she retired and that she would be elected to the board of directors. A new manager for the country branch was hired, so the widow was relieved of active management duties.

The general loan criteria of the subject bank did not change under new ownership. Current conventional real estate loan policy at the time of the study was to make loans of up to 75 per cent of the value of the property. A 10 per cent down payment was available for real estate loans. Real estate loan policies from 1965 were not known. Target loan/deposit ratio of the subject bank after merger was 50 per cent. This is lower than most other large banks in the study but was kept this low because the bank had three or four very large commercial accounts that frequently withdrew \$8 to \$10 million in one week. The bank invested in a large amount of government securities to protect its liquidity.

The control bank was an extremely conservatively managed bank. It offered few services and did not really try to provide modern banking services to its community. The management of the control bank was proud that they were one of the few banks conservative enough to survive the Depression. Since then, they have kept their banking practices very similar to those prior to the Depression. The control bank responded that its conventional real estate lending policy five years ago was to loan a maximum of 55 per cent of the value of the property. This had

remained the same up to the time of the study. A low down payment plan was not available. Target loan/deposit ratios for the control bank were not established; however, the Chief Executive Officer made it clear they do not encourage customers to borrow money.

Five years ago the subject bank did not pay maximum Regulation Q interest rates, but it did pay maximum interest rates in 1970. The control did not at the time of the study and did not in 1965 pay maximum interest rates. Full trust services are available from the subject bank, whereas only limited trust services are available from the control bank. Floor planning, credit cards, and computerized accounts are available from the subject bank, but these are not available from the control bank.

The subject bank responded that consumer loans had been the most rapidly growing loan service demanded by its customers the last five years. The President of the subject bank said they did not have exact records on the number of customers for the other types of loans serviced, but they thought they remained steady. The control bank did not have monthly payment consumer loan service available. It did have records of numbers of customers for different types of loans.

Interest rates from the subject bank for real estate loans were 7-3/4 per cent; farm loans, 7 per cent; and commercial and industrial loans, 7 per cent. The control bank charged 7 per cent interest for all types of loans.

Consumer loans and residential improvement loans were 6 per cent add-on from the subject bank. The control bank did not make monthly payment consumer and residential improvement loans.

The subject bank was open thirty-six hours per week compared to thirty hours for the control bank. Both banks were open on Saturday. Evening hours were kept by the subject bank, whereas the control bank was not open in the evening.

Three competitors of the subject bank were interviewed. The Production Credit Association representative said that under previous ownership the bank was a "farmers' bank" and had lost this orientation under current ownership. He thought the bank had done a better job of financing farmers under past ownership. The Federal Land Bank representative responded that the subject bank made larger farm real estate mortgages under new ownership than they did under past ownership. He thought the bank had improved in making farm operating loans. He stated that his customers were quite happy with the services available from the bank under new ownership. A bank officer in a firm located six miles away reported he had not noticed any change in customer patterns between the two banks since the ownership change. He stated that at the time of the merger their bank did pick up a few customers; however, most of these had returned to their original banking office.

Community acceptance of the new bank ownership was very good. The president of the bank said the community seemed quite happy with the new ownership, and he had heard no complaints. He thought the people of the local community were glad to get a branch of a larger bank in the community so they could have more services available. He said that there had been no major change in operating procedures after the ownership change, and that no major personnel changes were made. The representative citizen stated that he thought the people of the community were highly favorable to the change both immediately after the ownership change and at the time of the study. He reported the new bank ownership was pushing commercial loans and consumer loans more than the prior management. He thought the community was much more aware of the range of services from the bank now than in the past. He noted bank advertising was stressing home improvement loans. As a businessman, he was quite pleased with the increased communication between the bank and the business community. He felt the change had been a big help to the community, was well accepted, and gave better service.

A performance summary of Case Analysis 4.5.12 is presented in Table 4.12.

4.5.13 A Bank in a Crop/ Livestock Area

The merger was effected because the past owner of the subject bank wanted to change jobs and still remain in the banking business. He negotiated a merger of his bank

TABLE 4.12.--Performance Summary of Case Analysis 4.5.12,
A Bank Located in a General Farming Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	N.A.	50	N.A.	N.A.
Loan Interest Rates:				
a) Real estate (%)	XXX	7-3/4	XXX	7
b) Farm operating (%)	XXX	7	XXX	7
c) Consumer (add-on %)	XXX	6	XXX	X ³
Maximum per cent of value loaned for conventional real estate loans:	N.A.	75	55	55
Are low down payment real estate loan plans available?	XXX	Yes	XXX	No
How have credit requirements changed from five years ago? ¹	XXX	S	XXX	S
What are the loan limits of				
a) Bank office manager	XXX	N.A.	XXX	N.A.
b) Bank (legal limit)	XXX	320	XXX	33
Are maximum Regulation Q rates paid on savings accounts?	No	Yes	No	No
How do your checking charges compare to your competitors? ²	XXX	L	XXX	N.A.
Does the bank offer				
a) Trust department	XXX	Yes	XXX	Yes
b) Credit cards	XXX	Yes	XXX	No
c) Computerized accounts	XXX	Yes	XXX	No
d) Floor planning	XXX	Yes	XXX	No
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

³This type of loan was not available

with a very large nearby city bank and took a position with the large bank. His new position was supervising eight rural branches and three other rural banks owned by the acquiring bank officers. He also had responsibility for developing new rural branches, purchasing other country banks for the bank officers, and negotiating mergers with other rural banks. Although the former owner of the subject bank was on the board of directors of the acquiring bank and lived in the subject community, he had very little contact with the banking operation in his former community. Management continuity was provided because all the other executive personnel from the subject bank had remained with the bank after merger.

Loan granting criteria of the subject bank had been liberalized somewhat since 1965. Conventional real estate loans from the subject bank had increased from 60 per cent of the value of the property in 1965 to 75 per cent in 1970. It also now had a low down payment real estate loan plan available.

The subject bank faced a large loan demand in 1965 and set its target loan/deposit ratio at 70 per cent. Since it had merged with a larger bank, the target loan/deposit ratio of the combined operation had been reduced to 65 per cent.

The officer being interviewed responded that over the last five years consumer loans were the fastest growing loan category followed closely by real estate loans. He

also responded that farm loans decreased in numbers, and commercial and industrial loans remained constant.

The control bank was informally affiliated with a larger city bank also. The owner, a former employee of the city bank, was listed as a vice president and a director of the city bank. He utilized the control bank to provide a financial base for another business operation he was running. Because of the fact that the control bank's primary function (as implicitly defined by the owner) was to provide a financial base for his other business interests, the data may not be a measure of the community service. The target loan/deposit ratio of the control bank was at 60 per cent in 1965. This had increased to 70 per cent at the time of the study. The control bank made conventional real estate loans up to a maximum of 70 per cent of the value of the property in 1970, an increase from 65 per cent in 1965.

There was a greater range of services available from the subject bank. It offered trust services, credit cards, and computerized accounts. It did not do floor planning. In contrast, the control bank provided floor planning service for its retail customers, but it did not have a trust department, credit card service, nor computerized accounting. The subject bank was open forty hours per week, including Saturday; the control bank was only open thirty-three hours per week, including Saturday. Neither of the banks paid maximum Regulation Q interest rates on

savings in 1965. But in 1970 both banks paid the maximum amount allowed by law.

Interest charges on various types of loans were generally higher from the control bank than the subject bank. The subject bank charged 7-3/4 per cent for real estate loans, the control bank 8-1/2 per cent. For farm operating loans the subject bank charged 7-3/4 per cent; the control bank charged 8 per cent. Consumer loan customers were charged 6-1/2 per cent add-on from the subject bank and 6 per cent add-on from the control bank. Commercial and industrial loans were written at 7-1/2 per cent by the subject bank and at 8-1/2 per cent by the control bank. Residential improvement loans were at 6 and 7 per cent add-on from the subject and control banks, respectively.

A Production Credit Association representative from the area stated that he noticed very little difference in the subject bank's farm operating loan policies since the ownership change. His association had not taken customers away from nor lost any customers to the subject bank. The Federal Land Bank representative reported the bank made larger real estate loans than before. He said that previously the bank was strapped for funds and was unable to make and service large farm real estate loans. He also stated that the subject bank had a specialized farm service representative available to help the local branch managers analyze farm loans. A rural branch manager

of a competing city bank was interviewed. He said he noticed a significant improvement in the services available from the subject bank since the merger. Before the merger his banking office had been drawing a lot of customers from the subject bank's service area. However, since the merger his bank had lost several customers from the subject bank's service area.

The former Chief Executive Officer of the subject bank stated that he felt community acceptance of the merger was positive. He thought many people in the community were happy because the banker-customer relationship was now a "business" rather than a "personal" relationship. He said he had been the town banker for twenty years and many people in the community became antagonistic toward him because of the way he operated the bank. Now that he was no longer there, he felt that the antagonism toward the bank because of the local manager had diminished. He also believed the community was happy because the banking operation was larger and was able to provide a wider range of services.

A representative citizen responded that immediately after the ownership change community response to the merger was unfavorable. He also stated that at first the community mistrusted the new personnel. However, this feeling changed, and the community has accepted the ownership change. He reported the bank ownership was doing a better job of servicing consumer loans than had been done before. Although

the new organization was using substantially more television and radio advertising, the representative citizen thought there was no change in the awareness of the community about services available from the bank. For loan services, he noted, net worth statements were more important than "who you are." He was quite satisfied with the present banking arrangement and reported he had been well served on small loan needs. He stated that he would not prefer a locally owned bank.

A performance summary of Case Analysis 4.5.13 is presented in Table 4.13.

4.5.14 A Bank in a General Farming Area

The reason given for the merger of the subject bank office into a nearby city bank was a lack of upcoming management talent in the bank. When this became critical, the owners decided to sell their stock rather than restaff the bank. The best offer was from a nearby banking company. There were no management personnel that stayed with the bank after merger, and no directors from the previous organization were elected to the board of the acquiring bank.

Service changes at the bank included a liberalized lending policy after merger. It was not known what the conventional real estate loan policy had been in 1965, but in 1970 loans of up to 75 per cent of the property value were written. Also, a 10 per cent down payment plan was

TABLE 4.13.--Performance Summary of Case Analysis 4.5.13, A
Bank Located in a General Farming/Livestock Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	70	65	60	70
Loan Interest Rates:				
a) Real estate (%)	XXX	7-3/4	XXX	8-1/2
b) Farm operating (%)	XXX	7-3/4	XXX	8
c) Consumer (add-on %)	XXX	6-1/2	XXX	6
Maximum per cent of value loaned for conventional real estate loans:	60	75	65	70
Are low down payment real estate loan plans available?	XXX	Yes	XXX	Yes
How have credit requirements changed from five years ago? ¹	XXX	L	XXX	C
What are the loan limits of				
a) Bank office manager	XXX	5	XXX	60
b) Bank (legal limit)	XXX	1200	XXX	120
Are maximum Regulation Q rates paid on savings accounts?	No	Yes	No	Yes
How do your checking charges compare to your competitors? ²	XXX	C	XXX	C
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	No
c) Computerized accounts	XXX	Yes	XXX	No
d) Floor planning	XXX	No	XXX	Yes
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.

²C for comparable, H for higher, L for lower.

available. The target loan/deposit ratio of the subject bank was 70 per cent in 1970; the 1965 target was not known.

The control bank had not changed its lending policies in the last five years. Its conventional real estate loan of up to 65 per cent of the value of the property was the only real estate mortgage service available. Target loan/deposit ratio of the control bank was 70 per cent, which was an increase from 65 per cent in 1965.

Loans serviced by both banks had a similar pattern. Consumer loans had been the most rapidly growing loan service for both banks in the past five years, and real estate loans were the second most rapidly growing loan service. Both banks had a decrease in farm loan business. The subject bank also had a decrease in commercial loan business, but the control bank had a steady demand for commercial loans.

A broader range of services was available from the subject bank. It had trust department services, floor planning for retail customers, credit cards, and computerized accounts. The control bank did not provide any of these services. In 1965 neither the subject nor the control bank paid maximum Regulation Q interest rates on deposits. In 1970 the subject did, but the control bank did not. Checking account charges from the subject bank were reported comparable to those of other area banks, but the control bank had decidedly lower checking account

charges than other area banks. The subject bank was open thirty-three hours per week in comparison to twenty-four hours for the control bank. Both banks were open on Saturday mornings, but neither was open during an evening.

Interest rates were somewhat higher from the control bank. The subject bank charged 8 per cent for farm operating loans, whereas the control bank only charged 7 per cent. Commercial and industrial loans were written at 8 per cent annual interest from the subject bank, whereas the control bank charged 6 per cent add-on interest for this type of loan. The two banks charged the same rates for residential improvement loans, 6 per cent; the same for consumer loans, 6 per cent; and the same for real estate mortgages, 8 per cent.

Competitors of the subject bank included a Production Credit Association representative and an Federal Land Bank fieldman. The Production Credit Association representative stated he noticed no major change in the farm lending policies of the subject bank after the mangement change. He did say the subject bank was able to do a better job financing some farmers after the merger because of the larger loan size available. The Federal Land Bank Association representative stated he had not noticed any substantial change in the farm loan activities of the subject bank.

The subject bank branch manager reported community acceptance was poor at first but had improved by the time

of the study. He said most of the people were quite happy because of the broader range of services available. He stated that current management gave harsh credit checks and used credit rating services prior to granting loans, whereas past ownership did not use credit checks. He thought there was some community unhappiness because the local manager had changed three times in the four years since the merger.

The representative citizen said current community feelings regarding the ownership change were favorable, and the feeling immediately after the ownership change had also been favorable. He observed that the current bank ownership pushed all types of loans more than past ownership, with special emphasis on consumer and commercial loans. He thought the community was more aware of the range of services available in the bank now than prior to the ownership change, and he attributed this to an increase in the bank's advertising. The advertising, he reported, usually features the home office, even in the subject community. Since the ownership change he had noticed a higher proportion of the checks his business received were drawn on the local bank. His personal feeling was "economically it should help the community. There will be more money available; for this I like it. There is a feeling in the community (which I share) that it is no longer a local bank and that anything good in the

development of the community will be channeled to the home office. The first manager was not a local man and was not active in local community affairs. We now have a 'native' as a manager so this should improve things. Other personnel are local and efficient. I have the feeling that on a given day a decision could be made to close the local branch and that would be it. If a locally owned bank could find a way to offer the same services, I would prefer it."

A performance summary of Case Analysis 4.5.14 is presented in Table 4.14.

4.6 Summary of Case Analyses

The case summaries presented indicate how the different banks in the survey have changed over the five-year period from 1965 to 1970. There are two elements lacking in the case summaries which would have been desirable but were not available. They are: (1) What was the position of the former country bank owners with respect to the measures of progressiveness (as defined in Chapter III)? (2) What are the individual goals of the people who control the banks in the survey?

The case summaries do give a view of some of the individual bank situations and how management/ownership has changed over the five year period. Responses from competitors and citizens in the community indicate how the changes were perceived by community members. When adverse feelings or responses were made by the competitors

TABLE 4.14.--Performance Summary of Case Analysis 4.5.14, A Bank Located in a General Farming Area.

Performance Variable	Acquired Bank		Control Bank	
	Pre-Merger	Post-Merger		
	1965	1970	1965	1970
Target Loan/Deposit Ratio	N.A.	70	65	70
Loan Interest Rates:				
a) Real estate (%)	XXX	8	XXX	8
b) Farm operating (%)	XXX	8	XXX	7
c) Consumer (add-on %)	XXX	6	XXX	6
Maximum per cent of value loaned for conventional real estate loans:	N.A.	75	65	65
Are low down payment real estate loan plans available?	XXX	Yes	XXX	No
How have credit requirements changed from five years ago? ¹	XXX	L	XXX	S
What are the loan limits of				
a) Bank office manager	XXX	20	XXX	20
b) Bank (legal limit)	XXX	320	XXX	40
Are maximum Regulation Q rates paid on savings accounts?	No	Yes	No	No
How do your checking charges compare to your competitors? ²	XXX	C	XXX	L
Does the bank offer				
a) Trust department	XXX	Yes	XXX	No
b) Credit cards	XXX	Yes	XXX	No
c) Computerized accounts	XXX	Yes	XXX	No
d) Floor planning	XXX	Yes	XXX	No
e) Saturday or evening hours	XXX	Yes	XXX	Yes

N.A. - Not Available

¹S for same, L for more liberal, C for more conservative.²C for comparable, H for higher, L for lower.

or community members, the reasons that precipitated the
adverse comments were presented.

CHAPTER V

THE FIELD STUDY - SUMMARY OF FINDINGS

5.1 Introduction

This chapter will summarize (1) the differences between the merged and independent banks, (2) the responses of the competitors of the merged banks, and (3) the responses of the representative citizens from the merged bank communities. The summaries will be presented using the framework of the Bain-Caves performance criteria of equity, progressiveness, and resource use efficiency.

Before looking at the summary of the field studies it is useful to consider major differences in the two types of banks. The fourteen banks in the survey that had acquired a rural branch were much larger than the fourteen independent banks. After merger, as of December 31, 1970, total assets for the merged banks averaged \$54.5 million; the range was from \$18 million to \$183 million. Ten of the merged banks were in the range of \$30 to \$70 million in assets. The fourteen independent banks averaged \$7.3 million in assets with a range from \$3 to \$15 million. Ten of the independent banks were in the \$5 to \$9 million total asset range.

It is also helpful to have a feeling for the type of management in the acquired banks prior to merger. Most of the banks were family-owned and were managed by an individual who was near retirement age. The reason cited for ten of the fourteen bank mergers was the lack of upcoming management potential in the bank. Also given as reasons for merger were a shortage of capital and the need to attract outside deposits to serve the community. Two of the rural bank offices became branches of larger banks because of a normal sale of controlling interest to a nearby bank. One bank was merged into a larger banking firm when the owner-manager became a senior executive with the larger bank.

5.2 Theoretical Framework Review

The Bain-Caves structure-conduct-performance theoretical framework is structured around the following definitions. Structure denotes all predetermined characteristics of the industry and the rules that constrain the player's choices. Conduct denotes all strategies that the players adopt, and performance denotes all consequences of the players that are, to them or to others, pay-offs of the game.

The four performance goals suggested by this framework provided the criteria on which the performance of Michigan banking was evaluated for rural residents. The four performance criteria are (1) full employment of

resources, (2) progressiveness, (3) equity, and (4) efficiency. In this study full employment of resources was primarily concerned with the rural banks' utilization of deposits. Progressiveness was concerned with the rural banks offering auxiliary banking services such as trust departments, credit card service, and computerized accounting which helps facilitate the financial transfer function in the rural areas. Equity considerations are changes in banking services or requirements that make banking services more accessible to the community. Efficiency is most often thought of as the profitability measure of the firms in the industry, or as providing a product or service to the consumer in an accurate reflection of consumer preferences and real costs. These measures of efficiency were beyond the scope of this study, but inferences about market efficiency can be made.

Several of the variables selected have implications for more than one of the performance criteria. For example, interest rate levels have implications for both equity and efficiency. And credit card availability has implications for progressiveness (as an element of innovation) and for static efficiency (given that someone has introduced them, it is desirable that consumer demand for them be reflected in making the service available).

This chapter contains three sections with major headings of equity, progressiveness, and resource use efficiency. The findings about efficiency will be

discussed under the major heading most applicable. Although some findings are applicable to more than one performance criterion, they will be discussed only once.

5.3 Equity Considerations of Bank Mergers

The first performance criterion discussed will be equity. Equity considerations are changes that make banking services more accessible to a larger segment of the rural community. Discussed here will be changes in the criteria to qualify for loan service, real estate loan services available, interest rates on loan types, loan size limits, interest rates paid on savings accounts, and growth rates of different types of loans. Some of these criteria, such as real estate loan services available, are also a measure of progressiveness, and interest charges for loans and interest paid on savings are also measures of resource use efficiency.

5.3.1 Loan Service Criteria

Each interviewee was asked how the criteria to qualify for loan service at his bank changed from 1965 to 1970. The criteria in question were the three "c's" of credit: repayment capacity, collateral, and character. Since it was not easy to specify measurements of these criteria, the question asked was, "Have your loan criteria become more 'liberal' or more 'conservative' in the past five years?"

For the fourteen merged banks, nine responded that criteria to qualify for loan service had been liberalized since the merger. Four banks reported there had been no change. Only one bank reported that loan criteria were more conservative in 1970 than in 1965. This was the bank that merged because it had many "bad" loans in its portfolio.

Of the fourteen independent banks, ten reported that loan service criteria had remained the same. Of the remaining four banks, two reported their terms were currently more liberal, and two reported that their terms were more conservative.

5.3.2 Real Estate Loan Service Available

Prior to merger, conventional real estate loan policies from the two groups of banks were somewhat different. The banks that merged had more conservative policies than the banks that remained independent. As seen in Table 5.1, the banks that merged made, on an average, real estate loans of 62 per cent of the value of the property. This compares to an average of 64.6 per cent for the banks that remained independent.

However, this trend has since reversed. As of 1970, as seen in Table 5.2, the merged banks were more liberal in granting funds for conventional real estate loans. The merged banks granted loans up to 75.5 per cent of the value of the property, whereas the independent banks only granted loans to 67.9 per cent of the value of the property.

TABLE 5.1.--Number of Banks, by Type, Reporting Conventional Real Estate Loan Policy as a Maximum Per Cent of Value of Property, 1965.

Type of Bank	Maximum Per Cent of Value of Property ^a						"Average" ^b Policy
	55	60	65	70	75	80	
	(Number of Banks)						
Independent	1	3	6	2	1		64.6
Merged	2	3	4	1			62.0

^aRounded to nearest 5%.

^bMany of the tables in this chapter contain "average" figures. These "averages" use original data, but are not weighted by volume of activity in the service analyzed from each bank in each category. Nonetheless, these figures should be helpful in conveying differences between types of banks.

TABLE 5.2.--Number of Banks, by Type, Reporting Conventional Real Estate Loan Policy as a Maximum Per Cent of Value of Property, 1970.

Type of Bank	Maximum Per Cent of Value of Property*						"Average" Policy
	55	60	65	70	75	80	
	(Number of Banks)						
Independent	1	1	5	3	4		67.9
Merged			1	2	7	4	75.5

^{*}Rounded to nearest 5%.

In addition to the conventional real estate loan service, by 1970 twelve of the fourteen merged banks had low down payment real estate loan plans, such as the FHA or MGIC plan, available for their customers. This compares with three of the fourteen independent banks that had low down payment plans.

Interest charges for conventional real estate loans for the two types of banks were shown in Table 5.3. The independent banks showed a greater disparity in rates charged because one bank had an unusually low interest charge of 7 per cent for all loans. Excluding this bank, there was little difference in the rate charged for real estate mortgage loans. The average rate charged by independent banks was 8.00 per cent; for merged banks the average charge was 7.98 per cent.

TABLE 5.3.--Interest Rates Charged on Conventional Real Estate Loans by Type of Banks, 1970.

Type of Bank	Interest Rate (Per Cent)				"Average" Charge
	7.0	7.75	8.0	8.5	
	(Number of Banks)				
Independent	1	2	8	3	8.00
Merged		5	7	2	7.98

5.3.3 Interest Rates on Farm and Business Loans

Independent banks charged lower rates for farm operating loans than the merged banks. As seen from Table 5.4, the independent banks charged an average 7.29 per cent, whereas the merged banks charged an average of 7.80 per cent. Nine of the fourteen independent banks reported charging only 7 per cent for farm operating loans which contrasts to nine of the merged banks charging 8 per cent. One other independent bank charged 7.5 per cent, and four charged 8 per cent. The other merged banks charged the following rates for farm operating loans: one each charged 7.75 per cent and 8.5 per cent, and three charged 7 per cent.

Managers of some of the acquired banks stated that they transferred some farm operating loans from conventional 7.5 or 8.0 per cent annual interest loans to 5 or 6 per cent add-on interest type monthly payment loans. Monthly payment loans were issued for small trucks, dairy equipment, and other types of products used in enterprises where income was generated monthly. The practice, which increases the annual interest rate, appears to be more prevalent in merged banks than independent banks. So, the cost of farm operating loans from merged banks may be even greater than the table indicates.

The average charge for other business loans was 8.24 per cent from the independent banks and 8.04 per cent

TABLE 5.4.--Number of Banks, by Type, Reporting Various Interest Charges for Farm Operating and Commercial and Industrial Loans, 1970.

Type of Bank	Interest Rate (Per Cent)							Other	"Average" Charge
	7.0	7.5	7.75	8.0	8.25	8.5	9.5		
	(Number of Banks)								
Farm Operating Loans									
Independent banks	9	1		4					7.29
Merged banks	3		1	9		1			7.80
Commercial and Industrial Loans									
Independent banks	2		1	6	1	2	1	1 ^a	8.24
Merged banks	1	1		8		4			8.04

^aThis one bank charged 6 per cent add-on interest, which is approximately 11.1 per cent for a 36-month loan.

from the merged banks. Six of the fourteen independent banks and eight of the fourteen merged banks charged 8 per cent for commercial and industrial loans. Four merged banks charged 8.5 per cent, and one each had rates of 7.0 and 7.5 per cent. Of the remaining eight independent banks, two charged 7 per cent, one charged 7.75 per cent, one charged 8.25 per cent, and two charged 8.5 per cent. One independent bank charged 6 per cent add-on interest, which is equivalent to 11.1 per cent for a 36-month loan.

An interesting finding is the number of banks having the same or different rates for farm loans than for business loans. Table 5.5 shows the number of banks by type charging more, the same, or less for farm operating loans than for commercial and business loans.

TABLE 5.5.--Number of Banks, by Type, Charging Higher, the Same, or Lower Interest Operating Loans than for Commercial and Industrial Loans.

Type of Bank	More	Same	Less
	(Number of Banks)		
Merged	1	9	4
Independent	0	5	9

Nine of the fourteen independent banks reported charging farmers lower rates than they did for other business loans. The other five independent banks reported similar charges for farm loans and business loans. This differs

substantially from the practices of the merged banks. Nine of the fourteen independent banks charged farmers comparable rates, one bank charged more, and four reported charging farmers less than other businessmen. The merged banks charging farmers lower rates were among the smallest in the merged group.

By charging farmers "market" interest rates, larger banks appear to impose fewer institutional constraints on local loan market activity. Because of this, the local financial market may be regarded as more efficient; i.e., borrowers face the same resource (capital) prices, regardless of their use of loan proceeds.

5.3.4 Interest Rates on Consumer Loans

Interest charges for new automobile consumer loans were similar from both types of banks. Eleven of thirteen independent banks and twelve of the fourteen merged banks charged 5.5 per cent or 6.0 per cent add-on interest for new automobile loans, as indicated in Table 5.6. In both categories, one bank reported 5.0 per cent and another 6.5 or 7.0 per cent. One independent bank did not offer monthly payment loans.

Residential improvement loans were also at basically the same rates. Six of the thirteen independent banks and eight of the fourteen merged banks reporting charged 6 per cent add-on rates. Three merged banks reported interest

TABLE 5.6.--Number of Banks, by Type, Reporting Various Interest Charges on Types of Consumer Loans, 1970.

Type of Bank	Interest Rate (Per Cent)					Other	"Average" Charge
	5.0	5.5	6.0	6.5	7.0		
	(Number of Banks)						(%)
New Automobile Loans							
Independent	1	4	7	1			5.85
Merged	1	2	10				5.89
Residential Improvement Loans							
Independent	1		6	1	3	1 ^a	6.43
Merged	1	2	8		3		6.07

^aThis bank charged 8.5 per cent nominal interest, which is approximately 4.8 per cent add-on interest for a 60-month loan.

rates below 6 per cent and three reported charges of more than 6 per cent. Two of the independent banks reported rates below and four reported rates above the modal 6 per cent rate.

5.3.5 Loan Service Growth

The banks were asked which loan service grew most rapidly in terms of customer numbers from 1965 to 1970. Twelve of the thirteen responding banks reported consumer loans were the fastest growing loan category in terms of customer numbers. Nine of these banks had real estate loans as the second most rapidly growing category. Only one

independent bank had an increase in farm loan customers, and it was attributed to a management change in a nearby bank that had formerly serviced many farm loans but had since reduced its farm loan portfolio.

Merged banks had an almost equal increase in real estate loans and consumer loans. One merged bank also reported farm loans as its second most rapidly growing category. The reason given for this was that prior to merger the bank had a policy of making a maximum loan of \$10,000, which was too small to serve commercial farmers. After merger the policy to limit individual customers to \$10,000 was discontinued. Commercial and industrial loan customers increased at three of the merged banks. The reason given for this increase was that the previous ownership did not service this type of loan.

The representative citizens noticed an increase in loan services from the acquired banks. Eleven of the twelve respondents reported that the new ownership groups were "pushing" some types of loans more than past ownership. All types of loans received some mention as increasing. Most often mentioned were consumer loans; then came mortgage loans. Only one person responded that his local bank was withdrawing any loan service since being acquired, and this was mortgage loan service.

5.3.6 Farm Loan Service Effects

Changing the structure of rural banks may affect the business volume and customer structure of other rural financial institutions. The nature of the farmer cooperative lending agencies, the Production Credit Association and Federal Land Bank Associations, make these agencies well suited to indicate how the structure of farm loan business was affected by the merger of a rural bank. In each instance where a rural bank was acquired by a larger city bank, a Production Credit Association representative was asked about changes in the merged bank's farm operating loan activities, and a Federal Land Bank Association representative was asked about changes in the merged bank's farm real estate lending activity. Table 5.7 lists the four types of responses received and the frequency of each response.

TABLE 5.7.--Farmer Cooperative Credit Agency Responses on the Activity of Merged Banks in the Farm Credit Market.

Response	Respondent	
	PCA	FLBA
1. The merged banks had no noticeable change in farm lending activity.	8	8
2. The merged banks are not as interested in acquiring new farm business, but serve "good" customers well.	2	1
3. The farmer cooperative agencies lost customers to the merged banks.	2	3
4. The farmer cooperative agencies gained customers from the banks.	2	2

Eight Production Credit Association representatives and eight Federal Land Bank representatives reported that the merger of the subject bank had no noticeable effects on its farm loan activity. Representatives from two PCA's and one FLBA responded that the new bank ownership group served "good" customers well, but did not appear to be interested in acquiring new farm business or serving all farm business that they had previously. About an equal number of the farmer cooperative associations "gained customers" as well as "lost customers to" the merged banks. The Production Credit Association representatives reported two banks extended more farm operating loans and gained customers from the local association, and two PCA representatives responded that they gained customers from the merged banks. Two Federal Land Bank Association representatives reported gaining customers from the banks, whereas three FLBA representatives reported losing customers to the newly merged banks. In summary, there appears to be little change on the competitive effects for farm loans after rural banks merge.

5.3.7 Maximum Loan Limits

A frequent complaint heard about the branch banking system is that a branch manager's loan granting authority is lower than an independent bank manager's. The survey data support this complaint. The chief executive officers of the independent banks were, on an average, able to

authorize loans of \$27,000. The merged bank branch managers had, on an average, authority to grant \$18,000 in loans. However, a large range exists in each category. For the independent banks the range in loan granting authority was from \$1,500 to \$60,000; for the merged banks it was from \$2,000 to \$100,000.

Because the branch manager of an acquired bank has a lower lending authority than the chief executive officer of his independent counterpart, one might superficially conclude that bank acquisitions resulted in lower credit availability. However, this is not the case. For the banks in total, maximum loan size limits per customer is decidedly higher for the merged banks. The upper limit ranged from \$240,000 to \$1,500,000 for merged banks, as contrasted to maximum limits of \$20,000 to \$110,000 for independent banks. So, once credit had been granted by the head office, the acquired banks could make larger loans than the independent banks.

This comparison may overstate the advantage of dealing with a merged bank. All of the independent banks had arrangements with city correspondent banks to assist in servicing loan requests which exceeded its legal limit. However, correspondent bank arrangements to service large loan requests were seldom used. Only nine of the fourteen independent banks reported loan requests above their lending limit, and these banks together reported thirty-five requests in the previous year. It is possible that the small

banks discouraged customers from requesting loans larger than the bank's lending limit.

This leaves almost no significant difference in servicing large loans. Moreover, the arrangements for loan service above the independent bank's loan limit were fairly prompt. Typically it took less than two weeks for a correspondent bank to act on a loan request from one of its country bank customers.

5.3.8 Interest Rates Paid on Savings and Charges on Checking Accounts

Maximum interest rates that banks can pay on savings deposits are set by Regulation Q, which is established by the Comptroller of the Currency and the Federal Reserve System. In 1965 there was little difference in the number of banks of each category paying maximum Regulation Q rates. Six of the fourteen independent banks did not and eight did pay maximum Regulation Q rates.

At the end of 1970 there was more difference. Thirteen of the fourteen merged banks paid maximum Regulation Q rates, whereas only ten of the independent banks paid the maximum rates. At the time of the interviews (November and December 1971) when interest rates were declining several merged banks were planning to reduce interest rates paid on savings accounts.

At the time of the interviews, interest rates were starting to decline after having stabilized at a higher

plateau for the previous six months. The finding that more of the merged banks than independent banks had paid maximum rates on savings accounts during the time of high interest rates, and the finding that some of the merged banks were planning to reduce savings account interest rates during a period of declining interest rates suggests that the merged banks were more aligned with money market conditions than independent banks. These findings have implications for the equity consideration because factor prices are more in line with factor productivity. Also this finding has implications for the efficiency criterion because savings draw the same rate at all institutions.

5.3.9 Summary of Equity Considerations

It appears that the accessibility of banking services for members of rural communities was increased after the local bank was acquired by a larger bank. The criteria to qualify for loan service were generally more liberal. Real estate loans could be obtained for a higher proportion of the value of property. More of the acquired banks had low down payment real estate loan plans available.

Interest charges for consumer loans were similar at both types of banks with the exception of one independent bank that did not offer monthly payment consumer loans. Interest charges for commercial and industrial loans were also similar. Farm operating loan interest rates were markedly lower at the independent banks (and smaller merged banks).

Checking account charges appeared to be comparable for both types of banks. The merged banks paid higher interest rates for savings at the time of the survey. It appears that the merged banks were more "market" oriented. They did not appear to offer subsidized loan notes to any particular type of loan customer, and it appeared that the interest rates paid on savings accounts followed the money market interest rates more closely.

Numbers of real estate loans and consumer loans increased for both types of banks. Numbers of farm operating loans increased for only one bank in each category, which was the result of the merger of the bank or of a primary competitor. Commercial and industrial loans increased more in the banks that had been acquired.

Loan limits per customer were higher at the merged banks, but the independent banks reported mechanisms which kept a small loan limit from being a problem.

These are the findings which emerged from the survey. There are, of course, many other questions that would have uncovered other interesting facts regarding equity considerations of bank mergers. One of these questions is: How many people in the local community who did not do business with the local bank prior to merger are now doing business with the merged bank? Conversely, how many local customers of the prior ownership do not do business with the new ownership? During some interviews

comments were heard that certain new ownership groups asked for more records and justification for some business loans, causing some prior customers to do business elsewhere. On the other hand, some representative citizens reported that the new ownership groups loaned money for many more purposes than former management.

The merged banks paid higher rates on savings accounts than independent banks. A question to follow this observation would be: Did paying the higher savings account rates give the local bank a higher proportion of the community deposits than local banks obtained in other communities which did not pay maximum Regulation Q interest rates? Answers to the types of questions posed here would facilitate further observations on the equity of the rural banking system after small banks merged.

5.4 Progressiveness Considerations of Bank Mergers

Progressiveness is a second performance criterion. Rural bank progressiveness is defined as offering more services than absolutely necessary to provide the financial transfer function in rural areas. Many of the measures of "progressiveness" defined here are subject to question. Some people may consider certain of them essential, others may consider them unnecessary.

The elements discussed in this section are the auxiliary services of bank credit cards, inventory financing,

trust services, and having computerized accounts. Also mentioned will be the banks' facilities and operating hours. Other evidence includes a section on criticism received by the local banker and a section on representative citizen attitudes toward bank management. These pieces of evidence relate to the accessibility of rural people to services from rural financial organizations.

5.4.1 Auxiliary Services

The number of auxiliary services available from the merged banks is substantially greater than those available from the independent banks. Thirteen of the merged banking offices made trust services available, whereas only two independent banks offered trust services.

Floor planning, the service of financing inventories on a continuous basis for retail merchants, was available from thirteen of the fourteen merged offices. This service was available from only eight of the fourteen independent banking offices.

The question on the availability of bank credit cards brought a wide variety of responses. Thirteen of the fourteen merged banks were affiliated with credit card services (Master Charge or BankAmericard), whereas only two of the independent banks were allied with one of these services. The banks not associated with these services volunteered several reasons for their positions. Frequently they reported that profit potentials for small banks are

too low to justify the costs of offering the service, e.g., risk acceptance, advertising expense, personnel, and book-keeping. But most often the bankers that did not offer credit card services gave moralistic reasons to justify their position. Responses such as "I don't believe in credit cards," "they lead to reckless spending," and "people don't use them with prudence" were received.

Thirteen of the fourteen merged banks offered computerized bookkeeping services for customer accounts. Only three of the independent banking offices had computerized the customer accounts. Whether or not computerized accounts are a service to customers or not depends upon one's point of view. Arguments for this service include: (1) it is cheaper if enough accounts can be processed, (2) it is more accurate, and (3) more changes and charges can be taken into consideration. Arguments against computerized accounts include: (1) the change from hand posting to the computers leads to errors, (2) customers are slow to understand the requirements imposed upon them (using pre-encoded checks, deposit slips, etc.) and make errors, (3) there is a longer time lag in posting of deposits to accounts (computerized accounts usually record deposits and withdrawals one day later than manual accounting), and (4) less personal attention is given to customers. The majority of the criticisms received from both the merged and independent banks who were using computerized services stemmed from the transfer from manual to computerized records. This

criticism, however, subsided somewhat after the people became adapted to the computerized system.

The representative citizens were asked if the people in the community were aware of the banking service changes. Nine respondents reported that their community members were much more aware of the availability of bank services after merger than previously. Two reported no change, and one thought the community was less aware of services currently available. This awareness of services probably stemmed from an increase in advertising. Ten of the twelve representative citizens reported noticing an increase in advertising; the other two reported no change.

5.4.2 Operating Hours and Facilities

There was little variation in operating hours between the different types of banks. In eight of fourteen bank pairings, merged banks had longer hours, although by an average of only 2.8 hours more per week. Seven of the merged banks and eight of the independent banks were open on Saturday. Nine merged banks and eight independent banks were open after 6:00 p.m. one evening per week. All of the banks in the survey were open either during an evening or on Saturday.

In general the physical bank office facilities were most comfortable at the acquired banks. Only ten of the offices were visited, but all of them were either recently

built or remodeled. This differs significantly from the independent offices. Of the fourteen independent offices visited, nine were newly constructed or recently remodeled, but five were old, unattractive offices.

5.4.3 Serving Community Needs

Some respondents believed that a positive correlation existed between where a bank manager lived and the responsiveness with which he tried to serve the community. If this is true, it appears that the local independent banks should give their communities better service than branch offices of larger banks. More of the independent bank officers and directors were "local" people than were the officers, including the branch manager and directors, of the acquired banks.

However, the evidence from this study does not bear out the assertion. Most of the acquired operations had management whose primary interest was to have a sound, growing banking operation. They realized that this required that they serve the community's needs and establish long-term local business relationships.

Independent banks are often--just as the name of the category implies--independent. Several of the independent banks were closely held, or owned by an individual. The objectives of these owners ranged from providing the best community service possible to providing a financial base for the owners' other business interests. This latter

reason was evident for at least three of the fourteen independent banks surveyed. It was also evident in the cases of three of the pre-merger owners of the banks that had been acquired. On the other hand, many of the independent bank managers were extremely interested in community affairs and community development. Given their limited resources and the restrictions imposed upon them by law, it appeared they were trying to do the best they could for community development.

5.4.4 Criticism Received and Changes Planned

To obtain a feeling of progressiveness and to find out how bank management reacted to the feelings of the community, each respondent was asked to identify an area in which his bank had received criticism from the local community in the past two years. Only one of the independent bankers reported any criticism. That was because the office was not open on Saturday morning, whereas some nearby banks were.

The officers of the merged banks seemed to be more abreast of community feelings toward their operations. Eight of them reported criticism. Common grounds for criticism came from the "lack of individuality" of banking services and problems stemming from the transfer to computer records. This criticism was reported by four of the eight bankers listing criticism. Another common area of criticism

involved changes in requirements for loan service. After merger the banks required more extensive records or had more conservative credit terms than before. One acquired bank also reported some criticism of banking hours. The specific criticism was that after the merger took place, the bank was closed on Saturday whereas under previous ownership it had been open on Saturday.

Much of the criticism that merged banks received may be relevant for the independent banks. The changes planned by independent banks include computerizing accounts (mentioned by three out of nine banks) and adding a branch office or drive-in service window (mentioned by five of nine banks).

An interesting, but difficult to explain, finding is that the number of window customers for the independent banks has grown more than twice as fast as for merged banks. Data were obtained from thirteen independent banks and five merged banks on the numbers of checking account customers, passbook savings account customers, and time certificate holders.¹ The rate of growth in time certificate holders was unusable because (1) many banks did not offer time certificates in 1965, (2) some banks changed accounting methods, and (3) some customers transferred some funds from a passbook account, which is still maintained, to a

¹Because of management changes and unavailability of records, some of the responses were "best estimates" by respondents.

certificate of deposit. The rate of growth indicated by independent banks for passbook savings and checking accounts was substantially faster than it was for merged banks. Data for checking account growth in merged banks showed one bank lost 25 per cent of its 1965 accounts while the other four gained between 15 and 25 per cent. Of the independent banks, four banks reported customer increases between 20 and 35 per cent, four reported customer increases between 40 and 50 per cent, and four reported customer increases between 85 and 100 per cent. Data for passbook savings accounts showed only three merged banks having substantial growth in this area. These rates were 20 per cent, 25 per cent, and 100 per cent. Two others reported increases of less than ten per cent. Of the eleven independent banks with data available, five had growth rates of 15 to 30 per cent, four banks had customer increases of 45 to 65 per cent and two banks had 90 per cent growth rates.

This large increase in window customers for independent banks over merged banks is hard to explain. As measured, services available from merged banks were greater, interest paid on savings accounts was greater, and charges for services were generally comparable. It appears, too, as though the merged banks advertised their services more and attempted to grow rapidly. Possible reasons for the results include: (1) rural people have less "trust" for bankers who are not local people, (2) the data received may

be incorrect, (3) the previous owners of the merged banks increased customer numbers as much as possible before they sold, (4) a locally owned business may mean a lot to rural people, and (5) the base period may have given an incorrect impression.

Competitors of eight of the merged banks were surveyed to see what affect the bank merger had had on customer structure between the organizations. Two of these banks reported gaining window customers after their competitor's merger. The reasons cited for this included the merged bank's delay in crediting funds to accounts and the merged bank's "unsatisfactory" hours of operation. One competitor responded that his bank lost customers to the merged bank. He attributed this to an increase in services available from his competitor after the merger. Two competitors reported no change.

Three banks reported that immediately after the merger they had gained business from their newly merged competitor. However, this increase was short-lived. They noticed that most of the new customers were again doing business with the bank they originally used. The competitors in this situation all mentioned that "convenience" seemed to be the main factor in customer attraction. Personal feelings for or against an institution were usually not long lasting. An interesting example comes from a situation where a competing bank made a concentrated effort to attract customers when its competitor was acquired (see Case 4.5.6).

They obtained "commitments" to change banks after the merger from 60 to 70 per cent of the acquired bank's customers. About 20 per cent of the customers did change banks after the merger, but three years later most customers were doing business with their former bank.

5.4.5 Management Attitudes and Factors

Management teams of the banks that had purchased rural banks to be branch offices were very aware that an ownership change can create much animosity in the community. As a result, most of these teams took great pain to lessen the impact of the ownership change. Four of the new ownership groups established "advisory boards" for the new branches. These boards usually included people from the former board of directors, who were asked to serve in an unofficial capacity to "advise" and "consult" with the new management team on bank business. They had no legal obligations but were helpful to management because they acted as a sounding board for community opinion and advised the new management team on loan experiences with local borrowers.

Management of acquired rural banks often stressed the "independence" of the branch office. If the branch did its accounting internally, or had its own credit files, this was frequently pointed out in the interview. One ownership group charged less for services at the acquired office than they charged at their other offices. In another instance,

one newly acquired branch office paid higher interest rates on savings accounts than were paid at the main office.

Management changes in the rural offices were kept to a minimum. Several of the banks were purchased because the previous chief executive was retiring or had died, so the new ownership had no alternative but to hire a new manager. But where this was not the case, past management personnel were retained even if a new manager was hired and the former manager "retired on the job."

One vice president of a city bank stated that he was not happy with the rural branch they acquired. He said that it had not yet made a profit or shown any growth in the first three years of operation and had not met any of the original goals that had been set for the office. Nonetheless, he said the bank was going to keep the branch open because it was expected the subject community would change from rural to suburban in ten or fifteen years, so the long run potential was favorable.

In another instance, one of the independent banks was in the process of taking over a rural branch from a larger city bank. The city bank had several community relations problems in the rural community, and as a result the rural branch performance was unacceptable to them. The city bank's solution to this problem was to sell the office to another "country bank" that would not have the "big city image." The prospective purchaser did not

anticipate any community relations problems and was certain deposit levels would increase rapidly after the take-over.

5.4.6 Representative Citizen Attitudes

At the time of merger of their independent banks into large banking firms, the representative citizens stated that the community members were, in general, unhappy with the change. These results are summarized in Table 5.8.

TABLE 5.8.--Representative Citizen Assessment of Community Attitudes toward Bank Mergers.

Attitude	Number of Responses	
	Immediately After Merger	Currently (Dec. 1971)
Highly favorable	2	4
Favorable	3	5
Unchanged from previous ownership	1	2
Unfavorable	5	1
Highly unfavorable	1	0

One respondent stated that community feeling was highly unfavorable, five stated unfavorable feelings toward the merger, one reported no change, three reported favorable reactions, and two stated highly favorable reactions. The representative citizens did report that the current feeling toward the bank was much better than the feeling at the

time of the merger. Currently four reported highly favorable community feelings, five reported favorable responses, and two reported no change in attitude toward the current ownership compared with past bank ownership. Only one community representative responded that the community currently viewed the change as unfavorable. (This was the bank where prior management granted many "questionable" loans which were recalled by the new management team.) Of the twelve respondents, seven stated that their current opinion of the new ownership was improved over their impression at the time of merger.

Each representative citizen was asked: What is your personal feeling toward the bank ownership change? Do you like it? Did it benefit the community? Would you like to see the bank go back to a locally owned bank? What other comments would you like to make about this bank ownership change? (It was stressed that this survey was confidential and comments would be held in confidence.) Eight of the individuals thought the change would benefit members of the community. Three of twelve respondents did not comment. Only one stated he did not like the change, his reason being that the bank management was twenty-two miles away and unresponsive to local community needs.

5.4.7 Summary of Progressiveness Considerations

Given the responses to the field survey it appeared that the acquired banks were more progressive than the

independent banks. More auxiliary services--trust services, credit card services, inventory financing, and computerized accounts--were available from the merged banks.

The management of the merged banks was more aware of criticism than were the independent bankers. It appeared as though the management of the acquired banks took great pains to lessen the impact of ownership change by permitting the acquired office to be autonomous, keeping former bank directors on advisory committees, and retaining former management when possible.

However, the study indicated that the independent banks were gaining customers at a faster rate than the acquired banks. Also, it appeared that some large city bank management practices cause community relations problems in rural areas and that some rural branches fell short of the expectations the city bank held at the time of acquisition.

These findings lead to the question of what rural people deem to be desirable from their local bank. Perhaps they do not want a progressive banker as defined in this section, but prefer "old fashioned" service. Perhaps many people in a rural community prefer to have loan service granted on a "who you are" basis rather than on the basis of the individual's repayment capacity. Some farmers may feel that the need to justify a farm operating loan with financial statements and budgets is an insult when new

bank management requests it, because it was never required under past management.

Research to determine what rural residents do desire from their local bank might give insight into other progressiveness criteria. There would be problems with this type of study because of a lack of understanding on the part of the respondents. Rural residents may not be aware of the alternatives available and the trade-offs between local friendly service and other effects. One problem is that merger may change the service mix in ways that benefit some people and make others worse off. Ultimately, it is a problem of the relative weights assigned (say) farmers who now have to present pro forma cash flow forecasts versus the local TV repairman whose family savings now earn a higher interest rate.

5.5 Resource Use Efficiency Considerations of Bank Mergers

The third performance criterion is resource use efficiency. The primary resource that a rural bank controls is the deposits it holds for the community members. It can invest these deposits in a number of alternatives--government securities, municipal bonds, loans--or it can hold them in cash. Assuming most loans made by rural banks are issued locally, the loan/deposit ratio is an important measure of bank performance for the local community since it reflects the proportion of deposits going to customers and businesses

as loans. Investments in rural communities may stimulate employment and future economic growth. This section will summarize the changes in target loan/deposit ratios in both the independent and acquired banks between 1965 and 1970.

5.5.1 Target Loan/Deposit Ratios - 1965

Target 1965 loan/deposit ratios were not much different by type of bank, acquired or independent. However, there were some interesting situations in individual banks. The loan demand appeared to vary tremendously. Some banks reported a loan/deposit ratio of more than 80 per cent. Others reported a loan/deposit ratio of less than 40 per cent. The banks with the highest loan/deposit ratios were located in the sparsely populated, generally lower income, northern part of the state. The high loan/deposit ratios here may reflect a small deposit base upon which to draw for loan sources and/or the unavailability of other loan sources in the community.

The local bank manager in a small community may affect loan demand greatly. If the local banker is eager to serve and does not refuse loan requests of, say, third quality loans, he may get a substantial loan demand for these third quality loans. But if he routinely refuses third quality loans and makes only higher quality loans, he may be, in effect, turning away potential loan customers

just by the imposition of these quality standards. Thus, the bank manager could have a great effect on loan demand.

Two of the banks that merged had loan/deposit ratios of 70 per cent or more in 1965. Both of these bankers reported that the loan demand was higher than they could adequately serve and stated the loan/deposit ratio was uncomfortably high. After merger, both of these banks had reduced their loan/deposit ratio to 65 per cent. They reported that, on a larger deposit base, this was a more comfortable portfolio position for them.

Three of the banks that remained independent reported 1965 loan/deposit ratios of 70 per cent or more. By 1970 two of these banks lowered their target loan/deposit ratio to 65 per cent, which they considered a more workable level. One other bank reported a 70 per cent target loan/deposit ratio in both years. Its manager stated it was the bank's policy to carry a loan portfolio of this size.

At the low end of the target loan/deposit ratio spectrum were five banks reporting target loan/deposit ratios of 55 per cent or less in 1965. Of these five banks, three were acquired during the next five years, and two remained independent. The three acquired banks each increased their loan/deposit ratios by 15 per cent after merger. The reasons given for these low 1965 loan/deposit ratios were: (1) one bank had an ex-manager/owner who was "not at all aggressive," (2) one bank faced an extremely heavy consumer

loan demand and wanted to remain liquid to serve these customers, and (3) one bank was extremely cautious about taking any loans with any degree of risk.

One of the two independent banks with low loan/deposit ratios in 1965 increased its target loan/deposit ratio 20 per cent. The primary reason for this was a change in the Chief Executive Officer and in the philosophy of the bank. The other bank increased its target loan/deposit ratio from 55 per cent to 60 per cent over the five-year interval. It stated that it was still a "conservative" bank in its lending policies but was forced to increase its loan/deposit ratio to serve its customers. Another independent bank did not urge customers to borrow and risk financial security. That bank's December, 1965, loan/deposit ratio was 39.4 per cent.²

5.5.2 Target Loan/Deposit Ratios - 1970

The target loan/deposit ratios reported for 1970 are as shown in Table 5.9.

In the aggregate, the merged banks had slightly higher target loan/deposit ratios. But they also had a wider range of target ratios. The merged bank with 50 per cent target loan/deposit ratio had four extremely large

²One of the reasons for such a low ratio was that the bank had a \$1,000,000 deposit from a local school bond issue. Excluding this deposit, which was invested in Treasury bills, its loan/deposit ratio would have been 70.1 per cent.

TABLE 5.9.--Number of Banks, by Type, Reporting Selected Target Loan/Deposit Ratios, 1970.

Type of Bank	Loan/Deposit Ratio % [*]						"Average" Policy
	50	55	60	65	70	75	
	(Number of Banks)						
Independent		1	3	5	4		64.6
Merged	1	1		6	5	1	65.7

^{*} Rounded to nearest 5 per cent.

commercial deposits that fluctuated widely. So, in the event of large withdrawals from these firms, it was forced to keep an unusually large portfolio of short term governments, and thus had a smaller loan portfolio than many banks of comparable size.

One thing of interest was the change in target loan/deposit ratios of the two types of banks. As seen in Table 5.10 the banks that were acquired had a larger increase in target loan/deposit ratios than the banks that remained independent.

This finding may reflect that managers of larger banks are willing to take slightly larger risks with a loan portfolio than are smaller bank managers. Also, with a larger portfolio there is a lesser chance of liquidity problems resulting from deposit withdrawals or bad loans, so a higher loan/deposit ratio can be maintained with greater ease. The banker that reported the highest target

TABLE 5.10.--Number of Banks, by Type, Reporting Per Cent Change in Target Loan/Deposit Ratios, 1965 to 1970.

Type of Bank	% Change in Loan/Deposit Ratio*								"Average" Change
	-15	-10	-5	0	+5	+10	+15	+20	
	(Number of Banks)								
	(%)								
Independent	2		1	5	3	1	1	1	+2.0
Merged		1	1	1	3	1	4		+5.5

* Rounded to nearest 5 per cent.

loan/deposit ratio, which was 74 per cent, reported his bank was able to do this by using the federal funds market extensively. He state, "At times federal funds are expensive money, but over the long run we consider using federal funds a profitable strategy." This bank was one of the largest in the survey and had easy access to the federal funds market. Also, this bank acted as a clearing correspondent for many of the smaller area banks so it could tap the excess cash positions (which most of them had) of the small area banks for low cost overnight loans.

5.5.3 Summary of Resource Use Efficiency Considerations

The rural banks that were acquired had higher target loan/deposit ratios than the banks that remained independent. This may be explained by the fact that the acquired banks controlled more assets and had more accounts and thus could

keep a larger portfolio without experiencing liquidity problems. It may also be because the acquired banks made loans to a wider spectrum of the community members. Or it could be a function of more aggressive management or higher skilled management.

The basic assumption of resource use efficiency for rural communities is that the local bank makes local loans. From the field survey it was evident that this is not always the case. Although data as to where loan funds were used was not available, it appeared that in three instances the independent bank owner/manager used the bank's deposit base to further his personal business interests outside the community. This same factor was also evident from three of the prior ownerships of banks that had been acquired. A common statement heard about management practices of city banks that have rural branches is that they actively seek deposits in the rural area, but make the loans to the city customers. This was not evident from the survey, but again, data as to where the deposits are acquired and where loan funds are utilized were not kept by most banks.

5.6 Summary of the Field Study

The field study results were analyzed using the Bain-Caves framework of structure, conduct, and performance. The performance criteria of equity, progressiveness, resource use efficiency, and efficiency were the main components of the analysis of rural bank performance to rural

communities. It appeared bank mergers enhanced the equity in obtaining banking services because of liberalized credit standards and a broader range of loan services. The merged banks also were more progressive as evidenced by offering more auxiliary services and a wider range of loan service plans. The resource use efficiency of the acquired banks was increased because of the higher target loan/deposit ratios. Market efficiency or awareness was also enhanced by bank mergers. It appeared that merged banks brought savers and borrowers "closer together." It also appeared that merged banks are more aligned with money market conditions than independent banks. Granted that these criteria of equity, progressiveness, and resource use efficiency are subject to interpretation. Several of the performance variables are subjective, based upon the feelings of the people involved in the study.

There was no attempt in this study to investigate the financial or economic efficiency associated with acquiring a rural bank to operate as a branch. Two of the common financial efficiency concepts, rate of return on investment from banks of different sizes and problems in evaluating economics of size are covered in sections 2.4 and 2.6.4. Measures of economic efficiency--the accurate reflection of consumer wants and preferences for the least real cost--were also beyond the scope of this study. Both studies of financial efficiency and economic efficiency

would be interesting and helpful in evaluating the performance of the rural banking industry.

CHAPTER VI

SUMMARY, MAJOR FINDINGS AND IMPLICATIONS

6.1 Introduction

There have been many bank mergers in Michigan in the past several years. Many citizens and several researchers commented on this situation and have suggested the question: How do bank mergers and consolidations affect the banking services available to rural residents? To answer this question the following specific objectives for the study were formulated: (1) to determine how bank ownership changes affect lending, savings, and other banking services to rural residents; (2) to investigate changes in the competitive position of rural banks after merger relative to other institutions that provide farm credit; (3) to obtain a feeling of how rural residents view bank mergers in their communities; (4) to suggest appropriate changes in bank structure legislation.

6.2 Review of Method and Procedure

To accomplish the objectives the study was divided into three main parts. First, twenty-eight Michigan bank

offices were surveyed during November and December, 1971. Fourteen interviews were held with city banks that acquired a rural bank between June, 1966, and January, 1970. The remaining fourteen interviews were with rural unit banks, each of which had been selected as a counterpart to one of the acquired rural branches. Questions asked in these interviews determined how the services presently available from the rural branch or independent bank differed from what was available in 1966.

The banks that acquired a rural branch were asked to name their primary competitors. The second part of the study was to poll the competitors and ask how the competitive relationship between the acquired bank and their organization had changed after the merger.

Many rural communities only have one bank, so it was deemed necessary to have an indication from the community of how the community members liked the bank ownership change and if any bank service changes occurred. In order to obtain such an indication, the third part of the study involved a mail survey of a knowledgeable representative from each community where the local bank had been acquired. This representative was selected after consultation with the county extension agent who was asked to nominate "a person knowledgeable about the local banks changing structure and services, and the community's reaction to the changes." Questions to this representative included his impressions of the community feeling toward

the bank ownership change, how he thought the bank was serving the community after merger as compared to before it was acquired, and his feelings on the effects of the local bank's merger.

6.3 Summary of Findings--Overview

The primary reason for bank mergers was a lack of upcoming management talent in the banks that were acquired. In general, the acquired banks were small, family owned and operated institutions. As the bank manager reached retirement age, the bank owners decided to sell the bank rather than hire new management. (See section 2.6 for further discussion of reasons for bank mergers.)

The fourteen banks that had acquired a rural bank were much larger than the fourteen independent banks. After merger, as of December 31, 1970, total assets for the merged banks averaged \$54.5 million; the range was from \$18 to \$183 million. Ten of the merged banks were in the range of \$30 to \$70 million in total assets. The fourteen independent banks averaged \$7.3 million in assets, ranging from \$3 to \$15 million. Ten of the independent banks were in the range of \$5 to \$9 million in total assets.

An overview of each bank pairing (case summary) is presented in Chapter IV. Each case analysis compared services and the change in services between the acquired or merged bank and a control located in the community with similar population and economic base. Repeating the details

of each case analysis here would be repetitious. But, the aggregate findings presented in Chapter V will be summarized in this chapter.

6.3.1 Services Available

Bank services available to rural residents were enhanced when the rural banks were acquired by larger city banks. The merged banks had liberalized their credit arrangements more in the past five years than the independent banks. Specifically, merged banks required a lower down payment for conventional real estate loans and more of the merged banks were affiliated with a low-down-payment real estate loan program. However, interest charges for real estate loans were comparable from both groups of banks.

The acquired banks offered more auxiliary services, such as credit cards, trust department services, and inventory retail financing. More of the merged banks also used computers to record transactions for the customers' accounts.

As expected, the size of loan available to a single customer was larger from the merged banks. However, to compete on loan size, all the independent banks in the survey had established relationships with city correspondent banks to assist in servicing large loans. Chief executive officers of independent banks could authorize and grant larger loans than the branch managers of the acquired banks, but there was a broad range of loan granting authority for managers of both categories of bank offices.

6.3.2 Resource Use and Service Costs

In terms of resource use, the merged banks reported having higher target loan/deposit ratios than did the independent banks. Also, the banks that merged increased their target loan/deposit ratios from 1965 to 1970 more than the banks that remained independent.

Both groups of banks indicated that in the past five years consumer loans and real estate loans were the most rapidly growing loan services. A major difference in loan service was that some of the independent banks did not offer a full range of loan services. Short term, monthly payment, consumer loans were not offered by some independent banks.

Interest charges on loan types were similar except for farm operating loans. For farm operating loans the merged banks charged higher rates. Nine of the fourteen merged banks reported charging 8 per cent interest, whereas nine of the fourteen independent banks charged farmer borrowers only 7 per cent interest. Also, more of the merged banks set some farm operating loans up on higher cost monthly payment plans.

There was little difference reported by the merged banks between the interest charged for farm operating loans and other types of business loans. Frequently independent banks charged farmers less than other business customers. Larger banks may be more in tune with money markets

and may place fewer institutional constraints on market activity.

Increased market awareness and efficiency is indicated because more of the merged banks reported paying maximum regulation interest rates on savings accounts than the independent banks during periods of "high" interest rates.

6.3.3 Competitive Effect of Mergers

A major objective was to evaluate the change in the structure of rural banks with respect to changes in competition between them and other rural lending agencies. It was found that bank mergers had little effect on competition between agencies offering farm loan service. The Production Credit Association and Federal Land Bank Association representatives who were surveyed reported little change in the acquired bank's farm lending activity after merger.

Banking competitors of eight merged banks were also contacted. Overall, these representatives reported no significant change in the competitive relationship after the merger of the subject banks. They reported the most important factor in establishing customer relationships was the convenience of the bank office to the people instead of services available and service costs.

6.3.4 Community Feelings

Community members were often unhappy with the bank ownership change at the time of merger of the local bank into larger banking firms. However, by the time of the survey the disappointment had lessened and most communities viewed the bank mergers favorably. The representative citizens reported an increase in the community's awareness of services available and noticed an increase in the availability of loan funds after merger.

As a measure of responsiveness to local problems on the part of bank management, information was gathered indicating where the officers lived. It was found that independent banks had a higher proportion of their officers and directors from the local community. However, as a measure of community responsiveness this proxy variable has major shortcomings. In several cases it appeared that the independent bank owner's primary goal, even though he lived in the community, was not related to local community development. On the other hand, some of the non-resident managers of merged branches seemed to be especially concerned with community development.

There were other minor differences between merged and independent banks. The merged operations had somewhat more modern and comfortable physical facilities. Service charges on checking accounts were reported to be similar for both groups of banks. Managers of the merged banks

reported criticism of "impersonal" services and of the change in bookkeeping techniques from a manual to a computerized system. The independent bank managers did not report any substantial criticism. Hours of operation varied little between the two types of banks.

There was no attempt in this study to measure either financial or economic efficiency as they relate to bank mergers. Most of the managers of the acquired banks were "satisfied" with the results of the newly acquired office, but some of the city banks indicated their acquired country branches had not lived up to "expectations."

6.4 Major Findings

A major finding with respect to Michigan agriculture is that farm operating loans are often available at lower interest rates from independent banks than from rural branches of larger banks. Also, independent banks frequently charge farmers less for loan funds than they charge for other business loans. In contrast, the merged banks typically charge the same rate for farm loans as other business loans.

There may be several reasons for this. One may be an attitude among some country bankers that "farmers can't afford high interest rates." Another reason country banks may charge less for farm loans is to increase the size of their loan portfolio. In order to stimulate loan demand, independent banks, which may have few loan investment

alternatives, may offer more favorable rates to farm borrowers than merged banks which have more loan investment alternatives. In any event, market efficiency is enhanced because all resource demanders face more similar resource costs regardless of the planned use of the resources. An important finding for consumers is that merged banks granted more types of loans to a broader class of people. Interest charges for consumer loan service were comparable at both types of banks. In serving a broader population a bank makes loans to some poorer risk customers and on some loans has a larger risk of not being repaid. But because his loss from one given bad loan may be less disastrous for a large bank than it is for a small bank, large banks may accept this risk more readily than would a small bank.

Merged banks paid higher interest rates on savings accounts than the independent banks. In this sense, savers are brought closer to money market rates of interest. This may have implications for community development also because it may enable the local bank to attract more local deposits. These deposits, if used locally, may further stimulate local economic growth.

Records which show where loan proceeds are used were not available. It was found that some of the independent banks had substantial amounts of loan funds outstanding to customers who lived outside the bank's primary service area. The reason for this was that some independent bank owners

use the bank's deposit base to facilitate personal business interests. This action drains off loanable funds from the local community and may affect community development.

6.5.1 Implications for Customers

The major implication of the merger of rural banks for bank customers is that more services become available to more people because of the merger. Credit standards tend to become more liberal and more objective after merger. Real estate loan down-payment terms are liberalized, and more people can qualify for real estate loan services. Loans are written for more purposes. However, the costs of loan service are similar except independent banks charge lower rates for farm operating loans than for other business loans. This contrasts to merged banks which charge the same rates for farm operating loans and other business loans. Higher interest rates are likely to be paid on savings deposits. More auxiliary services are available. Merged banks are also likely to have higher loan/deposit ratios.

These additional services are not available without "cost," even though the charges for the services may be similar. One cost of merger may be the loss of "personalized" service that is often associated with a small firm. Larger banks commonly use electronic data processing rather than hand posting. There may be less time for friendly chatter while using a drive-in window than going into the

bank lobby to transact business. The "decision makers" of a merged bank may be less well known or even totally unknown to the resident of a small town.

A second cost may be that people will have fewer bank firms with which to conduct business. Under the Michigan banking rules, the merger of a small town bank into another banking firm forecloses one alternative source of bank service each time a merger is consummated.

A major implication for agriculture is that the merger of a small town bank into a larger banking firm may affect farmers with different sizes of businesses differently. Larger banks typically put more emphasis on financial statements in evaluating credit worthiness of loan applicants, whereas small banks look more at personal and family characteristics of the loan applicant. So merger of a small town bank into a larger firm may require farmers to supply detailed records and budgets to support loan applications. Some smaller farmers may find it difficult to supply this type information. Also, larger banks may have a minimum size farm business loan. This minimum size may be larger than some small farmers would need. Therefore, smaller farmers may be forced to use higher cost consumer types loans to finance their businesses. If sufficient (or potential) farm loan business exists, a large bank may hire a farm loan specialist to give financial counsel to farmer borrowers. The specialist may segment the farm loan

market and limit his services to borrowers that need large lines of credit, thus making the merged bank a more aggressive competitor for prime farm accounts. Because of these practices, large banks may serve only larger farmers and issue fewer farm loans than independent banks.

6.5.2 Implications for Other Credit Agencies

A major effect of bank mergers on other credit agencies is that a larger bank can, if its management desires, enter a market with a greater resource base and drive than a smaller bank. It is a common allegation that a large merged bank, having a footing in many business areas, can subsidize its efforts in one market area from earnings in other market areas. Moreover, their competitors are likely to be restricted-line institutions such as savings and loan associations, Production Credit Associations, and similar agencies. However, this allegation is inconsistent with profit-seeking behavior. If management of a larger bank sees an unexploited area or an unusually profitable market, the bank can be expected to enter that market. Conversely, the pressure of severe competition or low profits in a given market will cause the bank to withdraw resources from that market. Since cross-subsidization implies the acceptance of unusually low (or negative) returns in a particular market, it is at odds with profit maximization and requires alternative managerial goals and

sufficient insulation from competition to pursue them. A more reasonable expectation is that banks will be active in the markets of the specialized agencies only when they have surplus funds--if rates of return are lower for urban than for rural customers--and that the intensity of competition the specialized loan agencies will feel and the demand they will enjoy will be much more unstable when their principal competitors are acquired branches than when they are independent banks.

Evidence of this was seen between 1965 and 1970 when merged banks became more active in real estate and consumer loan markets and gave less emphasis to the farm loan market. Real estate loans and consumer loans are generally thought of as profitable loans, and farm loans are often characterized as being specialized and risky. These trends were noted in a period when monetary conditions were increasingly "tight."

6.5.3 Implications for Regulatory Agencies

As the regulations are currently written and interpreted, once mergers are effected there are no major changes for the regulatory agencies. There may be some effects in that there will be fewer banks to examine and they will need to explain new rule changes and forms to fewer people. So more mergers mean less work for the regulators after the mergers are consummated.

Before merger applications are approved, though, the regulatory agencies must do a thorough review of the competitive effects of the proposed merger. As more mergers are consummated and fewer banking firms result, the analysis of the competitive effects will become more difficult. After time, competition for certain types of business may be lessened. (See section 2.1.2 for discussion of bank markets.) If this happens, new regulations may be necessary to insure that the resulting banking firms serve all the citizens' needs. Institution and enforcement of new rules may be difficult and may require increasing the depth and quality of regulatory agencies.

A disturbing aspect is that we know very little about the power structure in the state banking industry. One respondent told the interviewer that the major Michigan bank law changes since 1930 came as a result of two individuals: Howard Stoddard and Donald Parsons. The Stoddard interests pushed for the branch banking law changes, and they were made. The Parsons group was involved in a banking operation which almost caused insolvency of several banks. This latter situation spurred the Bank Holding Company Act of 1970, an act which allowed some other banking interests to "bail the banks out of the situation." Both of these bank law changes were used by some banking groups for financial gains. These allegations should force us to ask a question about the future: Will a few large financial

concerns be able to have undue influence over the Michigan financial markets and operating rules? Because of economies of size and power, a few powerful interest groups may be able to gain special privileges by obtaining passage of regulations which are not in the best interests of the states' citizens.

6.6 Suggestions for Further Research

This study looked at the effects of bank mergers on financial services available to rural Michigan residents. Equity, progressiveness, and resource use efficiency from the point of view of the rural citizens and community were the primary criteria used in the evaluation. There are several additional questions for further study suggested in Chapter V at the conclusion of the discussion of each criterion. (See sections 5.3.9, 5.4.7, and 5.5.3.) This section will suggest four additional areas of research.

A logical extension of this research would be to take an indepth look at the economic and allocative efficiency aspects of bank mergers. Questions here include: What is the optimum size of rural banks and what criteria should be used to measure this size? Do bank service prices accurately reflect the cost of providing the services? How do bank mergers affect the customer structure of banks?

A second area of further research is in the area of "market" research. Are rural banks providing the service that is desired? If local banking service is "unsatisfactory" how far will people travel to find "satisfactory" service? How extensive is the rural community's knowledge of capital markets and the alternatives available to them?

Market research in the area of "quality" of banking services is also needed. In this study there was no measure of the quality of service available from the different banking firms. Of what value are six checking account plans from which to choose if accounting errors are commonplace? Of what value is a trust department if the trust officers are incompetent? Of what value are low interest charges on loans if the bank makes very few loans? Research quantifying the quality of service available from banks is needed. Only then can one assess the overall service of one bank compared to another.

A third research need concerns investigating the extent to which local banks serve the community's needs. Some imaginative research to develop a "community services index" may be necessary before attacking this problem area. This index should include items relating to what the community wants and needs, where loan proceeds are used, interest rates paid on savings accounts, charges on loans, which segments of the community are and are not served, returns to stockholders, etc. This index should be

weighted to show the bank's performance for all classes of people that it is chartered to serve.

If it is found that some banks do not serve their communities well, research might examine ways to make banks more responsive to serving community needs. Suggestions of possibilities to investigate here include having some publicly elected members on the Board of Directors of the bank. Publishing information from the "community service index" may give banks an incentive to give better local service. If some people are denied banking services, perhaps an appeal board could be established to review the bank officers' decisions. Another possibility to investigate would be the effects of allowing another bank office to be operated in the same community as the unresponsive bank. The threat of additional competition may have positive effects on a bank's community service.

New developments in the rural financial markets suggest the fourth research area. What will be the impact of other financial institutions providing demand deposit services? How will this affect the flows of funds into various uses? What will be the effects on the bank's ability to attract funds? Bank holding company legislation has recently been passed in Michigan. What will be the impact on rural areas of a bank holding company owning several financial institutions? These and other questions need to be answered so policies can be developed to meet financial service needs of rural people.

6.7 Suggestions for Legislative Consideration

This study revealed that rural bank offices that are branches of larger banking firms offer more banking services, have more liberal credit requirements, and reduce some loan requirements. Also, the branch offices of larger banks pay higher interest rates for savings deposits and have higher target loan/deposit ratios. If these results are desirable, legislative action to encourage rural bank mergers and consolidations should be enacted.

Increasing the minimum capital requirements of banks would be a passive means of requiring consolidation of banks. Even if rural banks did not consolidate to meet the minimum capital requirements, the additional capital may help the bank attract more customers. By serving a larger customer base, a bank should be able to afford to offer additional services.

As the bank merger rules are currently written, before a merger can be consummated it must be shown that the merger will not lessen competition. But as it is currently practiced, all bank merger applications show enhanced competition by defining a geographical market with the primary competition being larger banks. Eliminating this "lessened competition" requirement may also pave the way for additional consolidations of rural banks.

Rules that would act to protect bank loan customers and potential loan customers should also be considered. Banking laws are currently written to give a large amount of protection to depositors, but there are few regulations to give any protection or service to other groups using bank loan service. It was found that some banks did not provide some of the desirable types of loan service to the local community. Perhaps legislative consideration should aim to protect people living in communities from bank managements that do not give adequate local service. But, before specific suggestions can be made in this area, further research would be necessary to define where legislation is needed and the limits of the legislation.

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APPENDICES

APPENDIX A

QUESTIONNAIRE USED FOR BANK INTERVIEWS

APPENDIX A

QUESTIONNAIRE USED FOR BANK INTERVIEWS

Name of Bank: _____ Branch: _____

Officer Interviewed: _____ Date: _____

Information from December 31, 1970, Call Report:

Assets

- | | |
|---|-------|
| 1. Cash and due from banks | _____ |
| 2. U.S. Treasury securities | _____ |
| 3. Securities of other U.S. Government agencies | _____ |
| 4. Obligations of States and political subdivisions | _____ |
| 5. Other securities | _____ |
| 7. Federal funds sold | _____ |

Liabilities

- | | |
|-------------------------------------|-------|
| 22. TOTAL DEPOSITS | |
| (a) Total demand deposits | _____ |
| (b) Total time and savings deposits | _____ |

Capital

- | | |
|--|-------|
| 34. Capital notes and debentures | _____ |
| 35. Equity capital, total | _____ |
| 36. Preferred stock-total par value | _____ |
| 37. Common stock-total par value | _____ |
| 38. Surplus | _____ |
| 39. Undivided profits | _____ |
| 40. Reserve for contingencies and other capital reserves | _____ |
| 41. TOTAL CAPITAL ACCOUNTS | _____ |
| 42. TOTAL LIABILITIES, RESERVES, AND CAPITAL ACCOUNTS | _____ |

Schedule A

1. Real estate loans:
 - (a) Secured by farmland _____
 - (b) Secured by 1-4 family residential properties _____
 - (1) Insured by FHA _____
 - (2) Guaranteed by VA _____
 - (3) Not insured or guaranteed by FHA or VA _____
 - (c) Secured by multi-family residential properties _____
 - (d) Secured by nonfarm nonresidential properties _____
2. Loans to financial institutions:
 - (a) To domestic commercial and foreign banks _____
 - (b) To other financial institutions _____
4. Loans to farmers _____
5. Commercial and industrial loans _____
6. Loans to individuals for household, family and other personal expenditures:
 - (a) To purchase private passenger automobiles on installment basis _____
 - (b) Credit cards and related plans:
 - (1) Retail (charge account) credit card plans _____
 - (2) Check credit and revolving credit plans _____
 - (c) To purchase other retail consumer goods on installment basis _____
 - (d) Installment loans to repair and modernize residential property _____
 - (e) Other installment loans for household, family, and other personal expend. _____
 - (f) Single-payment loans for household, family, and other personal expenditures _____
8. TOTAL LOANS, GROSS _____

Information from December 31, 1965, Call Report:

Assets

1. Cash, balances with other banks _____
2. United States Government obligations _____
3. Obligations of States and political subdivisions _____
4. Securities of Federal agencies and corporations _____
5. Other securities _____
6. Federal funds sold _____

Liabilities

20. TOTAL DEPOSITS

(a) Total demand deposits _____

(b) Total time and savings deposits _____

Capital Accounts

26. (a) Capital notes and debentures _____

(b) Preferred stock--total par value _____

(c) Common stock--total par value _____

27. Surplus _____

28. Undivided profits _____

29. Reserve for contingencies and other capital reserves _____

30. TOTAL CAPITAL ACCOUNTS _____

31. TOTAL LIABILITIES AND CAPITAL ACCOUNTS _____

Schedule A

1. Real Estate Loans

(a) Secured by farmland _____

(b) Secured by residential properties _____

(c) Secured by residential properties (other than farm) and guaranteed by Veterans Administration _____

(d) Secured by residential properties (other than farm) and not insured or guaranteed by FHA or VA _____

(e) Secured by nonfarm nonresidential properties _____

2. Loans to financial institutions:

(a) To domestic commercial and foreign banks _____

(b) To other financial institutions _____

4. Loans to farmers (include secured and unsecured loans to farmers, except loans secured by real estate above):

(a) Loans directly guaranteed by the Commodity Credit Corp. and certificates of interest _____

(b) Other loans to farmers _____

5. Commercial and industrial loans _____

6. Loans to individuals for household, family, and other personal expenditures:

(a) To purchase private passenger automobiles on installment basis _____

(b) To purchase other retail consumer goods on installment basis _____

(c) Installment loans to repair and modernize residential property _____

(d) Other installment loans for household, family, and other personal expenditures _____

- (e) Single-payment loans for household,
family, and other personal expenditures _____
8. LOANS AND DISCOUNTS, GROSS _____

Interest Rates

What is your basic interest rate for the following types of loans?

Real Estate		Consumer Loans	
Farmland	_____	Auto (new)	_____
Residential	_____	Credit Card	_____
Other	_____	Residential	_____
Farm Loans	_____	Improvements	_____
Commercial &	_____	Single Payment	_____
Industrial Loans	_____		

Competition on Loan Service

1. How large is your primary service area? (i.e., radius in miles that represents 80 per cent of your customers)

_____ miles

2. In this area who are your primary competitors for the following types of loans?

<u>Type of Loan</u>	<u>Competitor</u>	<u>Where is his office?</u>
<u>Real Estate Mortgages</u>		
a. Farmland	_____	_____
b. Residential	_____	_____
<u>Farm Loans</u>	_____	_____
<u>Commercial &</u>		
<u>Industrial Loans</u>	_____	_____
<u>Consumer Loans</u>		
a. Auto	_____	_____
b. Credit Cards	_____	_____
c. Residential	_____	_____
Improvements	_____	_____
d. Single Payment	_____	_____

Which competitor's operations have changed substantially in the last five years?

Have their changes made your lending policies:

Much more liberal _____	Some more conservative _____
Some more liberal _____	Much more conservative _____
Not much change _____	

Have these changes affected the total availability of the following types of loans to the community?

<u>Loan Type</u>	<u>Increased Substan- tially</u>	<u>Increased Somewhat</u>	<u>No Change</u>	<u>Decreased Somewhat</u>	<u>Decreased Substan- tially</u>
Real Estate _____	_____	_____	_____	_____	_____
Farm _____	_____	_____	_____	_____	_____
Consumer _____	_____	_____	_____	_____	_____

Loan Limits

<u>Type of Loan</u>	<u>1965</u>	<u>1970</u>	<u>Practiced Limits (if different from legal)</u>	
			<u>1965</u>	<u>1970</u>
Nominal (\$)	_____	_____	_____	_____

	<u>Practiced Limits, Conventional Loans</u>		<u>Limit Under Special Arrangements</u>	
	<u>1965</u>	<u>1970</u>	<u>1965</u>	<u>1970</u>
Real Estate (% of Value)	_____	_____	_____	_____

Number of loan requests over nominal legal limits:

1965 _____ 1970 _____

How are nominal and secured loan requests over these limits serviced? (% of requests)

_____ % a. Correspondent	_____ % c. Handled by board members or other community members
_____ % b. Referred to other bank	_____ % d. Refused

How are real estate loan requests over your ability to serve handled? (% of requests)

____ % a. Correspondent Bank ____ % c. Savings and Loan Assn.
 ____ % b. Life Insurance Company ____ % d. Federal Land Bank Assn.

Time involved in servicing loan requests:

If this office is a branch

1. What is the loan limit of the branch manager? \$ _____
2. What is the loan limit of the branch loan committee? \$ _____
3. If this loan request is referred to the main office, how long does it take for approval of various size loans?

<u>Approving Officer or Body</u>	<u>Loan Limits (\$ 000)</u>	<u>Days Necessary For Approval</u>
Senior Officer	_____	_____
Loan Committee	_____	_____
Board Committee	_____	_____
Board of Directors	_____	_____

4. How long does it take to obtain approval for a loan request from your correspondent bank? _____ days

Loan/Deposit Ratios

What is your bank's 'target' loan/deposit ratio? _____ %

Does your bank have 'target' loan/deposit ratios for each of the various types of loans? ____ No ____ Yes

If yes, what are they?

<u>Type of Loan</u>	<u>Target Loan/Deposit Ratio</u>
Real Estate	_____
Farm Loans	_____
Commercial & Industrial	_____
Consumer Loans	_____
All Other	_____

Has your target loan/deposit ratio changed the last five years? ____ Yes ____ No

If yes, from _____ % to _____ %. Reason for change: _____

Deposit Services

Were Regulation Q rates paid in:	1965		1970	
	Yes	No	Yes	No
Time Certificates	—	—	—	—
Passbook	—	—	—	—

What was the number of depositors in:	1965	1970
Checking Accounts	—	—
Passbook Savings	—	—
Time Certificate Depositors	—	—

Competitors

Checking Accounts	(1)	_____
	(2)	_____
Passbook Accounts	(1)	_____
	(2)	_____
Time Certificate	(1)	_____
Depositors	(2)	_____

Are your checking account charges ___ higher, ___ comparable, ___ lower than your competitors?

If your bank has not paid maximum Regulation Q rates on deposits the last five years, when and why not? _____

How has competition for deposits changed the last five years?

___ Increased Substantially
 ___ Increased Somewhat
 ___ Remained the Same
 ___ Decreased Somewhat
 ___ Decreased Substantially

Which competitors changed? How? _____

Municipal Services

- What per cent of the total amount of services to local governmental units that are demanded does your bank provide?

_____ % of short term operating loans
_____ % of municipal bonds purchased
_____ % of checking and other banking services

If a branch office, does the branch have facilities to serve these needs, or are they referred to the main office? ___ Main office ___ Branch

Other Services

	<u>Yes</u>	<u>No</u>
1. Do you have a trust department?	_____	_____
2. Do you do 'floor planning' for your retail customers?	_____	_____
3. Do you offer your customers credit cards?	_____	_____
4. Are your accounts computerized?	_____	_____
If yes, do you have your own computer?	_____	_____
If not, where do you rent computer time?	_____	_____

Customer Structure

How many customers from each type of loan category have increased or decreased the last five years (net)?

<u>Type of Loan</u>	<u>No. of Customers</u>		<u>Reasons for Major Change</u>
	<u>Amount of Change</u>		
Real Estate	+ _____ - _____		_____
Farm	+ _____ - _____		_____
Commercial & Industrial	+ _____ - _____		_____
Consumer	+ _____ - _____		_____

If your capital expanded, did this change help attract significantly more customers? Yes No

If yes, which of your loans services gained most? _____

Did competitors changes in the last five years cause you to gain or lose loan customers? Yes No Why? For which services? _____

Service Changes

1. What has been the fastest growing loan service the last five years? _____
2. What has been the second fastest growing loan service the last five years? _____
3. What bank operations or services do you expect to change in the next two years in response to expected community changes? _____
4. Is your bank affiliated with a bank credit card service?
Yes No If not, do you expect to be in the next year? Yes No
5. Which of your bank operations have received criticism from the community in the last year? _____
6. What actions have you taken, do you intend to take, or can you take to alleviate this? _____

7. What are your hours of operation? _____
In the last five years have these expanded? ____ Yes
____ No Change ____ Were Shortened
Are you open on Saturday? ____ Yes ____ No
Are you open any evenings? ____ Yes ____ No
8. What was your advertising budget in 1965? \$ _____
in 1970? \$ _____
9. Did the type of your advertising change between these
two periods? _____
10. Do you think people are more aware of the range of
services that your bank office offers now than they
were five years ago? _____
Why? _____

Ownership and Management

1. What was the last ownership control change of this bank (or branch office)? _____
2. Is ownership control of the bank local? Yes No
If not, how far away or where is the controlling group located? _____
3. How many directors does the bank have? _____
Of these, how many work in the bank? _____
What are the primary occupations of the rest? _____
How many of the directors live in the local community? _____

For Branches of Larger Banks

1. What was the primary reason for merger?
 - a. _____ Lack of upcoming management talent
 - b. _____ Need for additional capital
 - c. _____ Normal sale of bank stock which other bank purchased
 - d. _____ Need to offer additional services to the community which old bank was unable to do because of small size
2. How many of the 'old' bank directors are on the 'new' bank board? _____
3. How many of the 'old' bank executives are with the 'new' bank? _____
4. How many of the 'old' bank executives left of their choice? _____
5. What is your feeling of how the community views the change from a unit bank to a bank that is a branch of a larger organization? _____

APPENDIX B

**QUESTIONNAIRE SENT TO COMMUNITY
REPRESENTATIVES**

APPENDIX B

QUESTIONNAIRE SENT TO COMMUNITY
REPRESENTATIVES

Name of Bank: _____ Reference Number: _____

Branch Location: _____

What is your impression of the _____ Highly favorable
current community feeling toward _____ Favorable
the bank since the ownership _____ No change
change? (Please check one answer.) _____ Unfavorable
_____ Highly unfavorable

What was your impression of the _____ Highly favorable
community feeling toward the bank _____ Favorable
immediately after the ownership _____ No change
change? (Please check one answer.) _____ Unfavorable
_____ Highly unfavorable

Is the current bank ownership _____ Yes
'pushing' some types of loans more _____ No
than the past ownership did?

If yes, which loans? (Rank in order _____ Farm Loans
of increasing emphasis.) _____ Real Estate Loans
_____ Consumer Loans
_____ Commercial Loans
_____ Other _____

Is the current bank ownership _____ Yes
'holding back' on writing some loans _____ No
that the past ownership serviced?

If yes, which loans? (Rank in
order of decreasing emphasis.)

☐ Farm Loans
☐ Real Estate Loans
☐ Consumer Loans
☐ Commercial Loans
☐ Other _____

Are the people of the community
more aware of the range of services
available from the bank now than
they were five years ago? (Please
check one.)

☐ Much more aware
☐ Some more aware
☐ No change
☐ Slightly less aware
☐ Less aware

Has the current bank ownership
improved service to any group of
customers that the past bank
ownership did not service well?
(Please check one.)

☐ Yes
☐ No

If yes, what type of customers?
(Please fill in.)

Have you noticed any change in the
bank's advertising the past five
years?

☐ Yes
☐ No

If yes, what changed? _____

What is your personal feeling toward the bank ownership
change? Do you like it? Did it benefit the community?
Would you like to see the bank go back to a locally owned
bank? What other comments would you like to make about this
bank ownership change? (Remember, this is confidential.)

THANK YOU!