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The Role of Community Banks in Rural Indiana

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Introduction

Imagine your local community, or your whole county, without a full-service bank or even a bank branch. Although such a situation might be difficult for many rural Indiana residents to imagine, it is a distinct possibility. In fact, that possibility has already become reality in some counties in rural America. Approximately 40% of low-population, completely rural counties in the United States do not have a bank branch located in the county (Ellinger, 2012). Two overarching factors will likely determine if that outcome becomes a reality for rural Indiana counties.

First, as discussed in Population Trends in Rural Indiana (Waldorf et al., 2012), rural counties are usually characterized by slow, or even declining, population growth. Such a trend usually results in slow bank deposit growth, which has a negative impact on the feasibility of operating a full-service bank or bank branch profitably.

Second, the delivery means used to provide financial products and services to the residents of those rural counties are changing. The financial needs of technology-oriented customers are often satisfied by mobile or online banking, and the need for a brick and mortar facility is almost nonexistent. On the other hand, there is a more affluent, but decreasing, percentage of rural Indiana residents who still desire a community bank or the branch of a larger bank located in the county.

The major issue for community banks located in rural Indiana counties for the foreseeable future is how to profitably deliver financial products and services in a manner that satisfies the financial needs of both segments of the market. To further complicate that issue is the fact that the population of many of those counties may be declining.

Background

Historically, the financial needs of most rural Indiana communities have been satisfied by locally owned, full-service community banks or savings institutions, a branch of a larger bank headquartered in an urban area, or both. However, a brick and mortar facility brings with it fixed costs (e.g., depreciation on buildings and equipment, salaries, etc.) that need to be spread over a large volume of business to be cost-effective and result in a profitable business. As fixed costs increase, there must be a corresponding increase in the volume of business to offset those costs. Passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act will result in additional bank oversight, which will translate into higher fixed costs regardless of what else occurs in the foreseeable future (Dodd-Frank Progress Report, 2013).

The issue of rural depopulation and the implications for delivering financial services is neither new nor unique to Indiana. It was addressed in detail in a

The Rural Indiana Issues Series

Audience: Local and state leaders who work with rural communities.

Purpose: To find data about issues of concern in rural communities and to interpret that data in meaningful ways to aid in decision-making.

Method: Federal Deposit Insurance Company, Summary of Deposits, June 30, 2011 data analyzed across the county groupings—rural, rural/mixed, urban.

Potential Topics: Demographic changes, business development, health, health care, local government, taxes, education, agriculture, natural resources, leadership development, etc.

Outcome: Better, more informed decisions by rural decision-makers.

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2004 article published in the FDIC Banking Review (Walser and Anderlik, 2004). Although the implications discussed in that article are aimed primarily at the Great Plains states, due to a higher rate of depopulation in that region than in other regions of the country, the current situation in some rural Indiana counties is similar.

Counties experiencing depopulation are losing a demographic battle on two fronts. First, there is a disproportionate number of elderly citizens who remain in the county. Second, those counties are losing well-educated, younger people of working age (Walser and Anderlik, 2004). However, the younger people who remain in those counties often desire to receive bank products and services through electronic delivery.

Financial Needs of Rural Community Residents

Rural Indiana residents' needs for financial services are in a state of transition, as is the case across the country. As previously stated, many younger, technology-oriented residents can satisfy their need for financial services through online or mobile banking technology. A 2012 survey conducted by the Board of Governors of the Federal Reserve found that 95% of individuals who are ages 18 to 24 have a mobile phone and that 49% have a smartphone (Gross et al., 2012). Nearly 21% of mobile phone owners used mobile banking during the past 12 months, an additional 11% report they will definitely or probably use it in the next 12 months, and an additional 17% reported they will use it at some point in the future. Consequently, there is essentially no need to provide a brick and mortar facility in a rural county to satisfy the financial services needs of that segment of the market.

However, there is a segment of the market in rural counties that prefers a bank or bank branch be located in the county to provide financial products and services. They want that financial institution to not only accept deposits, but also to perform important roles as providers of relationship-based and information-intensive banking services. There are two primary consumers of such products and services: small businesses, including some family farms, and depositors of low to moderate wealth (Keeton et al., 2003).

The owners of many small businesses, including some agricultural businesses, want loan officers to take into account a wide variety of factors when considering loan requests, including the character of the borrower and local market conditions. This is in contrast to large, money center banks that tend to rely more on credit scoring models when considering loan requests to smaller businesses. Furthermore, loans to small businesses often require close, long-term relationships with the borrower, which requires cost increasing time and effort (Hoeing, 2003).

Depositors of low and medium wealth may also desire a relationship with a financial institution. These depositors may desire individual customer service for specialized financial products. However, specialized legal, investment, tax, trust, or other financial services needed by those customers usually require expertise in areas such as estate planning, tax management, investment advisory services, etc. Staffing costs typically represent 75-80% of a trust department's operating budget (Larrabee, 2006). The cost of providing such services may be beyond what can profitably be offered by some locally owned community banks. Consequently, some of those potential trust customers may already be using the services at specialized financial services firms or from larger commercial banks headquartered in urban areas, depending on the size of the locally owned community bank.

Current Deposit Market in Indiana Counties

A review of the current market situation in terms of potential deposits provides a context for discussing the capacity of community banks to provide the services discussed above. Total deposits available in urban Indiana counties ($64.873 billion) are nearly three times that of rural/mixed counties ($21.877 billion) and more than five times that of rural counties ($12.430 billion) (Table 1). Average deposits per county in urban counties ($3.8 billion) are more than five times that of rural/mixed counties ($663 million) and nearly 13 times that of rural counties ($295 million).

Table 1. Deposit Distribution Among Indiana Urban, Rural/ Mixed, and Rural Counties, June 30, 2011

(Billions)			
County Category	**Total Deposits**	**Avg. Deposits Per County**	**Avg. Deposits per Branch per County**
Urban	$64.873	3.816	$0.048
Rural/Mixed	21.877	0.663	0.034
Rural	12.430	0.295	0.032

Source: *Federal Deposit Insurance Corporation, Summary of Deposits, June 30, 2011.*

Although it may be desirable from the perspective of some residents of rural counties to have a locally owned community bank in the county, the trend is to fewer of them. In 2001, 36 of the 42 rural counties in Indiana had at least one locally owned community bank in the county. In 2011, that number had declined to 23. Of the 35 locally owned community banks located in those 23 rural counties, the average size in terms of deposits was $110 million. Furthermore, of the 35 locally owned banks, 20 had total deposits less than $100 million, and the average deposits for those smaller banks were only $66 million. The average bank size for the remaining 15 locally owned banks, which had total deposits greater than $100 million, was $180 million (FDIC Summary of Deposits).

Another designation used to sort commercial banks in rural areas is "agricultural banks," which are defined as commercial banks in which the agricultural loan concentration is higher than the agricultural loan concentration for all commercial banks. In 2011, there were 24 agricultural banks in Indiana, of which all but two were smaller than $350 million in total assets. Total assets for the two larger banks were $1,108 and $518 million. Both were headquartered in rural/mixed counties, but both had branches in rural counties. Average total assets for the 20 agricultural banks located in, or that had branches in, a rural county were $223 million, and six of the 20 had total assets less than $100 million. Average total assets for the 18 agricultural banks with total assets less than $350 million and located in rural counties were only $158 million (FDIC Summary of Deposits).

Hence the number of locally owned community banks in rural Indiana counties is decreasing, and the size in terms of deposits of those remaining is often insufficient to cost-effectively provide many of the products and services desired by the residents of rural counties who want a brick and mortar facility to be located in the county. The legal lending limit of those banks is often below what would be needed for some small businesses and many commercial farmers. Furthermore, the bank size would be below what would justify a trust department that could offer many of the sophisticated financial services needed to adequately service the accounts of low to medium wealth customers. The products and services needed to service some of those small businesses and low and medium wealth customers may already be provided by branches of larger commercial banks headquartered in rural/mixed or urban counties.

In order for a commercial bank or savings institution located in an urban county to locate full-service branches in a rural community, there must be the potential to grow to a scale of operations that will enable the lending institution to operate them profitably. That scale is different for each institution due to the fixed and variable costs specific to the particular institution. However, one study conducted on the amount of deposits needed for a bank branch to breakeven by the end of the first five years of operation found the breakeven amount to be $40 million (Manning, 2009).

The average branch size in deposits for urban Indiana counties is over $48 million, compared to $34 million for rural/mixed counties and $32 million for rural counties (Table 1). Eight of the 17 urban counties (47%) have an average branch size in excess of $40 million, compared to only five of the 33 rural/mixed (15%) and seven of the 42 rural counties (17%). Consequently, it is difficult for a commercial bank or savings institution to justify operating a full-service branch in many rural counties when the size will likely be below what the institution needs to profitably operate the branch. The justification becomes more difficult if the population growth in that county is stagnant or declining.

Computer Adoption and Internet Usage

In the 2004 article on the future of banking in rural America, one of the implications of depopulation was the need for increased use of the Internet in rural America to deliver bank products and services (Walser and Anderlik, 2004). For that implication to become a reality, the adoption of computers and the use of the Internet must continue to increase over time, which has been the case.

Two surveys conducted by the U. S. Department of Commerce demonstrate this. In 2000, it was found that about 54% of the U. S. population used a computer at least occasionally and 90% of children between the ages of five and 17 were computer users (Batte, 2004). A similar survey conducted in October 2010 found 77% of U.S. households had a computer and more than 68% of households used broadband Internet access service, up from 64% the previous year. Approximately 80% of households had at least one Internet user, either at home or elsewhere (Economics and Statistics Administration, 2011).

Computer adoption and Internet use are not only increasing across the U.S. in general, but are also increasing in rural areas of the Corn Belt, particularly by commercial farmers. A 2003 survey of Ohio farmers with gross sales greater than $40,000 found computer adoption and Internet use were increasing among all farmers surveyed, with over 44% of those farmers reporting they used a computer for some aspect of their businesses, which was an increase from 32% in 1991. For farmers with gross sales $250,000 to $499,999 and over $500,000, computer usage percentages were 56 and 72%, respectively. Of those farmers who used the computer in their businesses, 29% used online banking or bill paying. Hence, as early as 2003, nearly three out of 10 farmers were already using online banking.

A 2012 survey conducted by the Board of Governors of the Federal Reserve System found mobile banking use to be more popular with younger customers, while online banking was used more by older age groups. Individuals between ages 18 and 29 accounted for approximately 44% of mobile banking users, while individuals 60 and over accounted for only 6% of all mobile banking users. However, 30% of customers who used online banking were between ages 30 and 44, while 20% were 60 and older (Gross et al., 2012).

Further evidence of the interest bank CEOs have in implementing electronic delivery means for bank products and services is provided by a 2012 survey of bank CEOs. All bank CEOs surveyed managed banks with average total assets of $540 million and were asked about their interest in implementing five technology-related delivery channels during the next 18 months. CEOs could select from five levels of interest: no interest, low interest, neutral, some interest, and very interested. More than 50% of the CEOs selected some interest or very interested for mobile banking (79%), Web/online products (76%), social networks (59%), and I-Pads (58%). Some interest or very interested were selected by only 23% of CEOs for branch video technology.

However, the average size for the 20 agricultural banks located in, or with branches in, rural counties was $223 million in total assets, including the two large banks. Excluding the two large banks, the average size was only $158 million (FDIC Summary of Deposits). When the results for the CEOs surveyed were sorted by size, results reported for smaller banks, with average total assets of $186 million, were similar to those of all banks surveyed. Again, over 50% of CEOs surveyed from smaller banks selected some or very interested for mobile banking (75%), Web/online products (72%), I-Pads (66%), and social networks (53%). Again, interest in branch video technology was last among the choices (14%) (CEO Survey, 2012).

What Are the Implications?

Implications are not very heartening for those rural residents who strongly prefer a bank or bank branch be located in their county to provide financial products and services.

The current average deposit volume for rural Indiana counties is smaller than in either rural/mixed or urban counties. With declining populations in many rural counties, the likelihood that volumes will increase in the future is questionable. In addition, only 23 of the rural counties currently have a locally owned community bank in the county. The average size in deposits of those 35 banks is $110 million, with 20 below $100 million in total deposits. That scale is too small to provide many of the products and services desired by small businesses, commercial farmers, and low and medium wealth residents who desire a bank or branch to be located in the county.

In addition, 19 rural Indiana counties already have their financial product and service offerings determined by an entity headquartered outside the county and in several cases outside the state. The average branch size for rural counties is only $32 million, which is below the size necessary for a branch to operate profitably. So the potential deposit growth needed to justify additional bank branches does not seem likely in the foreseeable future, especially in those counties with declining populations. On the contrary, the trend in the foreseeable future will likely be to decrease the number of bank branches in those counties through competitor purchase, consolidation, or closure.

Consequently, the financial service needs of residents of rural counties will likely be increasingly met through electronic delivery means rather than through additional locally owned community banks or bank branches. The implications for rural counties in Indiana are likely to be similar to the findings reported in the 2004 study on the future of banking in rural America. The adoption of computers and the use of the Internet will enable community banks to expand their customer base and deliver financial products and services to rural counties where locating a branch would never be feasible (Walser and Anderlik, 2004). The situation in rural counties in Indiana appears similar.

The transition in the foreseeable future toward mobile and online products and away from brick and mortar facilities provided by community banks or bank branches appears to be underway. However, the move toward more technologically oriented financial products and services will likely be gradual in order to continue to satisfy the needs for as long as possible of the declining, but influential, segment of the market that desires a brick and mortar facility. The transition will likely be implemented through reduced hours and services provided at fewer local banks and branch locations. Financial incentives (e.g., enhanced services, fees, etc.) will likely be provided to customers to move to online or mobile banking as well as other cost-effective banking services during the transition period.

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