

# THE ROLE OF THE TOWN BANK IN THE AGRARIAN UNITED STATES

By Kathleen A. Graham

BACK WHEN THE UNITED STATES was primarily an agrarian society, the banker, the doctor, the preacher, the lawyer and, in a way, the bar owner, were the enduring pillars of each town. It was the town banker, however, who enabled the farm-centric communities to survive and thrive.

According to Bob Watt, a scripophilist specializing in obsolete bank stock certificates, the agrarian town bank emerged about 30 years after the money center banks, which began on the East Coast in 1781 to serve the interests of merchants, importers, and exporters. Money center banks—and the insurance companies, investment banks, and national and international banks—are the “out-of-town financiers” who are very different from the town bank.

The town bank is the institution that services the monetary needs of a local rural community; it is manned, owned, and financed by the community in which it is physically situated. Watt explains that its existence surfaced in the early 1800s in response to farmers’ complaints that money center banks would not loan them money because they preferred doing business with merchants.

The farmers’ complaints are somewhat ironic, given the attitudes of most early U.S. citizens. From colonial times, farmers were placed upon a pedestal, while merchants and their commercial trade were somewhat vilified. Benjamin Franklin in a 1769 piece published in his 1907 book, *Writings*, captures the mood. “Finally, there seem to be but three ways for a nation to acquire wealth. The first is by *War* as the Romans did in plundering their conquered neighbors. This is *Robbery*. The second by *Commerce* which is generally *Cheating*. The third by *Agriculture* the only *Honest Way*...”

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Reviewing the Banker's Activities for a Better Agriculture and Rural Life  
Continued by the Agricultural Committee of the American Bankers Association

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Early issues of Banker Farmer, the first publication from the American Bankers Association for agricultural bankers.

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## THE NEW IDEA OF THE BANKER

How the Bankers State Associations are Working for Agriculture—Pages 2-3-4

What honest people want with a tool of the “cheats” is obscure, but what is quite apparent is that farmers used banks extensively and that their love/hate relationship with banks, especially the “out-of-town financiers,” was present throughout U.S. agrarian history until just recently.

Three unique relationships between the bank and its community distinguish the town bank from its city cousin. The first is that the capital the bank lends originates from the area’s inhabitants. This local community capital investment weds the lender to the borrower more closely than the relationships between out-of-town financiers and their customers.

Iowan Congressman and Chairman Emeritus of the House Banking and Financial Services Committee Jim Leach, whose father, grandfather, and great-grandfather were all town bank

presidents, concurs. “By the 1870s, the town banker was financing every farm, house, and crop. Furthermore, community bank ownership was the general rule; every farmer would own at least half of one percent of bank stock,” Leach said.

Watt owns old bank certificates that illustrate this phenomenon. “Old certificates usually cost about \$100 per share, which was a lot of money back in 1860,” he said. “Of the average 350 total shares issued, a typical farmer would buy two shares on a payment plan. I have certificates where each payment was noted until the farmer had paid it off in full. The beauty of this approach was that the debtor was also the bank owner and very motivated to pay his loan.”

He added, “What a great system: make the farmer the investor. That worked so well and was different than the English and Scottish banking

systems. The town bank met our uniquely American needs.”

As time passed, ownership of bank shares consolidated through inheritances and sales, so fewer parties now own more town banks (although many of them are still family owned). Quentin Satterfield, senior vice president of the nearly century-old First Community National Bank in Steelville, Missouri (population: 1,600), said his bank reflects this trend. It has gone from a broader community ownership to about 15-20 shareholders over the last 20 years to being primarily family owned when one of the shareholders acquired enough of the stock to have a controlling position.

Local community ties—financial, geographic, and psychological—are another unique feature of town banks. Congressman Leach explains, “The banker knows the community, and the

community knows the banker. That mutual knowledge generates the enormous amount of trust necessary to bring together the capital needed to make the bank function. In the 19th century, it was a much harder feat to accomplish, which is reflected in the average cap ratio being 15-25 percent versus two to six percent nowadays.”

These ties benefit both community lenders and borrowers. A recent study of lending practices of large and small banks by A.N. Berger and N.H. Miller, Board of Governors of the Federal Reserve System; M.A. Petersen, Northwestern University; R.G. Rajan, University of Chicago; and J.C. Stein, Harvard University concludes that town banks closer to their borrowers have a competitive advantage over out-of-town financiers because of the lesser distance that “soft” information has to travel to the decision-makers.

Satterfield, a 43-year rural bank veteran and a farmer who with his brother raises “some (about 100) cattle because they enjoy doing it,” calls that soft information “character.” “We know our customers, so we can make loans to the young farmer because we know him and his family personally. We know that they’re good for the money lent, even though financial statements might not reflect that fact,” he explains.

Statistics from the USDA Agriculture Economics and Land Ownership Survey concur: today banks serve 75 percent of the youngest farm operators, 72 percent of the family farmers, and vastly more women and minority-owned farms than any other source of funding.

John Blanchfield, director for agricultural and rural banking at the American Bankers Association (ABA), says that it is the town banks doing that lending as the out-of-town financiers, although very engaged in agribusiness, tend to finance second tier agriculture: the processors, millers, etc., who are once removed from the farmer.

These close community ties also benefit the borrowers. To remain com-



*Jamey Grafing, senior vice president of the Farm Credit System in Minneapolis.*

petitive, most town banks now provide Internet access and other services that they may not have offered if the out-of-town financiers did not exist. Therefore, borrowers get these services no matter which bank they choose.

In addition, town banks offer borrowers more downside protection. The last big agricultural turmoil occurred in the 1980s, when after a period of increasing real estate values caused by surging inflation, rising farm product prices, and expanding farm mortgage indebtedness, inflation dropped and interest rates rapidly rose. According to Jamey Grafing, senior vice president with the Farm Credit System in Minneapolis, this triggered a major collapse in farmland values.

Grafing, whose office boasts a picture of his family’s Iowa farm (which they have owned since the 1800s) and who was working for one of the out-of-town financiers during this period, recalls the different reactions. “I remember my best friend, whose dad was a town banker, telling me how his dad was only averaging two to three hours of sleep nightly, as he died a thousand deaths emotionally,” Grafing said. “How could he not react this way, as those impacted were his

friends, his family, and neighbors, in addition to it being his locally-owned bank that was losing money?”

Satterfield remembers the 1980s, too. “While the city banks charged the going high rates, most of the community banks tried to keep lower lids on the rates,” he explained. “After all, this is our community, so we need to charge what works for both us and the borrower.”

As for Grafing’s out-of-town employer, in response to their losses they closed their local offices, quitting Midwest lending. Their reaction was an understandable business decision, given their geographically larger client population perspective, where the same rules need to be applied to all within defined categories to prevent fraud and discrimination in addition to enhancing the same branding throughout the organization. However, from the borrower’s perspective, the better capital choice was the more locally enmeshed, more flexible town banker.

According to Blanchfield, the 1980s experience, coupled with new computer technologies and access to better information, gave farmers the sophistication to understand how money/banking/commerce works.





Courtesy of Bob Watt

Bank stock from The First National Bank in rural Fairmont, Nebraska, issued in 1887.

Grafiag agrees, noting that family farmers are now less emotional and more pragmatic about viewing their livelihoods as a business instead of a calling. Thus ends the centuries old love/hate relationship between farmers and bankers, cured by experience and knowledge.

Town banking also differs from city banking due to the size of the community. Blanchfield explains that on both U.S. coasts there are more opportunities to finance (import/export, manufacturing, etc.), so agriculture is only one investment choice among many. The coasts' larger range of opportunity choices also attracts larger populations, which means fewer towns and more cities. Looking at the Heartland stretching over vast terrains, Blanchfield said he thinks the most profitable, and sometimes the only, use of these resources is farming.

Grafiag adds that magnifying this factor is the Heartland's climate. "Basically, the Midwest can grow annual row crops (corn, soybeans,

etc.) and livestock. Compare that to the year-round season available in parts of the South, and in California. These areas, with their considerable variety choices (strawberries, nuts, etc.) and full planting year, have a higher value per acre," Grafiag explains. "Couple that with their close proximity to large populations already present because of the sizeable other opportunities, and it's not surprising that the relationships and the interdependency between banker, investor, and borrower change rapidly."

Diversification also decreases risk, so it is not surprising to see friendlier state banking laws on the coasts enacted earlier than in the Heartland. The combination of laws and dwindling interdependency has resulted in town banks virtually gone from both coasts.

In fact, of the original town banks on the East Coast that Watt identified in his research, none exist today. Contrast that to Illinois, a very agrarian

state outside of Chicago, that as recently as 1991 still had 177 banks that were over 100 years old. Even after a decade of less restrictive Illinois banking laws that permit branches, acquisitions, etc., more than two-thirds of those century banks in agrarian communities still exist.

The departure of Bank One, which had acquired a number of the original century banks during its Illinois headquarters period, temporarily leaves Chicago without a money center bank headquartered there. However, for the rest of Illinois and the other Heartland states, the town banks' focus on providing continuing sustenance and growth to their agrarian communities for the next 100 years is to them the more important story. **FH**

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