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## Bank Consolidation

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It is not surprising that factors relating to cost efficiencies and avoidance of duplication were rated as the strongest factors encouraging cooperation by the key informants. This is consistent with the conservative ethic of Grand Rapids metro communities. A 10-year examination of expenditure patterns of metro communities in Grand Rapids found that per capita spending by local governments in Grand Rapids metro is collectively less than 2/3 of the national average.

All this leads to the subject of leadership. Looking at the charts, one notes that when the two leadership factors are added together, all but one key informant cited leadership, or lack of it, as a major factor. Clearly, the need for metropolitan leadership is a major factor in promoting further cooperation among units of local government in Grand Rapids metro.

Two significant points need to be made in conclusion. First, the findings in Grand Rapids (and to a significant extent in other communities) make it clear that the leadership push for more inter-local cooperation will need to come from business leaders. Second, it is evident from the research that there is no formula or theory of metropolitan governance which can be generalized to all metro areas. Each is unique. While much can be learned from the experiences of other communities, the mix of factors which inhibit or encourage cooperation differs in each metropolitan area. Each must address inter-local cooperation for the delivery of public services in its own way, after thoughtful introspection and as part of strategic planning for the future of the metro region.

**Note:** This article is extracted from the author's doctoral research in progress, scheduled for completion in Spring, 1996.

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## *Bank Consolidation*

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Merger mania has hit the banking industry! Virtually, every day we hear of another "mega-merger" between banks in the works. Indeed, the pace at which banking organizations have joined forces has been feverish over the last couple of years. Through the third quarter of 1995 alone, nearly 300 bank mergers deals valued at nearly \$40 billion had been announced, with little end in sight in the immediate future. While industry consolidation is hardly new, the scope and nature of the participants in this latest round is unprecedented. We've seen the alliance of titans created by the union of Chemical Bank and Chase Manhattan, a deal valued at \$10 billion, and the joining of "super regionals" such as First Union's \$5.1 billion buyout of First Fidelity and, a little closer to home, the \$5.3 billion merger of NBD and First National of Chicago.

As of the end of last year, the 2 largest American Banks (measured by assets), BankAmerica and NationsBank were engaged in merger discussions that if consummated would create a bank with \$410 billion in assets and 7% of all bank deposits nationwide. If these monoliths are ripe for consolidation, then just about any banking organization could be vulnerable.

### *Legislation*

Under the McFadden Act of 1927, legal authority over bank branching for both state and national banks was given to the states. The original purpose of the Act was to place national banks on an equal footing with states with respect to geographic market access. In effect, the McFadden Act eliminated interstate banking. For the better part of 50 years, states legislatures, which essentially controlled geographic restrictions on banking activities, avoided taking actions that would have allowed natural interstate competition among banks.

1975 marked the beginning of a change in attitude on the part of state governments toward interstate banking. In this year the state of Maine passed the first "reciprocity" law granting branching authority to banks headquartered in other states as long as these states provided reciprocity for banks headquartered in Maine. Similar arrangements were slow to

develop in other states, however, in 1986 regional "compacts" became widespread. At the end of 1993, 49 states permitted some form of interstate banking, 34 of which allow complete national interstate banking. Michigan was one of 17 states that allowed entry by banks headquartered in any state that reciprocates as of June, 1993. Finally, late in 1994 the Congress passed legislation that effectively repealed the interstate banking prohibitions of the McFadden Act and has hastened the consolidation process.

### *The Economics of Consolidation*

In theory, business combinations should reflect synergism in the form of economies of scale (efficiency gains from expanded scale of operations) or scope (efficiency gains from expanded scope of operations). Given the restrictions that historically have been placed on bank operations by artificial political boundaries, we might expect banks to combine in order to participate in geographic markets that they can serve in a cost effective manner and to provide banking services in which they have particular expertise. Such combinations should be good for efficiency and, hence, profitability. A number of academic and other professional studies have attempted to measure the efficiency gains and profitability of bank mergers. A recent Federal Reserve paper summarizes the results of 39 bank cost and profitability studies published between 1980 and 1993. Generally, the findings conclude that bank mergers on average have surprisingly little effect on efficiency and profitability. However, these results reflect mergers that almost exclusively occurred before 1989 and mergers taking place currently could be significantly different. To illustrate, in the takeover of First Fidelity Corporation by First Union Corporation, one analyst has suggested that First Union's expertise in branch based installment lending could be applied to double the branch lending in the First Fidelity system. In addition, future economies of scale may be created by the technological requirements of the banking industry. With the introduction of ATMs, debit cards, automated payroll processes and other electronic payment services, banking has become increasingly technology driven. Evidence suggests that scale of operations has become increasingly important in support of technological spending and development. In 1985, Salomon Brothers estimated that the 35 largest banks spent nearly \$5 billion or 59% of the industry total on technology. By 1990 the 35 largest banks were estimated to have spent \$12 billion or 68% of the industry total on technological investment. Industry expenditures in 1995 have been estimated at a remarkable \$175 billion with the largest banks accounting for more than 80% of this figure.

Another potential economic rationale for mergers is portfolio diversification. Historically, smaller banks serving smaller geographic markets have often been at the mercy of local economic conditions. Many small banks have failed precisely

because they were tied too tightly to small economies that depended on a few major employers or industries. Possibly to mitigate the effects of poor diversification in their loan portfolios, small banks tend to lend less than larger banks on a per deposit dollar basis, choosing to invest in securities' portfolios more heavily. To illustrate, between 1988 and 1991 multi-state banking companies recorded a loan-to-deposit ratio of 84% compared to 66% for all other insured banks. Consolidation, particularly across regions whose economic performance is not highly correlated, would reduce the risks associated with lending, reducing the chance of small banks failing and possibly increasing bank lending.

### *Consolidation and West Michigan Banking*

Is consolidation the solution for all banks, including those in West Michigan? Based on the scramble to find merger partners that currently is going on, one might be lead to believe the answer is yes. The West Michigan banking community is composed of relatively small and medium sized banks of assets ranging from several hundred million to roughly \$20 billion, and many analysts predict that this portion of the banking market will be the next to rapidly consolidate. Indeed, every passing day seems to bring with it another rumored local bank takeover. But is this inevitable? Perhaps not. As we have seen, size alone may not promote efficiency, and many argue that size hinders service for certain classes of customers. Recent survey evidence suggests that certain customer groups are often not satisfied with the quality of services provided by their primary bank. Small and medium sized independent banks might have a customer service niche and may find growth, capturing customers that are "lost" in the upheaval of consolidation. Indeed, some bank experts argue that there are inherent advantages for small and medium sized banks in providing services such as problem solving or the provision of financial advice to their small and medium sized commercial clientele. So there may be breathing room for the independents. But just in case, don't sell those West Michigan bank stocks yet!

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### *West Michigan Stock Returns*

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The year just ended was a very good year for investors in most West Michigan based companies. On average, investors saw their stock prices increase 22 percent from December 30, 1994, to December 29, 1995. Tower Automotive led the way, nearly doubling its price during the year. Not far behind was Wolverine World Wide whose stock price increased more than 83%.