Have Borrower Concentration Limits Encouraged Bank Consolidation?

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Bank consolidation has been going on for more than a decade, in part the result of legislative and regulatory changes and in part a reflection of the large number of banks that became financially troubled in the late 1980s and early 1990s. However, the rapid consolidation of institutions still continues, even though the health of most banks has improved and many states long ago liberalized regulations on intrastate branching and interstate merging. Over the past three years alone, the number of commercial and savings banks in the United States dropped from 11,491 to 10,017. This suggests that other factors may also be playing an important role.

Much of the press attention given mergers has focused on the largest depository institutions, but the perception that acquirers are predominantly very large institutions is not accurate. The most common type of merger is a combination where both the acquirer and the target are small. Such mergers have contributed to a significant shrinkage in the number of institutions with less than $100 million in assets and an increase in the numbers in larger size categories.

The large number of mergers involving target banks with assets under $100 million and the preponderance of mergers where both target and acquirer are small banks suggest that some of the merger activity may be an attempt to overcome limitations imposed by small size, such as borrower concentration limits. The fastest-growing segment of the lending market is loans over $1 million, and borrower concentration limits prevent the smallest banks from servicing such loans. This raises the possibility that weak demand for small business loans and attempts to avoid lending constraints may help explain the regional patterns in merger activities. In the New England, Middle Atlantic, and Pacific regions, where small business loans have grown more slowly than the national average, the declines in the numbers of small banks due to nonaffiliate mergers have been the greatest. This is particularly striking because these regions already had a relatively small share of small banks.

In the Midwest and the South, which have recently experienced more rapid growth in small business loans, fewer small banks have been lost due to nonaffiliate mergers.

The first section of this article examines motivations for bank mergers and considers whether patterns in bank consolidation over the past three years are consistent with those explanations. The second section examines regional patterns in the structure of the banking industry and how that structure is changing with bank consolidations. The third section reviews possible causes of regional patterns, with a particular emphasis on the importance of borrower concentration limits on bank lending and changes in loan demand. The final section considers the outlook for further bank consolidation.

I. Patterns in Bank Consolidation

Technological change, the deregulation of financial markets, the growth of nonbank financial firms, and increased direct access to capital markets by nonfinancial firms have all increased competitive pressures on banks. Relaxation of product and geographic restrictions has contributed further to structural change and evolution in the banking industry.

Motivations for Mergers

Given these pressures, many banks have turned to mergers in the hope of improving their performance and reducing their costs. Cornett and Tehranian (1992) find that merged banks outperform the industry and Whalen (1994) finds that intracompany consolidation produces positive abnormal returns. In contrast, Pilloff (1996) finds no evidence of merger-related performance improvements or abnormal returns in the aggregate, although he does find evidence in cross-sectional data suggesting that certain bank characteristics may be associated with subsequent performance improvements.

Alternatively, mergers may be motivated by efforts to diversify assets (across both products and geographic regions) in order to decrease risk, to increase size to benefit from an implicit "too big to fail" regulatory policy, and to increase market share and market power. Several studies have found that relaxation of state laws on branching and on intrastate and interstate mergers have contributed to the merger boom (see, for example, Nolle 1995). However, recent evidence suggests that increasing market power has not been an important contributor to the merger wave (see, for example, Laderman 1995).

Still another possible incentive for banks to merge, one that has received relatively little attention, is the limits on borrower concentration. Both banks' internal guidelines and varying federal and state regulations limit the size of loan that a bank can make to a single borrower, measured relative to the bank's capital. The Office of the Comptroller of the Currency (OCC) limits loans by national banks to a single borrower to no more than 15 percent of the bank's unimpaired capital and surplus for loans not fully secured by marketable collateral. For fully collateralized loans, the limit is 25 percent. Lending limits for state-chartered banks vary substantially by state, with differences in the lending limit, in the definition of a single borrower, and in the exceptions for fully collateralized loans. Even though state laws often are more liberal than the requirements for national banks, however, many banks follow self-imposed limits that are lower than those required by regulators.

The perception that acquirers are predominantly very large institutions is not accurate. The most common type of merger is a combination where both the acquirer and the target are small.

The purpose of lending limits is to ensure that a bank is sufficiently diversified that problems at a few of its major borrowers will not severely impair the bank's capital. Bank examiners do review borrower loan concentrations relative to the regulatory limits during exams. And, in fact, many bank failures can be attributed to problems with large borrowers whose indirect interests were not fully considered in limiting exposure to individual borrowers.

While lending limits are a sensible way to prevent lending concentrations that could impair the safety and soundness of a bank, an additional consequence of the lending limits is that they prevent small banks from making large loans. Over the years, the combination of lending limits and regulations that limited mergers and branching created a clientele effect, whereby small banks were forced to focus their busi-

Table 1
Accounting for the Change in the Number of U.S. Banks by Asset Class, July 1, 1993 to June 30, 1996

		Asset Class					
		<$100 million	$100 million–300 million	$300 million–500 million	$500 million–3 billion	>$3 billion	Totals
1	Banks in class June 1993	8,108	2,270	436	493	184	11,491
2	Less: Failed	18	8	3	1	0	30
3	Less: Merged with affiliate	609	295	71	71	30	1,076
4	Less: Merged with nonaffiliate	486	129	14	34	4	667
5	Less: Other	36	21	11	26	4	98
6	Less: Grew (some acquisitions)	174	110	62	35	0	
7	Less: Grew (no acquisitions)	552	157	78	10	0	
8	Less: Shrank	0	23	19	12	3	
9	Plus: De novo	177	7	2	4	1	191
10	Plus: Other	103	58	18	22	5	206
11	Plus: Grew (some acquisitions)	0	157	92	95	37	
12	Plus: Grew (no acquisitions)	0	551	147	89	10	
13	Plus: Shrank	25	23	6	3	0	
14	Banks in class June 1996	6,538	2,323	443	517	196	10,017

ness lending on small business loans. In many geographic regions, such a market structure likely would have emerged even in the absence of regulation, because of the prevalence of small businesses that valued personal lending relationships. However, in regions where the demand was disproportionately for larger loans, small banks could do little to satisfy this loan demand.

As restrictions on bank mergers and branching are eased, one might expect that geographic areas with rapid growth in the demand for large loans compared to small would also see rapid consolidation, particularly among smaller banks. Small banks might choose to merge, in this way increasing their size and easing borrower concentration constraints, in order to better serve the market segment experiencing the fastest growth.

Recent Patterns in Banking Consolidation

The merger boom in banking that began more than a decade ago has shown no sign of slowing. Table 1 shows the sources of changes in the number of commercial and savings banks, by asset class, over the past three years.[1] In all, 1,474 fewer commercial and savings banks filed call reports in June 1996 than in June 1993, despite the creation of 191 de novo banks. The decline has been relatively steady: 421 banks between June 1993 and June 1994; 552 between June 1994 and June 1995; and 501 between June 1995 and June 1996.

In contrast to the late 1980s and early 1990s, bank failure has not been an important factor in this reduction in the number of banking institutions. Over the three-year period, only 30 commercial and savings banks failed, and most (26) of these were small, with less than $300 million in assets.

Mergers with nonfailed banks as targets account for almost all of the decline in the number of institutions, with 1,743 commercial and savings banks the merger targets of other commercial and savings banks during the three-year period. Much of this consolidation reflects mergers of banks within the same holding company; over 60 percent of the mergers occurred between affiliated banks. Most of the affiliate mergers reflect intrastate consolidation, particularly of smaller entities. However, with the full implementation of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which permits full interstate branching after June 1997, nonaffiliate mergers can be expected to accelerate.[2]

[1] Only FDIC-insured commercial and state-chartered savings banks in the 50 states and the District of Columbia are included in the analysis. Special purpose entities such as private banks, industrial banks, cooperative banks, trust companies, nonbank banks, credit unions, credit card banks, bridge banks, and workout entities are excluded, as are banks located in U.S. possessions.

[2] This study examines only mergers in which the target is consolidated with the acquirer, and does not address changes in ownership in which the target is not consolidated into the acquiring institution. Once the Riegle-Neal Act is fully implemented, many of these independent subsidiaries are likely to be consolidated within the parent holding company, resulting in a wave of affiliate mergers.

As can be seen in Table 1, the decline in the number of banks is not evenly spread across asset-size classes. All of the drop in the number of commercial and savings banks has occurred among those with less than $100 million in assets, with their number declining by nearly 20 percent. In contrast, the number of banks in each of the larger size categories actually rose. The largest increase in number occurred in the $100 million to $300 million asset-size category, and the largest percentage increase (6.5 percent) occurred in the set of banks with more than $3 billion in assets.

The reduction in the number of the smallest banks occurred primarily because asset growth pushed some banks into a larger asset class (either through internal growth or through mergers) and because others were the target banks in mergers. Of the 1,570 reduction in the number of commercial and savings banks with less than $100 million in assets, 1,095 disappeared as a result of mergers, with 609 of those mergers representing consolidation within a holding company and only 486 reflecting a change of ownership.

This reduction in numbers was not offset by creation of new banks or by shrinkage of larger banks. Only 177 banks entered the smallest asset class as de novo banks and only 25 entered as a result of asset shrinkage. The wave of bank failures had ebbed by the beginning of the period, and failures accounted for the loss of only 18 banks. The "other" categories (accounting for a net addition of 67 banks to the under $100 million asset class) are composed primarily of institutions that shifted to or from an Office of Thrift Supervision charter, newly chartered institutions formed from one or more other institutions (and, thus, not included in the de novo category), and, in a few instances, institutions that underwent a voluntary liquidation.

In each of the larger asset classes, the major reason for the net increase in number was asset growth that moved banks from smaller classes, often through mergers. Relatively few banks shifted downward into a smaller asset size class. Not surprisingly, de novo entry and the "other" category accounted for few changes in the number of banks with assets above $300 million.

Table 2 shows the merger patterns based on asset size classes for both acquirer and target institutions, with each observation representing an acquirer-target pair. Most mergers involved small banks, because they make up such a large share of the total number of banks. Most small banks were acquired by other small banks or by medium-sized banks. Larger banks (assets greater than $500 million) accounted for under 30 percent of acquisitions of small banks, even though they were the acquirers in 70 percent of the remaining mergers. And of the 1,034 banks with less than $100 million in assets that were acquired, only 10 percent were acquired by banks with more than $3 billion in assets, even though these largest banks were acquirers in over 20 percent of all mergers.

The prevalence of both acquirers and targets with less than $100 million in assets is consistent with the hypothesis that small banks merge in order to be able to service larger loans.

The last column of Table 2 reports the percentages of commercial and savings banks in each asset size class, as of June 30, 1993, that were merged into other commercial and savings banks during the subsequent three-year period. While the absolute number of acquired banks in the smallest asset size class easily overwhelms the number in any other size class, that same group represents the smallest number when measured as a share of the banks in the asset size class.

The bottom two panels of Table 2 describe the patterns in merger activity separately for affiliate and nonaffiliate mergers, again by asset size classes. While 62 percent of mergers were between affiliates, the proportion of affiliate versus nonaffiliate mergers also varied by bank size. Small banks played a larger role in mergers involving nonaffiliated banks than in mergers of affiliates. Of the affiliate mergers, 53 percent had targets with less than $100 million in assets compared to 72 percent for nonaffiliate mergers. Also, acquirers with less than $100 million in assets comprised only 18 percent of the affiliate mergers, compared to 26 percent of nonaffiliate mergers.

The prevalence of both acquirers and targets with less than $100 million in assets is consistent with the hypothesis that small banks merge in order to be able to service larger loans. The greater importance of mergers among small, nonaffiliated banks may reflect the limited lending options available to them. Small banks with much larger affiliates can refer loans to affiliates not constrained by borrower concentration lending limits, while small banks with no affiliates

Table 2
Merger Activity by Commercial and Savings Bank by Asset Size, July 1, 1993 to June 30, 1996
Number of Banks

Asset Size of Acquired	Asset Size of Acquirer: <$100 million	$100 million–300 million	$300 million–500 million	$500 million–3 billion	>$3 billion	Total	Percent of Asset Size Class Acquired
Total Mergers							
<$100 million	340	313	87	192	102	1,034	12.8
$100–300 million	23	63	51	157	145	439	19.3
$300–500 million	3	3	12	38	41	97	22.2
$500 million–3 billion	0	1	5	35	72	113	22.9
>$3 billion	0	0	0	4	31	35	19.0
Total	366	380	155	426	391	1,718	15.0
Affiliate Mergers							
<$100 million	174	175	48	110	55	562	
$100–300 million	17	59	39	101	93	309	
$300–500 million	3	3	11	30	31	78	
$500 million–3 billion	0	1	4	32	46	83	
>$3 billion	0	0	0	3	28	31	
Total	194	238	102	276	253	1,063	
Nonaffiliate Mergers							
<$100 million	166	138	39	82	47	472	
$100–300 million	6	4	12	56	52	130	
$300–500 million	0	0	1	8	10	19	
$500 million–3 billion	0	0	1	3	26	30	
>$3 billion	0	0	0	1	3	4	
Total	172	142	53	150	138	655	

cannot make such large loans unless they can participate them out to larger, unaffiliated banks.

II. Regional Patterns in Bank Consolidation

Differences in the structure of the banking industry across geographic regions of the country also may affect regional bank consolidation patterns. These differences stem both from specialization strategies of banks and from variations in the composition of loan demand across regions. Regions that are more rural, with mostly small businesses, are more likely to be serviced by small banks with strong local ties. Regions with large industrial companies are more likely to require the services of large, globally active banks that can provide a wider range of services. Trading operations, derivatives activity, and international operations, for example, are generally conducted by the largest institutions, since they require economies of scale and scope for the bank to provide the service effectively. Because smaller banks tend not to provide such services, they may be at a competitive disadvantage in attracting the business of larger customers, particularly those that value services besides loans.

Table 3 highlights the differences across Census regions in the numbers of banks, disaggregated by asset size class, as of June 30, 1993. In the New England and the Middle Atlantic regions, banks with assets under $100 million account for approximately one-third of banks. In contrast, the West North Central, West South Central, and Mountain regions have more than 75 percent of their banks in this smallest asset size class. The general pattern across the country is that small commercial and savings banks account for the smallest percentage of institutions in the Northeast, a somewhat greater share in the Pacific states, and much larger shares in the rest of the country.

Figure 1 shows that a pattern similar to that for

Table 3

Number of Banks by Asset Size Class and by Census Region, June 30, 1993

	Census Region									
Number of Banks	New England	Middle Atlantic	South Atlantic	East North Central	West North Central	East South Central	West South Central	Mountain	Pacific	Total
Total Banks	392	662	1,464	2,187	2,732	890	1,905	694	565	11,491
By Bank Asset Size:										
<$100 million	117	231	956	1,458	2,377	636	1,485	538	310	8,108
$100 million–300 million	163	231	321	504	271	194	331	106	153	2,274
$300 million–500 million	40	64	63	103	44	28	40	15	39	436
$500 million–3 billion	58	92	86	95	32	19	40	24	44	490
$3 billion or more	14	44	38	27	8	13	9	11	19	183

the geographic distribution of small banks held for the distribution of small business loans as of June 30, 1993, when small business loan data first became available. Banks in the New England, Middle Atlantic, and Pacific regions had a smaller percentage of small business loans compared to those in the South and the Midwest.[3] Loans of $1 million or less accounted for only 27 percent of domestic business loans in the Middle Atlantic region, but 71 percent in the Mountain region, for example.[4]

Such regional differences in both the composition of business loans and the composition of commercial and savings banks by size suggest that policies that affect bank consolidation will likely have very uneven geographic effects. In general, large banks and large loans are relatively more prevalent in the Northeast and along the West Coast, and smaller loans and smaller banks are more prevalent in the South and the interior of the country. Because small banks are constrained by borrower concentration limits, it should not be too surprising to observe such similarities in the regional concentrations of small banks and small loans.

The top portion of Table 4 shows the patterns of changes in the number of commercial and savings banks during the June 1993 to June 1996 period, disaggregated by Census region. Each region experienced a decline in the number of banks, with the declines ranging from 9.6 percent to 22.2 percent. In each region, mergers were the dominant cause of the shrinkage, with de novo entry and the net contributions from the "other" category, related primarily to changes to and from Office of Thrift Supervision charters, doing little to offset the shrinkage.

The relative numbers of banks disappearing as a result of affiliate and nonaffiliate mergers differ sharply across regions. In the New England, Middle Atlantic, West South Central, and Pacific regions, more banks were absorbed by nonaffiliate mergers than by affiliate mergers. In the remaining five regions, consolidations within bank holding companies accounted for the majority of mergers. The number of nonaffiliate mergers in New England was more than double that of affiliate mergers, while the number of affiliate mergers in the East North Central region was almost five times that for nonaffiliate mergers.

The lower portion of Table 4 shows, for each Census region, the percent shrinkage in the number of banks during the three-year period; the percentage of banks that disappeared owing to mergers, both affiliate and nonaffiliate; and the shares of banks with less than $100 million and less than $300 million in assets as of June 30, 1993. As already noted, small banks dominate the merger picture. Nonetheless, while most of the commercial and savings banks acquired through mergers have less than $300 million in assets (see Table 2), regions with a large number (or share) of

[3] Beginning with the second-quarter 1993 bank Call Reports, federal regulators have been required to collect information annually on small business loans. Banks are asked for data on two types of nonfarm business loans—nonfarm, nonresidential real estate loans, and commercial and industrial loans—in three size categories: $100,000 or less, more than $100,000 through $250,000, and more than $250,000 through $1 million. Unfortunately, the size of the loan, rather than the size of the business borrower, is used to define small business loans. However, for small loan sizes, it is likely that using the size of the loan to define small business lending is satisfactory.

[4] Patterns for business loans of $250,000 or less are similar, accounting for only 13 percent of bank business loans in the Middle Atlantic region, but 50 percent in the Mountain region.

Figure 1

Percent of Domestic Business Loans under $1Million by Census Region as of June 30, 1993

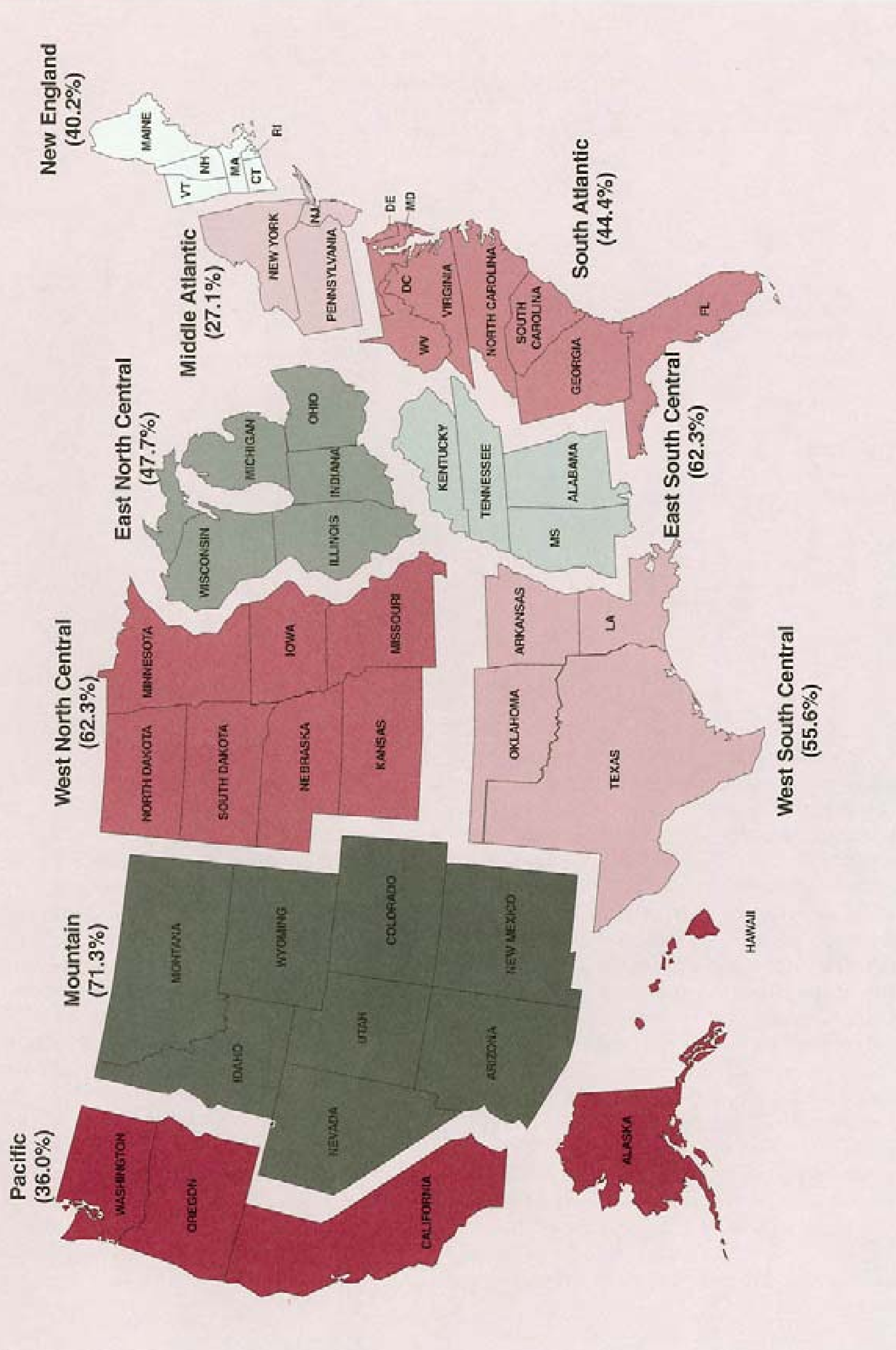

Table 4

Accounting for the Change in the Number of Banks by Census Region, July 1, 1993 to June 30, 1996

	Census Region[a]									
	New England	Middle Atlantic	South Atlantic	East North Central	West North Central	East South Central	West South Central	Mountain	Pacific	Total[a]
Banks in Region, June 1993	392	662	1,464	2,187	2,732	890	1,905	694	565	11,491
Less Failed	5	1	1	0	1	0	5	0	17	30
Less: Merged with Affiliates	15	53	145	278	222	88	98	149	28	1,076
Less: Merged with Nonaffiliates	38	62	124	60	101	37	160	34	51	667
Less: Other	9	15	43	12	10	1	1	6	10	107
Plus: De Novo	4	7	33	46	30	26	6	26	13	191
Plus: Other	7	34	32	80	10	15	20	8	9	215
Banks in Region, June 1996	336	572	1,216	1,963	2,438	805	1,667	540	481	10,017
Percent Shrinkage	14.3	13.6	17.0	10.2	10.8	9.6	12.5	22.2	14.9	12.8
Percent Merged	13.5	17.4	18.4	15.5	11.8	14.0	13.5	26.4	14.0	15.2
Affiliate Mergers	3.8	8.0	9.9	12.7	8.1	9.9	5.1	21.5	5.0	9.4
Nonaffiliate Mergers	9.7	9.4	8.5	2.7	3.7	4.2	8.4	4.9	9.0	5.8
Percent < \$100 million Assets	29.8	34.9	65.3	66.7	87.0	71.5	78.0	77.5	54.9	70.6
Percent < \$300 million Assets	71.4	69.3	87.2	89.7	96.9	93.3	95.3	92.8	81.9	90.3

[a]The totals for the "Other" categories differ from the totals in Table 1 because this category now also includes banks that shifted their headquarters from one Census region to another. There are nine such instances.

small banks did not necessarily experience higher rates of decline in the number of banks or a higher rate of acquisition through mergers. Of the four Census regions with the largest shares of small banks (each with over 90 percent of their banks having assets less than $300 million), only the Mountain region had a rate of bank shrinkage above the national average and an above-average rate of banks lost because of mergers. It was the regions with the smallest shares of small banks that tended to experience the greatest shrinkage in banks and the largest shares of banks lost to mergers.

When the mergers are broken out into affiliate and nonaffiliate mergers, more consistent regional patterns emerge. Nonaffiliate mergers are most prevalent in the New England, Middle Atlantic, and Pacific regions, which also have below-average percentages of affiliate mergers and the smallest percentages of small banks. In contrast, affiliate mergers have been most prevalent in the Mountain and East North Central regions, areas with a relatively small percentage of nonaffiliate mergers and a relatively high proportion of small banks.

The data on affiliate mergers are greatly affected by changes in a relatively few states. For example, of the 149 affiliate mergers in the Mountain region, 101 were in Colorado and 59 were consummated by just three acquiring banks. In the East North Central region, 128 of the 278 affiliate acquisitions occurred in Illinois. Colorado forbids statewide branching, and Illinois only removed statewide branching restrictions in 1993. Thus, a significant proportion of the affiliate mergers likely still reflect residual effects of restrictive branching and merger laws.

While no simple pattern emerges relating the share of small banks in a region to the degree of shrinkage in numbers or the share of banks lost due to mergers, it does appear that having a small share of small banks is correlated with having a high percentage of nonaffiliate mergers. This suggests an economic rationale for the relatively large numbers (and share) of small banks in particular Census regions, perhaps related to the presence of a relatively large number of smaller firms and thus a larger proportion of loan demand composed of smaller loans.[5]

The important points here seem to be that during

[5] See, for example, Carlino and DeFina (1996) for a discussion of the role of such regional differences in the mix of large and small borrowers in the context of the effectiveness of monetary policy.

the three-year period, the bulk of the shrinkage in number of banks has occurred among the smaller banks; that the shrinkage in the number of banks has occurred across all Census regions; and that no simple relationship can be seen between the degree of shrinkage and the share of small banks in a region, suggesting that many banks may be (and intend to remain) small banks by choice. Large numbers of quite small banks remain. In this regard, several studies have concluded that small banks may have little to fear from a wave of bank consolidation. (See, for example, Calem 1994; Moore 1995; Nakamura 1994; and Robertson 1995.)

III. Borrower Concentration as a Factor in Regional Consolidation

The previous section highlighted the substantial regional differences in the composition of banks by size and in the patterns of bank consolidation. An extensive literature has examined the influence of state legislation on the organizational structure of banks, but most studies have not examined the role of borrower concentration limits. Borrower concentration limits are likely to be most binding in areas where the composition of banks no longer corresponds to the composition of loan demand by borrowers. An example would be a region with many small banks, possibly because of branching and merger restrictions, that has an industrial structure dominated by rapidly growing, larger firms. Small banks, unable to satisfy the loan demand of these larger firms because of borrower concentration limits, would have a strong incentive to acquire other banks in order to become large enough to service those larger borrowers.

The upper panel of Table 5 lists some of the characteristics that might be important in describing regional bank consolidation patterns, if lending limits matter. Regions with relatively few small banks, such as New England and the Middle Atlantic, tend to have a low percentage of small business loans and high population density. Regions with high population density are also likely to have a greater number of large firms, while less densely populated regions can be more easily serviced by small banks that do not offer some of the more sophisticated services sometimes required by large companies. Because population density numbers can be distorted when a region is composed of a mixture of very high density metropolitan areas and very sparsely populated nonmetropolitan areas (for example, the Pacific region's population density jumps from 46.1 per square mile to 125.2 when Alaska is omitted), we also include a measure of the percentage of a region's population living in metropolitan areas. By this measure, the Pacific region also falls into the group with relatively few small banks, a small share of small business loans, and a high population density. In contrast, states with a high percentage of small banks, such as those in the West North Central and Mountain regions, tend to have a high percentage of small business loans and a low population density.

Borrower concentration limits are likely to be most binding in areas where the composition of banks no longer corresponds to the composition of loan demand by borrowers.

The second section of Table 5 shows that the highest rate of merger acquisitions of nonaffiliated banks with under $100 million in assets occurred in the New England and Middle Atlantic regions, regions that already had the smallest shares of small banks. Banks in these two regions had the slowest growth in small business lending, a decline of 8.4 percent in New England and growth of only 0.2 percent in the Middle Atlantic, while small business loans at banks nationwide grew by 12.3 percent. New England and the Middle Atlantic are also the regions of the country with the slowest population growth, providing fewer opportunities to create the new small businesses that are the focus of community bank lending. The decline in New England is particularly striking, because it was accompanied by a 22.7 percent increase in loans of more than $1 million. With little demand for small business loans but substantial growth in the demand for large business loans, small banks may seek merger partners so that they can service the most rapidly growing segment of the market.

The regions with the lowest rates of nonaffiliate mergers of small banks, the East North Central, West North Central, and East South Central, also had small business loan growth rates above the national average. These regions provide ample opportunity for small

Table 5
Factors Affecting Small Bank Consolidation

	Census Region									
	New England	Middle Atlantic	South Atlantic	East North Central	West North Central	East South Central	West South Central	Mountain	Pacific	Total
Percent Banks < $100 million Assets	29.8	34.9	65.3	66.7	87.0	71.5	78.0	77.5	54.9	70.6
Percent Banks < $300 million Assets	71.4	69.3	87.2	89.7	96.9	93.3	95.3	92.8	81.9	90.3
Percent Loans ≤ $1 million	40.2	27.1	44.4	46.7	62.3	62.3	55.6	71.3	36.0	42.8
Population per Square Mile, 1993	210.7	382.5	171.8	176.4	35.6	87.9	65.6	17.3	46.1	72.9
Percent Metropolitan Population	84.1	87.6	78.4	79.5	58.8	56.8	76.4	70.6	91.6	79.7
Percent Merged Banks < $100 million Assets	15.4	16.0	16.7	12.5	11.1	12.4	12.2	24.9	13.2	13.5
Affiliate Mergers	1.7	4.3	6.9	9.3	7.2	7.7	4.3	19.5	2.3	7.5
Nonaffiliate Mergers	13.7	11.7	9.8	3.2	3.9	4.7	7.9	5.4	11.0	6.0
Percent Merged Banks < $300 million Assets	10.4	15.7	18.3	14.6	11.7	13.7	13.3	26.4	13.4	14.6
Affiliate Mergers	1.1	5.7	8.9	11.7	8.0	9.3	4.8	21.3	3.9	8.7
Nonaffiliate Mergers	9.3	10.0	9.3	2.9	3.7	4.5	8.5	5.1	9.5	5.9
Percent Change Loans ≤ $1 million	−8.4	.2	19.0	12.8	21.1	24.3	21.7	4.9	10.4	12.3
Percent Change Loans > $1 million	22.7	.1	37.3	50.0	47.4	42.3	62.7	117.9	22.7	28.0
Percent Change in Population, 1990–1994	.5	1.4	6.5	.8	3.1	4.7	6.4	11.4	6.4	4.7

community banks to flourish, and their size does not prevent them from growing internally. However, many of these Midwestern and Western states have above-average rates of affiliate mergers, possibly reflecting a desire to restructure within the bank holding company before making new acquisitions of nonaffiliate banks.

IV. Conclusion

The consolidation boom continues, and it is likely to be further enhanced by full implementation of the Riegle-Neal Interstate Branching Act. Initially nonaffiliate mergers may slow, as banks devote management time and resources to consolidating internally, but in time the Act probably will result in substantially fewer institutions. It remains to be seen whether the consolidation will result mainly in a reduction in the number of small banks or will reduce the number of medium-sized banks as well.

Consolidation over the past three years has depleted primarily the numbers of the smallest banks. The ranks of small banks also have been reduced through growth, in part because many small banks have been acquirers. It has been common for small banks to merge to create one medium-sized bank. This explains why the ranks of medium-sized banks have not been depleted, despite many being merger targets.

One incentive for small banks to merge is that borrower concentration limits preclude them from making large loans. While this is not much of an impediment in regions of the country with substantial growth in small business loan demand, in regions with stagnant or declining small business loan demand it creates an incentive to seek growth through mergers. New England provides a good example of this phenomenon. Despite already having the smallest percentage of small banks of any region, New England has experienced the highest percentage of nonaffiliate merger acquisitions of banks with less than $100 million in assets. Slow growth of small business loans, despite rapid increases in large loans, is likely to provide a further incentive for small banks in this region to merge.

Regional patterns of consolidation are likely to continue to vary, as long as the composition of borrowers differs across regions. If anything, the pattern has been for regions to diverge further in terms of the share of small banks, as the rate of small bank shrinkage through nonaffiliate mergers has been relatively greater in those regions where small bank shares were already the smallest.

At the same time, small banks remain prevalent in the interior of the country, where states are less populated and small business loans account for a larger percentage of total business lending. Unless the industrial structure of the borrowing firms changes, small banks are likely to remain an important segment of banking in those more rural areas. In areas such as New England and the Middle Atlantic states, weaker loan demand for small relative to large business loans is likely to continue to encourage small banks to seek new opportunities through mergers.

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