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Nationwide Branching: Some Lessons From California

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ABSTRACT

California provides a case study of a large and diverse geographic area with few restrictions on branch banking. In spite of the lack of restrictions, branching occurred primarily in two periods, the 1920s and 1960s. Large banks took over smaller banks during these periods, but, particularly in the 1960s, new banks opened to fill the gap. Branching without limitation did not result in a few banks domination of the market.

Introduction

Events of the 1980s--widespread failures among savings and loan institutions and banks and several changes in law--have generated a new interest in the impact of deregulation on the United States financial industry. There has been particular interest lately in the possibility of interstate banking. Indeed, the numerous cases where banks and savings institutions have been regionalizing their operations have made it virtually certain that banks will soon be branching across the nation.

California is an interesting case study of a large area with a liberal legal framework for the financial industry. The state is large and diverse in its social and economic styles, and has offered ample opportunities to experience the benefits and abuses predicted from freeing banks and savings institutions from restrictive laws.

With respect to the issue of nation-wide branching, the state is uniquely appropriate for studying the impact. State-wide branching was never prohibited, and it usually was unrestricted. In spite of this, branching occured mostly in two periods. The first period was during the

1920s when the Bank of Italy took a predator's position and began devouring unit (one office) banks with an appetite that sent banks nationwide scurrying for protection.

The second period of branching activity occurred in the 1950s and 1960s and involved most of the larger banks and many smaller banks. This period was characterized by larger banks purchasing smaller banks which had established their market niches, and has particular significance for projecting the results of nation-wide branching.

The Issues

Those favoring nationwide branch banking generally contend the financial system would be stabilized by such an arrangement. The Federal Reserve, the FDIC and many state agencies have lately allowed a number of acquisitions across state lines to prevent the failure of banks or savings and loan institutions; these actions have served to validate the contentions that geographic diversity adds strength to financial institutions. In addition, banks and savings and loan associations have been exposed to increasing competition from brokerage firms, money market funds, and other financial services which are substitutes for deposit accounts. These other institutions are not limited by state boundaries in their expansion and some contend that banks are placed at a disadvantage in this competition.

The opposition to nation-wide branch banking comes mostly from small, independent bankers and seems to be based on the following two hypotheses: 1) liberal branching laws allow a few large banks to dominate the market and 2) the expansion of these large banks, if branching restrictions are removed, would substantially damage the smaller banks.

This paper examines California history to determine how the structure of the financial services industry would be affected by easing laws against branching across state lines by banks and savings and loan associations.

Theorectical Basis

Branching is perceived as a method of extending the limited geographic area from which a bank's customers usually are drawn and a way of increasing competition in areas where the need for bank services is limited. Even though there are nearly 14,000 firms in the banking industry and almost another 3,000 in the closely competing saving and lending businesses, banking is not perceived as a highly competitive industry. Each firm tends to have some monopoly power based on the convenience of its location. The competitive edge is more important from the perspective of the bank's ability to attract deposits than from their lending patterns. Several studies support this perception. A 1957 study by the New York State Banking Department used a questionnaire to locate depositor and borrowers at upstate New York banks and found the bulk of deposits originated within the town where the office was located. For unit banks, 63% of the deposits were from the town in which the office was located, and another 29% came from the immediately surrounding area (New York State Banking Dept.). Other studies have shown that deposit customers particularly are located near the banking office. For branches, the distance from the main offices seems less important (New York Bank Dept., p. 33).

The assets of the banks, in contrast, are usually distributed between local loans and loans in impersonal or distant markets. Only the small borrower with a very local reputation, and possibly the very large borrower needing to deal with a world class bank, could face a situation where they must choose from a limited number of bankers. Even real estate mortgages, once considered a locally held asset which would be held away from the property only if heavily discounted, are now nationally funded through the various mortgage associations.

Numerous studies have attempted to measure the impact of branch banking on competition. Some studies on the policies of branch banks showed that when a branch bank system took over a small local unit bank, they seemed to extend the services and prices offered at the main office to each of the branches (Alhadeff, p. 175). This pricing policy would tend to extend the more competitive market situation of the large city, where the large market allows several banks to exist, to the small community. The competitive impact of branching may be strong enough that the mere existence of such branching laws increases competitive behavior.

Paul Horowitz and Bernard Schull found in a 1974 study that in states which allowed statewide branching higher interest on deposits was paid than in unit banking states (p. 176). The study also showed that branch banks performed differently than unit banks, and that unit banks in branch banking states performed differently than unit banks in unit banking states. Restricting the results to rural areas, where branching laws are thought to have the most impact on competition, Horowitz and Schull found several indications of the benefits of branching to small businesses and consumers. They found unit banks in states where branching was allowed paid higher interest on time deposits, had more time deposits of their total deposits, and had a greater loan: asset ratio than unit banks in unit banking states. Comparing branch and unit banks showed branch banks were bigger, had higher loan: asset ratios, and offered more services than unit banks (Horowitz and Schull, p. 166). There was a very slightly higher ratio of bank offices to population in small towns allowing only unit banks, but in larger towns the branching states had much higher service index.

Economies of scale are the reason for banking's existence. A financial institution exists to pool funds for investment and some economies of scale should result from expanding the pool. Larger pools of funds will lower transaction costs associated with buying bonds or stocks and with acquiring information about investments and loans. In loans there are

economies in the cost of evaluating credit worthiness and in processing applications. There would be lower brokerage fees for bond purchases made in larger blocks and risk reduction from diversification. Larger banks experience economies of scale, too, in their liability management. Larger deposit accounts are normal at larger banks and require proportionately less bookkeeping as account size grows. In spite of this, the diseconomies associated with covering a larger geographic area may eventually overwhelm these economies. Several recent studies support a view that average costs decline as banks grow to about $25 million in assets, level off to about $100 million in assets, then grow as bank size increases. (Benston, et. al.; Clark, Kilbride et. al.)

Given that some banks, perhaps those banks already large, will expand if nationwide branching is permitted, what will be the effect on the small, independent banks? Banks might expand by constructing new branch offices, known as "de novo," but smalltown bankers seem to fear most the expansion path of a large bank which grows by acquiring small, independent banks and converting them to branches. The choice of the expanding bank depends on several factors. The first factor is location. The bank will naturally want to establish new branches contingent to population center. When populations have shifted recently, established banks are less attractive as potential branches. In other situations, location may be providing strong monopoly power for established banks.

A very strong attraction of acquisition versus de novo branching is provided by the established loan and deposit accounts. This may be further enhanced by well established personal relations between bank officers and customers which can continue in the newly formed branch. If the independent bank is well-located and well-managed, there seems to be a real danger of a take-over by a large bank recently allowed into the market by changed branching law. It does not seem, however, that this position would be necessarily detrimental to the small bank. If the larger bank's incentive to merge stems from the economies of scale derived in expansion, the small bank would experience higher profits as the branch of a large bank than as a smaller independent bank. This would indicate capitalized gains which the larger bank would be willing to pay to acquire the small bank. Small independent banks could therefore benefit from the liberation of branching laws if larger banks added branches by merger and acquisition.

The independent banker may have more to fear from the de novo method of expansion. Some isolated towns have markets too small to support additional independent banks but large enough to attract branches of out-of-town banks. Changes in the law might then be equivalent to conversion of an oligopoly (or monopoly) market to monopolistic competitive. Existing profits would decrease for established banks. The self-interested independent banker should not be opposed to nationwide branching per se, but should attempt to block de novo branching where possible.

The California Case

California is a large state with a history of liberal banking laws. The state is as diverse as the country in its economic bases, urban/rural mix, and population distribution. With respect to the issue of nationwide branching, the state is uniquely appropriate for studying the impact. Branching has never been legally restricted in the state. Prior to 1909 no piece of legislation gave specific legal recognition to the activity. Even though there were no legal restraints on banks establishing branches, branching was not common before 1905. Bankers perceiving a need for financial services in neighboring towns simply opened another bank at the new location, so that in 1905 only 5 branches existed among the state's banks (Southworth, pp. 29-30).

From 1905 to 1910, the number of branches increased significantly. In 1910, 35 branches were held by banks. In most cases, a bank held only one branch. One bank in Oakland had 2 branches, one in Los Angeles had 3 branches, and two in San Francisco had one in Los Angeles bank had one branch each located outside the city limits and several located within the same city as the main office (Southworth, p. 53). One does not have to look far to find the reasons behind this increase in activity. In 1905 the state initiated requirements that a bank have paid-in capital before opening for business. The capital requirements were based on the size of the town in which the bank was opened and ranged from a minimum of $25,000 to $200,000 for cities of more than 25,000 population. About 10 percent of all state chartered banks in existence did not have $25,000 in paid-in capital in 1900 (Pierson Doti, p. 139). This law was ruled unconstitutional in 1907 because of discrimination between banks in different cities, but a minimum capital requirement of $25,000 was immediately required of all banks. Branches were not mentioned in either the 1905 or 1907 requirement. With the capital requirement, opening a branch formed a profitable alternative to founding a new bank, and from 1905 to 1909 many bankers were exposed to the beneficial aspects of branching. A.P. Giannini formed the first branch of the Bank of Italy in 1907 and Joseph Sartori established the first of Security Bank's branches in Los Angeles. The success of these two first branches set the course of California banking over the next fifty years. At least 25 other bankers experimented with branches in this four year period.

The number of branches would not have increased so rapidly and impressed so many bankers with branching's advantages had this period not been one of increasing opportunity for expansion of financial services. Although the 1905 law also imposed reserve requirements for the first time in the state's history, the total number of banks grew rapidly to 1908. In 1901 through 1904 a total of only 79 new banks opened, while in 1905 alone 98 banks opened. In 1906 70 banks opened, and 77 state and national banks opend in California in 1907. At the end of 1909 there were 456 state chartered banks in California, with 30 branches (California State Banking Dept., Annual Reports).

The California Bank Act of 1909 provided the state with its first comprehensive statute restricting the activities of bankers. The existence of branching was recognized and discouraged by two provisions. First, the Superintendent of Banks had to approve the creation of each branch, but only after ascertaining that the public convenience would be promoted by the creation of the branch. Also $25,000 additional capital was required to open a branch. Because of these provisions, the number of branches increased moderately until 1922.

The First Banking Era

In 1920 there were 420 state banks with 167 branches. In 1922 the number of branches increased by 88. The increases continued large until 1928 (see Table 1).

TABLE 1

YEAR	INCREASE IN # BRANCHES
1922	88
1923	159
1924	69
1925	47
1926	47
1927	>104 *
1928	37 **

* 104 established 4 months before the end of the fiscal year.
** Covers 18 months, January 1, 1927 to June 30, 1928 (from California State Banking Department Bulletins).

The period 1920 to 1924 changed the character of banking in California. The 1920 report of the Superintendent of Banks describes the pattern of banking in the state at the time. He says the usual case was a unit bank with the commercial, savings, and trust departments in one building. The commercial department had a federal charter, while the savings department was state chartered. All trust activities were supervised by the state.

By 1924 the state's banking was dominated by large branch banking systems. The Bank of Italy was operating 86 banking offices in 56 cities. The Pacific Southwest Trust and Savings Bank had 99 offices in 1925 (Cross, pp. 909, 923). Mercantile Trust Company of California, the American Bank, and Security Trust and Savings Bank also had numerous branches. The rapid increases in the number of branches from 1922 to 1927 were probably due to changes in both state and federal laws in 1917 and 1919. In 1913, when California authorized state banks to join the

Federal Reserve system, the provisions were necessarily quite broad. A 1915 amendment limited the state banks joining the system to exercising powers "not in conflict with the laws of this state." The reserve requirements of the state remained in force when a state bank became a member of the system. Since the Federal Reserve System counted as reserves only those funds deposited in Federal Reserve System counted as reserves only those funds deposited in Federal Reserve Banks while the state required half the reserves in U.S. government currency, national bank notes, or clearing balances, the required reserves were increased when a state bank joined the federal system. Only 53 state banks had joined the system by 1917 because of these problems of dual jurisdiction.

In 1917, the Bank Act was changed to encourage state banks to join the Federal Reserve System. The reserve requirements for California banks were changed to match those of the FRS. Coincidentally, the Federal Reserve decreased reserve requirements in 1917. The state legislature countered in 1919 by allowing any state bank which became a member bank to comply with the Federal Reserve requirements instead of the California requirements. Membership was still more expensive than conforming to state rules only. In spite of the slight extra expense, this last change in the Banking Act provided the stimulus for state banks to join the system. Between 1918 and 1922, the number of California banks in the Federal Reserve System rose from 4 to 45 (Southworth, pp. 94-96). The number of new national banks in California also increased in 1919 and 1920; many were conversions from state charters.

The increasing number of banks coming under the jurisdiction of the Federal Reserve disrupted the established correspondent relationships between the larger city banks and independent small town banks. The Bank of Italy had moved into eighteen towns by 1918, and by the end of 1922 had 61 branches in 42 communities. Their acquisitions also disrupted or threatened the correspondent relationships other banks had established. Large city banks not involved in branching found their resources endangered by the loss of their county correspondents. For all reserve city banks (state and national), the percentage of resources "due from banks" dropped from 8.8% in 1919 to 7.5% in 1920 (Southworth, p. 67). Among state banks the percentage dropped even more dramatically--from 9.2% to 7.0%. Many of these banks decided to follow the example set by Bank of Italy and obtain branches to replace those lost resources.

Once these banks embarked on a program of acquiring branches, the banks found several advantages other than the extra resources acquired. In purchasing the independent bank, the price paid would normally be at least sufficient to capitalize the profits of the bank as an independent unit. Since the purchasing banks did not appear unwilling to pay high prices to acquire other banks as branches, it is likely that profits increased for the unit bank when it became a branch.

There were several sources of the increased profit. The country unit bank had seasonal shifts in demand for funds. During periods of low

demand for loans, the surplus was deposited in the correspondent banks at about 2% interest, or invested in commercial paper. A branch system would have more potential for keeping loan funds active. The branch system, with larger assets, could make the larger loans that the small unit banks had to pass on to their city correspondents. A branch system could often substitute a prestigious name for fancy buildings and furniture. This may have been an important factor in this period. The amount invested in bank premises as a percentage of assets had been increasing: it doubled from 1899 to 1910 (Wright, p. 148). It was expensive for city banks to acquire correspondent banks. They used traveling agents and offered free services to their correspondents. Converting correspondents to branches would save on these expenses. For these reasons, bankers rushed to acquire other banks or open newly formed banks as branches in 1922, 1923, and 1924. The rapid spread of branch banking in California proved alarming to the federal government, California state banking organizations, and small unit bankers.

The 1922 to 1924 trend toward branching caused a notable decline in the number of national banks in California. The small national banks were absorbed by the large banks, and new national banks were not formed to replace the absorbed banks. The situation so alarmed the Federal Reserve that representatives of the board were sent to San Francisco. The results of this meeting brought about a special Federal Reserve Board hearing on branch banking in September 1922. A subsequent Federal Reserve hearing on branch banking resulted in the adoption of a set of resolutions. Henceforth, "in general" state banks should not be admitted with such branches, and members of the system could not establish branches outside the city limits of the home office location (Cross, p. 919).

There was a great deal of bankers' opposition to branch banks, spearheaded by the Association of Independent Bankers. This group was composed of representatives from small-town unit banks. Although open to all unit bankers, only one of its executive council members during the early twenties was from a bank in a reserve city. The independent bankers opposed all types of branch banking (Southworth, p. 72).

Shirley Southworth's study of branch banking in the 1920s suggests reasons for the country unit banker's opposition to branches. Southworth believes that these bankers had strong fears of their bank's takeover by the branching systems, based on damage to these bankers' positions in the community. The directors of small country banks were, most often, the important businessmen of the community. These businessmen were, according to Southworth, "more interested in their private business ventures than in the business of their bank." These bankers feared that acquisition of their bank by a larger bank would endanger their own best loan source, and also threaten their power and status in the community. Southworth surveys articles in *Independent Banker* and concludes: "In this literature, the great emphasis on the concentration of credit control, combined with the reference to the loss of prestige on the part of individual bankers, indicates that there is some personal advantage to the small town banker in exercising such control. It is apparent that the main advantage consists in the power to make loans to certain individuals or under circumstances which would not meet with the approval of a branch banking institution being operated for profit as a bank rather than used for the profit of an outside business," (p. 71-73). This suggests the independent banker was willing to sacrifice the interests of the stockholders of the company he represented to protect his own personal power and retain a loan source.

The independent bankers' opposition hampered the spread of branch banks only slightly. The main impediment to the attempt by city banks to acquire branches during this time period was the "de novo rule," a principle developed by State Superintendent of Banks Jonathan Dodge in 1921 (Cross, p. 964). He opposed banks establishing offices in the hometown of the head office; he also required a bank which wished a branch outside its hometown to first buy any bank then existing in the targeted town. This principle was enforced until Will Wood became Superintendent in 1927.

If the de novo rule was a response to the independent bankers' opposition to branching, it was a strange rule in light of the above mentioned motives for opposition. If the independent bankers coveted their independent loan sources and their prestigious titles above profit, they should have opposed the de novo rule and preferred a new branch in town to the loss of their own bank. The de novo rule was not opposed by independent bankers. On the contrary, one result of a 1923 meeting between representatives of the Independent Bankers League and Superintendent of Banks J. Johnson was an agreement to allow branches only by acquisitions or merger and only allow such combinations between banks when both had existed for three years previously to the merger proposal (Cross, p. 915).

This promise clearly grants the existing banks some monopoly power and increases the price of the unit banks. The assumption that the small banks did receive high prices is born out by warnings to bank directors to resist the pressures of profit-hungry stockholders to sell, and also by testimony before the Dawes Committee hearings in 1924, when unit bankers testified about the coercion of larger banks seeking their assets. None claimed the large banks were offering prices below the owners' own valuation of their bank (Southworth, pp. 71-72)!

By 1925 the branching trend had slowed considerably. There were several causes. First, the profitable aspects of branching had been exploited. Secrist, in his 1928 study of banking ratios, notes that earnings were generally lower for the branch systems belonging to the Federal Reserve System than the unit banks (p. 280). For example, he finds the average ratio of net earning to earning assets in 1925-1927 significantly lower for banks with branches.

Economies of scale are not apparent in Secrist's ratios. For 1925-1927 the ratio of total expenses to the amount of earning assets is

slightly higher for national banks with branches in California than for national unit banks in California, and the ratio is also higher for state banks with branches than state banks without branches. The ratio of total expenses to gross earnings is also higher for banks with branches than for those without branches (Secrist, p. 238).

When Will Wood assumed the office of Superintendent of Banking in 1927, there were 626 banks in California. Eighty-eight had 668 branches. Of the 27,377 banks in the United States, 789 had 2,771 branches. The Bank of Italy was still the only California bank with branches spread over the state. After a 1927 consolidation of the Giannini controlled banks, there were 2,379 offices. Other large branch systems were Pacific Southwest Trust and Savings Bank with 99 offices, American Trust Company with 95 offices, and Security Trust and Savings Bank with 25 offices (see Southworth, p. 23 and Cross, pp. 909-911).

Even though the change in bank superintendents created a more favorable client for creating new branches, the rate of increase slowed through the end of the decade. From October 1928 to October 1929, for example, only 27 branches were established while 44 independent banks closed or became branches. California increased its reserve requirements to 18% for cities with populations of more than 100,000, and made other changes toughening the state's Banking Act. Nationally, the McFadden Act permitted state banks joining the Federal Reserve System to retain all those branches in lawful existence as of February 1927, but restricted future branching of national banks in states which allowed branching to holding one local branch in a city of 25,000-50,000 population, two branches in cities of 50,000-100,000 population, and more branches only in cities with more than 100,000 population.

The McFadden Act was not able to restrain the Giannini operation from extending its branch system. As a national bank, the Bank of Italy was able to buy banks located in the same town as one of its existing branches. This didn't satisfy Giannini's urge to blanket the state (or the world?), and he quickly found a loophole in the McFadden Act. The holding company which owned Bank of Italy set up a new branching system under a state charter. The Bank of America of California began acquiring small branch banking systems, then moved their headquarters to San Francisco to be acquired by the Bank of Italy. In the fall of 1930 the merger wave brought 106 new branches to the Bank of Italy, which was then renamed Bank of America N.T. & S.A.

As the depression and the war slowed the growth of the banking industry in the United States, the growth of branch banking in California also slowed. The pattern, however, had been established in those few years in the early 1920s and when rapid growth returned to the California postwar economy, the advantages of branch banking were rediscovered.

The Second Branching Era

The 1950s witnessed a further shift from unit banking to branch banking in California. Only 41 new banks opened in the decade, and 114 banks disappeared (Findley, p. I-19, 18). The number of unit banks in the state dropped from 156 in 1950 to 55 in 1960, while the number of branching banks went from 46 to 62.

The change occurred almost without a pause (see Table 2).

TABLE 2

Number of Banks and Branches in California 1950-1960

Number of Banks				Number of Branches
Year	Unit	Branch	Total	
1950	156	46	202	979
1951	151	50	201	1004
1952	147	52	199	1036
1953	148	58	2	1058
1954	117	54	171	1121
1955	96	54	149	1212
1956	85	55	139	1304
1957	74	58	128	1387
1958	69	62	124	1466
1959	57	65	115	1566
1960	55	66	117	1676

Source: Federal Deposit Insurance Corporation, Annual Reports from 1950 to 1960.

Although this trend was extreme in California, other areas of the country were also participating in this change. City banks followed customers to the suburbs with branches when possible, or with unit banks held through bank holding companies.

In the nation as a whole, the number of banks declined 5% from 1953 to 1962. The principal cause of bank disappearance was merger. Where branch banking was illegal, the number of banks actually rose by 500, but in branch banking states the number of banks fell by nearly 20 percent. The merger rate in branching states was over twice as high as in states where branching was limited (Schull and Horowitz, p. 113). The reason seems readily apparent. The attitude of the U.S. Comptroller of the Currency and the California's banking department showed excessive concern about the competitive impact of new banks. Although the same

agencies were quite concerned about Bank of America's move to buy more banks, they showed less interest in the acquisitions of other banks (Fischer, p. 217).

A study of upstate New York showed that from 1945 to 1955 the assets of branch banks went from less than half to almost three-fourths the total assets of the banking system. The number of banks opening branches outside the headquarters community more than doubled. As in the California case, it was usually a few large banks taking the initiative. Only 85 of 449 separate commercial banks had branches in more than one town (New York State Banking Dept.).

In California the most aggressive bank was still the Bank of America, N.T. and S.A., successor to A.P. Giannini's Bank of Italy and to the more than 300 independent banks which had been devoured by the Giannini group. By the early fifties, the bank had become so large and important in the state that its growth could no longer take star status. G. Preston Martin writes in 1952 "the behavior of the Bank of America is not of such a nature as to guarantee it eventual ownership of all financial institutions in the state" (Martin, p. 187).

The phenomenal growth of the Bank of America had taken place against opposition by most banking authorities, and in June 1948, the Board of Governors of the Federal Reserve charged Transamerica, which owned the bank, with continuously and systematically acquiring the stock of independent banks in five states. After two years of hearings the board ordered Transamerica to divest itself of all stock in 47 majority-owned banks not integrated into Bank America. Transamerica appealed, but during the proceedings the board continued to limit the number of branches added by the Bank of America, allowing only 30 branches between 1949 and 1952 (Fischer, p. 278 and James and James, p. 496-8).

When the ruling against Transamerica's acquisitions was overturned in 1953, the group moved quickly. In 1953 Transamerica sold 22 banks to the Bank of America, sensing that a multi-bank holding company like Transamerica would be difficult to sustain in the anti-trust climate. The Justice Department halted the action. Transamerica characteristically changed tactics and renamed a San Francisco Bank "First Western Bank" and merged the 22 banks into this institution. First Western bought the assets of five banks in 1955 and merged with one other bank. The Bank of America also bought one bank (Findley, p. I-27).

At the same time the Bank of America had slowed its campaign to buy up small-town banks, other larger banks began acquiring small unit banks in the suburbs. California Bank of Los Angeles (before acquisition by United California Bank, and a later name change to First Interstate Bank) had begun an expansion program with a purchase of 5 banks, and another 8 before the end of the decade. The Bank of California, a San Francisco bank with one of the longest histories of any bank in the state, had been the first bank to branch. Before the turn of the century the Bank of California had five offices, three of which were outside California. In 1955 it began an expansion program which included the acquisition of four unit banks. Security First National Bank of Los Angeles bought nine banks in the late 1950s, including the historic Farmers and Merchants Bank and another bank which had three branches acquired in the fifties. Crocker First National Bank and Ango California National Bank, which merged in 1956, acquired ten banks between 1955 and 1960 (Findley, p. I-42).

The widespread move to make unit banks part of the networks of larger city banks began rather abruptly in 1954 in California and the nation. In California, a very large number of banks disappeared. The number of merged banks equalled nearly 23% of the banks which remained at the end of the year. The acquisition rate continued high until 1960, then moderated substantially (see Table 3).

TABLE 3

California Banks Absorbed by Year 1951-1962

Year	Number of Absorbed Banks	% California Banks At End of Year
1951	2	1.00
1952	5	2.51
1953	3	1.46
1954	39	22.81
1955	29	19.46
1956	12	8.63
1957	15	11.72
1958	3	2.42
1959	11	9.56
1960	3	2.56
1961	6	4.95
1962	5	3.88
TOTAL	133	

Source: David Alhadeff, California Banking and Competition" (p. 183). Taken from Federal Reserve Board of San Francisco material.

The banks acquired to become branches were mostly small closely-held banks. The management was closely tied to the ownership, the bank directors were local businessmen, ranchers, and farmers; the bank was oriented toward the local community. Greater emphasis was placed on demand deposits rather than savings accounts.

Two key factors tended to make these unit banks attractive to the larger banks. First, the loan to deposit ratio was generally very low. Gerry Findley estimates the ratio was below 60% and the loan to resources ration was below 50% (p. I-24). The second attractive feature

was the capital makeup. According to Findley, the larger part of the bank's capital at the time of the merger had been accumulated from retained earnings. These banks also often had significant "hidden" assets in the form of real property which had appreciated greatly since purchase, valuable bank fixtures and equipment, large loan loss reserve accumulations, and values in securities held and owned (Findley, p. I-24).

The small banks in California (and some bigger ones) were like banks acquired nationwide in their reasons for selling. A survey conducted by the Comptroller of the Currency of 169 bank sales nationwide gave the following reasons:

Management problems	68	Larger bank needed in community	7
Attractive price	65	Achieve more competitive status	7
Identical owners	33	Bank in overbanked community	5
Weak earning capacity	21	Uneconomic banking units	4
Closely held bank, owner wanted to retire	9	Embezzlement	4
		To obtain fringe benefits for employees	4

J.W. Hellman, grandson of the founder of Farmers and Merchants Bank of Los Angeles gave these typical reasons for selling: 1) the Hellman family could no longer provide leadership, 2) the difficulty of holding and securing business at the present location (a declining neighborhood), 3) lack of branches, and 4) lack of a good pension plan for employees (Cleland and Putnam, p. 184).

In spite of the large number of mergers and acquisitions, de novo branches accounted for three times as many extra branches. Naturally, as the decade of the 1950s ended, the ranks of unit banks which would make attractive branches was thinning considerably.

Results of the Fifties Merger Movement

The characteristic bank activity was large banks becoming larger and branching out into the suburbs by opening new branches and buying small independent unit banks. This led to a consolidation of the banking system into fewer entities but also resulted in a large increase in the number of offices. The assets of California banks doubled over the decade.

California banks have always been big. While most U.S. banks fell into the $1 million to $25 million range, most California banks had resources of more than $15 million and over a fifth of the banks had more than $50 million in assets. It seems certain the events in this period shifted the structure of banking toward bigger banks, but it is not apparent that the competitiveness of the industry declined. Even when two branches or more of one bank were only counted as one bank, the percentage of cities which qualified as "one bank towns" dropped from 61.2% to 46.4% (Alhadeff, p. 192). The growth of bigger banks, while the biggest, Bank of America, slowed its growth, probably brought more balance to the industry.

However, Bank of America's position as the largest bank was not threatened by others' expansion. In 1959 Bank of America held almost 45% of the state's deposits, while Security First National held 13.1%, and American Trust 7.3% (Fischer, p. 285).

The 1960s

There was a subtle but very definite shift in emphasis in the early years of the 1960s. More of the new branches were de novo. Whereas 75% of the new branches were de novo in the fifties, by the early 1960s, 85% were de novo (Fischer, p. 132). The number of new banks chartered reversed its decline, and increased from 118 to 200 between 1960 and 1964.

There were two reasons for the increase in the number of new charters. The first was a change in the Comptroller of the Currency. James Saxon took office in 1961 and immediately liberalized the granting of charters. In that year, only 11% of the applications for a national charter were rejected. This was the lowest rejection rate in four decades. State bank authorities seemed to follow this lead. By the end of 1962 the Comptroller's rate of denials had begun to increase and by the end of 1963 nearly half of the applications had been rejected. In the Comptroller's statement of policy in the 1965 annual report, Saxon notes that a temporary halt may occasionally be required in the chartering of new banks in some markets to sustain the viability of the banking system. Late in February 1965, the Comptroller announced that Los Angeles, Oakland, San Francisco, San Diego, and Orange County (essentially all of the metropolitan areas of California) "which are patently well banked at this time" would be closed to new banks. Other areas of the country were also closed and 80% of the charter applications in the first half of 1965 were rejected. The rejection rate for the year 1965 was 70%, but nearly 40% of the applications were to convert state banks to national banks. In spite of these dramatic shifts in attitude, the state regulators seemed to follow his lead, and the number of new state banks declined sharply after 1964 (Fischer, p. 221, pp. 210-211).

The second reason for the increase in the number of newly chartered banks in the first half of the 1960s was California investors' enthusiasm for bank stocks. New banks had little trouble subscribing the initial capital. According to Gerry Findley, this zeal of the investing public for new bank stock was based on the general belief that those who owned these small banks which had recently merged were earning high returns on their investments. And as Findley also reports, the shareholders of the banks merged in the 1950s generally experienced a highly satisfactory rate of return on their investments, both in terms of capital stock appreciation and dividend returns. In some cases, he says, the returns were phenomenal (Findley, pp. I-20 - I-22). Paul Wendt also notes this situation and says that not only did California banks have a higher rate of net profits to stockholders' equity than have all insured U.S. banks, but their earnings were better than earnings of other corporations in the postwar period (p. 306).

Investors' interest in new banks changed the character of California banking in the later 1960s. Most of these new bank owners were relatively unsophisticated investors who owned no other stock, and who invested relatively small amounts in the bank but took and avid interest in the management. They wanted quick returns on their investment and waited impatiently for one of the big banks to tender offers for their bank's assets. Many of the aggressive marketing techniques of the later 1960s may have been the result of these new owners being more interested in short term profit than in traditional banking activities. The aggressive marketing, which included gifts for deposits and new forms of advertising, created an interest on the part of banking authorities in higher capitalizations. The initial capitalization of banks for the period 1960 to 1965 was about three times larger than the initial capitalization of banks organized in California in the 1950s (Findley, pp. I-20 - I-22).

In terms of the realization of the bank organizer's hopes of being acquired, the hopes were frequently realized. Of all the banks opened between 1960 and 1965, 57% were merged within ten years. In the peak year, when the highest number of banks opened 43% of them were acquired within five years (see Table 4).

TABLE 4

Acquisition of Banks Opened 1960 to 1965

Year	Number Of Banks Opened	% Acquired Within 5 Years	% Acquired Within 10 Years
1960	6	16	50
1961	10	0	50
1962	11	36	45
1963	30	43	63
1964	48	35	64
1965	13	30	38
1966	1	100	100
Total	118	33	57

Source: Based on information from Gerry Findley, *Mergers and Acquisitions*, pp. I-2 to I-5.

Results of the Early Sixties Trend

All of the new bank chartering reversed the downward trend in unit banks. In 1960 the number of unit banks had dropped to 55. In 1964 there were 109 unit banks in spite of continuing mergers, and some unit banks began acquiring branches. Slightly less than forty eight percent of the 1960 banks were unit banks (down from 68% in 1954) and 54.5% were unit banks in 1964 (see Table 5).

TABLE 5

Number of Banks and Branches in California 1960-1965

Year	Number of Banks Unit	Branch	Total	Number of Branches
1960	55	62	117	1676
1961	57	65	122	1792
1962	63	66	129	1968
1963	80	75	155	2127
1964	109	91	200	2278
1965	95	104	199	2424

Source: FDIC Annual Reports.

The increase in the number of unit banks chartered in the early 1960s seems to have checked the rising dominance of the big banks. In 1951 the eight largest banks held 85.8 percent of California's deposits, by 1960 their deposits had risen to 93.6 percent. In 1965 the rates had dropped to 88.4 percent (Fischer, p. 334).

Conclusion

Although one example cannot add much support to theory, it is reassuring to find that the California case does not conflict with the predicted result of liberal branching laws. In the early period one bank, the Bank of Italy, expanded rapidly; and other larger banks established limited branch networks. Owners of small unit banks reacted against branch banking. Although they expressed fear of acquisition and concentration in the banking industry, they supported public policy encouraging banks establishing branches to buy existing banks rather than open new competitive branches, thus enhancing the value of their banks.

The trend to branch banking was interrupted by the depression and World War II, but resumed in the 1950s. Regulatory agencies were reluctant to approve new banking charters after the unstable 1930s. This fact, combined with shifting population centers created an attractive situation for expansion by existing banks. Many larger banks branched into evermore distant communities. There was a shift in the balance between unit and branching banks as branches were formed from unit banks. Most larger California banks had established branches by the early 1960s and profits had been earned by small banks sold to larger banks. These profits made the formation of new unit banks attractive. The state and federal government loosened restrictions on new bank formation as banking became more profitable. The number of unit banks increased as banks opened with the goal of speedy acquisition by branch bank systems. This speculative bank formation continued until very recently, reestablishing the balance between branch and unit banks.

This history provides some indication of the results of nationwide branch banking. First, it supports the independent bankers' contention that larger banks will expand and buy smaller unit banks. It does not support their contention that this will be damaging to the independent banker. The independent banker can gain from the larger bank's acquisitions. The branching movement has produced high prices for purchased unit banks. The history does not seem to indicate branching will inhibit competition in the industry. While it is difficult to measure competition in the banking industry, the branching periods do not seem to have resulted in less competition in the California market. Although the number of bank or bank offices have dropped at times, there have been coincident reductions in the number of charter applications granted by regulatory agencies. It is likely that more regulation, rather than less will restrict competition.

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