The Impact of Poverty on the Location of Financial Establishments: Evidence from Across-County Data

By Robin Newberger and T. Lynn Riggs

Introduction

The location of bank branches is an important issue for consumer advocates and other groups that monitor access to financial services for low- and moderate-income people. The proximity of banks and their branches to the places where people live and work is one basic element of mainstream financial access. The ability of people to choose from an array of financial products, especially those offered through the banking system, is fundamentally related to the economic well-being of a community.

In a recent working paper, T. Lynn Riggs of the *Chicago Census Research Data Center* examines the location patterns of both mainstream depository institutions and "alternative" financial services providers, including payday lenders and pawnshops.[1] The study summarized in this article contributes to the conversation about branch placement by applying empirical methods to the question of establishment location. Addressing the issue from an empirical perspective is useful for determining whether a specific connection exists between poverty rates and the places where different types of financial services companies locate their businesses.

Brick and Mortar Bank Establishments Are on the Rise

Over the past two decades the number of deposit-taking *firms* has fallen by almost 50 percent, yet there has been substantial growth in the number of establishments – i.e., offices, branches, and stores – of these financial services companies. There were 30 percent more branches of commercial banks and savings institutions in 2004 than there were in 1984. Alone, commercial bank branches grew by 67 percent. Savings and loan branches actually *fell* by 14 percent. Credit union establishments displayed some growth between 1992 and 2002, but relative to banks this number was small, just 4 percent. Figures 1 and 2 show the changes in the growth patterns of these depository institutions over this time period.

The financial services establishments analyzed in this study are found in the Standard Industrial Classification (SIC) industry category of Finance, Insurance, and Real Estate. The subgroups with this category include:

1. Depository institutions – national commercial banks, state commercial banks, savings institutions, credit unions, branches and agencies of foreign banks; and

2. Non-depository institutions – personal credit institutions, business credit institutions, mortgage bankers and loan brokers.

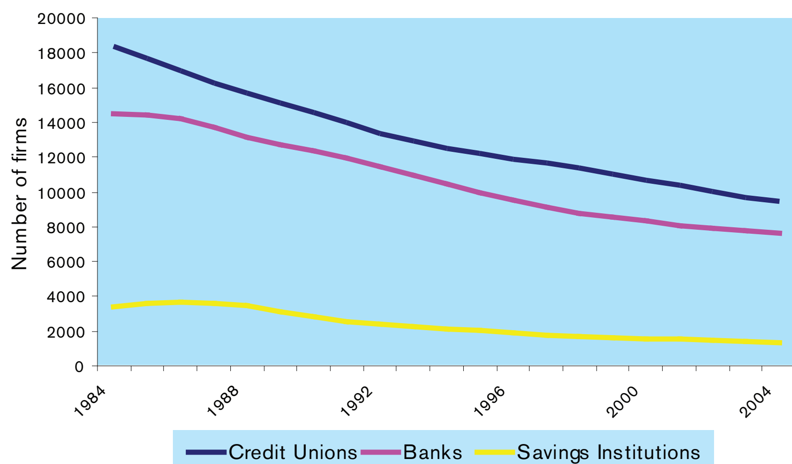
- Personal credit institutions include consumer finance companies; establishments engaged in the financing of automobiles, furniture, appliances; and loan companies.
- Business credit institutions include establishments engaged in extended credit with installment notes; factors of commercial paper; and purveyors of working capital financing and intermediate investment banks.

This analysis also includes firms classified under a separate SIC category called "Used Merchandise Stores." This category includes pawnshops.

The Number of Branches, Offices, and Storefronts of Non-depository Credit Institutions also Grew in the 1990s

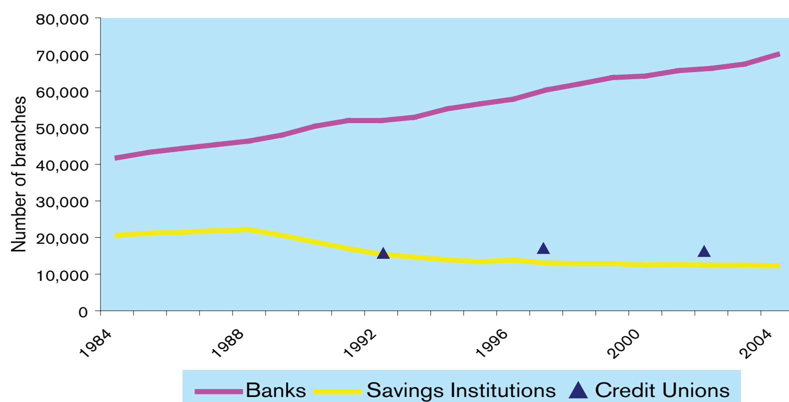
Non-depository credit institutions, including both personal and business credit institutions, have displayed similar growth patterns with respect to the number of establishments over the last two decades. Most of this growth occurred in the mid 1990s. Between 1992 and 1997, establishments of non-depository credit institutions grew dramatically, by 32 percent. Between 1997 and 2002, growth dropped to 3 percent, but the number of firms in this group again grew, by 2 percent, between 1997 and 2002. Pawn shops entered these figures when, in 1997, the Census Bureau began to report pawn

Figure 1: Growth of Depository Firms



Source: United States Credit Union Statistics (CUNA), Federal Deposit Insurance Corporation.

Figure 2: Growth of Depository Branches



Note: Credit Union data from the Economic Census is available for years 1992, 1997, and 2002.

Source: United States Credit Union Statistics (CUNA), Federal Deposit Insurance Corporation, Economic Census (U.S. Census Bureau).

shops as their own category within non-depository credit intermediaries. Pawn shop establishments grew by 10 percent while the number of firms grew by approximately 5 percent.

High-poverty Counties Have Fewer Financial Establishments, Including Those in the Alternative Financial Services Sector

Throughout this period, many more commercial banks, savings institutions, and credit unions established branches in counties with fewer lower-income residents than in higher-poverty areas (Figure 3).[2] In 1997, there were almost three times as many depository establishments in low or very low-poverty areas (VLLP) as in high or very high-poverty counties (VHHP). This imbalance persisted throughout the decade even though there was much greater growth in the number of depository institutions between 1989 and 1995 in higher-poverty counties, on average, than in lower-poverty counties. The trend reversed between 1995 and 1997 when the average number of depository establishments fell in higher-poverty counties and increased in lower-poverty counties.

Surprisingly, non-depository credit establishments displayed the same patterns as depository establishments during this time. These establishments are usually associated with the alternative financial services sector, which typically serves lower wealth and lower-income households. As Figure 4 shows, there were about 25 percent more personal non-depository establishments – e.g., payday lenders and other consumer finance companies – in low-poverty areas than in high-poverty areas in 1997. Non-depository business credit institutions were also more prevalent – by more than three times – in lower-poverty counties than in higher-poverty counties.

In sum, not only did wealthier areas have more bank branches and offices, they also had more establishments associated with the alternative financial services sector. This finding gives reason to look more closely at the nature of the relationship between poverty in a given county and the prevalence of financial services establishments, particularly those related to the alternative financial services sector. Statistical tools help clarify the role that poverty plays in the location decisions of financial establishments.

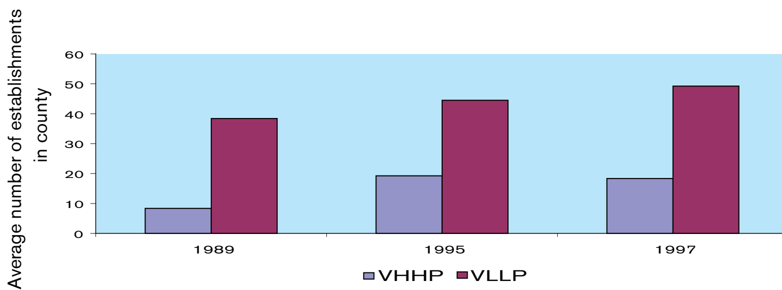
> According to Small Area Income and Poverty Estimates from the U.S. Census Bureau, the average poverty in a given county was between 13 and 16 percent over the period analyzed in this study. A very high-poverty county had over 30 percent of its population in poverty; a very low-poverty county had about 6 percent.

The Impact of Poverty on Financial Services Providers

The motivation for this analysis is to isolate the relationship between the extent of poverty in a county – i.e., the percent of the county population estimated to live in poverty – and the share of financial establishments in that county. It makes sense to perform this analysis separately for depository establishments – commercial banks, thrifts, and credit unions – and for non-depository establishments, since the role that poverty plays may not be the same for each type of establishment.

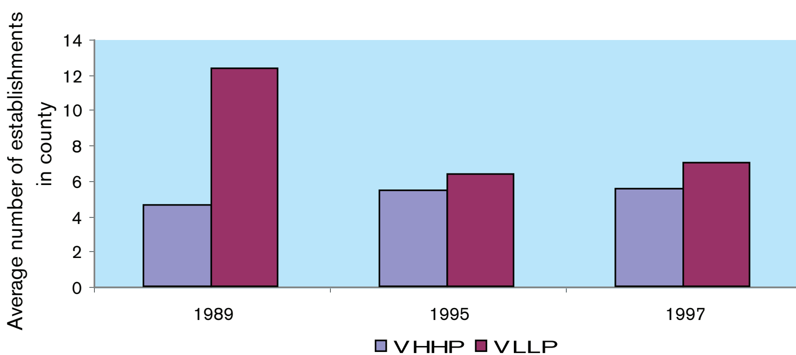
In addition to poverty rates, the analysis controls for other factors that might influence the location of financial establishments, including the share of businesses that operate in a given county.[3] It is important to separate the

Figure 3: Average Number of Depository Establishments by County Poverty Levels



Source: Longitudinal Business Database and Small Area Income and Poverty Estimates

Figure 4: Average Number of Personal Credit Establishments by County Poverty Levels



Source: Longitudinal Business Database and Small Area Income and Poverty Estimates

effect that local firms and their employees might have on the presence of financial services establishments.

It should also be noted that financial establishments are represented in the analysis as a county's share of financial establishments relative to the total in the U.S., divided by the county's share of the U.S. population. Standardizing financial establishments by population is important to avoid mistaking the role of poverty with that of population. Poorer counties may have fewer people than wealthier counties, and this could lead to a given county having fewer financial establishments.

After combining data from 1989, 1992, and 1997,[4] the results show that the extent of poverty in a county does matter for the location of financial establishments. However, there is a different impact for depository versus non-depository institutions. For commercial banks, thrifts, or credit unions, the share relative to the county's population *rises* as the intensity of poverty falls. For example, low-poverty counties have, on average, six more community banks per 100,000 population than high-poverty counties, three more savings institutions per 100,000 population, and one more credit union per 100,000 population.

Conversely the share of personal credit establishments relative to the county population *decreases* as poverty levels fall. In other words, rising poverty rates increase the share of alternative financial services organizations in a given county. For example, on average, high-poverty counties have six more personal credit establishments than low-poverty counties. Business credit establishments, like factoring companies, follow a similar pattern as the personal credit establishments, but the results are less strong.

Poverty therefore does affect the proportion of depository establishments in high-poverty areas as well as the proportion of alternative financial services providers in these same counties.

Conclusion

A simple count of alternative financial services companies in low- versus high-poverty counties does not reveal the complete picture about the influence of poverty on the location of financial establishments. Poverty levels in a county do impact the location of mainstream establishments and alternative financial services providers. While this finding alone does not indicate that individuals in high-poverty areas are under-banked, it does have potential implications for the stabilization of high-poverty areas. The presence of mainstream depository institutions is an important indicator of the overall economic and social well-being of a community. The analysis described in this article uses county-level data. More work is needed to examine whether these results hold for smaller geographic areas as well.

Notes

1 This article is adapted from an unpublished study, "Location of Financial Services" by T. Lynn Riggs, April 2005. The study is based on data from the Economic Census and the Longitudinal Business Database of the U.S. Census Bureau, 1977-1997.

2

Category	Poverty Percentile	Percent of County Population in Poverty
Very high poverty	90th percentile	34%
High poverty	Between 75th and 90th percentile	23%
Above median poverty	Between 50th and 75th percentile	18%
Below median poverty	Between 25th and 50th percentile	13%
Low poverty	Between 10th and 25th percentile	10%
Very low poverty	10th percentile	6%
Source: Longitudinal Business Database and Small Area Income and Poverty Estimates		

3 Separate variables are constructed for businesses in the mining, construction, manufacturing, transportation, communications and utilities, wholesale trade, retail trade, finance, insurance, real estate, and services industries.

4 The most recent Economic Census survey years.

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