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West Michigan Stock Returns

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develop in other states, however, in 1986 regional "compacts" became widespread. At the end of 1993, 49 states permitted some form of interstate banking, 34 of which allow complete national interstate banking. Michigan was one of 17 states that allowed entry by banks headquarted in any state that reciprocates as of June, 1993. Finally, late in 1994 the Congress passed legislation that effectively repealed the interstate banking prohibitions of the McFadden Act and has hastened the consolidation process.

The Economics of Consolidation

In theory, business combinations should reflect synergism in the form of economies of scale (efficiency gains from expanded scale of operations) or scope (efficiency gains from expand scope of operations). Given the restrictions that historically have been placed on bank operations by artificial political boundaries, we might expect banks to combine in order to participate in geographic markets that they can serve in a cost effective manner and to provide banking services in which they have particular expertise. Such combinations should be good for efficiency and, hence, profitability. A number of academic and other professional studies have attempted to measure the efficiency gains and profitability of bank mergers. A recent Federal Reserve paper summarizes the results of 39 bank cost and profitability studies published between 1980 and 1993. Generally, the findings conclude that bank mergers on average have surprisingly little effect on efficiency and profitability. However, these results reflect mergers that almost exclusively occurred before 1989 and mergers taking place currently could be significantly different. To illustrate, in the takeover of First Fidelity Corporation by First Union Corporation, one analyst has suggested that First Union's expertise in branch based installment lending could be applied to double the branch lending in the First Fidelity system. In addition, future economies of scale may be created by the technological requirements of the banking industry. With the introduction of ATMs, debit cards, automated payroll processes and other electronic payment services, banking has become increasingly technology driven. Evidence suggests that scale of operations has become increasingly important in support of technological spending and development. In 1985, Salomon Brothers estimated that the 35 largest banks spent nearly $5 billion or 59% of the industry total on technology. By 1990 the 35 largest banks were estimated to have spent $12 billion or 68% of the industry total on technological investment. Industry expenditures in 1995 have been estimated at a remarkable $175 billion with the largest banks accounting for more than 80% of this figure.

Another potential economic rationale for mergers is portfolio diversification. Historically, smaller banks serving smaller geographic markets have often been at the mercy of local economic conditions. Many small banks have failed precisely because they were tied too tightly to small economies that depended on a few major employers or industries. Possibly to mitigate the effects of poor diversification in their loan portfolios, small banks tend to lend less than larger banks on a per deposit dollar basis, choosing to invest in securities' portfolios more heavily. To illustrate, between 1988 and 1991 multistate banking companies recorded a loan-to-deposit ratio of 84% compared to 66% for all other insured banks. Consolidation, particularly across regions whose economic performance is not highly correlated, would reduce the risks associated with lending, reducing the chance of small banks failing and possibly increasing bank lending.

Consolidation and West Michigan Banking

Is consolidation the solution for all banks, including those in West Michigan? Based on the scramble to find merger partners that currently is going on, one might be lead to believe the answer is yes. The West Michigan banking community is composed of relatively small and medium sized banks of assets ranging from several hundred million to roughly $20 billion, and many analysts predict that this portion of the banking market will be the next to rapidly consolidate. Indeed, every passing day seems to bring with it another rumored local bank takeover. But is this inevitable? Perhaps not. As we have seen, size alone may not promote efficiency, and many argue that size hinders service for certain classes of customers. Recent survey evidence suggests that certain customer groups are often not satisfied with the quality of services provided by their primary bank. Small and medium sized independent banks might have a customer service niche and may find growth , capturing customers that are "lost" in the upheaval of consolidation. Indeed, some bank experts argue that there are inherent advantages for small and medium sized banks in providing services such as problem solving or the provision of financial advice to their small and medium sized commercial clientele. So there may be breathing room for the independents. But just in case, don't sell those West Michigan bank stocks yet!

West Michigan Stock Returns

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The year just ended was a very good year for investors in most West Michigan based companies. On average, investors saw their stock prices increase 22 percent from December 30, 1994, to December 29, 1995. Tower Automotive led the way, nearly doubling its price during the year. Not far behind was Wolverine World Wide whose stock price increased more than 83%.

Investors in West Michigan financial institutions also fared well -- their stock prices rose an average of nearly 34 percent. This reflects not only their record earnings during the year, but also speculative demand for their shares created by the expectation that out of state banks will acquire West Michigan banks for a hefty premium.

The news for 1995 was not all rosy, however. Investors in one-third of publicly traded area companies lost money during the year. Eroding market shares and disappointing earnings were behind these losses. Moreover, local companies as a group under-performed when compared with broad measures of market performance such as the Dow Jones Industrial Average. For instance, both the Dow Jones Industrial Average and the Standard & Poors 500 indexes rose about 33 percent in 1995.

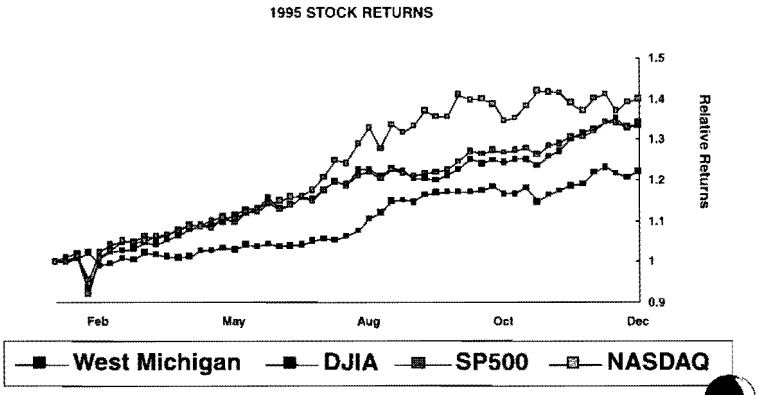
The NASDAQ Composite Index, a performance measure of smaller companies traded in the over the counter market, rose a stunning 40 percent. All three of these indexes, but particularly the NASDAQ Composite, were boosted by the frenzy buying of high-tech stocks. Investors' appetite for high-tech stocks by-passed West Michigan where stocks primarily represent manufacturing and financial services firms.

Rather than focus on the better performance of these other stock indexes, investors in West Michigan firms should savor their 22 percent return in 1995. That number is about double the average annual return US stocks have generated over the past seven decades.

Taking a longer view, the news is even better for investors in West Michigan firms. Since July 1993, local stocks have outperformed all three market indexes. Investors have earned an annual return of 17.7 percent from the Dow, 15.1 percent from S&P 500 stocks, 20.0 percent from NASDAQ stocks, and 20.2 percent from West Michigan stocks. Except for the S&P 500 Index, the returns do not include cash dividend payments. For West Michigan firms, cash dividends would add another percent to the annual returns earned by investors.

Stock Performance of West Michigan-Based Companies in 1995

Tower Automotive	+94%
Wolverine World Wide	83
Ottawa Financial Corp.	47
Foremost Corp.	43
Universal Forest Products	42
Old Kent Financial	42
Finish Master	34
Amway Japan Ltd.	29
Bank West Financial	27
Autocam	26
First Michigan Bank	24
Independent Bank	18
Herman Miller, Inc.	15
Amway Asia Pacific	9
Guardsman Products	5
Perrigo	-5
Donnelly Corporation	-6
Gentex	-7
Knape & Vogt	-11
Gantos, Inc.	-11
X-Rite Inc.	-29
Ameriwood	-55



West Michigan Economic Forecast

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Highlights

- There is a high level of confidence (around 80%) in the west Michigan economy
- Confidence levels are similar for 1995 and 1996
- The region's employment growth is expected to be around 2.5% for 1996
- Annual growth in sales for 1996 will approximate 5%
- Average growth in export-oriented firms for 1996 will be above 5%

Introduction: During November 1995, the Seidman Business School sent a short survey to the CEOs of 160 organizations in the west Michigan counties of Kent, Ottawa, Allegan and Muskegon. We tried to send the survey to a representative set of organizations in different sectors of the economy. Eventually, sixty two organizations responded, resulting in a response rate of almost 39%. The results of the survey should