PROFITABILITY OF MINORITY BANKS IN 1977

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A significant development in the American banking industry during the post-World War II era has been the interest shown by certain ethnic groups in the ownership and operation of commercial banks. So-called minority banks have drawn special attention from both the government and private businesses. The executive and legislative branches of the Federal government, along with the Federal bank supervisory agencies, have favored minority banks with a number of special programs, rules, regulations, and studies aimed at strengthening the operation of these banks. Private industrial firms and the major trade association of the banking industry also have been active in designing special programs to assist minority banks.

For purposes of the discussion that follows, minority banks are considered to be those commercial banks in which 50 percent or more of the common stock is owned and controlled by any of the following racial groups: (1) Black; (2) Hispanic-American; (3) Asian-American; (4) American Indian; (5) Eskimo, Aleut; and (6) Multiracial. A recent amendment to the Federal Reserve System's rules and regulations allows a bank to qualify as a minority bank if: (a) more than 50 percent of its stock is owned by women; (b) a majority of its board consists of women; and (c) women hold a significant number of its management positions.

Minority banks have existed in this country for many years and some can show an impressive record of sustained success. A number of black banks, for example, have operated profitably since early in this century, and eight such banks survived the "bank holiday" of 1933. Until recently, neither banking students nor bank supervisory agencies gave any particular attention to black or other ethnic banks, although in the 1930's J. B. Blayton, a noted black accountant, businessman, and college professor, reported on the successful operations of black banks in a number of studies of black business firms.[1]

In recent years, a steady flow of research has begun to focus on the operations of black banks and the growing number of banks owned and operated by groups designated as minorities. Most of this research compares the operations and financial performance of minority banks with those of nonminority banks. A previous issue of this *Review,* however, carried another type article which undertook to evaluate minority banks by comparing the high-earning banks in this group with the others.[2]

The paragraphs that follow extend that article by examining the general profitability of minority banks during 1977 and by comparing the financial performance of minority banks in that year and 1976. The data used were derived from Reports of Condition and Reports of Income filed by each insured commercial bank with its Federal bank supervisor. The study is limited to minority banks at least three years old. The reason for excluding less-than-three-year-old banks is that, in the first three years of their existence, new minority banks, according to an FDIC sponsored study, can typically expect to experience losses from current operations.[3]

PROFIT LEVELS, 1976-1977

Consistent with the trend for the entire banking industry, minority banks as a group realized increased profits in 1977. The number of profitable minority banks rose by 16.6 percent compared with an increase of 6.1 percent in the number of profitable banks in the industry generally. On the other hand, there was also an increase in the number of unprofitable minority banks in 1977, while the number of unprofitable banks in the industry as a whole declined. For this study, there were ten more minority banks in 1977 than in 1976. This fact, however, made the gain in the number of profitable minority banks in 1977 all the more impressive since the ten additional banks were just emerging from the less-than-three-year-old category, which contains a high percentage of unprofitable banks, according to the previously mentioned FDIC study.

[1] See e.g., J. B. Blayton, "The Negro in Banking," **Bankers Magazine,** Vol. 4, December 1936, p. 511.

[2] Bruce J. Summers and James F. Tucker, "Performance Characteristics of High-Earning Minority Banks," **Economic Review,** Federal Reserve Bank of Richmond, Vol. 62, No. 6 (November/December 1976), pp. 3-12.

[3] John T. Boorman, **New Minority-Owned Commercial Banks, A Comparative Analysis** (Washington, D. C.: Federal Deposit Insurance Corporation, 1973), p. 34.

Minority banks that had been in operation for three years or longer numbered 70 in 1977. Of these, 49 showed a net income (i.e., profit) for the year, while 21 experienced net losses. In 1976 there were 60 such banks, 42 of which showed net income for that year, while 18 experienced net losses. The percentage of the total number showing positive net income was practically the same, 70 percent for each year. By size group, as shown in Table I, slightly more than half the banks with assets under $10 million realized a net income in 1977, down from 62 percent in 1976. Seventy percent of those with assets in the $10-$25 million range were profitable in 1977, as against 75 percent in 1976. Of those in the $25-$50 million group, 80 percent were profitable in 1977 compared with 82 percent in 1976. All banks with assets over $50 million were profitable in 1977, whereas only 50 percent of this group showed a profit in 1976. The year-to-year changes in these percentages, and especially the reductions in the percentage of smaller banks that were profitable, were no doubt affected by such factors as the operating experience of the ten additional banks in 1977 and the failure of some of the banks to correct a number of long-standing problems.

Total net income of the 70 banks in 1977 exceeded $5 million, compared with just under $1.5 million for the 60 banks in 1976. The increase in 1977 was accounted for not by the inclusion of the ten additional banks in that year but rather by the growth and the greatly improved profitability of the larger banks. As shown in Table I, the number of banks with assets in excess of $50 million grew from four, with net income of $672,000 in 1976, to seven, with net income of over $4 million in 1977, thus accounting for the bulk of the year-to-year gain. Banks in the $25-$50 million category increased in number from 11 to 15, while their net income rose from $1.4 million to $1.8 million. Average net income per bank was up sharply for the largest banks, from $168,000 in 1976 to $581,000 in 1977. But for those in the $25-$50 million class, average per bank income was down a shade, from $124,000 to $118,000.

For smaller banks the income picture was much less favorable. As a group, those in the under $10 million category, numbering 21 in both 1976 and 1977, suffered losses in both years. Losses in 1977 totaled $609,000 or $29,000 per bank on the average. This was, however, an improvement over 1976, when losses came to $924,000 or an average loss of $44,000 per bank. The 27 banks in the $10-$25 million category lost a total of $54,000 in 1977. This compares unfavorably with the positive net income of $312,000 recorded by 24 banks in this category in 1976.

Table I

NUMBER OF PROFITABLE MINORITY BANKS AND AGGREGATE PROFITS IN 1976 AND 1977

Size of Banks by Assets (in millions of dollars)	Total Number of Banks		Number of Profitable Banks		Aggregate Profits (in thousands of dollars)	
	1976	1977	1976	1977	1976	1977
Under 10	21	21	13	11	−924	−609
10-25	24	27	18	19	312	−54
25-50	11	15	9	12	1,364	1,770
Over 50	4	7	2	7	672	4,067
Total	60	70	42	49	1,424	5,174

Net Operating Income While the magnitude of the increase in net income for the aggregate of minority banks in 1977 was substantial, the sources of the increase were perhaps equally important. As shown in Table II, the average minority bank in every size class except the $25-$50 million category actually incurred a loss on current operations during 1976. For the banks as a group, however, gains from securities transactions more than offset this operating loss and produced an overall net profit. In 1977, the situation was much different. The average minority bank in every size class except the under-$10 million category earned a net income on operations. Even the average bank in the under-$10 million category showed an improvement in operating net income over 1976, as the average loss fell from $56,000 to $30,000. Thus the average bank in every size category turned in a better operating performance in 1977 than in 1976, although in dollar terms the bulk of improvement was concentrated at the larger banks.

Profitability Measures Two commonly used measures for evaluating the earnings performance of commercial banks are the ratios of net income to average equity capital (return on equity) and net income to average total assets (return on assets). The former indicates the yield on the stockholder's investment, while the latter is a measure of the effectiveness with which management employs the bank's assets.

Both measures reflect increased profitability of minority banks taken as a group in 1977. For the average minority bank, the return on equity for 1977 was 5.2 percent, compared with 1.7 percent in 1976. The return on assets for 1977 was 0.3 percent as

Table II

INCOME AND EXPENSES OF THE AVERAGE MINORITY BANK BY ASSET-SIZE, 1976 AND 1977

(Amounts in thousands of dollars)

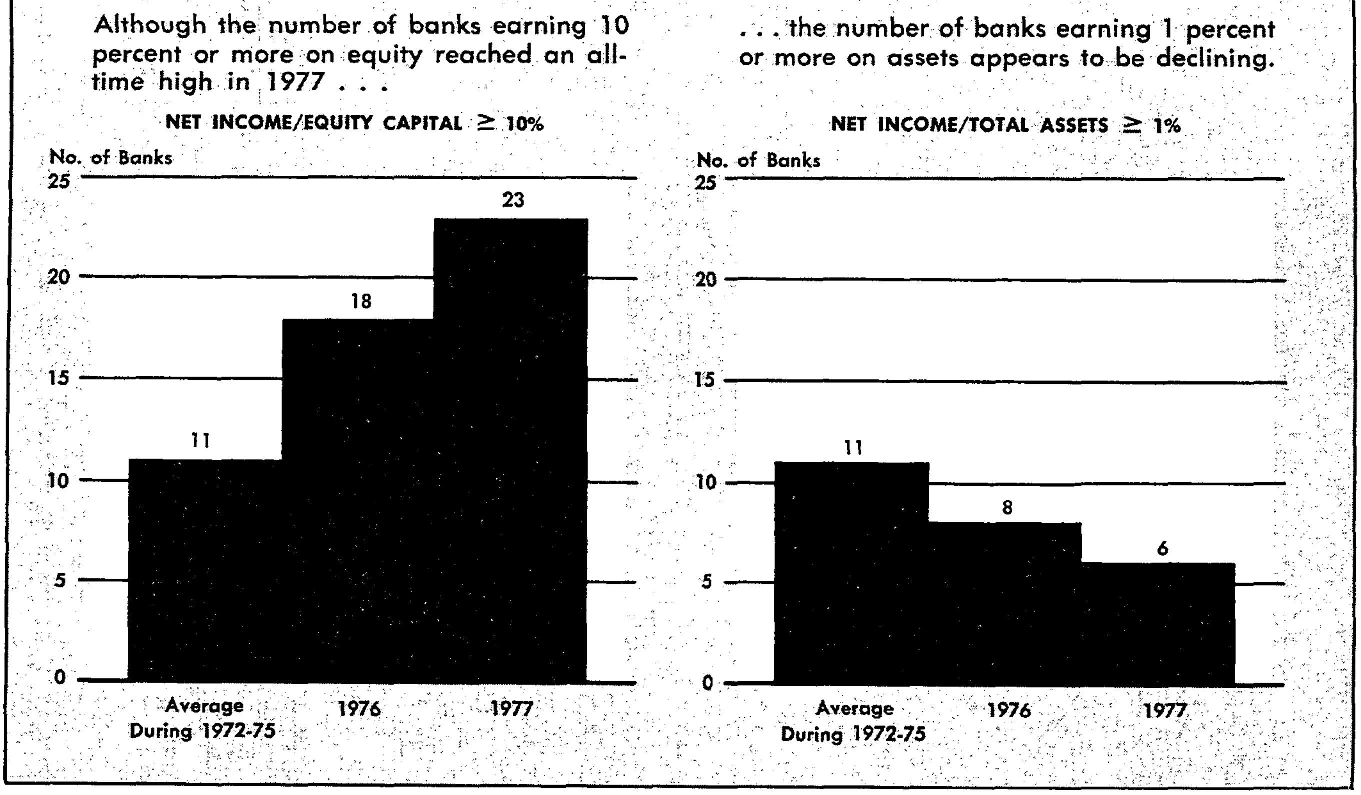
Item	Under 10		10-25		25-50		Over 50		Average, All Banks		
	1976	1977	1976	1977	1976	1977	1976	1977	1976	1977	% Change
OPERATING INCOME:											
Interest and Fees on Loans	316	325	705	681	1,316	1,345	3,738	3,138	883	962	8.95
Interest on Balances with Banks	5	4	24	12	49	17	159	150	31	25	−19.35
Income on Federal Funds Sold, etc.	38	36	101	81	135	150	198	300	92	104	13.04
Interest and Dividends on: U. S. Treasury Securities	76	69	143	157	252	243	482	706	162	204	25.92
Obligations of Other U. S. Government Agencies	45	39	130	115	297	198	402	373	149	136	−8.72
Obligations of States and Political Subdivisions	11	9	22	16	165	58	429	327	71	54	−23.94
All Other Securities	2	4	15	15	78	26	10	60	22	19	−13.64
Service Charges on Domestic Deposit Accounts	44	42	75	61	154	151	153	220	84	91	8.33
Other Service Charges, etc.	28	35	31	35	61	47	163	139	44	48	9.09
All Other Income	14	7	19	12	19	27	80	50	22	17	−22.73
Total Operating Income	578	570	1,266	1,185	2,526	2,262	5,813	5,463	1,560	1,659	6.35
OPERATING EXPENSES:											
Salaries and Employee Benefits	176	164	330	286	723	606	1,016	1,132	394	403	2.28
Interest on Deposits	193	187	433	404	888	768	2,739	2,307	586	607	3.58
Expense on Federal Funds Purchased	1	2	14	27	4	5	18	27	8	15	87.50
Interest on Other Borrowed Money			1	1	1	4	13	6	2	2	0.00
Interest on Subordinated Notes and Debentures	2	1	8	5	39	22	25	40	13	11	−15.38
Net Occupancy Expense	36	34	75	61	125	117	167	186	76	77	1.32
Furniture and Equipment Expenses	22	24	38	38	74	75	123	110	44	49	11.36
Provision for Possible Loan Losses	67	46	122	127	112	82	995	260	159	106	−33.33
Other Expense	137	141	263	229	456	447	881	782	296	305	3.04
Total Operating Expenses	634	600	1,283	1,177	2,420	2,126	5,976	4,849	1,577	1,574	−0.19
Income Before Tax and Securities Gains (Loss)*	−55	−30	−17	8	107	137	−162	615	−18	85	572.22
Applicable Income Taxes	−4		15	17	8	36	−197	119	−7	26	471.43
Income Before Securities Gains or Losses	−51	−30	−32	−9	99	100	35	496	−10	59	690.00
Securities Gains (Losses) Net	8	1	38	3	20	18	133	34	31	9	−70.96
Net Income Before Extraordinary Items	−43	−29	6	−6	119	118	168	530	20	67	235.00
Extraordinary Items, Net	−1		7	4	5			51	4	7	75.00
Net Income	−44	−29	13	−2	124	118	168	581	24	74	208.23
Number of Banks	21	21	24	27	11	15	4	7	60	70	16.67

Size Groups in Millions of Dollars apply to the Under 10, 10-25, 25-50 and Over 50 columns.

* May not add to totals due to rounding.

Chart 1

MINORITY BANKS AND TARGET EARNINGS PERFORMANCE FOR 1972-75, 1976 AND 1977



against 0.1 percent for 1976. Moreover, the number of minority banks realizing a return on equity of 10 percent or more was 23 in 1977, compared with only 11 in 1976. Return on assets also showed an improvement for minority banks as a group. The ratio of net income to total assets rose from 0.1 percent in 1976 to 0.3 percent in 1977. There was, however, a decline in the number of banks that realized a return on assets of 1.0 percent or more. This number declined from eight in 1976 to six in 1977 (Chart 1).

From these data it seems clear that a substantial number of minority banks that realized a return of 10 percent or better failed to earn as much as 1 percent on total assets. To some financial analysts this would suggest that such banks are either undercapitalized or are carrying too many low-yielding assets. Aggregate data for the 70 banks do, in fact, indicate that growth in equity capital for the group has lagged behind growth in other parts of their financial structure. From 1976 to 1977, for example, total equity capital for the group increased 3.1 percent while total assets rose 12.4 percent, net loans 9.8 percent, and total deposits 14.1 percent (Table III). The ratio of total equity capital to total assets over the same period fell from 8.8 percent to 8.1 percent. It should be noted, however, that in the same period this ratio declined from 9.2 percent to 9.0 percent for nonminority banks as well.

Sources of Profits Previous studies have suggested that the relatively high expense structure of minority banks was the principal reason for the difference in their financial performance and that of nonminority banks of similar size.[4] One study, comparing minority banks with each other, illustrated in detail that the crucial factor determining a given bank's position in a profitability ranking is the extent to which it is able to control expenses.[5] Thus experience suggests that effective measures to restrict the growth of operating expenses could become an important source of improved profitability. In fact, effective cost control appears to have been a major source of increased profits in 1977.

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[4] See John T. Boorman, "The Prospects for Minority-Owned Commercial Banks: A Comparative Performance Analysis," **Journal of Bank Research** (Winter 1974), pp. 263-279.

[5] Summers and Tucker, **op. cit.**, pp. 9-10.

Table III

SELECTED ASSETS AND LIABILITIES OF THE AVERAGE MINORITY BANK BY ASSET-SIZE, 1976 AND 1977

(As of December 31)

(Amounts in thousands of dollars)

Item	Size Groups in Millions of Dollars										
	Under 10		10-25		25-50		Over 50		Average, All Banks		
	1976	1977	1976	1977	1976	1977	1976	1977	1976	1977	% Change
ASSETS:											
Cash and Due From Banks	684	1,041	1,933	1,648	3,755	3,937	9,092	7,791	2,307	2,571	11.40
Total Securities Held: U. S. Treasury	1,143	1,098	2,763	2,143	4,104	3,787	7,520	13,338	2,759	3,301	19.64
Other U. S. Government Agencies	686	646	1,568	1,845	3,871	2,745	4,630	5,480	1,885	2,042	8.33
States and Political Subdivisions	169	215	424	404	2,384	1,258	9,017	5,692	1,267	1,059	−16.42
All Others	25	42	193	208	884	196	74	838	253	219	13.44
Federal Funds Sold, etc.	382	664	1,768	2,019	1,820	3,156	7,138	8,593	1,651	2,514	52.27
Loans, Net	3,241	3,300	7,323	7,123	15,255	14,640	42,276	37,568	9,679	10,631	9.83
Fixed Assets	244	316	411	405	1,345	1,243	2,837	1,907	986	708	3.21
All Other Assets	88	95	229	246	478	438	1,667	1,262	321	344	7.16
Total Assets	6,663	7,516	16,612	16,043	33,896	31,402	84,251	82,470	20,808	23,389	12.40
LIABILITIES:											
Demand Deposits, IPC	1,595	1,812	3,886	3,797	9,777	8,701	16,420	17,768	5,000	5,650	13.00
Time and Savings Deposits	2,854	2,635	6,717	6,021	14,977	12,371	40,191	39,677	9,111	9,732	6.81
Deposits of U. S. Government	354	800	1,009	1,885	1,906	2,126	2,885	4,728	1,069	1,896	77.36
Deposits of States and Political Subdivisions	984	1,278	2,632	2,632	3,329	4,286	9,329	8,283	2,629	3,145	19.62
Deposits of Commercial Banks	43	32	140	24	66	30	5,625	3,272	461	352	−23.64
Other Deposits	81	97	295	236	373	808	2,284	1,995	367	494	34.60
Total Deposits	5,911	6,655	14,687	14,598	30,428	28,323	76,734	75,723	18,638	21,269	14.11
Demand Deposits	2,154	2,812	5,919	6,413	13,272	12,279	24,363	26,743	7,179	8,623	20.62
Time and Savings Deposits	3,758	3,843	8,768	8,185	17,156	16,044	52,372	48,980	11,459	12,646	10.36
Federal Funds Purchased, etc.	26	65	396	96	230	17	313	729	231	139	−39.83
Mortgage Indebtedness	5		13	13	448	322	121	66	97	80	−17.53
All Other Liabilities	74	61	245	174	273	558	1,495	992	274	304	10.94
Total Liabilities	6,017	6,801	15,342	14,881	31,380	29,220	78,662	77,510	19,240	21,792	13.26
Subordinated Notes and Debentures	48	27	128	138	530	282	338	511	188	173	−7.98
EQUITY CAPITAL:											
Preferred Stock—Par	20	17	43	52	143	28		203	50	51	2.00
Common Stock—Par	378	414	630	541	601	708	1,690	1,204	608	605	.49
Surplus	233	251	393	399	915	798	3,163	2,457	618	646	4.53
Undivided Profits	−39	−99	76	31	244	347	398	586	88	115	30.68
Reserves for Contingencies, etc.	6	5		1	83	20			17	6	−64.71
Total Equity Capital	598	589	1,143	1,024	1,986	1,900	5,251	4,449	1,381	1,424	3.11
Total Liabilities and Equity Capital	6,663	7,416	16,612	16,043	33,896	31,402	84,251	82,470	20,808	23,808	12.40
Number of Banks	21	21	24	27	11	15	4	7	60	70	

Table IV

KEY OPERATING RATIOS, AVERAGE MINORITY BANK, 1976 AND 1977

Item	Average Total		Under 10		10-25		25-50		Over 50	
	1976	1977	1976	1977	1976	1977	1976	1977	1976	1977
Percent of Average Total Assets:										
Operating Income	7.5	7.1	8.7	7.7	7.6	7.4	7.5	7.2	6.9	6.6
Operating Expense	7.6	6.7	9.5	8.1	7.7	7.3	7.1	6.8	7.1	5.9
Percent of Average Financial Assets:										
Gross Interest Earned	8.0	7.6	6.6	8.1	8.1	7.8	8.1	7.9	7.7	7.1
Gross Interest Expense	3.5	3.2	2.6	3.1	3.2	3.2	3.3	3.1	3.9	3.3
Net Interest Margin	4.5	4.4	4.0	5.1	5.9	4.6	4.8	4.8	3.8	3.8

Size Groups in Millions of Dollars

The data in Table IV indicate that, for the banks as a group, the improvement in the expense structure in 1977 was a considerably more important factor increasing net income or profits of these banks than the improvement in operating income. In fact, even though total net income of minority banks was greater in 1977 than in 1976, the ratio of operating income to average total assets declined in 1977. On the other hand, even with increased deposits, loans, and investments, the ratio of operating expense to average total assets declined from 7.6 percent in 1976 to 6.7 percent in 1977. In short, the drop in the operating expense to asset ratio more than matched the drop in the corresponding operating income to asset ratio, thereby resulting in an improvement in net income for the banks as a group. While the drop in the operating expense to asset ratio was indeed important, perhaps even more significant was the decline in the ratio of noninterest expense to average total assets, which fell from 4.7 percent to 3.9 percent (Table V). The decline in this latter ratio was greatest for the over $50 million asset-size banks, dropping from 3.6 percent to 2.5 percent.

Salary Expense A key expense that minority banks were able to improve upon in 1977 was the outlay for salaries and employee benefits. The improvement in this expense item is reflected in the reduction in the ratio of salaries and employee benefits to average total assets for the banks as a group (see Table V). Increased attention to recruiting and training, along with better utilization of personnel appear to have been the principal factors in this improvement.

Salaries and employee benefits tend to be relatively high expense items at minority banks. One reason for this is that more personnel are needed to service a given dollar deposit total when the average size of each deposit is small. Most minority banks levy service charges but the relatively high salaries that these banks must pay to secure qualified personnel are an offset to revenues from this source.

Table V

RATIO OF NONINTEREST EXPENSES TO AVERAGE TOTAL ASSETS AT MINORITY BANKS DURING 1976 AND 1977

Size Groups in Millions of Dollars

Noninterest Expense	Average Total		Under 10		10-25		25-50		Over 50	
	1976	1977	1976	1977	1976	1977	1976	1977	1976	1977
Salaries and Employee Benefits	1.9	1.7	2.6	2.2	2.0	1.8	2.0	1.9	1.2	1.9
Net Occupancy	0.4	0.3	0.5	0.4	0.5	0.4	0.4	0.4	0.2	0.2
Furniture and Equipment	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.1
Provision for Possible Loan Losses	0.8	0.4	1.0	0.6	0.7	0.8	0.3	0.3	1.1	0.3
Other Expenses	1.4	1.3	2.0	1.9	1.6	1.4	1.3	1.4	1.4	1.3
Total	4.7	3.9	6.4	5.4	5.0	4.6	4.2	4.2	3.6	2.5

Moreover, at many minority banks, a large fraction of the clientele is likely to be made up of small business owners and of moderately low income individuals or households whose banking needs are likely to require more personnel time than those of customers of established nonminority banks.

Loan Losses Of all the progress made in controlling expenses at minority banks during 1977, the improvement in curtailing expenses associated with provisions for possible loan losses was perhaps the most dramatic. As a percentage of average total assets, provision for possible loan losses declined more than any other noninterest expense between 1976 and 1977 (see Table V). Although the provision for loan losses is not viewed as a typical cash-outlay expense like salaries, it is related to net charge-offs and therefore has a direct influence on reported income. The ratio of provision for possible loan losses to average net loans decreased from 1.27 percent in 1976 to 1.07 percent in 1977. This improvement was much greater than that between the period 1972-75 (average ratio for these years) and 1976, even though the former period was marked by the deepest recession during the post-World War II era (see Chart 2).

In most of the studies and observations to date on the performance of minority banks, analysts have concluded that the high volume of loan losses has kept these banks from achieving the earnings level enjoyed by nonminority banks of comparable size. A study of the 1970 operations of minority banks, for example, found that "the provision for loan losses consumes three times as much income at minority banks than at either new or established white banks."[6] Another study concluded that the substantial difference in profitability between minority-owned and nonminority-owned banks was "attributed to the very high loan losses suffered at the minority banks."[7] Thus, by reducing losses from loans in 1977, minority banks succeeded in mitigating a long-standing problem in their current operations and in drawing

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[6] Donald L. Kohn, "Minority Owned Banks," **Monthly Review,** Federal Reserve Bank of Kansas City (February 1972), p. 19.

[7] John T. Boorman, **New Minority-Owned Commercial Banks: A Comparative Analysis.**

Chart 2

SELECTED OPERATING RATIOS FOR 1972-75, 1976 AND 1977

The key to increased profitability for the average minority bank in 1977 was . . .

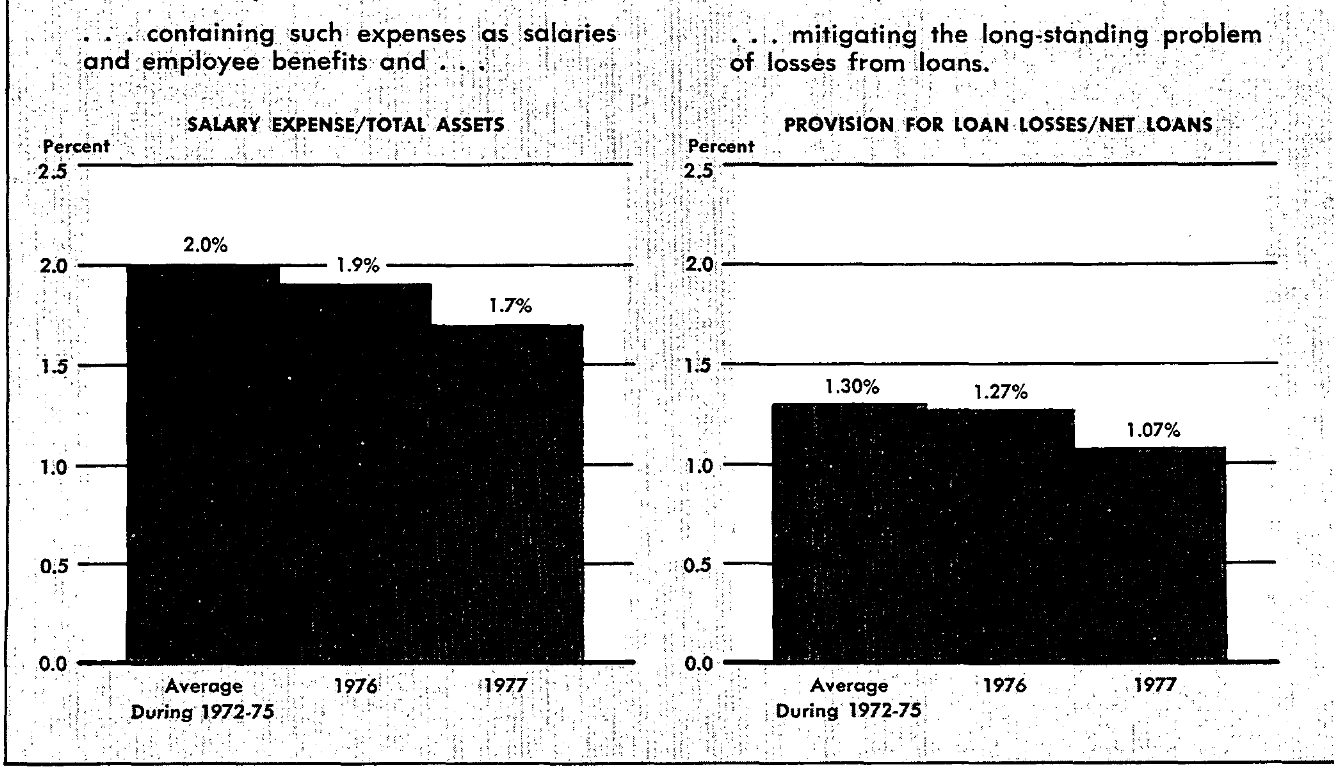

Table VI

NONINTEREST EXPENSES AT MINORITY BANKS DURING 1976 AND 1977

Noninterest Expense	Average Total (in thousands of dollars) 1976	1977	Percentage Change
Salaries and Employee Benefits	394	403	2.3
Net Occupancy	76	77	1.3
Furniture and Equipment	44	49	11.4
Provision for Possible Loan Losses	159	106	−33.3
Other Expenses	296	405	3.0
Total	969	940	−3.1

closer to the rest of the industry's experience with one of its key operating expenses.

Other Noninterest Expenses A reduction in the relative burden of other noninterest expenses was also noticeable at minority banks in 1977. The ratio of net occupancy to average total assets dropped from 0.4 percent in 1976 to 0.3 percent in 1977, and the ratio of "other expenses" dropped from 1.4 percent to 1.3 percent (Table V). For the 70 banks taken in the aggregate, total outlays for noninterest expenses were 3.1 percent less in 1977 than in 1976 (Table VI).

The need to lower the overhead at these banks has been emphasized in several studies.[8] No doubt the decline in loan losses helped to bring about the relative reduction of "other expenses," since in the past these other expenses have been closely associated with monitoring problem loans.

Changes in the Revenue Mix In addition to the rather successful control of operating expenses at minority banks during 1977, a change in the distribution of revenue over its several sources was an important factor contributing to profitability. For the 70 banks in the aggregate, an increased proportion of operating income came from interest fees earned on loans and less from earnings on government securities in 1977. Income from interest and fees on loans amounted to 58.0 percent of total operating income in 1977 as compared with 56.6 percent in 1976 (Table VII). As was the case for the banking industry generally, minority banks' portfolios shifted toward loans in 1977, and, with loan rates rising sharply, earnings benefited. The ratio of interest and fees on loans to average net loans was 9.0 percent in 1977 compared with 8.6 percent in 1976 (Table VIII).

For the 70 banks, loans in 1977 rose almost 10 percent above the 1976 level. This increase in net loans suggests that minority bankers might be experiencing more success in developing loans, not only in their traditional markets, but also in nontraditional markets—particularly in the suburbs.

Income and Yields Interest and fees on loans and interest and dividends on securities provided the bulk of minority bank income in 1977. Gross income from interest and fees on loans in 1977 increased by almost 9 percent over 1976, while gross income from interest and dividends on securities increased by only 2.4 percent. Of the four categories of securities held by most banks, only U. S. Treasury securities produced a larger gross income in 1977 than in 1976 (see Table II). Also, the percentage increase in income from U. S. Treasury securities was greater than that from any other single source.

U. S. Treasury and Government agency securities constituted the largest element in the investment portfolio of minority banks in both 1976 and 1977. Holdings of these securities rose substantially in 1977 and in that year dominated investment portfolios to an even greater extent than in 1976. As a matter of

Table VII

DISTRIBUTION OF REVENUE AT THE AVERAGE MINORITY BANK IN 1976 AND 1977

Item	As a Percent of Total Operating Income 1976	1977
Interest and Fees on Loans	56.6	58.0
Interest on Balances with Banks	2.0	1.5
Income on Federal Funds Sold, etc.	5.9	6.3
Interest and Dividends - Total	26.0	24.9
U. S. Treasury Securities	10.4	12.3
Obligations of Other U. S. Government Agencies	9.6	8.2
Obligations of States and Political Subdivisions	4.6	3.3
All Other Securities	1.4	1.1
Service Charges on Domestic Deposit Accounts	5.4	5.5
Other Service Charges, etc.	2.8	2.9
All Other Income	1.4	1.0
Total Operating Income	100.0	100.0

[8] See e.g., Summers and Tucker, **op. cit.**, p. 10. This study points in particular to high occupancy expense as a major factor depressing earnings of these banks.

Table VIII

RATES OF RETURN ON FULLY CONSOLIDATED PORTFOLIOS OF THE AVERAGE MINORITY BANK IN 1976 AND 1977

Item	Percent 1976	Percent 1977
Securities - Total	6.5	6.2
U. S. Treasury	5.9	6.2
Obligations of Other U. S. Government Agencies	7.9	6.7
Obligations of States and Political Subdivisions	5.6	5.1
All Other Securities	8.7	8.7
Loans - Gross	8.6	9.0
Total Securities and Gross Loans	8.1	8.0

fact, holdings of municipals and other securities declined during the year. The large increase in Treasury securities may have been associated not only with yield differentials, but also with increases in public deposits requiring a pledge of such securities (Table III).

Although the rate of return on gross loans at the average minority bank increased during 1977, the overall return on total securities and gross loans remained at about the same level as in 1976 (Table VIII). This was not too different from developments in the banking industry as a whole. The margin of difference in the overall rate of return between minority banks and the industry, .87 percent, was accounted for by the increase of 124 basis points earned by the industry on "all other securities." This difference may result from the longer experience and more intimate knowledge of the securities market possessed by nonminority banks. It might be noted, however, that despite rising interest rates, the rate of return on total securities and gross loans for all insured commercial banks in 1977 was only 20 basis points higher than the rate for 1976.[9]

SUMMARY

Taken as a group, minority banks experienced a substantial improvement in profitability in 1977. Both the number of profitable banks and net income for the group increased, although a large portion of the increased net income was accounted for by a relatively small number of the larger banks. Unlike the situation in 1976 when the net income came solely from securities transactions, almost all of the income in 1977 was derived from current operations. Improved expense performance as well as increased gross revenues figured importantly in the better profitability picture in 1977. Perhaps the most outstanding development in the 1977 operations of these banks was the reduction in noninterest expenses compared with the previous year. As a group, the banks were especially successful in reducing the loan loss expense. High loan losses have been the major obstacle to increased profitability at these banks in the past. The marked reduction in such losses during 1977 suggests that minority banks are devoting more resources to such functions as credit investigation and are placing the adherence to sound banking principles ahead of other considerations, such as community economic development.

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[9] Barbara N. Opper, "Insured Commercial Bank Income in 1977," **Federal Reserve Bulletin,** Vol. 64, No. 6 (June 1978), p. 442.

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