Statement of
Dr. William F. Staats
at the
Farm Credit Administration Symposium on
Consolidation in the Farm Credit System
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Thank you, Madam Chair, and members of the FCA Board, for this opportunity to testify regarding consolidation in the Farm Credit System.

My name is Willie Staats and I am a board-appointed director for the Farm Credit Bank of Texas, where I have served since 1997. I also serve as vice-chairman of the Farm Credit System Audit Committee and as Professor Emeritus of Finance at Louisiana State University. Prior to LSU, I served as Vice President and Corporate Secretary of the Federal Reserve Bank of Philadelphia. Also, I was a founder of a national bank in New Braunfels, Texas, in 1977, and more recently as a director of Lakeside Bank in Lake Charles, Louisiana. That bank was the first to receive a charter in more than 1 year. Also, in the late 1970's, I served as a consultant in the Office of the Comptroller of the Currency in Washington. My charge was related to bank capital management and regulation.

In theory, consolidation in any industry can create economies of scale, scope, structure, and skills; and, specific to the banking industry, a diversity of portfolio and risk exposure (through a better mix of geographic service areas, industries, loan types, and maturity structures). The reality, however, is that roughly 70 percent of all mergers fail, according to a 2010 McKinsey and Company report.[i]

Most researchers, according to an FDIC study, have not been able to identify any of the broad-based improvements in cost efficiency that one might expect, especially among large institutions.[ii] In fact, banks can actually become less efficient, in the sense that operating costs can rise with no accompanying increase in services provided.[iii]

The FDIC study goes on to say that there is little evidence that either consumers or shareholders have benefited from consolidation in the banking industry; and that the emergence of large, complex banking organizations have probably increased systemic risk as activities are concentrated in a few very large banking companies.

The point I want to make is that there is little correlation between being a big financial institution and being a good financial institution.[iv] Numerous studies have examined the effects of bank mergers on operating efficiency and profitability, and the results generally suggest that mergers are not a silver bullet to improve either one.[v]

Like commercial banks, Farm Credit institutions come in all shapes and sizes; and when it comes to consolidation, Farm Credit is not immune to the same challenges. In fact, in the Texas district, we have large associations (as a result of mergers over the years) that are no more effective serving their marketplace, nor more profitable to a significant degree, than associations that are much smaller.

What's more, we operate as a federated cooperative so associations, regardless of size, are able to capture value by leveraging the resources of their funding bank. Rather than each association maintaining their own technology, lending systems, and back-office support, these expenses can be shared at the funding bank level. And by partnering with the bank, associations, regardless of size, are able to expand and diversify their portfolios by participating in complex credits.

This principle applies to the funding bank as well. The Farm Credit Bank of Texas, even though we are the smallest of the district banks in the System, is able to maximize efficiencies and profitability by partnering with other System entities—buying and selling assets, and sharing back-office systems. We operate with significant strategic alliances with both CoBank and AgFirst.

I believe the research supports what we have experienced in our district—that disciplined operational focus and strategic partnerships can achieve scale and value creation without merging, which can often be more about empire building or managerial hubris, than ownership interests.[vi] In other words, as System entities consider consolidation, they should not focus so much on size as a goal, but rather on the development of new business models that help them serve their marketplace and compete effectively.[vii]

As mentioned previously, the point of consolidation should be to gain economies of scale and scope, to improve human capital skills that enhance capabilities and performance of the new entity, and to diversify service territory and mitigate portfolio risk. But there may be alternatives that accomplish the same objectives with less risk of value destruction (and by that, I mean the disruption, complexity, cost, and risk associated with accomplishing synergies and effectively integrating multiple entities; as well as the loss of local control, and potential for diluted customer service and relationships). System institutions and FCA should evaluate both sides of this equation as these important decisions are considered.

In summary, mergers are not always the answer to an entity's challenges; and worse, can be pursued for reasons that have nothing to do with fulfilling the System's mission or adding value to borrowers. However, under the right circumstances and for the right reasons, consolidation has its place; and System entities should not be limited in their pursuit of improving their operations through consolidation for the benefit of their stockholders. Each locally-owned institution should have the right of self-determination. If their stockholders determine, following appropriate due diligence, that it is in their best interest to consolidate with another institution, they should have the right to pursue that arrangement.

In fact, if the System and the Agency is serious about creating efficiencies and economies of scale for stockholders, we would work together with Congress to amend the Act so that funding banks can merge with retail associations to serve the market more effectively and with less built-in overhead throughout the System. Not only would this create capital efficiency (because we would no longer be capitalizing two levels of delivery structure), but it would reduce the number of operating systems. Today, there are more operating systems in Farm Credit than existed when there were more System entities (because, as entities get larger, they often want to establish and maintain their own systems). Consolidation in this regard would create more efficiency than mergers would and is the most logical way to gain efficiency and maximize value for Farm Credit borrowers across the country. I believe it is a natural progression for the System to consider for the future.

Thank you, Madam Chair, and other members of the Board, for this opportunity to share some thoughts on these important issues. I'll be happy to respond to any questions.

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[i] McLetchie, J., & West, A. (June 2010). Beyond Risk Avoidance: A McKinsey Perspective on Creating Transformational Value from Mergers. *Perspectives on Merger Integration,* p. 11.
[ii] Jones, K. D., & Critchfield, T. (January 2006). Consolidation in the U.S. Banking Industry: Is the 'Long, Strange Trip' About to End? *FDIC Banking Review*, p. 10-11.
[iii] Berger, A. N. (May 1995). The profit-structure relationship in banking - tests of market-power and efficient-structure hypotheses. *Journal of Money, Credit and Banking,* p. 404-31.
[iv] Boyd, J.H., & Graham, S.L. (December 1996). Consolidation in U.S. Banking: Implications for Efficiency and Risk. *Federal Reserve Bank of Minneapolis*, p. 1-12.
[v] Rhoades, S. A. (July 1994). A summary of merger performance studies in banking, 1980-93, and an assessment of the 'operating performance' and 'event study' methodologies. *Staff Study 167, Board of Governors of the Federal Reserve System.*
[vi] Gorton, G. & Rosen, R. (1995). Corporate control, portfolio choice, and the decline of banking. *Journal of Finance 50*, p. 1377-1420.
[vii] Ghemawat, P. & Ghadar, F. (July-August 2000). The Dubious Logic of Global Megamergers. *Harvard Business Review*, p. 72.