

Financial Industry

ISSUES

FEDERAL RESERVE BANK OF DALLAS

THIRD QUARTER 1995

Has Consolidation Reduced Competition in Texas Banking?

“Standard measures of market concentration indicate that, while Texas banking resources have become more concentrated on a statewide basis, the level of concentration in most local Texas markets, including individual metropolitan areas and rural counties, has either remained even with or declined from preconsolidation levels.”

Consolidation and the entrance of large, out-of-state competitors have raised concerns that the increased concentration of Texas' banking resources could reduce competition in the state's banking industry. The number of banking organizations with full-service offices in the state fell from 1,179 in 1980 to 865 by year-end 1994. In addition, the banking difficulties that followed the state's energy and real estate crises in the mid-1980s led to a change in state law that allows out-of-state banking organizations to acquire Texas banks. Today, several out-of-state organizations control a significant share of Texas banking resources. If the consolidation observed at the state level has reached local markets as well, competition among the remaining banking services providers could decline, potentially leaving financial consumers with fewer options and less favorable rates on loans and deposits.

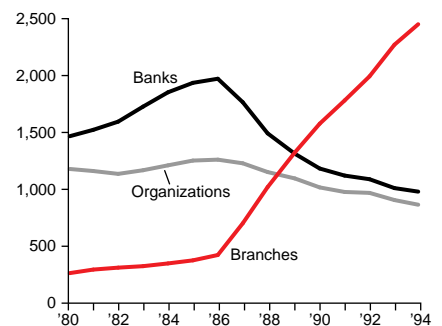
It turns out, though, that such an outcome has not occurred. Standard measures of market concentration indicate that, while Texas banking resources have become more concentrated on a statewide basis, the level of concentration in most local Texas markets, including individual metropolitan areas and rural counties, has either remained

even with or declined from pre-consolidation levels. The lack of significant increased concentration at the local market level casts doubt on the view that the recent wave of bank mergers and acquisitions has resulted in a less competitive financial services market.

The Consolidation Trend

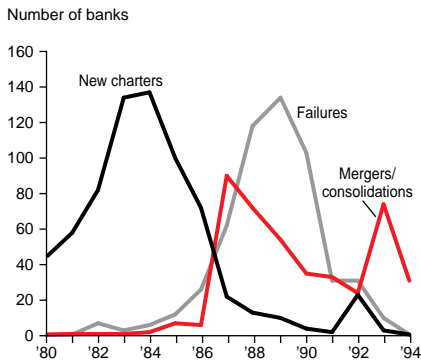
Although failures, mergers and branch conversions have reduced the number of Texas banks, the number of banking offices in the state, including head office banks and branches, has increased. As Chart 1 shows, the number of Texas banks grew to 1,972 at year-end

Chart 1
Texas Banks, Banking Organizations
And Branches



DATA SOURCES: Report of Condition and Income; NIC (the Federal Reserve's National Information Center for Systemwide Structure and Financial Information).

Chart 2
Structural Changes Among Texas Banks



DATA SOURCE: NIC.

1986 but has been declining since, falling to 980 by year-end 1994. Until 1987, new bank charters exceeded both mergers and failures combined, as shown in Chart 2. However, from 1987 to 1993, failures exceeded new charters and were a major contributor to the declining number of Texas banks.

Mergers and the conversion of banks to branches also have been a strong force behind the continuing reduction in the number of Texas banks. Once Texas began to allow countywide branching in 1987 and statewide branching in 1988, banking organizations that previously operated separate banks were able to convert their banks to branch offices. As Chart 1 shows, the number of branch offices increased at the same time the number of banks was declining. Counted together, the number of head office banks and branches actually increased during the 1980s and early 1990s.

Banking organizations with full-service offices in Texas also have declined in number, though less dramatically than have banks. Banking organizations numbered 1,261 at year-end 1986 but only 865 by year-end 1994, as shown in Chart 1. Accompanying this decline has been an increase in the average size of banking organizations. The average deposit size of Texas' banking organizations, adjusted for inflation, increased from \$96 million at year-end 1980 to \$118 million at year-end 1994. In addition, the

largest banking organizations in Texas now account for a greater share of statewide deposits. The share of deposits controlled by the 10 largest Texas banking organizations increased from 48 percent in 1980 to 53 percent in 1994.

The composition of the top 10 banking organizations also has changed. In 1980, all top 10 banking organizations were headquartered in the state. However, only one of the Texas-based organizations from 1980 remained in the top 10 by 1994. A change in state law in 1987 allowed banking organizations headquartered outside Texas to purchase Texas banks. By 1994, eight of Texas' top 10 banking organizations were based out of state, and the combined total of out-of-state organizations' deposits in Texas equaled 51 percent of statewide bank deposits.

Impact on Market Concentration

Despite these significant structural changes, standard measures of market concentration indicate that the consolidation trend has not led to pervasive increases in the concentration of Texas banking markets. The federal banking agencies and the Department of Justice use the Herfindahl-Hirschman Index (HHI) to measure market concentration. The HHI equals the sum of the squared market shares of the bank-

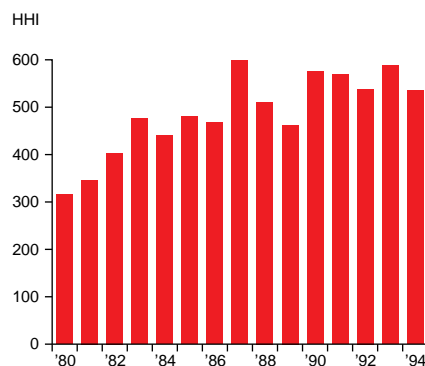
ing organizations competing in a particular market.

A reduction in the number of banking organizations represented in a particular market or an increase in the inequality of market shares for a given set of banking organizations tends to result in a higher HHI. For banking markets, an HHI below 1,000 is generally considered not concentrated, an HHI between 1,000 and 1,800 indicates moderate concentration and an HHI above 1,800 suggests a high level of concentration.

The State as a Market. As Chart 3 shows, the HHI based on each banking organization's statewide share of deposits increased from 316 points in 1980 to 513 points in 1994. But these figures indicate concentration only within the narrowly defined banking industry. Some consolidation is the result of banks' joining forces to compete with various non-bank competitors, such as mutual funds, finance companies and credit card companies, that have entered traditional bank markets, such as real estate and consumer lending. Therefore, although concentration within the Texas banking industry—as measured by the statewide HHI—has increased, overall competition for deposit and loan products likely has grown with the entry of new competitors into previously protected bank product markets.

Local Texas Markets. Concentration at the local market level is more important for assessing changes in the competitive environment than concentration as measured across the state. Because customers typically obtain banking services close to where they live, consolidation that reduces the number of local market alternatives implies fewer options for local customers and, as a result, a potentially less competitive environment. And less competition can lead to higher fees and loan rates and lower deposit rates. Diminished competition could be particularly troublesome for isolated rural markets that may offer customers access to fewer nonbank alternatives than

Chart 3
Texas Banking Industry Concentration
(HHI Based on Statewide Deposit Shares)



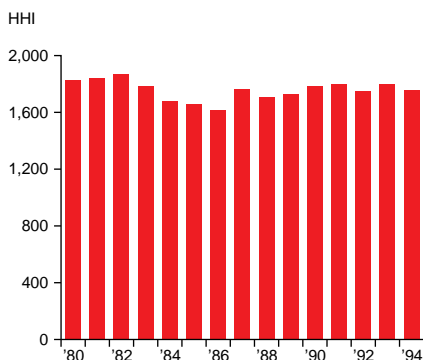
DATA SOURCES: Report of Condition and Income; NIC.

metropolitan areas.

For purposes of this analysis, individual markets are defined as either a Metropolitan Statistical Area (MSA) or a county not belonging to an MSA. Using these definitions, 218 local Texas markets are identified; 27 of these markets are MSAs, or urban markets, while the remaining 191 markets are non-MSA counties, or rural markets. To analyze concentration trends in Texas at the local market level, each individual market's HHI is multiplied by the ratio of the market's deposits to total Texas banking deposits. These weighted HHIs are summed across all markets to arrive at a weighted-average local market HHI for the state as a whole.

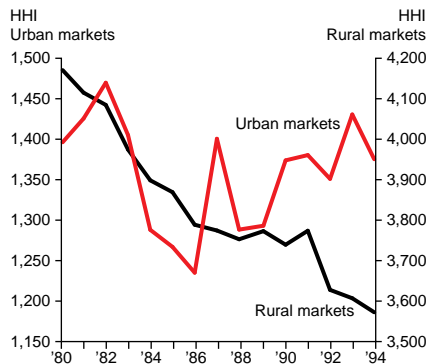
The weighted-average local market HHI, shown in Chart 4, indicates a higher level of concentration than the HHI based on statewide market shares. However, in contrast with the positive trend in the statewide HHI, the weighted-average local market HHI actually declined slightly from 1980 to 1994, falling 69 points to 1,757. Using an HHI of 1,800 as the benchmark to define highly concentrated, Texas would have been defined as highly concentrated in 1980 with a weighted-average local market HHI of 1,826. But by 1994, the HHI had fallen below the 1,800 benchmark. For 156 of the 218 local Texas markets,

Chart 4
Texas Banking Industry Concentration
(Weighted-Average HHI Based on Local Market Deposit Shares)



DATA SOURCES: Federal Deposit Insurance Corporation, Summary of Deposits; NIC.

Chart 5
Texas Banking Industry Concentration in Rural and Urban Markets
(Weighted-Average HHI Based on Local Market Deposit Shares)



DATA SOURCES: Federal Deposit Insurance Corporation, Summary of Deposits; NIC.

concentration either declined from or remained even with 1980 levels.

These findings indicate that the consolidation trend that led to increased concentration at the state level has not resulted in widespread increases in concentration at the local market level. Moreover, no markets with an HHI below 1,800 in 1980 emerged as highly concentrated during the 1980-94 period. And among the 201 markets that were highly concentrated in 1980, concentration levels fell in 122 cases and dropped below the 1,800 threshold in 10.

Rural markets often are quite limited and tend to be more concentrated than urban markets as a result of fewer competitors. Of the 191 rural Texas markets, 184 had an HHI of 1,800 or higher in 1994, compared with eight of the 27 urban Texas markets. Among the highly concentrated rural markets, 119 were characterized by three or fewer competitors, and 27 were home to only one banking organization. Each of the eight highly concentrated urban markets had at least five competitors.

Although rural markets tend to be highly concentrated, they account for most of the decline in Texas' local market concentration since 1980. As Chart 5 shows, the weighted-average local market HHI for rural markets has declined markedly from

its 1980 level, while the weighted-average local market HHI for urban markets has remained roughly even with its 1980 level. By facilitating entry of banking organizations into the state's rural markets, the liberalization of branching laws in the mid-1980s may have contributed to the decline in concentration among the state's rural markets. From 1980 to 1994, the number of competitors increased in 73 of the 191 rural Texas markets by an average of 1.3 banking organizations.

The consolidation trend has been characterized by increases in the average size of Texas banking organizations, the share of deposits controlled by the 10 largest banking organizations and the level of concentration measured by the state-wide HHI. However, concentration at the local market level does not appear to have been affected greatly by industry consolidation. Local market concentration, as measured by the weighted-average local market HHI, actually declined from 1980 to 1994, particularly in rural areas.

Impact on Texas-Based Banks

While the concentration levels of most local markets either remained stable or declined over the 1980-94 period, the makeup of local market competitors, for many markets, changed dramatically beginning in 1987, when out-of-state organizations were allowed to enter the state. As Table 1 shows, out-of-state organizations had offices in 18 local

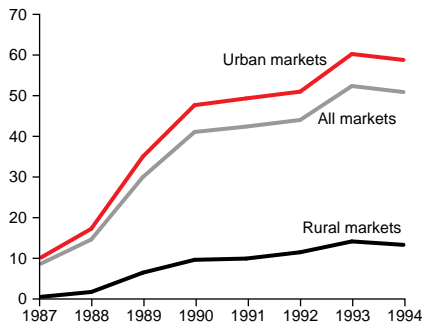
Table 1
Presence of Out-of-State Banking Organizations in Texas

	1987	1990	1994
Markets with out-of-state competitors	18	48	87
Percent of banking organizations	.32	1.43	1.93
Percent of deposits	8.70	41.07	50.89

DATA SOURCES: Federal Deposit Insurance Corporation, Summary of Deposits; NIC.

Chart 6
Out-of-State Presence in Texas Markets

Market share, percent



DATA SOURCES: Federal Deposit Insurance Corporation, Summary of Deposits; NIC.

Texas markets in 1987, accounting for less than 1 percent of all Texas banking organizations and about 9 percent of statewide banking deposits.

By 1994, out-of-state organizations were competing in 87 local Texas markets, accounting for 2 percent of Texas banking organizations and 51 percent of statewide banking deposits. As shown in Chart 6, the substantial share of statewide banking deposits controlled by out-of-state organizations mostly reflects their increased presence in urban markets, where their share of deposits increased from 10 percent in 1987 to 59 percent in 1994, compared with an increase from less than 1 percent to 13 percent in the state's rural markets.

Out-of-state organizations compete in all of the state's urban markets and in 60 of the state's rural markets. However, out-of-state organizations' share of deposits exceeds that of Texas-based organizations in only 17 of the markets. Among these 17 markets, the out-of-state share of deposits exceeds the Texas-based share by an average of 23 percentage points. For the remaining 70 markets in which out-of-state organizations compete, their share of deposits is, on average, 52 percentage points lower than that held by Texas-based organizations. While out-of-state organizations have greatly increased their presence within the state, their

offices are located in less than half of the state's local markets, and for many of the markets in which they compete, their share of deposits is lower than that of Texas-based organizations.

Nevertheless, banking organizations headquartered outside Texas represent a major competitive force in the state, particularly in metropolitan areas. Given the vast financial resources of these large, interstate organizations, competition in local Texas banking markets probably has increased beyond the levels suggested by the HHI figures alone.

Conclusion

The consolidation of the Texas banking industry, characterized by a decline in the number of banks and banking organizations and an increase in their average size, has increased the concentration of banking resources at the state level. However, measures of concentration at the local market level point to a slight reduction in concentration levels overall and show that concentration levels for numerous individual markets have declined.

On a statewide basis, a few organizations now account for a larger portion of the state's banking resources. But at the local market level, these relatively large banking organizations compete with other organizations that, while having a small statewide presence, account for a relatively large share of the individual local markets in which they compete. The lack of significant increases in the concentration of local banking markets, coupled with the growing presence of large, interstate banking organizations, suggests that the level of competition in Texas banking markets has not declined, but more likely has increased.

—Kelly Klemme

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