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 depositor 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 issue federal adjustable 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 markets for lending, deposits, and consumer services in the areas of third-party payment services and consumer lending. The initial impact of these changes on individual banks will vary widely in the areas of third-party payment services and thrift institutions a growing force in the areas of trust powers, greater lending flexibility, higher loan ceilings, and expanded investment authority.

The growing strength of thrifts is examined 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.

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 42.6 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&Ls 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 were authorized to operate in more than one county, whereas banks were prohibited from opening branches outside of their home-office county. Even more important, thrifts enjoyed a competitive interest-rate advantage over banks in the 1973-1978 period. Regulations enabled S&Ls to pay 0.25 percent more on time and savings deposits and CUs to pay up to 2.50 percent more on regular share accounts. Higher interest rates during most of the 1973-1978 period increased the incentive of individuals and companies 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. 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 attracting interest on third-party payment accounts. Today, approximately 124 CUs in Ohio are providing share drafts.

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. The delineating banking markets is a complex task that requires a large volume of information concerning banking, economic, demographic, and geographic factors. While examining how banking markets have been delineated, the study employed a combination of regulatory areas, competition among financial institutions, and other statistical information to delineate 137 markets in which Ohio thrifts were active. The results of the study are presented in table 2, which shows the share of deposits in each market from 1978.

The market share data in table 2 reveal that Ohio thrifts significantly increased their share of deposits and that they gained deposits in all areas of the state, except in Columbus, Lima, and Canton. These losses were due to competition from the Cincinnati, Lima, and Canton areas. Thrifts' share of deposits increased by 3.6 percent in 1977 and by 3.7 percent in 1978.

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Table 3 Deposit Share Changes: 1973–1978

Change in share of thrift deposits, percent

<table>
<thead>
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<th>Source</th>
<th>Number</th>
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<tbody>
<tr>
<td>Mean</td>
<td>All areas</td>
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<td></td>
<td>SMSAs</td>
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<td>Non-SMSA counties</td>
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<td>Dispersion</td>
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<td>5 to 9.9</td>
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<td>10 or more</td>
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NOTES: Thrifts include federally insured savings and loan associations and credit unions. Deposit share changes were calculated using the following data: commercial banks total deposits as of June 30, 1978; and savings and loan 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 share 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 open new offices in highly competitive areas where they operated fewer offices and held a smaller share of total deposits. Opening new offices to lend depositors to deposit gains, as 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.

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 been recognized as full competitors of banks. The Board has consistently 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 line of commerce for competitive analysis purposes, in certain cases the share of market deposits held by commercial banks may be "shaded" downward to take into consideration competition by thrift institutions.9

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 Gains and Losses," Economic Commentary, Federal Reserve Bank of Cleveland, May 19, 1980.

In response to the application of Toledo Trust and Savings Bank, Inc., to acquire National Bank of Defiance, the Board of Governors on April 7, 1989, "that while commercial banking is the appropriate line of commerce for competitive analysis purposes, in certain cases the share of market deposits held by commercial banks may be "shaded" downward to take into consideration competition by thrift institutions."

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