



A perfect blend

Mergers strengthen banks, maintain customer ties

Inspired by the time he spent in Costa Rica as a student years earlier, Danny O'Neill started roasting coffee in the basement of his Kansas City, Mo., home.

He knew what he wanted to channel his entrepreneurial energy into. He also knew he needed a small business loan.

O'Neill visited six banks, though just one "seriously considered" him.

"I really had no money, and I was in there asking for a lot of money," O'Neill remembers with a laugh. "I didn't know any better."

The staff at Missouri Bank listened to his dream. And, gave him a loan to start The Roasterie coffee shops and roasting plant.

Now, nearly 15 years later, the two popular cafes thrive in a trendy urban neighborhood and

in nearby downtown. Along the way, O'Neill received a few more loans from Missouri Bank.

It's this banking relationship that customers typically value from small community banks, like Missouri Bank. However, the bank merger boom of the 1990s and 2000s has reduced the number of community banks (those with assets less than \$1 billion) nationwide by one-third, causing many to worry their personal banking relationship will erode, says Julapa Jagtiani, a senior economist with the Federal Reserve Bank of Kansas City. She recently researched this merger boom and its effects on community

banking, finding that small banks are not being driven to extinction but may be benefiting from mergers.

“A common perception is that most of these small banks are being gobbled up by large banks,” Jagtiani says. “But more than half of the acquiring banks were actually community banks themselves, often creating stronger, more efficient banks.”

Fewer community banks

From 1989 to 2006, the number of community banks decreased by about 36 percent while large banking organizations increased their share of U.S. banking assets significantly. Mergers were the primary reason, Jagtiani says.

Of the 4,200 mergers of publicly traded banking organizations during the past two decades, more than 90 percent involved acquisitions of community banks. The number of community banks would have declined even more if the loss of banks through mergers had not been offset by a substantial number of new charters, she says.

Prompting concern, research shows bank mergers can significantly impact the supply of credit to small businesses. That impact depends on the size of the acquiring bank. Unlike large bank mergers, those among small banks are less likely to cause a reduction in supply of credit to small businesses, and small business lending could actually increase as a result.

According to Jagtiani’s research, mergers between community banks accounted for more than half of all community bank acquisitions in terms of numbers, and 30 percent in terms of assets acquired. Most of the remaining community bank acquisitions were by medium-size banks (\$1 billion to \$10 billion in assets) rather than by larger banks. This means it’s unlikely that community bank acquisitions reduced the supply of credit to small businesses, Jagtiani says.

While dollar volume of small business lending has increased for both large and community banks during the last 15 years,

small business lending has continued to represent a much higher percentage of assets at community banks.

Additionally, Jagtiani says acquiring banks tend to be more efficient and more profitable than the banks they acquire, which indicates the operations of the target bank could become more efficient. Community bank acquirers also seem to have more sound lending practices and practice more conservative reserve management than their targets. This means the transfer of assets from targets to acquirers could improve the overall health of merging banks, she says.

Large banks acquiring community banks

With the right approach, a large bank acquiring a small bank does not mean the merged bank can’t meet the needs of the community, says Clyde F. Wendel, president of the asset management division of UMB and vice chairman of UMB Bank. The key is to understand the community and establish a “sense of connection between the borrower and lender,” he says.

“We’re not coming in to just take your deposits,” Wendel says. “We’re coming in to be a part of the community.”

Customer concerns of personal service “are challenges for the acquiring bank and the bank that’s put itself up for sale,” he says.

UMB’s approach to this is twofold: keep decision making local and be a good corporate citizen in the community, such as sponsoring the Little League team. This requires the time and commitment of the acquiring bank.

“It’s important to know the people in your community,” Wendel says. “Banking is a relationship business.”

UMB Financial Corporation itself began as a small bank in Kansas City, Mo., in the early 1900s. Through acquisitions, it grew and eventually became a



bank holding company. More acquisitions led to expansion throughout the West, where its banking centers are located along with investment services and trust management.

Wendel says a large bank's entrance into a small community has certain advantages, including bringing in a well-known brand name with a large number of accounts to spread costs, as well as the ability to combine operations to improve efficiencies. For the customer, a large bank's resources translate into more options, such as online banking, ATMs, investment products, and the large scale of these options may mean less-expensive or even free services. However, the value of community banks is not diminished, Wendel says.

"I think there are always going to be strong community banks," he says. "There's always a role for well-run community banks."

Community banks acquiring community banks

There is research that supports focusing mergers, which would allow the concentration of strengths by combining banks that specialize in similar activities. Furthermore, Jagtiani's

research shows in the acquisitions of community banks, average merger bids generally are larger when the acquirer is also a community bank. This suggests community banks can create more value when they merge, rather than when a community bank is acquired by a larger bank, she says. Furthermore, merging with a bank of similar size may be more conducive to the community banking mantra.

Additionally, Jagtiani's research shows the majority of community bank mergers during the boom have been in-state, allowing the merged bank to continue their relationship with local customers and maintain their connection with the community with no interruption.

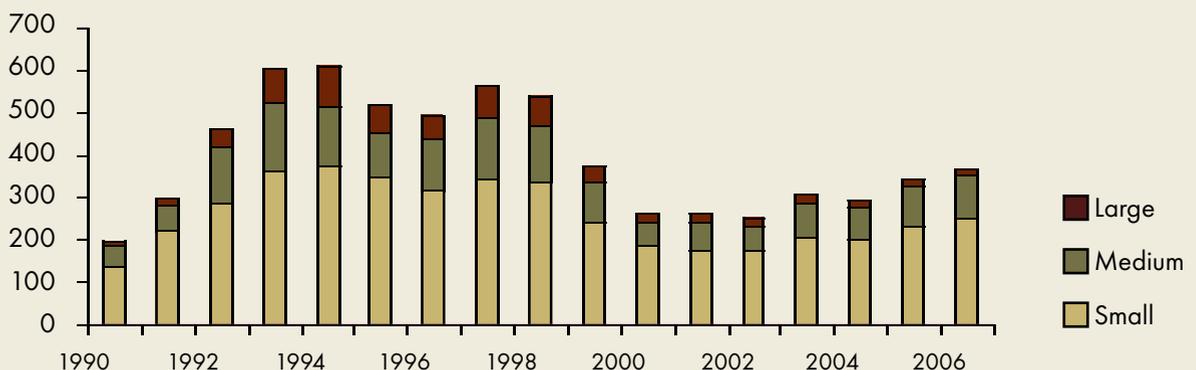
"Community banks appear to merge with the goal of concentrating their efforts on what they do best—provide personal service to small businesses and other local customers," Jagtiani says.

This is Central Bancompany Inc.'s strategy. Based in Jefferson City, Mo., the company has 15 bank charters with many of its community banks located throughout the Kansas City metro area.

"We believe banks should have a community base," says Chuck Weber, Central

Mergers and Acquisitions

Size of acquiring bank when the target bank is small.



Bancompany executive vice president and general counsel.

By acquiring only small banks, Central Bancompany uses its resources—innovation, technology, streamlined operating approach—to conduct business more efficiently while offering the customer more services, such as online banking, that might not

have been available when their community bank was under different, smaller ownership.

This approach offers customers the product and cost benefits of larger entity ownership via the community banking concept of personal service and local management, Weber says.

“Overall, the merger boom may be joining successful small banks with less successful ones,” Jagtiani says, “in effect creating stronger and better managed banks.”

After the boom

The community banking sector today remains strong, Jagtiani says. These banks have continued their commitment to small business lending and personal service. Even though thousands of community banks have disappeared through mergers, many new banks have been chartered.

“The community banks that survived the merger boom may be in a good position to continue serving the local businesses and depositors who value personal service and relationship lending,” Jagtiani says.

Though Missouri Bank has never acquired another bank nor has it accepted offers to be an acquisition itself, President and CEO Grant Burcham says, “We love mergers. It tends to create a lot of new customers for us.”

Burcham says his independent, privately owned community bank in Kansas City, Mo., offers relationships to its customers, like The



ONE OF THE ROASTERIE'S EMPLOYEES sorts coffee beans prior to roasting. The company's beans are sold to coffee shops, restaurants, grocery stores and others nationwide. Owner Danny O'Neill got his first small business loan from a community bank in Kansas City, Mo.

Roasterie owner Danny O'Neill.

“Banking is a people business. ... We have to focus on that,” Burcham says. “That's our point of differentiation. We'll always know our customers better.”

That's why O'Neill says he banks there.

“They just take really good care of us.”



BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

“UNDERSTANDING THE EFFECTS OF THE MERGER BOOM ON COMMUNITY BANKS”

By Julapa Jagtiani
KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.