Do Local Banks Bolster Regional Competitive Advantages?
U.S. Community Banking and Economic Development in Comparative Perspective, 1945-1970

Abstract
Fuji Conference
September 2013

The role of financial institutions in the development of industrial capabilities and competitive advantages has long received attention from business and economic historians. This has been particularly true of scholarship on large, universal financial institutions and their place in the development of big business in late developing countries, a context in which they arguably marshaled scarce managerial and entrepreneurial talents to allow firms to compete at the international level (Gerschenkron, 1962). But, more recently, the claim has also been made about small scale banks and other credit institutions in supporting the competitive advantages of regions and industrial clusters.

The growing interest among business historians in the role of financial institutions in supporting the development of regional competitive advantages is linked to the literature on small and medium sized enterprise development and flexible specialization as an alternative to the development of large Chandlerian firms (Piore and Sabel, 1984). Small, local financial institutions, it has been argued, played a pivotal role in supporting the developed of regional competitive advantages. Their access to local information about SMEs and industrial conditions put them in a stronger position to extend long-term financing to entrepreneurial firms. In countries that developed highly consolidated national financial institutions, like Great Britain, SMEs were often starved for financing, while those that maintained a strong variety of local financial intermediaries, like Germany and Italy, saw the development of healthy clusters and regional competitive advantages based on internationally competitive SMEs (Carnevali, 2005).

In this study, I examine the role of local financial intermediaries in supporting regional competitive advantages in the U.S. in the post-WWII period. For a variety of reasons, the U.S. developed a highly fragmented financial system characterized by thousands of local intermediaries. Yet, I find that SMEs and local firms often still lacked access to the range of financing they needed to grow and compete, as local institutions focused on a narrow range of financing opportunities. I argue that the impact of local financial institutions on SME development and the creation of regional competitive advantages hinge not only on the size of the institutions but also on the strategies and policies regarding credit and risk that came to be institutionalized.

Banking and Regional Competitive Advantage

Until recently, small, local financial institutions received relatively little attention from business historians, and were often considered an uncompetitive, marginal sector of financial systems. There were both theoretical and historical reasons for this relative neglect. Theoretically, large financial institutions seemed to occupy the modernizing frontier of financial systems because their size and level of diversification allowed them to use economies of scale to push down costs, to finance large projects, and to manage risks in ways that small institutions could not. As such, they seemed the only reasonable

competitor to the efficiency of organized financial markets as a modern form of financing. The Gerschenkronian thesis that large banks played an "entrepreneurial" and not just a financial role in the development of large scale enterprise in late industrializing countries further solidified the impression that small, local financial institutions were not at the frontier of competitive dynamics in modern economies, but rather simply financed the industrial periphery.

The recent growth of interest in small scale financial institutions is a shift that that has come about because of changes in both historical and theoretical considerations. The rediscovery of industrial clusters and SMEs by Sabel, Piore, Zeitlin, Scranton and others in the 1980s and 1990s brought increased attention to the sources of financing for these types of enterprise and for the sources of regional competitive advantages. Theoretically, greater attention to information and monitoring advantages as a basis for understanding financial firms led to a contention that small credit institutions of various types could succeed where large institutions fail if they have information advantages in lending to and in monitoring particular borrowers. Small, local financial institutions, it was contented, were better positioned to understand SMEs and regional circumstances than large national or international institutions seeking to extend credit through branch networks.

Carnevali's (2005) comparative study of banking structures and SME financing seemed to solidify the idea that local financial institutions were pivotal in regional development. In particular, she contrasted the highly consolidated banking system of Great Britain, with the presence of a variety of local financial institutions in Germany, France, and Italy to show that efforts to maintain local institutions in the latter cases facilitated long-term finance to growth oriented SMEs. Studies like Carnevali's also brought attention to the heterogeneity of such local financial intermediaries in many European countries, comprised as they were not just of commercial banks, but also of savings banks, credit cooperatives, mortgage banks, popular banks, and state-sponsored financing (Guinnane, 2002; Spadavecchia, 2005).

The U.S. Case in Comparative Perspective

The U.S. case provides an interesting contrast to developments in Continental Europe because even though small, local financial institutions thrived in postwar America, they do not seem to have played a particularly important role in the development of SMEs or in sustaining regional competitive advantages. As in Great Britain, SMEs in the post-World War II U.S. complained about a chronic lack of access to financing and eventually exacted political concessions from government, including the creation of the Small Business Administration. The paper will account for the reasons for this pattern of development by considering both the origins of postwar local banking structure and practices and its effects on SME financing and regional competitive advantage.

Origins of the Post-War US Banking Order

The postwar US financial system – like the German and Italian ones – was characterized by a plethora of local financial intermediaries, including community commercial banks, savings and loan associations, and credit unions. But the origins of this financial structure were quite different from that of Continental Europe. Unlike in Germany, where local savings banks and credit cooperatives sought to

compete against the big commercial banks by universalizing to include a range of services for regional households, businesses, and governments, localization in the United States involved a high degree of segmentation between different varieties of intermediaries. Institutions competed in the political arena by trying to segment markets and avoid direct conflict between varieties of institutions. Rather than universalizing, local institutions segmented themselves by geography and product line.

New Deal programs and regulations hardened this segmentation, prohibiting savings institutions, commercial banks, and thrifts from competing against one another and implementing restrictions on both sides of the balance sheet. The regulations helped ensure the stability of the fragmented banking system, but also inhibited innovation and prevented local financial institutions from becoming crucial one-stop shops for regional financial needs and information.

Effects on Post-War SME Financing and Business Practices

The result was that local financial institutions in the postwar United States rarely competed against each other, focusing instead on business models defined by meeting narrow financial need in local communities. This constricted the kinds of capabilities that local American financial institutions developed. Rather than seeing broad regional economic opportunities, they tended to focus more narrowly on their lines of business. This benefitted certain narrow, local markets, such housing, commercial real estate, and consumer finance. But its impact on growth oriented SMEs and regional competitive advantages were limited. Second, it provides a broader context for the emergence of venture capital and private equity industry. It suggests that the reasons such forms of financing developed in the late twentieth-century America was because despite the fact that the U.S. had local financial institutions they were limited in providing the services needed by SMEs.

Conclusion

The U.S. case profiled in this paper suggests that while size and access to local knowledge may matter in financing SMEs and regional advantages, it does not ensure that local institutions will support such developments. Rather, it suggests that the institutional rules governing such intermediaries and the strategies employed by them are just as important in shaping how they interact with local and regional economies.

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