

From the Mountains to the Prairies: The Banking Environment in the Tenth Federal Reserve District

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INTRODUCTION

While many factors play a role in a bank's success or struggle, certainly the conditions in which it operates are key. Banks flourish in instances where the local demographic and economic conditions and environment are robust and growing. The opposite is true when decline or stagnation marks local circumstances.

This article has two objectives: 1) to describe aspects of how the environment has changed over the past two decades in the Tenth Federal Reserve District,¹ and 2) to provide perspective for subsequent articles that explore bankers' comments on their industry and markets and investigate specific banking issues. Given the geographic breadth of the District, it is not surprising that there are multiple environments spanning the spectrum from robust to struggling. Our goal is to describe these varying conditions within the context of those attributes commonly held to affect banking conditions—demographic, economic, and structural trends.

Taking this long view provides a sense of not only where the various areas of the District have been, but perhaps where they might be going. To set the stage, the first section of this article will describe the District's demographic trends over the last 20 years, relying to a large degree on U.S. Census Bureau information.

The second section will focus on changes in the District's economic bases. Stretching from the Rocky Mountains to the Midwest, this region often may be thought of as slower to change than more

urban markets. However, the economic trends will show regional dynamics that promise to create both challenges and opportunities for District bankers in the years ahead.

The third section will consider the industry itself and the dramatic alteration of the banking landscape. The consolidation in banking has been a well-documented trend, but how has that pattern manifested itself in the Tenth District? Here we will explore whether the District's experience with consolidation mirrors that of the industry.

In the fourth section, we will briefly look ahead at areas that potentially could influence the future of banking. What are the possible future trends in delivery of banking services and to what degree is electronic banking making inroads in the Tenth District? Will the pace of industry consolidation continue? What is the demographic outlook for the region? These are just some of the factors that may affect the long-term success of individual institutions.

DISTRICT DEMOGRAPHICS

To thrive, banks rely on markets that have healthy demographic trends and prospects. Changes in the aggregate population and migration patterns can be two indicators of a market's health. The composition of an area's population, including generational characteristics such as percentage of elderly and racial/cultural factors such as minority growth, also can provide important insights into the needs and interests of its residents and the level of diversity that is present or evolving. U.S. Census data is useful for investigating these factors and for revealing key trends.

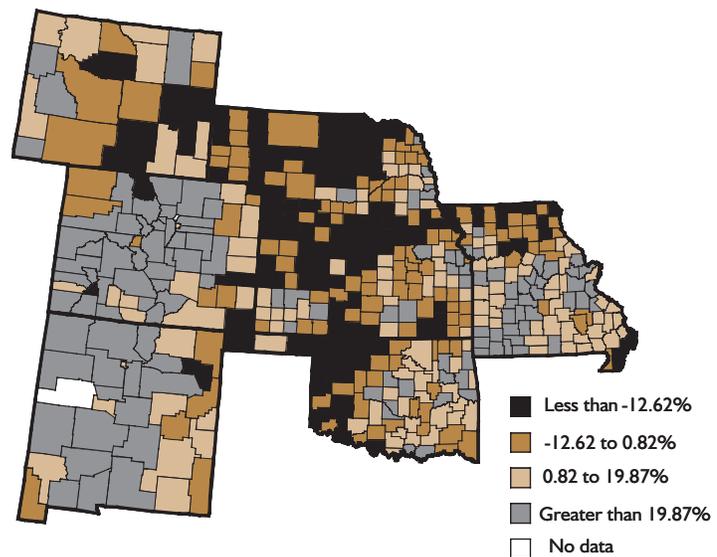
In considering the trends over the last two decades, Tenth District states report both

significant gains and losses. Map 1 shows the net change in population between the 1980 Census and the 2000 Census on a county basis.²

It is evident that the growth areas are concentrated in the District's western states, especially Colorado and New Mexico, reflecting the national trend of population increases in the southern and western portions of the country. But there also are other regions of notable growth—for instance, the Ozarks region of Missouri and Oklahoma, where entertainment and scenic amenities are proving to be attractive. Scattered pockets of population increases include southwestern Kansas and certain counties in Nebraska and correspond to unique local conditions, such as areas dominated by expanded meat-packing operations or along interstate corridors containing concentrated economic activity. The District's metropolitan areas also appear as centers of sustained growth.

By contrast, the largest portion of net population decline is focused in the Great Plains section of the District. Principally in the area from Nebraska to Oklahoma, the counties that have suffered steep decline are quite obvious. These areas are generally

Map 1
Population Change 1980-2000
(Seven Tenth District States)



Sources: 1980 and 2000 U.S. Census data

rural, dominated by small towns and agricultural operations. Many studies have focused on the struggles in rural America, including the Great Plains region. The October 2003 issue of *Financial Industry Perspectives* discussed slower growing counties in the Tenth District and the performance of banks operating in these counties.³ The Federal Deposit Insurance Corporation, in its 2004 *Future of Banking* series, considered rural depopulation in several large areas of the country, including the Great Plains.⁴

Map 1 reflects District growth patterns over the last 20 years, but a review of more recent data reinforces that the variance among District locations is continuing. Looking at population changes between 1990 and 2000—for the most part a prosperous decade for the nation—the concentration in growth in the District’s western states seems clear. The two fastest growing states in the District were Colorado, with 31 percent growth, and New Mexico, with 20 percent. Nebraska, with 8 percent growth, was the slowest growing state in the District.⁵

One component of population growth is immigration of people from other states. This can be a revealing measure of an area’s vitality and attractiveness, as most residents presumably move to more promising locations. Of the District states, Colorado has been the most successful in attracting out-of-state residents. According to the U.S. Census Bureau, Colorado had the fifth highest rate among all states for net domestic immigration between 1995 and 2000, with 644,000 people moving to the state during that period.⁶ California was the dominant supplier of migrants to Colorado, providing approximately one-third of its net domestic gain. Demographer William H. Frey described the fast-growing states in the South and West as the “New Sunbelt,” a grouping that includes Colorado.⁷ Although there are a myriad of reasons for individuals and families to relocate, the factors Frey mentions—growing economy, relatively low cost of living, and favorable climate or environmental amenities⁸—generally articulate many of

Colorado’s ongoing advantages and the attraction of its robust economy during the late 1990s.

Beyond aggregate change in population, the composition of that change is also important. Much has been said of the looming retirement of the baby boomer generation. States with a higher proportion of retirement or near-retirement age residents are confronting the need for specialized services and the challenge of ensuring an adequate future workforce. As reported in the 2000 Census, an average of 12.4 percent of the U.S. population was 65 years old and over. Four District states surpassed the national average: Nebraska, 13.6 percent; Missouri, 13.5 percent; Kansas, 13.3 percent; and Oklahoma, 13.2 percent. The three western District states, while below the national average in proportionate population of 65 and over, reported the highest District growth rates in this demographic and greatly exceeded the national growth rate between 1990 and 2000.⁹ Given that these states generally had higher growth in overall population, this result may not be surprising.

Finally, another facet of the population’s composition concerns race and culture. These factors can influence the types of banking products needed by differing groups of consumers, as well as require special language and cultural skills on the part of bankers to meet those needs. Again, there are distinct differences among the Tenth District states. As of the 2000 Census, the population of three states was each more than one-quarter minority: New Mexico, 56 percent; Colorado, 26 percent; and Oklahoma, 26 percent. By far, Hispanics/Latinos¹⁰ constituted the largest minority bloc in New Mexico and Colorado. Oklahoma’s population was more diverse, including sizeable African-American and Hispanic residents, but its largest minority group consisted of Native Americans. These three states also posted the largest growth between 1990 and 2000 in the proportion of their total population comprised of minorities, although all District states reflected increases. Overall, the District’s demographic trends reflect strong growth in the

West, a general decline of the rural sections of the Great Plains, and a more diverse population primarily concentrated in several states.

ECONOMIC FACTORS

The natural flow of business cycles can expose those regions that have become overreliant on a particular industry or product to great change. Some industries, such as energy, also have a particular history of spectacular booms and busts. Thus, the nature of a region's economy and level of industry concentration can lift or threaten banking conditions and outlook. For example, witness the dramatic number of bank failures during the late 1980s as weaknesses in agriculture and energy took their toll on financial institutions in this District. But a contrasting picture is seen in the number of new bank charters during the decade of the 1990s, with 140 charters granted in District states during that period.¹¹ Clearly, the prosperous economic times of the 1990s spurred start-up operations—even in the face of persistent overall industry consolidation.

An important economic engine for the central and eastern portions of the District continues to be agriculture. But changes under way in that industry could affect that reliance. The United States Department of Agriculture conducts a Census of Agriculture (Ag Census) every five years to examine trends in farming operational size, ownership, and output, among other factors. The 2002 Ag Census reported that the number of farms nationwide declined nearly 4 percent since the previous census in 1997.¹² The 2002 Ag Census further showed the number of farms in Tenth District states actually increasing 6.5 percent, rising in every state except for Nebraska. However, this growth occurred disproportionately in the smallest farms. Based on the number of farms by value of sales, the smallest category of farms, with sales of \$2,500 or less (so-called “hobby farms”), rose nearly

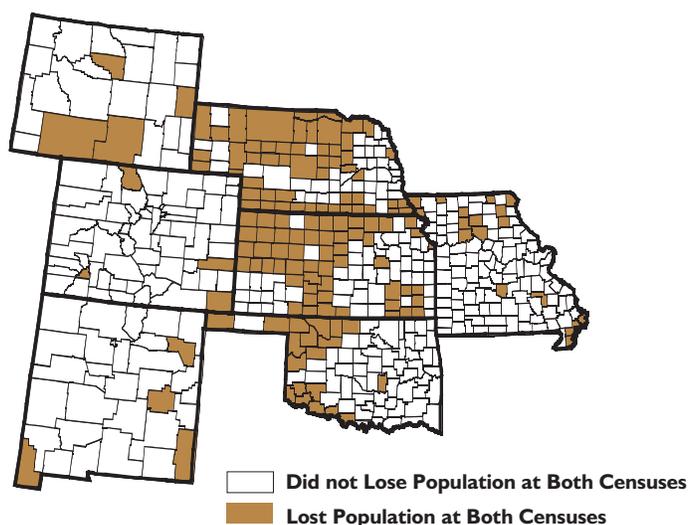
22 percent, while the respective number of middle- and largest-sized farms declined or increased slightly.¹³ Nevertheless, agriculture is expected to remain closely linked with the District's rural areas, many of which are losing population. This dependence on agriculture is fully illustrated by considering the trends over the past two decades.

Maps 2 and 3 reflect the reliance on agriculture in conjunction with population change. Map 2 isolates counties in District states that have lost population in each of the last two censuses. When compared with the *aggregate* population trends over the last 20 years as seen in Map 1, the region closely corresponds to the District pattern as one would expect. But the picture in Map 2 also stresses the pervasiveness of the declining population trend in those areas. Not only have these counties lost population, it is a sustained pattern through both good and bad economic times.

Map 3 again depicts county-level information. This map reflects those counties whose chief economic base is agriculture, thus reporting the “farm dependent counties”¹⁴ in the District. The match between Maps 2 and 3, while not exact, shows a strong relationship. This reliance on agriculture may

Map 2

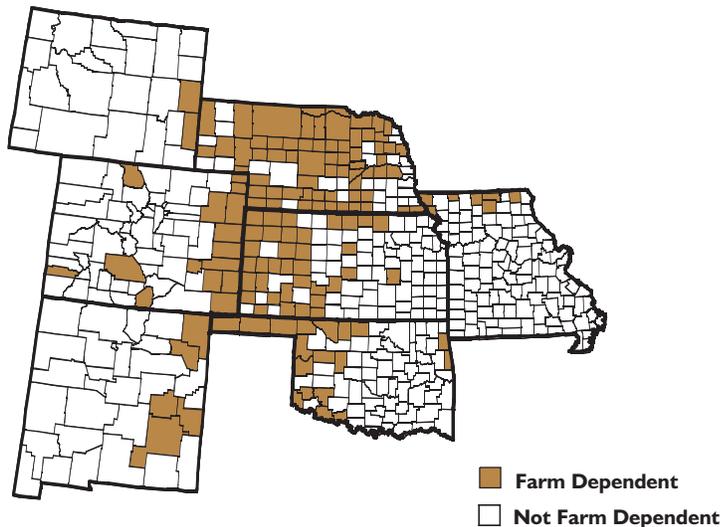
Counties That Experienced Population Decline at Both the 1990 and 2000 Censuses (Seven Tenth District States)



Sources: 1990 and 2000 U.S. Census data

Map 3

Farm Dependent Counties
(Seven Tenth District States)



Sources: 1990 and 2000 U.S. Census data

not be unexpected, given the historical prevalence of farming in the Midwest. But this long-time industry dominance raises questions about the prospects for some areas, particularly in light of the shrinking number of middle-sized farms reported in the 2002 Ag Census results. While there are undoubtedly multiple reasons for county population loss, the degree of correlation between population loss and agricultural primacy is striking and points to continued challenges for banks in those markets.

To look at changes in the District's economic base, we turn to the Gross State Product (GSP) statistics for each District state and the District as a whole. Much as the Gross National Product (GNP) details the origins of output for the nation, the GSP provides information on the contribution of individual industrial sectors—in the states' case, from 10 sectors¹⁵—to a state's total economic output. Table 1 shows the top three sectors for the entire District and each state for years 1980, 1990, and 2001 (the most recent available data). The District data reveals the decline of manufacturing as the primary component of the District's economy—and the parallel shift toward a service-based economy.

State patterns support this overall transition as well as reveal interesting local variations. For instance, mining continues to dwarf all other sectors in Wyoming, while it has fallen off in other states, such as New Mexico and Oklahoma. Also noteworthy is the absence of agriculture as a top sector in any state. Even in the traditionally agricultural states of Nebraska, Kansas and Oklahoma, the highest position that sector achieved in any of these states during these reporting periods was fifth in Nebraska in 1990. This is not to diminish agriculture's importance as a key District industry, particularly in many local markets. But this information points to the pre-eminence of the other

sectors in generating the states' total output. Finally, government is notable for its significance as a base in the District total and in most states.¹⁶ There are several inferences to draw from this information: 1) agriculture, while still important, is not the dominant District industry that many may think; 2) the high profile of government in many states points to both the continuing influence of government lands in the West and the key role government fulfills in many rural counties in providing necessary services; and 3) the overall diversity of the District economy. Regardless of area or economic focus, bankers must continue to stay attuned to changes in their market so as to meet the service needs of what might be a changing pool of potential customers.

BANKING STRUCTURAL CHANGES

Many factors have contributed to a dramatic consolidation in the banking industry since the 1980s, including the liberalizing of interstate acquisition and branching laws. Nationally, the number of banks has been nearly halved, falling from well over 14,000 in 1980 to 7,700 at year-end

Table I

Top Three Sectors—Gross State Product

District	Colo.	Kan.	Mo.	Neb.	N. M.	Okla.	Wyo.
1980	Mfg.	FIRE	Mfg.	Mfg.	Mfg.	Mining	Mining
	FIRE*	Govt.	Govt.	Services	FIRE	Govt.	Mfg.
	Govt.	Services	FIRE	FIRE	Govt.	FIRE	Govt.
1990	Services	Services	Mfg.	Mfg.	Govt.	Govt.	Mfg.
	Mfg.	FIRE	Services	Services	Services	Services	Govt.
	Govt.	Govt.	Govt.	FIRE	Mfg.	FIRE	Services
2001	Services						
	FIRE	FIRE	Mfg.	Mfg.	FIRE	Govt.	Govt.
	Govt.	Govt.	Govt.	FIRE	Govt.	Mfg.	Mfg.
							Mining
							Govt.
							TPU

Source: U.S. Department of Commerce, Bureau of Economic Analysis

*FIRE—Finance, Insurance, and Real Estate.

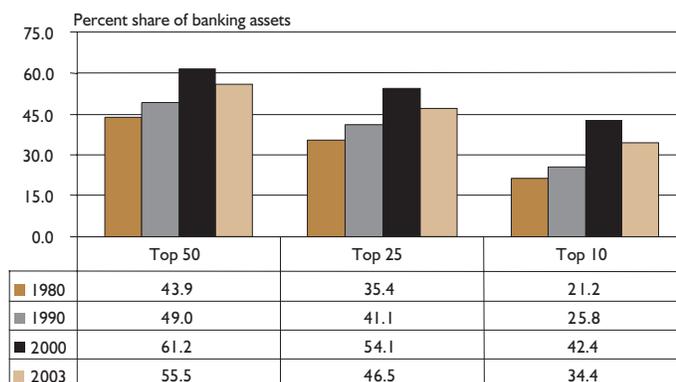
TPU—Transportation and Public Utilities.

2003. This has led to an increased concentration of banking assets in the largest organizations. In 1980, the top 50 organizations controlled 50 percent of banking assets, but by year-end 2003, it took only 10 companies to control roughly the same percentage of assets.

Within the Tenth District, this concentration phenomenon also has occurred, although not to as great an extent.¹⁷ Chart 1 depicts a long-term consolidation trend similar to the nation, including large organization dominance (the share of the largest organizations falls at year-end 2003, due largely to the elimination of Wells Fargo's District banks, which merged into the parent bank in San Francisco). In similar proportion to the nation's results, the aggregate number of District banks has fallen from more than 2,300 in 1980 to under 1,300 at December 31, 2003.

Consolidation has affected most size segments of the industry, but none so much as the smallest banks. Banks with total assets of less than \$100 million have witnessed the greatest shrinkage in their numbers. As revealed in the District bank trends in Chart 2, banks with assets under \$100 million fell by nearly 61 percent, while District banks over that level actually increased in number. Over time, this could pose a competitive challenge for

Chart I Tenth District Concentration Trends



*Share of banking assets, Tenth District, ranked by aggregate bank assets within District Organizations.

Source: Federal Reserve National Information Center financial institution structure and financial data

smaller institutions, which must meet an increasingly complex financial marketplace with inherently fewer resources than the large banks.

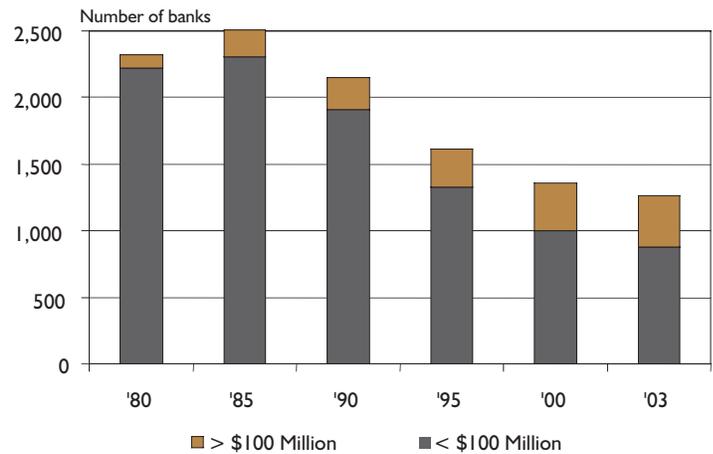
Despite the outright decline in the number of institutions headquartered in District states, the number of available locations providing banking services remains high.

Banks increasingly have deployed a branching strategy to enter new markets and solidify existing ones. In the Tenth District, the number of deposit-taking offices has increased 107 percent between June 1984 and June 2004. This trend for the individual states is shown in Chart 3.¹⁸ It is also apparent that some District markets are attractive to out-of-District organizations, given the rise in external banking presence over the past two decades. Between June 1984 and June 2004, banking offices of institutions headquartered outside the state of that office rose 23-fold. In particular, Colorado and Missouri display a significant out-of-state presence. In comparison to the 1984 data, where out-of-state banking offices were extremely rare, all District states evidence the growing profile of larger, often national banking organizations in the Tenth District. These patterns of outside presence and high growth in offices show that the process of industry consolidation is not as simple as just fewer banks.

FUTURE PROSPECTS

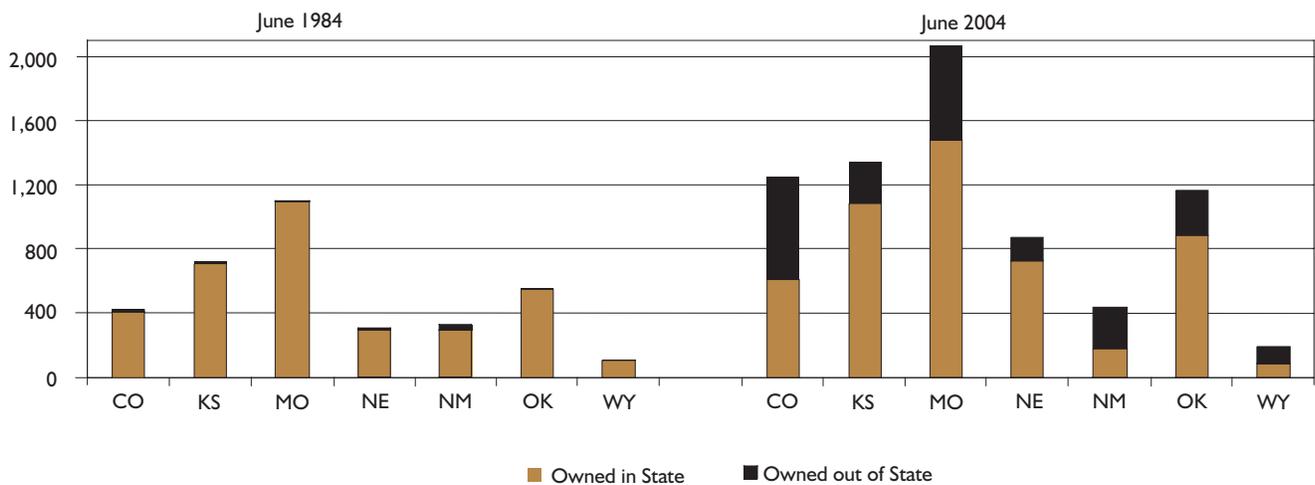
We have examined past trends in several different environmental categories, in some cases for the past two decades. What about the future? Will the previous patterns continue or might there be other discernible developments? Here we'll consider several possibilities.

Chart 2
Tenth District Commercial Banks by Asset Size Groups



Source: Reports of Condition and Income

Chart 3
Tenth District Commercial Banking Offices*



*Number of commercial bank deposit taking offices.

Source: FDIC—Summary of Deposits reports

Industry Changes

Technology continues to heavily influence the banking industry. A recent development, the Check Clearing for the 21st Century Act (Check 21), promises to spur new technology investments and encourage a further transition to digitizing financial data. Another area is electronic banking. Many observers have long expected online banking to increasingly become the method of choice for delivering banking services. As shown by the sharp rise in bank branches, physical sites are not falling in popularity for conducting banking business. Nonetheless, the availability of electronic banking slowly continues to grow. Chart 4 shows the rise in the number of Tenth District banks with transactional web sites.¹⁹ Each size category of District bank reflects growth; however, only banks with assets in excess of \$300 million surpass an 80 percent threshold for offering these services. Clearly large banks see this delivery channel as one they must offer to be competitive or where they can gain financial efficiencies. But it appears we reasonably can expect small banks to continue instituting electronic banking services in some measure, as an Internet presence becomes more the industry norm.

The industry has undergone tremendous consolidation over the last 20 years. Is it reasonable

to expect that this shrinkage will continue? While no one precisely can predict the number of future banking organizations, the recent pattern may suggest a likely scenario. As seen earlier in Chart 2, the District profile has reflected a moderating trend in consolidation, particularly over the last three years. Given that banking problems in the 1980s and liberalization of interstate banking and branching laws provided much of the previous momentum for District consolidation, continued slowing in this trend appears likely. The District profile also suggests that the pattern of greatest decline occurring in banks with less than \$100 million in total assets will persist.

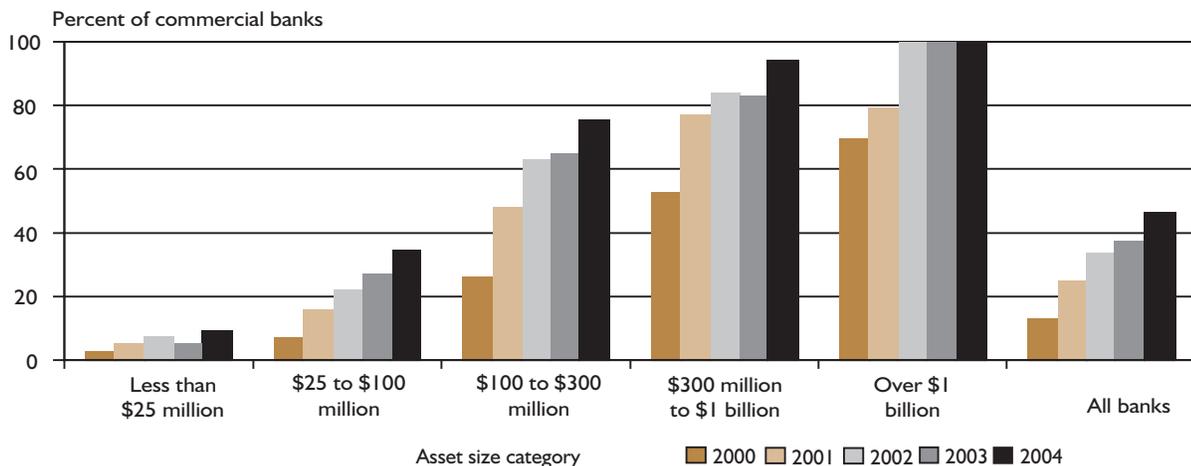
Demographics

Turning to demographics, can one expect the population changes of the past to continue? The Census Bureau offers one glimpse into the possibilities for District states. Based on estimates in 1995, the Census Bureau forecasted population changes to the year 2025. Limiting our look to roughly the next 10 years, Chart 5 shows that the District overall is projected to essentially match the nation's estimated growth rate. But the recent tendency of growth above the national average in the District's western states is likely to continue.

Chart 4

Adoption of Transactional Web Sites by Size of Bank

Commercial Banks in Tenth District States (First Quarter 2004)



Source: Federal Reserve Bank of Kansas City Payments System Research Department

Oklahoma is the other District state whose growth should nearly approximate the District and national average.

As for population composition, the Census Bureau predicts the District's percentage of population aged 65 and over will be 15.7 percent, which will be above the nation's projected rate of 14.7 percent. By 2015, all District states, except for New Mexico, are expected to exceed the national level in this demographic, led by Oklahoma at 17.3 percent and Nebraska at 16.4 percent. Colorado and Wyoming are projected to reflect the sharpest rise of the District states in the proportion of their population represented by 65 and over, which mirrors the recent history of general population increases in the nation's western and southern states.

Turning once again to the Census Bureau's projections from the 1995 base year, what is the possible population to be constituted by minorities? The Census Bureau's information shows that the District's three western states, aggregately, will increase the gap with the rest of the District in the percentage represented by the Hispanic population, rising to an estimated 24.4

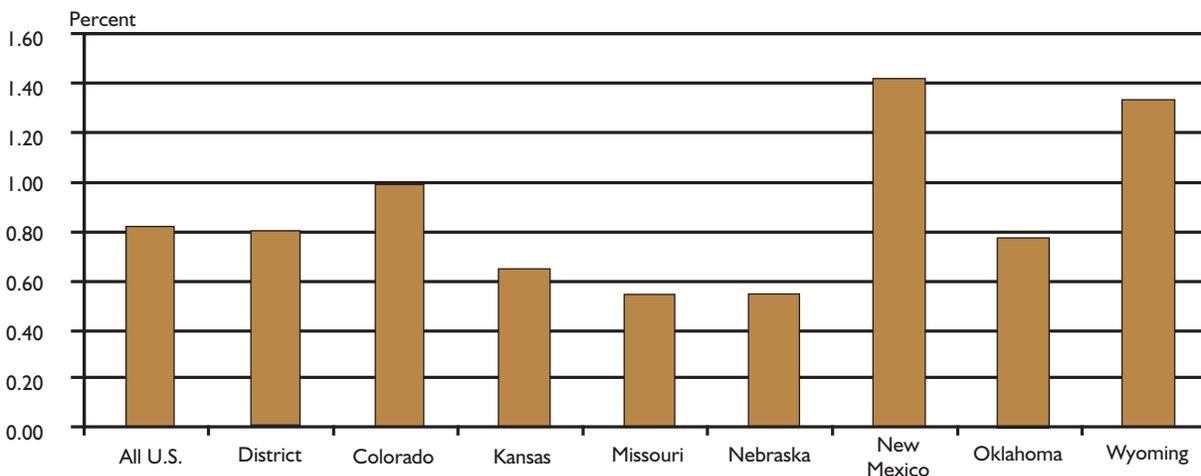
percent in 2015, compared to 7.1 percent for all District states.²⁰ African-Americans and Native Americans, the latter principally in Oklahoma, will be more dominant in the District's four eastern states. The overall rising Hispanic population reflects national trends and suggests District bankers, particularly those in the west, should consider the possible impact to their services.

SUMMARY

Through various business and banking cycles, we have witnessed the impact that environmental factors can have on bank performance and focus. As these factors change, banks must meet the new circumstances and change as well. Whether there are alterations in a bank's market composition or effects from economic fluctuations, the landscape has been and will remain dynamic. The industry's fortunes will rest to some degree on its ability to adjust to these new conditions and successfully plan ahead to meet those in the future.

This article has discussed various aspects of the environment in the Tenth Federal Reserve District, reviewing trends in demographics, economic base,

Chart 5
Population Compound Annual Growth Rate 2000-2015



Source: U.S. Census Bureau Population Projections by States

and industry structure. The growth in population in the District's western states and areas with unique attractions or market traits has been clear, with no discernible change to that pattern in sight. By contrast, the middle of the District, still dominated by agriculture and rural areas, persists in a declining trend. The District as a whole continues to show a slow evolution from a high reliance on manufacturing or agriculture in some regions to a mixture of economic bases. The banking industry has experienced an unparalleled consolidation, as financial, legal and regulatory forces have produced an environment ripe for business combinations. However, the number of physical locations for conducting bank business has had an opposite trend, and branch networks have flourished.

In addition, we have considered possible future trends in light of recent information detailing electronic banking adoption, industry consolidation, and projected demographic changes. The exact environmental future is unknown to us all. But by relying on the past as a basis to develop reasonable expectations for the future, some conclusions can be drawn. Electronic banking—relying on increasing capacity for transactional and not just informational means—is growing. Even with the recent slowdown in consolidation, some continued level of industry shrinkage appears likely. District bankers can look ahead to probable increases in both minority and older populations, as these two demographic forces continue on their paths. In summary, the environment in which District bankers operate promises continued changes and argues for attentive long-range planning to position their banks for future success.

ENDNOTES

- ¹ The Tenth Federal Reserve District consists of the states of Nebraska, Kansas, Oklahoma, Wyoming, Colorado, the northern one-half of New Mexico, and the western one-third of Missouri.
- ² The net change for counties over the last two censuses is divided into quartiles to help identify patterns emerging over larger areas. The percentages used to color code each county were based on the District's aggregate quartiles. Counties that are shaded gray were the fastest growing, showing increases of nearly 20 percent or more. Black counties reflect the other extreme, containing those with net population losses of 12.6 percent or more.
- ³ This study used both economic and demographic characteristics to identify slow-growing counties. Forest Myers and Kenneth Spong, "Community Bank Performance in Slower Growing Markets: Finding Sound Strategies for Success," *Financial Industry Perspectives*, 2003, Federal Reserve Bank of Kansas City. (http://www.kansascityfed.org/PUBLICAT/FIP/FIP_MAIN.HTM#2003).
- ⁴ Jeffrey Walser and John Anderlik, "Rural Depopulation: What Does It Mean for the Future Economic Health of Rural Areas and the Community Banks that Support Them?" *FDIC Future of Banking Study*. (http://www.fdic.gov/bank/analytical/futurefob_04.pdf).
- ⁵ The pattern of western growth apparently has continued beyond the 2000 Census period. From the Census Bureau's population estimate for the period 2000-2003, Colorado, at 5.8 percent, was the only District state to exceed the national growth rate of 3.3 percent. New Mexico was the second fastest growing state at a rate of 3.3 percent. Kansas was the slowest growing state at 1.3 percent.
- ⁶ U.S. Census Bureau, "State-to-State Migration Flows: 1995 to 2000," *Census 2000 Special Reports*.
- ⁷ William H. Frey, "Census 2000 Reveals New Native-Born and Foreign-Born Shifts Across U.S.," *PSC Research Report No. 02-520*, August 2002, Population Studies Center at the Institute for Social Research, University of Michigan.
- ⁸ The U.S. Department of Agriculture's Economic Research Service has developed a "natural amenities scale," based on a host of physical characteristics (including temperature, daylight hours, topography, etc.) that enhances the location's desirability for residency. All three western District states score highly on this scale. In addition, other scenic areas, such as the Ozarks region, score higher than much of the Midwest.
- ⁹ The national growth rate for the decade ending in 2000 was 12 percent. District state rates were: New Mexico, 30.1 percent; Colorado, 26.3 percent; Wyoming, 22.2 percent; Oklahoma, 7.5 percent; Missouri, 5.3 percent; Nebraska, 4.1 percent; and Kansas, 4 percent. U.S. Census Bureau, "The 65 Years and Over Population: 2000," *Census 2000 Brief*.
- ¹⁰ For the 2000 Census, respondents could choose to self-categorize themselves as Hispanic or Latino of any race, but "Hispanic" was not a category for racial identification. This population would then be included in available categories such as "white," "some other race," or "two or more races." Thus, "Hispanic or Latino" is treated as a characteristic of origin.
- ¹¹ Federal Deposit Insurance Corporation, Commercial Bank Reports.
- ¹² United States Department of Agriculture, "National Agricultural Statistics Services 2002 Census of Agriculture." (<http://www.nass.usda.gov/census/>).
- ¹³ This would suggest ongoing shrinkage in the farm size categories that typically are considered the more traditional family farming operations. (Calculations based on USDA Census of Agriculture, Center for the Study of Rural America, and the Federal Reserve Bank of Kansas City.)
- ¹⁴ Defined by the U.S. Department of Agriculture's Economic Research Service as those counties in which 15 percent or more of average annual labor and proprietors' earnings were derived from farming during 1998-2000 or counties where 15 percent or more of employed residents worked in farm occupations in 2000.
- ¹⁵ The 10 sectors are: agriculture, forestry, and fishing (dominated by agriculture in this District); mining; construction; manufacturing; transportation and public utilities; wholesale trade; retail trade; finance, insurance, and real estate (heavily dominated by real estate); services; and government. U.S. Department of Commerce, Bureau of Economic Analysis.
- ¹⁶ From a review of county-level data on these same sectors, government, agriculture, and services are the dominant sectors in the District. Of the 509 District counties, 174 are dominated by government, 146 are reliant on agriculture, and 100 primarily are based on a services economy.
- ¹⁷ At the regional level, the analytical picture is more complicated. Since data from quarterly Reports of Condition and Income are reported where the bank charter is located, the precise concentration level is difficult to discern. Banking assets that once were reported within the Tenth District remain in the District but are reported elsewhere.
- ¹⁸ To emphasize the recency and strength of this trend, in the five years between 1999 and June 2004, Wyoming and Colorado had the second and fifth largest percentage increases of branches in the country.
- ¹⁹ A transactional site is one in which the customer, at minimum, can access account balances through the Internet. Data were collected by visiting bank web sites. Payments System Research Department, Federal Reserve Bank of Kansas City.
- ²⁰ The respective figures for the three western states and the District aggregate at the 2000 Census were 22.7 percent and 10.5 percent. U.S. Census Bureau, "Population Projections for States, by Age, Sex, Race, and Hispanic Origin: 1995 to 2025."