Current State of African American Financial Institutions

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Abstract

African American banks are fixtures in many communities; this has evolved as a result of tradition and commitments to the African American community. However, as mainstream banks are currently experiencing tremendous growth and becoming larger financial institutions, African American banks in many cases find their asset growth rates and overall financial development slowing. According to ***Business Week 4-7-2003,*** *no individual African American bank has total assets of one billion dollars. An executive of One United Bank, a black bank, Robert Patrick Cooper talks about his bank's objectives in the context of black banking history in America:*

> *"Blacks would be wise to keep their independent third eye on the condition of their 'indigenous' institutions and consider how their community needs, economic conditions and political interests can be advanced by an increase in the quality and quantity of black banks."*

In this statement, Cooper encourages African Americans to increase their awareness and enhancement of African American financial institutions and to realize long run benefits that are based on the existence of these institutions. This research effort will give insights into the current state and future needs of African American banks.

INTRODUCTION

African American financial institutions have existed since the 19th century, and they have played an integral role in the growth and development of black communities across the country. In the early years after their inception, African American banks were established to provide African Americans an opportunity to gain economic independence (from whites) during times of segregation and discrimination. Also, the emergence of African American owned banks aided business enterprise in the black community and promoted 'racial solidarity'; such banks also provided an opportunity for blacks to gain strategic knowledge in the banking field. Today, there are 47 African American owned financial institutions in the United States according to the National Bankers Association (NBA), and the managers of these institutions are facing various challenges and obstacles.

A highly competitive banking industry coupled with increased federal regulatory pressures including the Sarbanes-Oxley Act and the Community Reinvestment Act (CRA) have made it more difficult for African American banks to survive. The Sarbanes Oxley Act (passed in 2002) is an important legislation that affects corporate governance, financial disclosure, and the practice of public accounting. The Community Reinvestment Act (passed in 1977) encourages a financial institution to meet the credit needs of its targeted communities, including low and moderate income areas as referenced by the web site **www.fdic.gov** .

During the 21st century, African American banks have had to adapt to the changing banking environment including recent trends such as mergers among large mainstream banks and the tremendous asset growth of Hispanic owned banks. Although, the second largest African American owned bank, One United Bank, has achieved $500 million in assets, the bank still faces major challenges. Kevin Cohee, Chairman & CEO of One United Bank recently stated:

> "Despite our progress, we still see a proliferation of check cashing outlets in inner city communities, while nearly one-third of the residents do not have bank accounts. We believe all customers, regardless of their account balances, need and deserve affordable access to capital in order to achieve financial security. Our mission is to meet that need."

Most African American banks are currently located within inner city neighborhoods and have historically provided banking products and services to low and moderate income segments. Recently, that customer base has slowly eroded due to increased competition from larger mainstream banks. Therefore, the African American bank has had to change its targeted markets; now it must reaching out to people of all races and income levels; in essence, the black bank has now extended beyond its traditional communities.

Even today, there are financial phobias within black urban areas that are major hurdles for many black banks. These financial fears can be traced to past failures of black banks. For example, a writer in the **New York Age** of January 11, 1917, tells of ongoing fears brought on by previous black bank failures:

> "It is a question of the gravest moment that the failure of the Freedmen's Saving and Trust Company, the Alpha Bank and the Capital Savings Bank, fifteen, twenty and forty years ago, so undermined the confidence of the Negroes of the District of Columbia that they are afraid as yet to deposit their money in a bank managed by their own people."

Today, this question of past black bank failures is still paramount in the black community. Hence, the critical question now becomes: what are current needed products/services for African American banks to allay such fears even as mainstream banks are actively seeking business from blacks and other minorities?

Continuing, in 2005, do African Americans still lack confidence in African American owned financial institutions? If so, what are the key reasons for this lack of financial confidence? As a result, it is imperative that African American banks pinpoint their competitive advantages and use them to expand their target markets and to negate past failures.

Despite the growing concerns over the uncertain future of African American banks, there is no disputing the fact that black banks provide tremendous financial support to the black and other minority communities. One United Bank's Senior Counsel, Robert Patrick Cooper, had this to say:

> "Without a bank, black communities will continue to excel at consuming but not saving, producing and investing. That is why we offer unique products and services that are aimed at overcoming this reality where as many a one-third of black people in inner-cities and rural areas do not have bank accounts."

Deposits in African American banks tend to turn into investments in the black community, and black bankers work to assist African American business to qualify for loans according the article, "Supporting Black Banks" in the October 1989 issue of **Essence** magazine. Also, community renovations and redevelopment and loans for black business enterprise are more readily available by the existence of African American banks.

Considering the above, leaders of African American banks must ask: why black banks have not grown at the rate of mainstreams banks or Hispanic owned banks? To date, according to federal records, total dollar assets among the 47 African American owned banks in just over $6 billion, compared to the $104 billion in assets of the 36 Hispanic owned banks.

In his paper, "Out of the Shadows: Business Enterprise and African American Historiography", Robert E. Weems, Jr. discusses the dynamics of the historical African American business enterprise and gives insight into one possible reasons why African American businesses have not achieved optimal (or better) levels of financial success; he says that "…black business must come out of the shadows of African American historiography and take its place as an integral part of the post-Emancipation African American experience." In other words, black banks must focus on the future (and not past failures) and continue to improve its current management teams, levels of technology, and decision making capabilities

The current state of African American banks can be characterized as holding satisfactory levels of assets, but their future seems cloudy and uncertain at best. An evolving banking environment and the emergence of banking trends including the aforementioned mergers of large mainstream banks, online banking, and the growth of Hispanic banks hinder the current income statements of African American banks. The African American bank managers must now take strategic actions and make effective plans for the future to ensure the survival of African American financial institutions.

BRIEF HISTORY OF BLACK BANKS

Most historical information on black banks has been generated by black newspapers and journals. "During the early decades of the 20th century, black-owned newspapers played special roles in the lives of blacks, whether they lived in small towns or large cities. Whenever there was a black population, there was likely to be a weekly newspaper, sometimes several." (Elizabeth Wright, Banking Pioneers) At a time when race relations in the United States were quite poor, black newspapers were very close to the pulses of the black communities.

The black press reported news and issues ranging from problems faced by oppressed groups, to black success stories, to community gossip and scandals. Most notably, according to a "Banking Pioneers" (written by Elizabeth Wright), some notable black reporting agencies included the Norfolk Journal and Guide, Pittsburgh Courier, Philadelphia Independent, Chicago Defender, Bee Newspaper Chain, Memphis Triangle, New York Age, Savannah Tribune, The World, Louisville News, The Freeman, The Afro-American, Nashville Globe, Boston Reliance, and the Black Dispatch just to name a few.

A prime example of the role of the black press, and how the black press displayed efforts of leadership was in the June 1, 1927 edition of the **Memphis Times.** In this article, the press contrasts the differing views of the "New Negro" vs. the "Old Negro" in an attempt to promote black enterprise within the community:

> "**The New Negro** is the optimistic Negro. He believes in himself and, therefore, in others of his race. He believes in Negro business and gives it his full support. He believes in Negro institutions and lends his cooperation in building them up. He believes in the future."
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> "**The Old Negro** is the pessimistic Negro. He does not believe in himself or any other Negro. He does not believe in Negro business and hence does not trade at Negro stores or put his money in **Negro Banks**. He believes the case of his race is hopeless unless someone else guides its destiny. (Elizabeth Wright, Banking Pioneers)"

EARLY HISTORY OF BLACK BANKS

Decades before the Civil War, enslaved black people received assistance for sickness, health care, and death benefits from early self help institutions. These institutions consisted of groups like Church Relief Societies, Black Lodges of Secret Societies (e.g. Masons), and later within the early 20th century, fraternities, sororities and other societies. There was not widespread acceptance of black and white intermingling business transactions. There was a sense of cooperation within black communities. Is that same level of cohesion and cooperation present in the black communities today? No, probably not. So, why do Blacks not now help each other? The "Old Negro" Syndrome is still present today.

In 1865, Congress incorporated the Freedman's Savings and Trust Company as a banking institution for former slaves. The institution was a failure due to: the "Get Your Hand Out of My Pocket Syndrome" or the embezzling of funds. After this debacle, the **Banking Pioneers** article written by Elizabeth Wright infers that the black community lost confidence in both the banking industry and government initiated financial institutions. That lack of confidence created a "go it alone" mentality among blacks, and it helped to encourage one of the most impressive phases of black business development and banking growth in Black American history (between the years 1888-1934).

In William Kenneth Boyd's 1927 study of Durham, North Carolina, he writes:

> " … The increase in wealth, the rise of institutions for public welfare, and the spirit of cooperation have not been confined to one race. The progress of whites has been accompanied by corresponding progress among the Negroes."

The first group to be granted a state charter to organize an incorporated bank was the Grand Foundation of the United Order of True Reformers. At that time, the need for black banks to set the tone for financial integrity and competence could not be overstated. Black banks and the black newspaper had to work in concert with black institutions to have hope of successful black communities.

There is a slave proverb that says "ain't nothing new under the sun…"; it means concerns that impeded people of color yesterday are issues that continue to shackle black communities today. An editorial in the 1916 edition of the **Journal and Guide** expressed the attitude of many blacks (that same sense of urgency is echoed today and still a valid concern for black communities):

> "The South will be better off, not worse off, if our people become thrifty instead of spendthrifts, become sellers instead of buyers, become producers and manufacturers instead of consumers only. A race that cannot buy and sell will always play the second fiddle to the race that does buy and sell. "

In spite of the growth of black banks through 1930, the black majority continued to deposit money in white owned institutions. Again, it is speculated that limited confidence in black financial institutions was the underlying reason for such deposits in majority banks. Also, black banks depended on majority banks to act as clearinghouses for many transactions. The black banking community needed a national bank that would serve as a clearing house for other black banks.

In 1922, Douglass National Bank was "the first national bank" to be owned and run by blacks. (Elizabeth Wright, **Banking Pioneers**)" This black national bank was a significant milestone in black banking history because it helped to alleviate the black banks' dependence on white banking institutions.

Continuing, the population drain of blacks leaving the South (for northern states) and the Great Depression caused many bank failures. As the Depression rolled across the land, it was no respecter of race. According to Elizabeth Wright, by 1933, of the USA's

25,000 banks, 11,000 had failed. Still, the black population continued to be dealt a more devastating blow to their finances; largely because blacks were racially oppressed.

Throughout the Depression, there were many attempts to salvage black banks. Two or three black banks would try to merger or consolidate. Black banks would close to reorganize and attempt to reopen later. Even in this poor financial environment "as late as the mid-1940's", many blacks found the courage to establish new banks.

Even so, by 1944, there were no black-owned bank in Chicago. In 1947, there were only 13 black-owned banks in the country. Eleven were Depression survivors and two were newly established." (Elizabeth Wright, **Black Pioneers**). Key to the efforts of black banks surviving was the "Negro's indomitable will to live-to try again, and to prove its strength and fortitude." The optimistic notion of "The New Negro" is what had driven black banks throughout the Depression. Soon after the Depression, the notion of "The Old Negro" seemingly was the reality that blacks were actually experiencing. In 1944, an editorial within the **Chicago Defender** entitled "We Need Banks" rejected excuses about black bank failures and cried out to the community to act:

> "But didn't this happen to big white institutions all over the country? White businessmen had the courage to reinvest and bounce back … And all we do is groan and complain because other racial groups with more money for capital move into our areas and gobble up opportunities for new ventures …. We have the money; there is certainly the need. (The Question is?) Do our men with means have the courage, imagination and vision to pool their resources to create this necessary institution?"…

Again, the consequences of the Depression were devastating, especially to blacks. The Depression is an important part of history for black banks. First, it marked a sense of defeatism on the part of the most influential blacks and their teachings. Second, it encouraged a bigger government presence in the lives of the poor across the country (Elizabeth Wright, **Black Pioneers**).

Finally, the notion of "political decisions are dollar denominated" as indicated by John Mickle, North Carolina Central University was clearly demonstrated. Mr. John Mickle was the former CEO of two black banking institutions. Mr. Mickle provided a clear overview of the banking as it relates to black banks when he made the above statement. In essence, he is saying: black banks' survival will have to be involved politically and on many levels. He further stated that the race factor will have to be eliminated in defining the new potential black banking customer.

The impact of political decisions like the New Deal policies encouraged too much dependence upon the government. In 1969, David Tucker summarized the importance of the Depression to Blacks and black banks:

> "Black capitalism suffered a drastic loss of prestige in the 1930s when the economic depression led the race intellectuals to initiate an anti-business tradition which has continued into the present."

The above quote alludes to what the black banks must overcome: the credibility and trust factors that appear to be missing in minority business. It is inconceivable that the one major event (i.e. The Great Depression) could have had such an enormous impact on a race of people even today, seventy-five years later. Today, black banks are still fighting to be considered equal with similar sized majority banks.

THE FUTURE , OPPORTUNITIES, AND TRENDS OF THE BANKING INDUSTRY

Banking research has been compiled through use of a black banking questionnaire, phone interviews, internet interviews, personal on-site interviews. The following has been gleaned from the banking research:

1. **Problems for larger (majority) banks can be opportunities for minority banks.**
   Question: Do black banks necessarily want to complete with the larger majority banks? A phone interview with a black banker pointed out the following:
   "As the mergers of the large banks continue to take place, there is an increased demand for smaller banks to take on loans and other offering that larger banks will now pass on in order to land the larger, more lucrative deals. …." (Wes Christopher, M & F Bank).

This quote seems to support what many now believe—as majority banks get larger, they will become more selective of customers, and they will in some cases abandon the banking needs of the smaller depositor. Smaller revenue producers will not command the same amount of banking attention from the larger financial institutions. The future of banking probably will mean a stronger emphasis on niche customer service. To be competitive, black banks must perform the tasks of customer service better and focus on different target markets; they must position themselves (their products and services) away from large majority banks.

At the root of this adaptation is the question: " How will black banks compete with the offerings of larger banks?" Black banks must continuously research and adjust in order to remain knowledgeable of their perspective customers. Historical events have weighed heavily on the state of black banks. Black banks in the past, predominately served the needs of blacks. The typical customer profile was generally someone who could not obtain a loan at a majority bank including black churches, the black blue collar worker, the elderly, and in many cases, the black professional. Today, the customer of the black bank is evolving due to banking technological advances, changing neighborhood demographics, and new psychographics of the black community. The challenge is to define accurately the customer and to provide effective services for his/her needs.

2. **Online Banking** Currently, most banks view online banking as a "value added" tool to attract and retain new customers while helping to eliminate costly paper handling and teller interactions. A challenge for banks is to get consumers to overcome the lack of trust in this evolving banking service. This obstacle is even larger for black banks due to their past financial shortcomings, their smaller size, and their perceived lack of management/ financial skills (that may stem from racial bias).

Typically, banks pass the money savings of online banking (lower building costs, tellers costs savings, and the like) to customers and shareholders in the form of lower costs and higher profit margins. Advantages of online banking include: convenience of 24 hour banking from any location and overall banking efficiency; while, disadvantages include: banking start-up time and costs and overcoming the trust in technology factor. (Online Banking: http://www.bankrate.com/brm/olbstep2.asp)

For black banks, customers, based on inner city demographics are typically older and poorer. This means their customers are less likely to have access to computers, and their potential learning curves for online banking are longer. Also, crucial to banking online are issues of financial trust. To overcome customer lower levels of computer ownership and use and financial trust, black banks must spend money to educate its targeted markets to the positive nuances of new banking technologies and the security of encrypted online banking sites. This educational effort will require both time and money to be effective; meaning black banks will lag majority banks in this regard. Home banking (online) will continue to grow in the near future; hence, black banks must hasten their efforts to open new banking technologies to include their key customers.

3. Multiple Automatic Teller Machine (ATM) Outlets/Locations

Most of the 47 black banks currently operate only a few branches (if any) to serve their customers. When compared to majority banks, the black bank's service offerings are extremely limited. Black banks may never be able to compete fully on the dimension of outlet location. Black banks can not afford the costs of setting up ATM outlets throughout their communities. However, there is now in many areas an opportunity for the strategic placement of banking outlets which may help black banks to become more visible and accessible.

"Perception is reality". If black banks slightly increase the number of ATM outlets within their communities, they will extend their reach and their markets' perception of outlet expansion. Potential market expansions will allow smaller black banks to reap economies of scale and result in operational costs reductions. Black banks must make better efforts to find key locations for ATM's and full service branch banking locations.

4. Bank Mergers and Interstate Banking

Banking is now experiencing a period of consolidation with frequent mergers and resulting cost savings labor layoffs. According to **Fortune Magazine,** "Few industries have experienced as intense a spasm of consolidation and corporate restructuring as has the banking in the past decade…" "Mega banks want market size, not specific markets. Banks like Bank of America are concerned with market share. (John Mickle, North Carolina Central University)".

Black banks are considerably smaller in size (as compared with many majority banks) and their service offerings are more limited. Banks with larger assets and portfolios generally benefit from operational economies of scale meaning lower per unit costs. Therefore, it is considerably less costly for Bank of America (per asset dollar) to do business than it is for a smaller black bank. Knowing this, Wes Christopher of Mechanics and Farmers Banks says, "as the big banks continue to get bigger, they lose smaller customers… part of competing is knowing the niche market that is available …." Black banks based on the increased number of majority bank mergers now have an opportunity to niche market their services. This having been said, black banks need to canvass the market for potential mergers or resource pooling activities.

Continuing, new governmental regulations now permit wider interstate banking. Historically, banks have been limited in their ability to serve in other states. The barriers of conducting business in other states have now been removed. For black banks, there is tremendous market opportunity because of their lack of presence in certain locations. Currently, telemarketing is a relatively low cost means for generating loans within other states; these loans can potentially be lucrative loans for black banks.

5. Possible increased demand for Banking Middle Managers

In the future, black banks may find it more difficult to hire well-trained managers. It is in the interest of black banks to better value its current employees and institute better internal retention measures (that may focus on heritage). State and federal governments actively recruit banking regulators. Sarbanes-Oxley, Community Reinvestment Act, and other federally mandated initiatives have created needs for new banking employees (Careers in Finance Website). Black bankers must be increasingly aware of changing banking employment issues because black banks potentially will lose productive employees to larger banks and governmental regulatory agencies. Black banks must gear up to pay their effective managers and employees higher salaries

CONCLUSIONS

This paper has given an overview of the issues that are paramount to black banks. Knowing that the banking industry is rapidly changing and is becoming a more competitive environment, Mr. John Mickle, a former CEO of two black banking institutions, states the following:

1. **Political Decisions are Dollar Denominated.**
   The financial growth for black banks is strongly impacted by the government and federal programs. For example, the newly built Atlanta Airport was largely constructed based on political decisions that granted work to minority contractors and its construction utilized black banks. Black banks must be very active in their local communities and maintain effective relationships with local, state and federal governments.
2. **Race is a double edged sword.**
   For black banks, there should be a distinctive advantage within their respective black communities. However, this simple fact can be a "double edged sword", John Mickle (North Carolina Central University). Larger banks are now competing harder for potential black urban customers. For larger banks, race is now less of an issue for generating customers. This means that black banks must become more competitive when it comes to market loan rates and other financial services if they want to retain current clients.
3. **Develop new customer profiles.**
   Black banks must develop new perspective customer profiles which are not defined by race; the potential customer of the black bank must not look like past profiles.

Knowledge of where black banks fit in the overall banking industry plays a critical role in the future survival of black banks.

Finally note: “We (black banks) need to provide competitive products realizing that we will never be able to match short term rates and incentives offered by the big banks. Customer service is one area where we should focus on and can make great gains.” (David Tracey, Illinois Service Federal Bank).

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