CUNA’s RESPONSE TO

Small Banks’ Competitors Loom Large
By Jeffery W. Gunther and Robert R. Moore
in Southwest Economy, FRB Dallas, Jan/Feb 2004

The authors claim that small banks have performed poorly over the past two decades, have lagged the rest of the market in growth, and are losing relevance. They further claim that credit union competition, fueled by statutory and regulatory advantages, is an important reason for the supposed demise of small banks.

CUNA has one response to these contentions: They are wrong in nearly every respect. In fact, small banks are thriving.

1. Most other analysts disagree with Gunther and Moore’s description of the poor performance of small banks. Federal Reserve Governor Mark Olson, in comments before the 2003 Federal Reserve Bank of Chicago Conference on "Whither the Community Bank" said: "The year that just ended was one of record profits for the industry as a whole, and for community banks in particular" ..."Community banking has a long history of strength and success and a bright future. The past year was a good one for community banks. Once again the vitality and adaptability of the community banking franchise were amply demonstrated."

Bill Basset and Tom Brady of the Fed’s Board of Governors have written two recent articles describing the strong performance of small banks. The most recent is titled: What Drives the Persistent Competitiveness of Small Banks? Publications like the New York Times, American Banker, ABA Journal, ACB Economic Journal and Independent Banker are replete with stories about how community bankers (individually and collectively) are making bumper profits and growing quickly. Shockingly, Gunther and Moore do not acknowledge any of these contradictory views.

2. The key reason for Gunther and Moore’s mischaracterization is that they fail to properly adjust for the effects of mergers in measuring the growth of small banks. They claim that small bank asset growth over the 18 ½ year period ending in mid-2003 was only 80%. Had they accounted for the effect of mergers properly, they would have found that small bank asset growth was actually around 200%, about the same as at credit unions.

After committing this fundamental analytical error, Gunther & Moore compound their inaccuracies by incorrectly laying the blame for the weakness they find at the doorstep of the nation’s credit unions.

3. In a report they call “Small Banks’ Competitors Loom Large,” the authors single out credit unions as a “particularly severe threat to small banks”, but oddly mention large banks as competitors only in passing. Astoundingly, the terms “mutual fund” or “money market mutual fund” do not appear in the paper. Apparently the authors did not notice how large these institutions loom in household financial asset holdings. In fact, credit union share of U.S. household financial assets has been under 2% over the entire 18 ½ year period covered by the Gunther & Moore study, whereas the mutual fund share rose from 5.2% to 13.5% in the period.
4. The authors make no attempt to sort out, with the use of standard statistical techniques, the effects of credit union competition from all the other influences on small bank operations over the past decade: widespread deregulation of both products and market structure in the banking industry, technological innovation, new methods of product delivery, economic fluctuations, etc. They nevertheless strongly suggest that credit unions are behind their erroneous finding of weak performance at small banks.

5. In suggesting that credit unions have a regulatory advantage compared to banks, they ignore the U.S. Treasury Department’s finding that “federal credit unions have more limited powers than national banks.” Gunther and Moore make no mention of the fact that credit unions still face binding field of membership restrictions, are subject to higher capital requirements than banks, have no access to net worth other than retained earnings, are much more limited in business lending than banks, and face more restrictive investment regulations.

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