Competition between Thrift Institutions and Banks in Ohio

by Paul R. Watro

Technological, regulatory, and economic changes each have contributed to more intense competition between thrift institutions and commercial banks. During the past decade, thrift institutions have increasingly expanded their services, and in particular they have become more involved with third-party payment services. Today, credit unions (CUs) are providing share drafts, while savings and loan associations (S&Ls) are offering negotiable order of withdrawal (NOW) accounts in several states.

With the passage in March of the Depository Institutions Deregulation and Monetary Control Act of 1980, all depository institutions will be permitted to offer NOW accounts, and all federally insured CUs will be authorized to offer share drafts after December 31, 1980. The act also allows federal CUs to offer residential mortgage loans and S&Ls to issue credit cards and to have trust powers, greater lending flexibility, higher loan ceilings, and expanded investment authority.

These regulatory changes will make thrift institutions a growing force in the market for banking services, particularly in the areas of third-party payment services and consumer lending. The initial impact of these changes on individual banks will vary widely in accordance with the competitive balance in particular markets. Banks in areas where the number of thrifts is relatively small initially will be affected less than banks in areas where thrifts are numerous and aggressive.

This *Economic Commentary* examines some changes in the competitive structure of Ohio's financial markets between 1973 and 1978. The growing strength of thrifts is clearly indicated by a significant increase in their share of deposits at both the state and local levels. In addition, the competitive structure of individual banking markets is examined with and without thrift institutions.

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Statewide Competition

Thrift institutions are numerous and have become strong and aggressive competitors for financial deposits in Ohio. Thrifts operate a larger number of institutions and currently hold 45.2 percent of the total deposits in the state (see table 1). Although S&Ls currently maintain the major portion of the thrift deposits, CUs are becoming stronger competitors for these deposits. Between 1973 and 1978, CUs were the fastest growing financial institutions in Ohio; CUs increased their deposits by 113 percent, while S&L and bank deposits increased by 89 percent and 40 percent, respectively. As a result, S&Ls and CUs gained an additional 6.8 percent and 0.7 percent, respectively, of the deposits in the state.

Many factors contributed to the deposit gains made by thrift institutions. S&Ls had more liberal branching laws than banks in Ohio. S&Ls could establish branches in more than one county, whereas banks were prohibited from opening branches outside of their home-office county.[1] Even more important, thrifts enjoyed a comparative interest-rate advantage over banks in the 1973-78 period. Regulations enabled S&Ls to pay 0.25 percent more on time and savings deposits and CUs to pay up to 2.00 percent more on regular share accounts. Higher interest rates during most of the 1973-78 period increased the incentive of individuals and organizations to economize on demand-deposit balances held by banks. Although Ohio S&Ls currently are not authorized to offer NOW accounts, the installation of remote service units (RSUs) and telephone-transfer services by some of the larger S&Ls provided a mechanism to utilize savings deposits for transaction purposes.[2] In addition, the introduction of share drafts by some of the larger credit unions offered a close substitute for demand deposits, as well as a means of earning interest on third-party payment accounts. Today, approximately 134 CUs in Ohio are providing share drafts.[3]

Table 1 Ohio Financial Institutions and Their Deposit Share: 1973–1978

	Number of institutions		Number of offices		Share of deposits, percent	
	1973	1978	1973	1978	1973	1978
Commercial banks	503	484	1,986	2,336	62.3	54.8
Thrift institutions	1,305	1,319	1,803	2,178	37.7	45.2
Savings and loan associations	446	301	944	1,160	35.9	42.7
Credit unions	859	1,018	859	1,018	1.8	2.5
Total	1,808	1,803	3,789	4,514	100.0	100.0

NOTES: Financial institutions refer to commercial banks, federally insured savings and loan associations, and federally insured credit unions. No mutual savings banks operate in Ohio.

Deposit data are based on the following: for commercial banks, total deposits of individuals, partnerships, and corporations (IPC) as of June 30, 1973, and June 30, 1978; for savings and loans, total savings capital as of March 31, 1973, and March 31, 1978; and for credit unions, total savings shares as of December 31, 1973, and December 31, 1978. The number of institutions and offices is based on the above dates. In a few instances, CUs operate more than one office, but data were not available on the total number of offices.

SOURCES: Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, and National Credit Union Administration.

Local and Regional Markets

A more meaningful way to gauge the strength of thrifts is to examine the competitive structure of local and regional markets for banking services. The area in which banks compete varies according to the type of service. For example, banks compete for large business loans and large certificates of deposit in national and international markets. In contrast, markets for such services as consumer checking accounts, savings deposits, and small business loans generally are confined to a smaller regional or local area.

Delineating banking markets is a complex task that requires a large volume of information concerning banking, economic, commuting, and demographic factors. While banking markets do not necessarily coincide with political boundaries, researchers and regulators often approximate markets for consumer types of financial services by counties or standard metropolitan statistical areas (SMSAs). In this study, the competitive structure of thrifts and banks is analyzed along SMSA and non-SMSA county lines.

Competition between thrifts and banks within individual market areas varies widely throughout Ohio. Thrift institutions are significant competitors for deposits in all the SMSAs and non-SMSA counties in the state, except perhaps in the 15 rural counties where S&Ls and CUs together hold less than 20 percent of the total deposits (see table 2).[4] Thrifts account for over one-third of the deposits in 30 of the 63 markets and over one-half of the deposits in eight of the markets. Thrifts maintain their largest market share in Defiance County (56 percent), where the two largest financial institutions are S&Ls and a relatively large CU offers share drafts. The other seven areas in which penetration by thrift institutions is the strongest have at least two thrifts ranked among the four largest financial organizations.[5]

Banks generally encounter more vigorous competition from thrifts in urban areas. Thrifts hold over one-third of the total deposits in 13 out of the 14 SMSAs. In addition, thrifts hold 42.4 percent of the deposits in the average SMSA in Ohio, compared with 27.5 percent of the deposits in the average rural county.

Table 2 Deposit Share of Thrifts: 1978

	Share of thrift deposits, percent	Number
Mean		
All areas	30.8	63
SMSAs	42.4	14
Non-SMSA counties	27.5	49
Distribution	0 – 4	5
	5 – 19	10
	20 – 34	18
	35 – 49	22
	50 or more	8

NOTES: Thrifts include federally insured savings and loan associations and credit unions.

The share of thrift deposits was calculated using the following data: commercial banks total IPC deposits as of June 30, 1978; savings and loans total savings capital as of March 31, 1978; and credit unions total savings shares as of December 31, 1977.

SOURCES: Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, and National Credit Union Administration.

Thrifts significantly increased their share of deposits between 1973 and 1978 in all of the areas examined in this study, except for the Cincinnati SMSA and seven rural counties (Jackson, Knox, Harrison, Noble, Monroe, Tuscarawas, and Defiance). The share of thrift deposits increased by at least 2 percent in 41 markets and by 5 percent or more in 21 markets (see table 3). The greatest gains occurred in Morrow and Marion counties, where thrifts increased their share by 14.5 percent and 10.8 percent, respectively.

S&Ls and CUs operating in urban areas experienced slightly greater success in attracting an additional share of the deposits in their areas. The share of thrift deposits increased by 3.7 percent in the average SMSA, compared with an increase of 3.3 percent in the average rural county.

To ascertain some of the reasons that contributed to the gains made by thrifts, an analysis of several factors was undertaken. It was found that the percentage of financial

1. On January 1, 1979, the Ohio branching law for banks was changed from home-county branching to contiguous-county branching.
2. RSUs are electronic terminals located in retail establishments to enable customers to make deposits, withdrawals, and transfers of funds between accounts without visiting a S&L office.
3. The figure was estimated in June 1980 and was obtained from the Credit Union National Association.
4. All Ohio counties are included in these markets except for Belmont, Washington, and Lawrence counties, which are part of the Wheeling, WV, Parkersburg, WV, and Huntington, WV–Ashland, KY, SMSAs, respectively. Counties in adjacent states that are part of Ohio SMSAs are included in this study.
5. These areas include Ashtabula, Logan, Muskingum, and Union counties and the Canton, Dayton, and Hamilton-Middletown SMSAs.

Table 3 Deposit Share Changes: 1973–1978

	Change in share of thrift deposits, percent	Number
Mean		
All areas	2.8	63
SMSAs	3.7	14
Non-SMSA counties	3.3	49
Distribution	-5 or more	2
	-0.1 to -4.9	5
	0	1
	0.1 to 1.9	14
	2 to 4.9	20
	5 to 9.9	19
	10 or more	2

NOTES: Thrifts include federally insured savings and loan associations and credit unions.

Deposit share changes were calculated using the following data: commercial banks total IPC deposits as of June 30, 1973, and June 30, 1978; savings and loans total savings capital as of March 31, 1973, and March 31, 1978; and credit unions total savings shares as of December 31, 1972, and December 31, 1977.

SOURCES: Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, and National Credit Union Administration.

deposits held by banking organizations in 1973, the percent change in the number of thrift offices, and the change in the ratio of S&L offices to banking offices were significant in explaining the changes in market shares by thrift institutions from 1973 and 1978.[6] In areas where banks were the dominant financial organizations, banks apparently were less concerned about competition from S&Ls and CUs than in areas where thrifts were among the largest competitors. Thrift institutions exhibited a greater propensity to establish new offices in areas where they operated fewer offices and held a smaller share of total deposits. Opening new offices presumably led to deposit gains, since an important factor in a consumer's choice of a financial institution is the proximity of its offices to residence, employment, or shopping areas.[7] Since S&Ls accounted for nearly all of the gains made by thrifts, deposit-share growth generally was greater in markets where S&Ls expanded their offices at a faster pace than competing banks.

6. Using a multiple-regression technique, it was assumed that market-share changes by thrifts between 1973 and 1978 (*MS*) were dependent on the following variables: percentage of financial deposits held by banking organizations in 1973 ($X1$); percent change in median-household income ($X2$); percent change in the number of thrift offices ($X3$); and change in the ratio of S&L offices to banking offices ($X4$). Based on 63 observations, it was found that:

$$MS_n = -6.15 + \underset{(2.01)}{0.06\,(X1_n)} + \underset{(1.47)}{0.06\,(X2_n)} + \underset{(2.15)}{0.02\,(X3_n)} + \underset{(2.48)}{1.09\,(X4_n)}.$$

NOTES: Adjusted $R^2 = 0.25$; and t-value is in parentheses.

Measuring Thrift Competition

The increasingly significant presence of thrifts in most SMSAs and non-SMSA counties is convincing evidence of the effectiveness of thrift competition. As more thrifts enter the third-party payment market at the end of 1980, banks obviously will encounter more vigorous competition from S&Ls and CUs. During the past few years, the Board of Governors of the Federal Reserve System has considered thrift competition when evaluating the competitive effects of acquisitions and mergers.[8] However, thrifts have not yet been recognized as full competitors of banks. The Board consistently has followed the Supreme Court interpretation that commercial banks provide a unique cluster of services that separates them from other institutions. Since S&Ls and CUs do not provide the same set of services as banks, it is argued that they cannot be fully effective competitors. However, the uniqueness of bank services has clearly eroded in the past several years, and this erosion will accelerate in 1981 as thrifts acquire broader powers. The acquisition of third-party payment services and broader lending powers by thrifts will tend to make them direct competitors of banks in a larger number of product lines.[9] As this occurs, it will be necessary to incorporate thrift institutions more fully into the competitive analysis of proposed bank mergers and acquisitions.

7. In a previous study, branch expansion was found to be an important factor that contributed to market-share gains made by individual banks. See Paul R. Watro, "Market Share Gainers and Losers," ***Economic Commentary,*** Federal Reserve Bank of Cleveland, May 19, 1980.
8. In response to the application of Toledo Trustcorp, Inc., to acquire National Bank of Defiance, the Board of Governors stated on April 7, 1980, "that while commercial banking is the appropriate line of commerce for competitive analysis purposes, in certain cases the share of market deposits of commercial banks may be 'shaded' downward to take into consideration competition by thrift institutions" (*Federal Reserve Bulletin*, May 1980, pp. 426-27).

Including thrift institutions as full competitors of banks in bank acquisition and merger analysis generally would increase the number of competitors and reduce the percentage of total deposits held by the largest banking organizations in a market. Recent shifts in market structure and those that are likely to occur in the wake of the new legislation clearly suggest that such an approach would reflect a more accurate picture of actual competitive structure in banking service markets. The outcome for regulatory decisions on individual mergers and acquisition applications, however, would depend on the relative size of thrift institutions and banks in the relevant markets.

Based on present standards and procedures, most banking markets in Ohio are considered highly concentrated by Justice Department guidelines.[10] In approximately 80 percent of the SMSAs and non-SMSA counties in the state, the four largest banking organizations control 75 percent or more of the banking deposits.[11] If thrift institutions were included in the four-firm concentration ratio, however, only one in every two markets would be classified as highly concentrated. The concentration ratio would be reduced by 20 percent or more in over one-third of the markets. The market-structure changes generally would be greater in SMSA areas where thrifts are usually concentrated. Rural markets, however, could be affected more, given that there are relatively fewer banking organizations and higher levels of concentration in these areas.

9. Even with their expanded powers, thrift institutions still will not be permitted to offer unsecured business and farm loans.
10. The Justice Department ordinarily would challenge proposed acquisitions or mergers if the market shares of the acquiring and acquired firms were above its guidelines. These guidelines depend on whether the market is highly concentrated (the four largest firms have a combined share of 75 percent or more) or less highly concentrated (the share of the four largest firms is less than 75 percent).

Concluding Comments

Thrifts have grown faster than banks in Ohio between 1973 and 1978. If thrifts and banks continue to grow at the same pace, thrifts will hold half of the total financial deposits in Ohio by 1982. Moreover, the Depository Institutions Deregulation and Monetary Control Act of 1980 will intensify competition between thrifts and banks. After year-end 1980, all financial institutions will be permitted to offer NOW accounts, and all federally insured credit unions will be authorized to provide share drafts. On the other hand, the legislation specifies a timetable over which interest-rate ceilings will be phased out. Consequently, thrifts will lose their comparative rate advantage on time and savings deposits during this phasing-out process over the next six years.

Competition for deposits in a given area will be assessed more accurately if thrifts are included in market-structure measurements. It can be expected that the Board of Governors will more fully include thrifts in its evaluation of competition as the character of thrift institutions changes in the months ahead.

11. However, statewide concentration of banking resources in Ohio is relatively low compared with other states. The five largest banking organizations in Ohio control approximately 37 percent of total state banking organizations as of year-end 1979.

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