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Banking and Its Impact on local Consumers

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ABSTRACT

The banking industry has undergone profound changes during the last five years. The most obvious change has been the large number of bank mergers, which have increased both the average size of banks and the area over which they operate. Other changes are the growth of Internet banking, combination of banking with other financial services, such as insurance and securities underwriting. The implications of these changes for the profitability and safety of banks have been widely discussed, but what do they mean for Indian economies? Some says that the changes will benefit most communities by increasing the public's access to financial services and making it easier for banks to continue lending during regional economic downturns. Others says that the changes will end up hurting many communities, especially smaller ones, because the large organizations created by mergers will be uninterested in serving small customers and will siphon off funds from smaller markets to lend in big cities. Thus the paper focuses on the two aspects that are consumers and small businesses. On studying different reports & surveys we found that these groups relied heavily on local banks for their credit and payments needs. Thus these groups most affected by any changes in local banking practices resulting from consolidation, Internet banking, or financial integration. A further reason for focusing on small businesses is that these enterprises play an especially important role in the economic performance of smaller communities and local economy. Thus we concludes that the recent changes in banking are likely to benefit consumers and small businesses in most communities, as long as they remain free to choose between small and large banks for their banking services. The first section of the article reviews the three major changes in the banking system, 2nd sections argue that these changes are likely to benefit both consumers and small businesses, provided small banks are available to fill any gaps in service or credit to smaller customers, and the last section concludes that small banks face a major but not intractable obstacle in continuing to fill this role.

Keywords: 1. Merger 2. Acquisition 3. Consumer 4. Banking

While always in a state of flux, the nation's banking system is now undergoing what is arguably the greatest transformation since the last depression. This change has taken three forms. First, banks have merged at an unprecedented pace during the last ten years. Second, new legislation has opened up the doors to combining banking with other financial services. And third, banks and other financial companies have begun to offer their services over the Internet. In assessing what these changes mean for local economies, this article has focused on the two groups that are most likely to be affected—consumers and small businesses.

I BANK MERGER

The objective of merger is to assess whether the merger could create or facilitate the exercise of market power. The division will analyze the impact of the range of products and services provided by banks in particular geographical areas[1]. It includes deposits, loan and investment and trust services sold to retail consumers, deposits, loans and various other services, including cash management services sold to businesses, and correspondent services, such as check clearing and foreign exchange services sold to other banks. Suppose small business needs loans for working capital and if merged banks tries to raise its prices, now if small business has other alternatives of getting loan than merged bank, then we won't be concerned from an antitrust perspective otherwise we have to be concerned about the merger.

Bank mergers affects lesser to competition in products and services provided to retail consumers as opposed to business consumer because retail consumers typically have local banking alternatives, like other banks, thrifts and credit unions sufficient to prove of the creation or exercise of market power such competitive concerns, targeted divestitures protect retail consumers.

It is clear that competitive concerns exists, so it is to the availability of banking services, including loans and credit, to small and medium size businesses, such as lines of credit for business start up and working capital purposes that may not attract neither in region thrifts or credit unions nor banks located in their regions[2]. These businesses tend to have to rely on local commercial banks for such credit. Thus a merger between two of only a few local commercial banks in a particular market could raise competitive concerns.

According to Fed[3] "Banking consolidation has led to a higher nationwide shares, such as measured by assets, of the largest institutions in the past fifteen years, concentration in local geographical markets has remained roughly constant". This is because of antitrust enforcement by the banking agencies and the antitrust division new entry into banking markets, and the fact that these mergers did not involve competition. Another effect of the mergers has been a sharp increase in multistate banking. Some mergers took advantage of new laws allowing banks to expand within and across state lines. Other mergers were undertaken to cut costs, although the evidence suggests they failed to achieve that goal more often.

II FINANCIAL INTEGRATION

Any nation's economic vitality depends upon the financial soundness and competitive structure of the banking industry it is the credit provided by that industry to consumers and businesses that helps the free market engine run smoothly. Experiences have shown that where there are competing sources of credit, the price of credit is lower than its availability is greater; it brings greater innovation and better quality financial services. The final often-cited change in the banking system is the least certain— the spread of diversified financial firms offering a wide array of services, such as insurance and securities underwriting in addition to traditional banking e.g. City Group and Travelers group , banks and insurance companies, banks and real estate agencies etc.

The passage of GLBA makes it easier for banking organizations to provide consumers with other financial services besides banking. Some of these services, such as the opportunity to purchase life insurance and property and casualty insurance, are currently provided by insurance companies and insurance agents. Other services, such as the ability to buy and sell individual stocks and shift funds into and out of mutual funds, are now provided by brokerage companies.

Allowing all these services to be provided by the same company could benefit consumers in two possible ways—through synergies on the production side or synergies on the consumption side[4]. Production synergies exist when it is less costly for a single company to provide a group of financial services than for several companies to provide them, each specializing in a different service. For example, both banks and insurance companies may need to know something about their customers' overall financial condition. With a single company providing both banking and insurance services, the costs of acquiring such information only have to be incurred once, allowing the consumer to be charged lower prices. Consumption synergies arise when it is less time consuming or more convenient for the consumer to purchase different financial services from a single company than from a number of different companies. Such gains from one-stop shopping accrue to the consumer directly, although they may be partly offset by the bank charging higher prices for services. It is unclear that either of these synergies from financial integration will be big enough to benefit consumers significantly. Empirical studies[5] have found little evidence of production synergies within the banking industry—for example, between lending and deposit-taking—casting some doubt on the existence of synergies between banking and other financial services. Studies have also found no evidence that customers are willing to pay more when banking services such as lending and deposit-taking are provided by the same bank than when they are provided by separate banks[6]. Furthermore, companies such as Sears that have offered consumers one-stop shopping for financial services in the past have met with little success.

Finally, because financial services to small businesses have substantial and overlapping information requirements, a good case can be made that combining these services will yield appreciable economies in information gathering that can be passed on to small businesses in the form of lower prices.

Despite these positive aspects of the transformation of banking, one important concern remains about the impact on local economies—with the public less willing to invest in bank deposits; will small banks be able to find enough funds to continue filling gaps in small business credit? The small-bank funding problem is likely to intensify as the growth of online finance gives local depositors more alternatives for investing their money. Furthermore, increased reliance on FHLB

Advances are unlikely to provide a long-term solution given public policy concerns about banks borrowing heavily from government-sponsored enterprises. By moving ahead with plans for online banking, small banks may find it easier to compete with larger banks and brokerage companies for funds. Ultimately, however, the only solution to the funding problem may be for small banks to pay higher deposit rates. While not a welcome prospect for any bank, it is one that the better managed banks should be able to afford by exploiting their knowledge of the local economy to make profitable, high-quality loans.

III IMPACT OF INTERNET BANKING

It was once thought that the main benefit to consumers of Internet banking would be lower fees for banking services or higher rates on deposits. According to this view, the cost to banks of online transactions would be much lower than the cost of traditional transactions through a normal branch. As a result, consumers would be charged lower fees or paid higher deposit rates if they banked online instead of going to a branch office. Proponents of this view pointed to the example of online brokers, who charge investors much less for trading stocks than either discount brokers or traditional full-commission brokers[7]. The hope that online banking would result in lower fees or higher deposit rates for consumers has not been realized, mainly because banks themselves have not reaped significant cost savings. One reason banks have not enjoyed substantial cost reductions are that they have had to make large investments in infrastructure and customer support. Another reason is that online banking has not enabled banks to cut back on their traditional delivery channels as much as initially hoped. Specifically, consumers have demonstrated that they strongly prefer the “click and bricks” approach to pure online banking, forcing banks to maintain their costly branch networks. Rather than lower fees, the main benefit of online banking to consumers is likely to be greater convenience. Through online accounts, for example, consumers can now pay their bills by creating a list of regular payees and then instructing the bank to make payments as they receive the bills, either by electronic funds transfer or paper check. Some banks have begun to offer consumers an even more convenient service called bill presentment. In this case, the bank collects the bills itself and transmits them to the consumer over the Internet, where the customer can review them along with his account balances and initiate payment as desired.

Another online banking service that is not yet widely offered, but could prove highly convenient to consumers, is account aggregation. This service allows the customer to view his entire portfolio online, including accounts at other institutions, and to shift funds in and out of different investments.3 Banks are not the only companies providing account aggregation—the service is also offered by some brokerage companies and by nonfinancial portals. Some consumers may prefer to have the service provided by a bank, however, because banks have more experience in funds transfers and are more closely regulated.

Some advocates of online banking also argue that banks will use the information they acquire about their online customers overall financial condition to provide higher quality service. According to this argument, a bank can use the information to determine which products would best serve each customer’s financial goals and then make those products available online; in the same way online booksellers use information about buying habits to determine which new books their customers will be interested in purchasing. This argument is controversial. Specifically, critics argue that banks could use the information they gather about their customers’ overall financial condition to engage in price discrimination (charging higher prices to customers with stronger demand) or to practice sorting (reducing service to less profitable customers to drive them away).
Finally, in very small communities, online banking may have the additional benefit of improving access to financial services. In particular, when such communities prove to be too small to support a brick-and mortar branch, the Internet may provide another way for people to invest their money and take out loans. To be sure, many rural communities currently lack high-speed Internet access because their low population density has discouraged private investment in broadband infrastructure. However, people in these communities can still access the Internet through dial-up services, which are sufficient to take advantage of the online banking services now offered

IV IMPACT OF CONSOLIDATION

One way mergers could hurt consumers is by reducing competition in local banking markets. Some economists argue that banks in highly concentrated markets are less likely to compete with each other for customers by offering superior service or better rates. Consistent with this view, Empirical studies have generally found that banks in highly concentrated markets pay lower interest rates on their deposits markets, consumers in those markets can be expected to suffer.

As it happens, however, the merger wave of the 2008 does not appear to have increased the concentration of local banking markets very much. Although the share of very large banks in nationwide deposits rose sharply in the 2008, the concentration of local banking markets increased only slightly. Furthermore, the increases in concentration that have occurred have been confined to urban markets, and in that case, mainly to cities with population over one million.

Mergers have so far had little effect on local market competition for two reasons. First, most mergers have been between banks in different markets. Second, when banks in the same market have merged, regulators have often required them to divest some of their branches.

While local market concentration has increased only slightly, it does not necessarily follow that consumers will feel no adverse effect from mergers. The last few years, annual surveys by the Federal Reserve have consistently found that large multistate banks charge higher fees for many retail banking services than smaller single-state banks.

On the whole, consumers appear to be benefiting from the changes. Consolidation has not reduced competition in local banking markets very much, because most of the mergers have not been between banks in the same city or county. Large multistate banks appear to charge higher fees, but consumers who believe those fees are unjustified still have plenty of smaller banks to choose from. The spread of Internet banking should also benefit consumers by reducing the time and inconvenience of banking transactions and, in very small communities, by providing access to banking services that might otherwise be unavailable. It is less clear that combining banking with other financial services will benefit consumers. Conglomerates show no evidence of producing retail financial services at lower cost than specialists, and the Internet provides other ways for consumers to reap the benefits of one-stop shopping besides buying all their services from the same provider.

For the most part, small businesses also appear better off as a result of the recent changes in banking. To be sure, the evidence suggests that banks taken over in mergers by large or distant organizations have reduced their small business lending. But some large multistate organizations have managed to overcome the disadvantages of size and geographic dispersion and expand their small business lending. Furthermore, where gaps in small business credit have remained, newly chartered banks and small banks not taken over in mergers have stepped in to make up the difference. Small businesses should also benefit from Internet banking, especially if it helps them take advantage of innovations in payments practices such as electronic billing and B_2B commerce.

V SUMMARY

Merger will not result in large institutions with mkt. power that would force customers to pay higher fees and lending rates, receive lower rates for deposits and receive lower service quality. Competition will remain even after merging of banking and financial services Bigger banks can offer more products and services to consumers, But for more facilities consumers have to pay more prices as Recent report[8] show that consumers pay more in ATM and checking fees at larger banks.

A study concluded that bank consolidation in metro areas has not adversely affected mortgage companies and others offset reductions in lending by merged banks Small businesses employ half of the workforce and account for half of private sector output. A fed study 2007 shows no negative impact of bank mergers thus far, on small business lending. The small banks that make most of the loans tend to be acquired by other small banks, not larger banks. Individual bank mergers have led to a significant job losses.

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