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Geographic Banking Markets

by Paul R. Watro

Various U.S. regulatory agencies are responsible for preventing bank mergers and acquisitions that would have substantially negative effects on banking competition. Regulatory agencies identify relevant product and geographic markets to assess the competitive impact of proposed mergers and acquisitions. Supreme Court decisions indicate that commercial banking generally should be considered as a separate line of commerce, or product market, for antitrust purposes.[1] Commercial banks traditionally offered customers a unique cluster of products that were not available from other institutions. Because of expanded powers, thrift institutions now operate more like commercial banks, becoming increasingly important suppliers of a wide range of financial services.

Like the line-of-commerce issue, the framework for defining the geographic area pertinent to a bank merger is also open for debate, even though the Supreme Court has provided some conceptual guidelines for delineating geographic market areas. The court has recognized, for example, that the type of bank customer would alter the pertinent geographic area.[2] A market consisting only of the largest corporations could be national or international in scope and thereby make the competitive effects of most bank mergers insignificant. In contrast, a market defined only in terms of very small businesses could be so narrow as to exclude competing banking institutions from the merger analysis. According to the Supreme Court, competitive assessments should focus on the class of customers, such as individuals and small businesses, that would be most affected by bank mergers. Market boundaries should be thought of as encompassing the area in which the bank to be acquired offers its services, as well as the area in which local customers could practicably turn for banking services.

Definitions of banking markets are often disputed by economists, attorneys, and regulators alike. Whether a proposed merger is approved or denied may ultimately depend on the geographic boundaries of a particular banking market. This *Economic Commentary* discusses the fundamental differences between service areas and market areas and reviews methods used by regulatory agencies to define geographic markets. The article also examines the areas in which a sample of Ohio's small businesses acquires services from commercial banks.

1. See *United States* v. *Philadelphia National Bank,* 374 U.S. 321 (1963); *United States* v. *Phillipsburg National Bank and Trust Company,* 399 U.S. 350 (1970); and *United States* v. *Connecticut National Bank,* 418 U.S. 666 (1974).

2. See *United States* v. *Philadelphia National Bank,* 374 U.S. 361 (1963).

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Bank Location and Small Businesses

To individuals and small businesses, a banking market is generally local. A 1981 survey of over 500 of Ohio's small businesses ascertained the locations and distances of the commercial banks that these firms used.[9] Small firms, for example, acquire financial services from commercial banks that operate near their place of business. The responding firms acquired over 80 percent of the banking services from offices located within the same community and within 5 miles of the firm (see table and chart). The firms acquired an additional 10 percent of their banking services within the same county and within 10 miles of their offices.

Location and distance of the supplier varied according to the type of service. Businesses tended to use banks farther away for loans and other services than for opening deposit accounts. Seventy percent of the deposit accounts and loans were held by banks within 3 miles of the responding firm. Ninety percent of the deposit accounts were within an 8-mile radius, whereas 90 percent of the loans were from banks within a 12-mile radius. The larger an area, the greater the probability of its containing an array of feasible sources for banking services.

Firm size, type of output, and location influence a small business' choice of banks. Manufacturing, suburban, and large firms (assets between $1 million and $5 million) generally bank with institutions located at greater distances from their offices than do nonmanufacturing, nonsuburban, and small firms. Manufacturing and large firms acquired about 25 percent of their banking services from banks located outside their local communities, whereas 17 percent of the banking services acquired by the total sample of firms came from banks outside their local communities. Manufacturing and large firms also obtained 15 percent of their loans from banks located at least 15 miles from their offices. Firms operating in suburban counties used banks outside the county for 12 percent of their banking, whereas the total sample acquired 6 percent of banking services outside the county. Suburban firms acquired 10 percent of their loans from banks at least 25 miles away. Indeed, suburban firms involved in manufacturing used out-of-county banks much more for all their banking services, particularly for acquiring loans.

When determining geographic boundaries of banking markets, it is necessary to investigate the alternative banking sources for local customers. The firms that responded to the survey indicated that they would consider using banks at much greater distances from their place of business if they became dissatisfied with their current financial services. Nearly one-half of the responding firms, for example, indicated that they would consider acquiring financial services from out-of-county banks. Over 40 percent of the responding firms considered possible banking alternatives more than 25 miles away. Moreover, a greater percentage of the manufacturing, suburban, and larger firms considered using alternative institutions located farther away from their businesses than did the total sample of firms. While some firms might be willing to travel greater distances for banking services under certain circumstances, these customers probably would prefer using alternative banks closer to their places of business.[10]

9. These small firms (less than $5 million in assets) were selected randomly from the *1981 Ohio Industrial Directory* and the yellow pages of various Ohio telephone directories. The 528 respondents were located in 78 of the 88 counties in Ohio, and two-thirds of the respondents reported assets of less than $500,000.

Conclusion

Banking markets are difficult to define, as market areas usually extend beyond the service areas of individual banks. For antitrust purposes, the Justice Department, FDIC, and FRS define banking markets by taking into account the area from which individual banks currently draw the bulk of their business, along with other supply and demand factors regarding the financial services used by local customers. In contrast, the CC tends to rely primarily on the service areas of the merging banks; the boundaries of these service areas can vary with the type of service and volume requirements.

Customer surveys are very helpful in determining geographic boundaries of banking markets. According to a survey of small businesses in Ohio, firms usually obtain banking services locally, depending on such things as the type of service and the customer. The survey results showed that loans were held at banks farther away from a place of business than deposit accounts. Manufacturing, suburban, and larger firms generally acquired all types of banking services from institutions located at greater distances from their place of business than did nonmanufacturing, nonsuburban, and very small firms. Since size and type of output influence a firm's choice of banking locations, it is important that the sample of firms in a survey represent the population in the area being analyzed. It also is essential to ascertain not only where firms and individuals currently are banking, but the specific locations of their practical banking alternatives.

10. To ascertain probable, rather than possible, banking alternatives, researchers should determine what circumstances would cause customers to seek alternative banking sources. Researchers should also identify specific locations of these alternative banking sources. Because our small business survey focused primarily on the product rather than the geographic market, such questions were not included.

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Services Acquired within Various Distances from Banks
Distances in miles

Service/type of firm	Percentage of services					
	70	75	80	85	90	95
Deposit accounts						
Total sample	3	4	5	5	8	15
Suburban[a]	3	4	5	8	12	20
Manufacturer	4	5	6	8	12	20
Suburban manufacturer	5	8	10	12	15	22
Large[b]	5	5	5	7	10	20
Loans						
Total sample	3	5	6	8	12	25
Suburban[a]	4	5	8	13	25	35
Manufacturer	5	7	9	15	19	25
Suburban manufacturer	8	10	13	20	25	35
Large[b]	6	7	10	20	30	65
Other services						
Total sample	3	3	5	6	9	20
Suburban[a]	3	3	5	6	12	22
Manufacturer	5	5	6	9	12	22
Suburban manufacturer	8	10	12	15	22	35
Large[b]	4	5	6	6	10	25
Total services						
Total sample	3	4	5	6	10	20
Suburban[a]	3	4	5	8	12	22
Manufacturer	5	5	7	10	13	22
Suburban manufacturer	8	10	12	13	20	25
Large[b]	5	5	6	8	15	35

a. Suburban firms are those located in SMSA counties adjacent to a central city.
b. A large firm is defined as having assets between $1 million and $5 million.

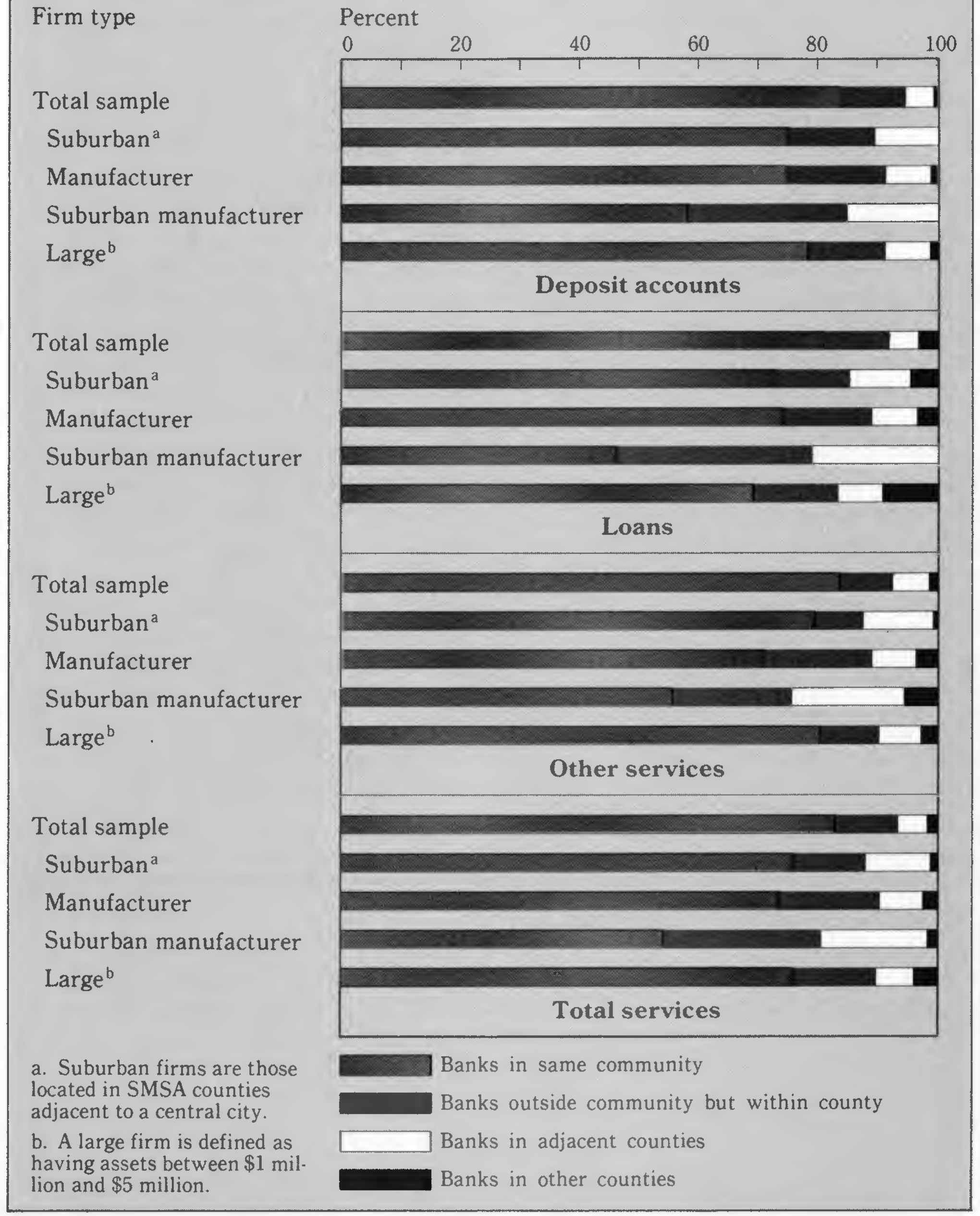
Market Delineations

Some analysts contend that the service areas of banks are the appropriate geographic areas for evaluating the competitive consequences of a bank merger. A *service area* generally represents the geographic area from which a bank draws the bulk of its existing deposits. The fundamental drawback with service areas is that such areas do not represent markets in the pure economic sense. A service area takes into account only a portion of existing customers of an institution, failing to consider potential customers who would use the institution as an alternative source for banking services.

Geographic banking markets are usually larger than service areas of individual banks. Determining which banks represent reasonable alternatives for a significant number of consumers and businesses within a given area is a subjective decision that is based not only on current banking practices but also on the amount of economic interaction between the communities or areas in question. If a high level of economic interaction exists between two communities—reflected in significant commuting for employment and shopping, ease of transportation, commonality of media coverage, and other factors—many customers in one community might consider the banks in the other community as a reasonable alternative to the banks currently serving them.

Methods used to define geographic banking markets vary among the regulatory agencies. The Justice Department, for example, initially assumes that the geographic market is approximately the same as the

Banking Location and Services



a. Suburban firms are those located in SMSA counties adjacent to a central city.
b. A large firm is defined as having assets between $1 million and $5 million.

service areas of the institution to be acquired and its nearest competitors.[3] In a second step, the Justice Department uses evidence on economic interaction as a basis for modifying the market area. The Justice Department expands the boundaries of the market area if it anticipates that a significant, nontransitory change in price would lead a significant number of customers to shift to banks outside the initial market area. While the area continues to be expanded as long as this criterion is met, the Justice Department does not specify how this judgment is made.

Although the banking regulatory agencies—Federal Deposit Insurance Corporation (FDIC), Federal Reserve System (FRS), and Comptroller of the Currency (CC)—do not appear to have explicit guidelines for defining geographic markets, past merger decisions provide some perspective regarding the definitions used by each agency. The FDIC has stated "the fact that a bank does not have any customers in a particular portion of its market can mean, among other things, that its marketing efforts in that area are overshadowed by those of competing banks."[4] Like the Justice Department, the FDIC and FRS consider both supply and demand factors in delineating banking markets.[5] Demand factors include commuting for employment and shopping, road networks, media coverage, and designated socioeconomic areas, such as standard metropolitan statistical areas (SMSAs) and Ranally metro areas (RMAs). Supply factors include prices, banking hours, advertising, and branching patterns.

Like the other regulatory agencies, the FRS usually does not provide detailed information in its decisions on how banking markets are defined. However, the FRS occasionally has cited selected data in market delineations when denying merger applications. In one decision, for example, the FRS considered Schenectady County in New York state to be part of the Albany banking market. Among other factors 17.6 percent of the employed residents of Schenectady County commuted to Albany County. Nearly all of the commercial banks with offices in Schenectady County also operated offices in Albany County, and rates on selected services were similar among these banking offices.[6] In another proposed acquisition that was denied, the FRS concluded that the two Michigan banking organizations involved were in the same banking market. One of the two banks drew 10 percent of its loans from the service area of the other bank; the banks were only 13 miles apart and directly connected by a highway, making the organizations practical alternatives for customers in either town.[7]

In contrast to the Justice Department, FDIC, and FRS, the CC very often adheres essentially to the service-area approach in defining banking markets. Yet, in a recent merger decision the CC stated that "commuting, shopping, pricing behavior, market strategies, and branch networks can sometimes cause banks to perform as if they were operating in a market area substantially larger than loan or deposit service areas."[8] The CC generally contends that the proper area to assess the competitive effects of the proposed merger is the area where the banks involved operate offices and from which they draw the bulk of their business. As a result, the CC's definitions of some market areas seem rather narrow.

3. See "U.S. Department of Justice Merger Guidelines," issued June 14, 1982, for a discussion of how markets are determined.

4. See decision to deny the proposed merger between the Pennsylvania Bank and Trust Company, Warren, Pennsylvania, and the Farmers National Bank of Conneautville, Conneautville, Pennsylvania, FDIC's *Annual Report,* 1980, pp. 205–07.

5. It should be noted, however, that the courts have often relied on the service-area approach because of the lack of evidence on demand factors.

6. See *Federal Reserve Bulletin,* vol. 64, no. 11 (November 1978), p. 895.

7. See *Federal Reserve Bulletin,* vol. 67, no. 5 (May 1981), p. 438.

8. See Firestone Bank, Akron, Ohio, to merge with Bank One of Medina County, N.A., Wadsworth, Ohio, *Quarterly Journal,* Comptroller of the Currency, Administrator of National Banks, vol. 1, no. 2 (1981), p. 48.