Some Aspects of Wal-Mart's Expansion in the Financial Services Industry

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Abstract This paper provides an examination of Wal-Mart's current and potential efforts to enter the financial services area. The first section of this analysis investigates the company's activities in seeking to obtain a state of Utah Industrial Loan Company Charter. A second part of the paper discusses current and future issues related to Wal-Mart's entrance into the financial services market. This discussion in followed by an examination of the efforts and potential outcomes from SAM'S Club moving into financial services. A fourth part of this study considers the likely competitive and innovation impacts of a Wal-Mart owned De Novo bank. A fifth section offers some conclusions on what may happen should Wal-Mart successfully expand into the financial services area through banking ownership.

Introduction

The long history of U.S. financial institutions has been one of adaptation to changes in the financial markets, and recent developments within the financial services industry are no exception (see Appendix E for a discussion of the evolution and history of bank regulation). Unlike the relatively stable period of the late 1960's, when banking markets were highly regulated, interest margins were locked in due to Regulation Q, and nobody cared much about banking issues except bankers, today many different bank constituencies are focused on financial institutions and the types of financial services offered. Stimulating public interest in the growth of industrial banking has been the creation of these non-bank bank entities by large corporations. Within the last several years, General Electric, Merrill Lynch, American Express, Target and Berkshire Hathaway have all created industrial banks in the state of Utah. [1] Appendix A provides a table developed from figures reported by the Insurance Information Institute showing the varying concentration of industrial banks by state across the country: [2]

While the relatively quiet development of the Merrill Lynch, American Express, GE, GMAC, Target and BMW industrial banks have occurred without much public outcry, the same can not be said for Wal-Mart's current foray into the banking market. Public interest may be due in part to the shear size of Wal-Mart and its extensive operations. According to the November 11, 2005 Valueline Investment Survey, Wal-Mart is the world's largest retailer with 1,353 discount stores, 1,713 Supercenters, and 551 Sam's Clubs operating across the US, Canada, Latin America, UK, Germany and most of the Pan Pacific region.[3] Wal-Mart sales account for 57.6% of entire sales within the retail store sector. [4] Given Wal-Mart's domination of the retail sales industry and its recent growth within the grocery sales segment, their latest move into industrial banking has stimulated public interest and comment about issues of competition and bank structure, some quite negative towards the creation of a Wal-Mart industrial bank. [5] Appendix B provides an outline of the types of services Wal-Mart intends to develop with its proposed industrial bank. The major focus appears to be in the areas of check clearing, debit card processing, point-of-sale transactions, and sale of short-term CDs to 501(c)(3) organizations.

This paper provides an examination of the development of a Wal-Mart industrial bank in three parts. A literature review of research on the current regulatory framework and bank structure issues related to industrial bank creation is presented along with a discussion of the possible strategies and motivations Wal-Mart may have in forming an industrial bank entity. Within this context, hypotheses are tested relating to the type of customers Wal-Mart may be seeking to serve in setting up their bank. A second section offers insights on the potential technological and economies of scale arguments which may favor Wal-Mart's development of a banking presence within its stores. Finally, a summary of findings and conclusions reviews some of the advantages and disadvantages associated with Wal-Mart's formation of an industrial bank in terms of bank structure and competition.

Review of Literature Relating to Industrial Banks, Bank Competition and Market Structure

Industrial loan companies (ILC), also referred to as industrial banks, are supervised by the Federal Deposit Insurance Corporation (FDIC), may be owned by a commercial firm, but not regulated by a federal agency. The creation of industrial banks within the context of state banking law is one of the last remaining loopholes to federal bank regulation. An article by West[2004] in FDIC Supervisory Insights provides an historical perspective on the development of ILCs in relation to bank failure. During the period from 1985 to 2004, there were 21 ILC failures against 1,129 S&L bankruptcies and 1,392 closures of bank holding company subsidiaries or stand-alone banks. [6] ILCs have existed since 1910 when Arthur J. Morris created the Fidelity Savings and Trust Company in Norfolk, Virginia to provide financial loans and savings accounts to industrial workers.[7] Up until the 1980s, ILCs were operated as savings and finance organizations chartered by various state governments. Some states would not allow ILCs to create deposits so these institutions issued certificates of investment, avoided the term, "deposit" and skirted the issue of whether they were engaged in taking deposits. However, because ILCs did not technically take in deposits, they could not be insured by the FDIC.[8] With the passage of the Garn-St. Germain Act in 1982, provisions to that piece of legislation allowed ILCs to come under FDIC insurance protection. In response, the FDIC amended its Statement of Policy Concerning Applications for Deposit Insurance clarifying the requirements under which an ILC would be granted FDIC insurance. The inclusion of FDIC insurance became an incentive for commercial firms to create ILCs that allowed them to get into banking without being subject to the more regulatory restrictive Bank Holding Company Act.[9] Today, there appear to be many similarities between BHCA banks and their ILC counterparts in terms of bank related services. The following table provides an abbreviated synopsis of comparable banking powers:[10]

Table 1
Some Similarities of Bank Services Provided by BHCA Banks and ILCs

Bank Service	State Commercial BHCA Bank	ILC
Accept Demand Deposits	Yes	Varies with State, where authorized ILC's assets must be <= $100 million or ILC has not been acquired after 8/10/1987
Ability to Branch	Yes	Yes
Ability offer full range of Deposits and Loans	Yes	Yes, including NOW accounts, subject to demand deposit restrictions above
Parent activities generally Limited to banking and Financial activities	Yes	No
Parent could be ordered by Federal banking authority To divest the subsidiary with Capital impairment	Yes	No

Source: www.fdic.gov/regulations/examinations/supervisory/instights/sisum04/industrial_loans.html

The literature on bank structure and competition can be divided into two historical segments, a 50 year period from 1930 to 1980 when banks were federally regulated based on principles of safety and soundness, versus the time after 1980 when the banking industry was deregulated for competitive reasons. The Bank Acts of 1933 and 1935, along with the McFadden Act or 1927 sought to limit the ability of new banks to enter an already existing market. In order for a de-novo bank to be created prior to the 1980's the bank applicant needed to show that (1) the new financial institution would not cause existing banks to lose profitability and (2) the entrance of the de-novo bank would greatly enhance the banking services in the local area.[11] The consequence of the McFadden Act was to focus bank structure studies on the impact a new financial institution would have on a local market. Beginning in 1980s with passage of the Depository Institutions Deregulation and Monetary Control Act (1980), the Garn-St. Germain Depository Institutions Act(1982), of 1982, the Financial Institutions Reform, Recovery and Enforcement Act (1989), the Riegle-Neal Interstate Banking and Branching Efficiency Act(1994) , and the Financial Services Modernization Act (1999), the banking industry has been deregulated to permit the creation of de-novo banks, branches and new bank services by any corporation operating within the financial markets. Recent studies on bank structure and competition must deal with the dual issues of (1) the size and scope of the bank market and (2) measures of competition and performance based on consolidated accounting information rather than individualized bank data.

Research on the competitive effects of bank holding companies and industrial banks on banking markets is mixed. Results appear to depend upon the scope of the market used to study bank services and the way concentration is defined. In 1979, Rhoades and Rutz wrote a Federal Reserve Board Study entitled, "Impact of Bank Holding Companies on Competition and Performance in Banking Markets."[12] Examining 184 standard metropolitan statistical areas (SMSAs) using multivariate analysis of measures of profitability and mobility, Rhoades and Rutz found that bank holding companies were not aggressive competitors in their local markets and seemed to weaken rivalry amongst banks operating in a particular area. A follow-up investigation, a Federal Reserve Board Staff Study by Rhoades[1996] provides an analysis of bank structure from 1980 to 1994. [13] According to the Rhoades [1996] investigation, a record number of bank mergers occurred in the 14 year period from 1980 to 1994 leading to high levels of concentration in the nationwide banking market. However, despite the decline in the number of commercial banks nationwide, through merger, and the consolidation of bank assets in large multi-bank holding companies, local bank market concentration remained the same while the number of branches increased for both standard metropolitan and non-metropolitan statistical areas (MSA and non-MSA counties).[14] This newer finding would appear to provide evidence of increased competition in local areas due to bank holding company activity. However, one concern is that the 1980-94 data represented a time before Riegle-Neal when interstate banking was restricted to friendly mergers orchestrated by the FDIC to get rid of bankrupt S&Ls or banks. Consequently, Rhoades issued an expanded Federal Reserve Staff Study in 2000 covering bank mergers and structure from 1980 to 1998. This follow on investigation reinforced many of the conclusions to the earlier 1996 investigation. In the most recent study, Rhoades (2000) finds a continuation in the reduction of banks in the US, a substantial increase in the concentration of bank assets in large nationwide multi-bank holding companies, and an increase in the number of banking offices across local markets. However, with respect to local bank market activity, Rhoades (2000) reports significant and important differences from the previous study. The Rhoade's (2000) finds a substantial rise in average local market concentration in most MSAs, with average concentration declining in non-MSA counties. His results indicate a large decrease in average concentration in many local markets, which appears to bolster the view that the large multi-bank holding companies are focusing their efforts on what is perceived to be the more lucrative urban bank market.[15] Consequently, competition may be declining in the larger MSA areas due to the increased concentration of multi-bank holding companies, but increasing in non-MSA locales due to the limited presence of multi-bank holding company operations.

Studies subsequent to the Rhoades investigations, have re-examined bank concentration and structure in relation to the definition of competitive area and the type of bank services offered. A study by Jeon and Miller (2002) examines the issues of bank concentration and performance on a state-by-state basis. The authors argue that given Riegle Neal and technological changes brought on by the Gramm-Leach-Bliley Act, local markets are best defined on a state rather than MSA basis. The Jeon and Miller (2002) investigation finds that bank concentration and profitability are positively correlated on a statewide metric.. Consequently, Jeon and Miller (2002) suggest the need for bank regulators to monitor consolidation at the state level in order to avoid accumulation of monopoly power in the hands of large bank interests. [16] A more recent study by Zaher and Kohli(2005) seeks to examine performance differences between conventional banks and internet-only financial institutions. Using call report data from 1999 to 2002, Zaher and Kohli (2005) completed an ANOVA analysis of balance sheet and income statement ratios for a group of internet only and conventional banking firms. They find that internet only banks have less liquidity, but higher levels of securities held and capital than their conventional banking counterparts. In terms of bank performance, the Zaher and Kohli study (2005) finds there to be little difference in measures of profitability between conventional versus internet-only banks.[17] This result appears to show that increasing a bank market to include the internet may expand the number of consumer choices of banks that are both profitable and well capitalized. As internet technology expands to meet consumer demand, retail firms and banks will be looking to increase the variety and types of bank related services to the public. A recent article by Akers, Golter, Lamm and Solt in the FDIC Banking Review (2005) includes a details of recent strategic alliance between Discover, Wal-Mart and GE's Consumer Finance Unit to launch a new credit card through the Discover network which will allow Wal-Mart to avoid paying interchange fees on transactions made at their stores. This initiative is similar to other dual-branded cards issued by Mastercard and Diners, as well as, American Express and Visa. In light of public concerns expressed about Wal-Mart's application to create an ILC, the U.S. General Accounting Office was asked by Congressman James Leach to examine current regulatory issues with respect to the formation of these financial banks. In September 2005, The GAO issued the report, "Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority." The GAO report highlights the need for more federal oversight of ILCs in order to protect to interests of the FDIC fund. Although the FDIC has supervisory oversight over ILCs within the context of its deposit insurance program, they have only limited powers to regulate the holding company controlling an ILC.[18] Under current banking law, ILC parents are able to mix banking and commerce more than the parents of other depository institutions. The present trend has been for large commercial firms to develop ILCs in order to integrate banking with traditional lines of commerce. The GAO report favors a revision in banking law to have ILCs treated in a way that is consistent with their bank related competitors. Their argument is that such a change would protect FDIC insurance reserves by making the parent holding company accountable to the actions of the ILC when providing bank services. [19] In relation to these studies, the recent Wal-Mart bank application serves to identify the types of services a proposed ILC would offer within the state of Utah. According to Wal-Mart's application, their bank subsidiary will act as a sponsor for Wal-Mart in certain regional and national processing networks, become a depository institution taking in short-term CDs and partnering with Visa and Mastercard to provide point-of-sale (POS) and debit card transactions.[20] Under the current application, Wal-Mart would be operating its ILC as a depository institution in terms of the issuance of short-term CDs and the clearing of debit and credit card transactions.

Wal-Mart and the Financial Services Industry

Currently, Wal-Mart offers money-orders for 46 cents which may serve some low income customers as alternatives to checks, a low cost ($3.00) payroll check cashing service, and low cost international money orders. These appear lucrative to Wal-Mart with one estimate for revenues as high as $5 billion [21] and, one may assume, very modest increases in costs. Also, many Wal-Mart customers may not have checking accounts. Some may use money orders as occasional substitutes along with cash payments. In addition, at least 1400 full service banks lease branch office space in Wal-Mart SuperCenters and Stores.

Wal-Mart seeks to directly market financial services to its current low and medium income customers in areas that do not require skilled professional employees or labor intensive skills. Wal-Mart executives may lack awareness that those customers using services in the leased branch bank offices may have incomes higher than the average Wal-Mart customer (see Appendix C). One can not offer comparative customer average income figures due to the open ended classes at the high end of the data. It is not clear if higher income customers can be induced to walk through a super center buy toothpaste, laundry soap, and tires, and then have a financial plan drawn up with investment advice on restructuring asset portfolios.

It is not apparent how Wal-Mart will address the problem of selling financial services that need to be sold with relatively high numbers of skilled employees. Certain financial products, such as term insurance, have been commoditized to the extent that they are bought by the consuming public. Term insurance does not have to be sold in contrast to the more expensive permanent insurance which requires selling the concept as part of a financial plan. In the late 1980's, Sears efforts to cross market a securities product line with insurance financial services within its stores did not work. The supporting Sears entities were sold after this strategy failed to live up to expectations.[22] In addition, the movement toward financial department stores selling what were formerly separate services has slowed, suggesting difficulty in developing economies of scale and scope to this marketing strategy.[23]

Financial Services at Sam's Club

The table in appendix D provides information on most of the financial services offered to members of the 540 Sam's Clubs operated by the Wal-Mart Company. These are "Warehouse Clubs" with membership fees and price competitive products targeted at small businesses, and consumers with higher incomes. Although company does not report the average income of Sam's Club members, outside analysis of the consumer profile of Sam's customers appears to show that Sam's members have incomes substantially higher than Wal-Mart shoppers. [24] Support for this perspective comes from the reported average income of Sam's rival, Costco. Costco's customers have an average annual income of $95,533.[25] The higher annual income levels for warehouse shoppers suggests that Sam's Club locations may represent a more profitable site of Wal-Mart banks than the Wal-Mart stores.

Appendix D also shows that Sam's Club managers have agreements with unrelated organizations offering a variety of financial services already. These financial services oriented organizations include, GE Capital Financial Inc., A.G. Edwards, Wells Fargo Bank, AIG Insurance, Discover and Member Services, a loan broker for credit unions. The member services guide from San's Club promotes individual toll free numbers or a San's Club website as sources of information on these individual company products. Another interesting financial service feature offered through Sam's Club membership is the Business Credit card. This particular card which Sam's Club members can apply for has a high rebate cap of $20,000 and a $1 million credit line, something an average Wal-Mart shopper would not be eligible for. [26]

The Economic and Competitive Impact of Wal-Mart's Entry into a Banking Market

The economic and competitive influence of a big box store, such as a Wal-Mart Super Center, entering a bank market area appears to be a function of the size, population density, competition, wage level and degree of unionization in the region to be served. A recent study by Basker in the Journal of Urban Economics, found significantly lower prices for selected consumer items in areas where Wal-Mart had a presence. [27] In another investigation, Stone, Artz and Myles, found that " host county metropolitan area super center stores captured sales from competitors in host and non host counties."[28] Host county stores that did not compete with super center stores, i.e., furniture retailers, experienced increases in sales due to the "pull" of non-county residential traffic. Competing stores in closely located non-host counties experienced significant sales declines.[29]

An investigation by Arnold, Kozinets and Handelman, suggests that Wal-Mart can alter preference structures by shifting attribute saliencies or characteristics of its products in its own favor.[30] For example, if Wal-Mart includes a Subway store, in its super center, it is likely to attract customers to the store that want to buy groceries, get goods and services and have lunch during one shopping experience. By shifting consumer preference ambiguity to capitalize on its own strengths, Wal-Mart has increased its market share in the studied markets.[31]

Basker in the investigation cited earlier quantifies the pull effect of Wal-Mart entry to average city-level prices of various consumer goods. He found robust price effects with magnitudes varying by product and specifications, but generally ranging from 1.5-3% in the short run, to four times as much in the long run.[32] Basker contends that "Wal-Mart's entry brings lower prices to consumers in relatively small cities, where establishments tend to be smaller and retail environments less competitive than in larger cities."[33]

The Stone study suggests that a "zero-sum game" prevails when Wal-Mart enters a rural trade center with small population or income growth. The "new entrant captures its sales from existing businesses, not from a growing market, and the existing retailers are likely to be adversely effected."[34]

A more recent investigation by Neumark in 2005, indicates that, "In the South, where Wal-Mart stores are most prevalent and have been open the longest, evidence indicates that Wal-Mart reduces retail employment, total employment and total payrolls per person."[35]

Critics suggest that a Wal-Mart bank will cause smaller, local banks to close, presumably due to price competition as a consequence of Wal-Mart's better economics of scale and scope. It is also feared that Wal-Mart may not lend to competing local retailers should smaller banks be driven out of the area. Ultimately, local banks may be forced to close lending operations due to a loss of depositor funds for that purpose going to the larger Wal-Mart bank. Maintaining adequate bank competition in a small local market with the presence of a Wal-Mart bank may be difficult due to differences in size. When Wal-Mart enters into full service banking, increased attention may be needed given the potential comparative advantages Sam's Clubs and Wal-Mart Super Centers have in catering to large scale depositors in a local area. If Wal-Mart were to siphon off local depositor money used for economic development and shift those funds to other parts of the country, local markets might have difficulty generating sustained economic growth.

Taken without consideration of other issues, the studies cited above suggest that adding a De Novo bank at a Wal-Mart store will likely cause a compensating loss in previously existing local banking services, along with possible price reductions and bank closings. However, adjustments are needed for the likely absence of branch density for a Wal-Mart bank, for the lack of bank accounts on the part of many of Wal-Mart's low income customers, and the possible lack of ability of the company to supply the skilled support needed for many retail banking operations. Wal-Mart's selling and distribution skills may not apply to products that required skilled sales personnel such as CDs, annuities, universal and variable life, and various types of loans. Accordingly, the company may prefer to continue the current leasing program using outside banks to provide financial services at Wal-Mart stores. This strategy would certainly be less controversial from a public perspective.

A contradictory school of thought is that pioneering efforts by the company will convert a number of higher cost banking products into less expensive, price competitive generic bank products that can be sold "off the shelf." These might include various standardized products currently being sold electronically over the internet, e.g., health insurance, disability insurance, term life insurance, index funds, mortgages, and annuities.

Conclusions and Perspectives on Wal-Mart's Expansion in the Financial Services Industry

This study discusses Wal-Mart's current efforts to charter an industrial loan company bank (ILC) in Utah. A commonly held opinion is that Wal-Mart will use this charter, to seek and eventually obtain a full-service bank charter. The public portion of Wal-Mart's application for a Utah carter for an ILC is suggestive of a small credit card transaction processing unit set up to return processing fees from the huge number of daily transactions at the company's stores. Nowhere in the public portion of that application is there reference to Wal-Mart's future interests in setting up a full service bank. However, once a ILC has been created, there is nothing to prevent Wal-Mart from using such a bank to seek to become a full-service bank through merger or acquisition.

The evidence presented suggests that the inclusion of full service banks in Wal-Mart stores and super centers will result in bank closings within smaller, local markets. It may be that the net effect of a De Novo Wal-Mart bank in selected markets could be greater availability of financial services, but this effect may be temporary if existing banks close. It should also be noted that there has been little research on the impact local bank closings might have on deposit insurance at a regional and national level. Maintaining competition and low banking concentration in smaller bank markets with the presence of a Wal-Mart bank would require careful regulatory attention.

Wal-Mart currently offers selective financial services through their Sam's Club stores that are suggestive of economies of scale and scope. It is not clear that these economies can be extended directly into full service banking when introduced in a regular Wal-Mart store. As a result, Wal-Mart's branch office leasing program using independent banks appears likely to produce the advantage of getting higher income customers into Wal-Mart Super Centers and Stores. This strategy will produce a stream of leasing income to Wal-Mart and overcome public objection to Wal-Mart creating its own banking operations within its retail stores.

In addition, a Wal-Mart owned bank is likely to lack branch density in large markets where customers are convenience oriented. In contrast, it may be that the company can develop a set of attractive generic low fee financial products that can be sold "off the shelf" with minimal labor input and still convenient to most Wal-Mart shoppers.

Sam's Club, with its higher income business owner and consumer customers, provides major opportunities for the sale of higher priced, on-site financial services requiring skilled labor. These higher income customers may be suggestive of greater opportunities for Wal-Mart owned banking and other financial services in Sam's rather than Wal-Mart super center stores. Wal-Mart's use of large financial service organizations to market a variety of services through the Sam's Club website and the individual toll free numbers may indicate future company plans for direct, on-site sales including eventual full service banking.

The Wal-Mart company, if management decides to engage in pioneering efforts, could potentially bring commodity status and lower buyer costs to a group of financial services current sold by other financial institutions. Certainly, a reduction in the higher bank fees for certain types of financial services offered to the public would be beneficial to consumers. However, the questions that remain are: (1) Do the benefits out way the costs associated with Wal-Mart forming an ILC? (2) To what extent can Wal-Mart offer quality financial services at a reduced cost to consumers given the differences between Sam's members and Wal-Mart super center shoppers? and (3) What impact will Wal-Mart's entry into banking have on existing, local banks in terms of competition and market structure? At the present time, the review of Wal-Mart's application to obtain an ILC charter in Utah has been extended to June 2006. Hopefully, with the extension of this review deadline, more information will be available for studying these questions.

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Appendix A

Top 10 FDIC-Insured Industrial Banks by Asset Size as of 2004

Rank	Bank Owner	State Charter	Total Assets
1	Merrill Lynch Bank USA	Utah	$66.7 Billion
2	UBS Bank USA	Utah	$17.5 Billion
3	American Express	Utah	$12.8 Billion
4	Fremont Investment	California	$ 9.9 Billion
5	USAA Savings Bank	Nevada	$ 7.2 Billion
6	Morgan Stanley	Utah	$ 5.3 Billion
7	Beal Savings Bank	Nevada	$ 2.7 Billion
8	GMAC	Utah	$ 2.3 Billion
9	GE Capital	Utah	$ 1.8 Billion
10	BMW	Utah	$ 1.5 Billion

Source: www.financialservicesfacts.org, Insurance Information Institute, Industrial Banks, "Top Ten-FDIC Insured Industrial Banks by Assets 2004."

Appendix B

Principal Functions and Services to be Provided by the Wal-Mart Industrial Bank

1. The Bank will serve as sponsor to provide access for Wal-Mart into the Automated Clearing House ("ACH") network for the purpose of presenting, processing, and settling electronic converted checks.

2. The Bank will act as sponsor for Wal-Mart with certain regional and National processing networks to present, process and settle on-line point of sale PIN (Personal Identification Number) authorized debit card transactions.

3. The Bank will become a depository institution member of Visa and Mastercard network associations, and serve as a sponsor for Wal-Mart in order to present, process and settle point-of-sale credit card and signature debit card transactions.

4. The Bank will offer short-term certificates of deposit to two classes of depositors: (a) non-profit, charitable and educational organizations designated as 501 (c)(3) entities by the Internal Revenue Service; and (b) individual investors generated through deposit brokers.

Utah Department of Financial Institutions, Federal Deposit Insurance Corporation, Wal-Mart Application File, Volume I of III, Wal-Mart Bank Application, p. 1.

Appendix C

Income Profiles of Wal-Mart Shoppers and Bank Customers in 3 Bank Size Categories

Income (1000's)	Walmart Top Shoppers (n=3940)	Banks <500 million	Banks 500-999 million	Banks 1000 million+
70	23%	31%	27%	27%
50-69	23%	27%	26%	24%
30-49	29%	23%	28%	27%
<30	26%	30%	18%	22%

The sample size was the number of banks in each sample (N=36,23, and 17 in increasing order of size). The average number of retail customers per bank within each category was 10,590; 33,892; and 177,854.

For hypothesis testing, a frequency distribution by income categories of the biggest spenders at Wal-Mart was obtained from data on a group of about 39,000 Wal-Mart shoppers monitored closely by a research firm. The hypothesis tested was that the income profiles of the customers within each bank size category were identical with those of the Wal-Mart shoppers. The sample included the highest income categories of Wal-Mart shoppers. In all cases H_0 was rejected using a Chi-square transformation of the greatest percentage difference ($\alpha = .01$). Wal-Mart has more lower income shoppers. Not surprisingly, the banks, even in the smallest size category (average sizes in each category were \$84.7 million, \$544 million and \$3.7 billion) have higher income customers.

Sources:

Bank Data: American Bankers Association staff and the ABA, Detail Banking Survey Reports, 11th Edition.

Wal-Mart Data: A.C. Nielsen Trends and Insights – Understanding the Wal-Mart Shopper: www2.acnielsen.com/pubs/2004_q1_ci_walmart.shtml

The statistical text was based on the table of critical values of "D" at the .01 level of significance in the Kolmogorov-Smirnov Two-Sample Test from: Siegel, Sidney, Non-Parametric Statistics for the Behavioral Sciences, (McGraw-Hill, New York, 1956),p. 279.

Appendix D

Sam's Club: Selected Financial Services and Providers for Business and Consumer Customers

Financial Service	Name of Organization	Type of Company
Auto, Boat, RV Program	Member Services	Loan Broker for Credit Unions
Auto Finance and Refinance Program	E-Loan	Large Consumer and Mortgage Loan Originator/Seller
Auto and Home Insurance	Answer Financial	Private, Independent Insurance Agency
Employee Health and Life Insurance	Extended Benefits Group, LLC	Private Employee Benefits Firm
Commercial Insurance for Property, Liability, Workmen's Comp, & Commercial Auto Coverages	Answer Financial	Private, Independent Insurance Agency
Premier Line of Credit Unsecured Working Capital Line	GE Capital Financial Incorporated	General Electric Company Operated Business Lender
Retirement Plans	A.G. Edwards and Company	Investment Banking and Brokerage
Vision Insurance	AIG Incorporated	Large Insurer and Reinsurer
Merchant Credit Card Processing	Wells Fargo Bank	Large Commercial Bank
One Consumer and Two Business Credit Cards	Discover	General Electric Company

Source: Sam's Club Member Services Guide, Business Members, Winter 2005-06 and internet search of company types.

Appendix E

The Evolution and History of Bank Regulation Related to the Creation of Industrial Banking in the United States

In the aftermath of the Great Depression and bank holidays of 1930s the federal government sought to protect the banking industry in terms of safety and soundness, enacting legislation to restrict competition and types of services offered by financial institutions. The Bank Act of 1933, better known as, the Glass-Steagall Act, separated commercial banking from investment banking and placed a wall between retail companies and banks. Later on the Bank Act of 1935 expanded the powers of the Federal Reserve and restricted De-Novo creation of banks, by giving the Comptroller of the Currency the right to deny national bank charters. National bank charters were granted only if an applicant could show convincingly that the new bank would not interfere with the competitiveness or safety of the bank market where the financial institution was to be operating. The 1933 and 1935 Bank Acts also placed restrictions on the type of services banks could provide and prohibited the development of interstate banking. [36] Up to 1980, bank regulation effectively limited the expansion of financial institutions both geographically and in terms of services. Banks were unique in that they could offer demand deposits, commercial and mortgage loans, and trust services. Credit Unions, S&Ls and industrial banks could offer some of these services but not as many as their banking counterparts. However, responding to the advent of electronic bank technology and the development of money market mutual funds in the late 1970s, the federal government enacted the Monetary Control Act in 1980 which expanded the types of services all financial institutions could offer.[37] Unfortunately, the federal government did not calculate nor comprehend the financial costs that might occur to the FSLIC and the FDIC as a result of the expansion of banking powers into the S&L industry. [38] The decade of the 1980s was highlighted by the failures of banks and savings and loans which depleted most of the insurance reserves in the FDIC and all of the funds in the FSLIC. By the time the Financial Institutions, Reform, Recovery and Enforcement Act was passed in 1989, the GAO estimated that losses would amount to over $500 Billion in the 500 plus S&Ls that had failed over the decade. The S&L bankruptcies were the result of taking on too much interest rate risk which caused asset quality problems within failing institutions. [39]

In the mid-1980s troubling signs emerged concerning the development of bank entities outside the regulatory framework devised by the federal government. While national bank charters could be regulated by the Comptroller of the Currency, states were free to charter their own savings banks and allow them to secure deposit insurance coverage through a private insurer. The failure of Home State Savings Bank of Ohio in 1985, brought to light difficulties associated with chartering state savings bank, allowing them to offer virtually the same services as any other federally regulated bank, and believing deposits were adequately insured by a private insurer. When Home State Savings failed in April of 1985, it was the largest insured institution covered by the Ohio Deposit Guarantee Fund [ODGF], a private, state of Ohio corporation. The collapse of Home State Savings wiped out the reserves at the ODGF leading to an immediate run on the bank. [40] In order to restore the safety and soundness of the banking system in Ohio, the federal government took the unprecedented step of coming in to work on a rehabilitation or successful merger of Home State Savings. In doing so, the federal government permitted an out of state financial institution, Chemical Bank, to bid on acquiring Home State and all it's branches. [41] This decision had far reaching implications because it allowed an outside bank to enter a local market without going through a formal application process with federal banking authorities. In the years following Home State, healthy financial institutions could bid and acquire failing S&Ls or banks in regions outside their markets to expand to other states. This era ushered in the development of interstate banking and the precedent of permitting interstate banking to encourage the merging out of failed financial institutions. However, it wasn't until the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, that the door was opened for holding companies to acquire banks in any state.[42] In addition to the Ohio state savings crisis brought on by the failure of Home State Savings, the Nebraska State Insurance Fund went under after the collapse of an industrial bank in Lincoln, Nebraska called Commonwealth Savings. Eventually the Home State Savings depositors recovered all their monies, but the case of the Commonwealth savers does not have a happy ending. The depositors in the industrial savings bank received very little of the $58 million that was owed them from Commonwealth Savings. [43]

Endnotes

[1] U.S.A. Today, "Wal-Mart Applies to Create a Utah Bank," July 19, 2005; CBC News,"Wal-Mart Stores, Inc. Applies to Create a Utah Industrial Bank," December 10, 2005.

[2]www.financialservicesfacts.org, Insurance Information Institute, Industrial Banks, "Top Ten-FDIC Insured Industrial Banks by Assets 2004."

[3] Value Line Investment Survey, Wal-Mart Stores, November 11, 2005, p. 1694.

[4] Value Line Investment Survey, op.cit., pp. 1675 and 1694.

[5] August 11, 2005, Letter to Mr. John F. Carter, Regional Director, FDIC, from Travis Plunkett, Consumer Federation of America, Margot Saunders, Counsel, National Consumer Law Center, Edmund Mierzwinski, Consumer Programs Director, U.S. Public Interest Research Group, and John Taylor, President, National Community Reinvestment Coalition, protesting Wal-Mart's application to create an industrial bank in Utah.

[6] West, "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective," FDIC Supervisory Insights, www.fdic.gov/regulations/examinations/supervisory/instights/sisum04/industrial_loans.html pp.1-10.

[7] West, op.cit. pp. 3-4.

[8] West, op.cit.p. 4.

[9] West, op.cit, p. 4 and 9. A Bank Holding Company Act bank was defined as a financial institution that offered both commercial loans and demand deposits. If a financial entity, such as ILC, provided only one of these services it did not come under the Bank Holding Company Act[BHCA]. Such financial institutions were referred to as nonbank banks because they were not banks under BHCA and could not be federally regulated, nevertheless they provided banking services while being covered under FDIC insurance.

[10] The following table gives most of the major services that are similar. A more extensive listing may be found in West, op.cit., pp. 2-3.

[11] Fraser, Gup and Kolari, Ibid., pp. 29-40; and U.S. vs. Philadelphia National Bank, et.al., 210 F. Supp 348 (1962); 83 S Ct. 1715 (1963). U.S. vs. First National Bank and Trust Co. of Lexington, et. al., 208 F. Supp. 457 (1962); 84 S Ct. 1033 (1964); also see, Edward Reed, Richard Cotter, Edward Gill, and Richard Smith, Commercial Banking, (Englewood Cliffs, N.J.:Prentice-Hall, Inc.,1976), Chapter 3.

[12] Stephen A. Rhoades and Roger D. Rutz, "Impact of Ban Holding Companies on Competition and Performance in Banking Markets," The Federal Reserve Board, Staff Study #107(August 1979), pp. 1-20.

[13] Stephen A. Rhoades, "Bank Mergers and Industrywide Structure, 1980-94, The Federal Reserve Board, Staff Study # 169 (January 1996), pp. 1-29.

[14] Rhoades, op. cit., p.27. The Rhoades results were determined using a three-firm concentration ratio, as well as, the Herfindahl-Hirschman indexes. As noted in this study, local market concentration may be important because bank competition seems to occur at the local market level for households and small businesses which indicates the degree of competition for local bank services.

[15] Stephen A. Rhoades, "Bank Mergers and Industrywide Structure, 1980-98, The Federal Reserve Board, Staff Study # 174 (August 2000), pp. 1-31.

[16] Yongil Jeon, and Stephen Miller, "Bank Concentration and Performance," University of Connecticut, Department of Economics Working Paper Series, # 2002-25, pp. 1-23. This paper provides a fairly thorough discussion on the relevant market definition, concentration measures and profit relationships for doing current bank studies.

[17] Tarek S. Zaher, and Raj Kohli, "Comparative Performance of Internet-only Banks and Conventional Banks, " Journal of the Academy of Finance, Vol. 3, #3(Winter 2005), pp. 152-164.

[18] United States Government Accountability Office, Report to the Honorable James A. Leach, House of Representatives, "Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority," September 2005, pp. 1-98.

[19] U.S. GAO, op.cit., pp. 65-81.
[20] Wal-Mart Bank Application, Industrial Bank Application Package, Utah Department of Financial Institutions, FDIC, Volume 1, FDIC Public File(2005).

[21] Wendy Zellner, "Your New Banker," Business Week, New York, Feb. 7, 2005, Issue 3919, p. 28.

[22] GAO Report to the Honorable James A. Leach, House of Representatives, Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority, September 2005, p. 76.
[23] GAO Report, op.cit., p. 76.
[24] Debby Garbato, "Club of the Community," Retail Merchandiser, September 2005, Vol. 45, Issue 9, pp. 14-16.

[25] John H. Helyar, and Ann Price, "The Only Company Wal-Mart Fears," Fortune, November 24, 2003, Vol. 148, Issue, 11.
[26] Garbato, op.cit., pp. 14-16.
[27] Emek Basker, "Selling a Cheaper Mousetrap: Wal-Mart's Effect on Retail Prices," Journal of Urban Economics, 58(2005),p. 203.

[28] Kenneth E. Stone, Georgeanne Artz, and Albert Myles, "The Economic Impact of Wal-Mart Supercenters on Existing Businesses in Mississippi," Mississippi State Extension Service, Fall 2002, pp. 10-11.
[29] Ibid, pp. 10-11.
[30] Stephen J. Arnold, Robert V. Kozinets, and Jay M. Handelman, "Hometwon Ideology and Retailer Legitimation: The Institutional Semiotics of Wal-Mart Flyers," Journal of Retailing, Vol. 77(2001), p. 243.

[31] Ibid, p. 243.
[32] Basker, op. cit., p. 203.
[33] Ibid, p. 203.
[34] Stone, et. al, op. cit., pp. 10-11.
[35] David Neumark, Jenifer Zhang, and Stephen Accarda, "The Effects of Wal-Mart on Local Labor Markets," NBER Working Paper Series, Working Paper 11782, p. 30.
[36] For a review of bank regulation from a thesis, antithesis perspective, see Fraser, Gup and Kolari, Commercial Banking: The Management of Risk, 2nd Edition, Southwestern Publishing, 2001, pp. 30-46; Gardner and Mills, Managing Financial Institutions: An Asset/Liability Approach, 3rd Edition, Dryden Press, 1993.
[37] For a discussion of the implications of the Monetary Control act in terms of the risks associated with the new bank services offered by financial institutions, see A. F. Thompson, Roger D. Rutz, and Frederic Stiner, "Fidelity Insurance: Are there Differences in Experience Among Financial Institutions?", Federal Home Loan Bank Board Journal, Vol. XVI #2(February 1983), pp. 2-7.
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[39] A. F. Thompson, Prasad Medury, Anju Ramjee, B. Ramjee, "An Actuarial Approach to the Analysis of Post Deregulation Thrift Failures in the U.S.A.," Paris, France, Vol. 1., pp. 35-59.
[40] L. Bowyer, A. F. Thompson, and Venkat Srinivsan, "The Ohio Banking Crisis: A Lesson in Consumer Finance," The Journal of Consumer Affairs, Vol. XX, #2(1986), pp. 290-292.
[41] Peter Jensen, "Depositors Push Home State Sale," Cincinnati Enquirer Business Section, April 15,1985.
[42] Frazer,Gup and Kolari, Ibid, p. 45.
[43] Bowyer, Thompson, and Srinivasan, Ibid., p.291; Patricia Dreyfus, "How Safe are Your Savings?" Money, (May 1985), pp.56-59.