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The effects of bank and nonbank provider locations on household use of financial transaction services☆

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ABSTRACT

We examine the influence that geographic proximity to bank branches and nonbank financial providers has on use of financial transaction services among U.S. households. We specify a bivariate probit model of bank account ownership and nonbank transaction product use to reflect the joint nature of these choices, and estimate the model on a large, nationally representative dataset. Our results indicate that households with reasonable geographic access to bank branches are more likely to have a bank account and less likely to use nonbank transaction products. The influence of bank and nonbank provider locations is fairly modest overall, although effects are bigger for households that are more likely to be on the margin of bank account ownership. Even among such households, however, the effects of bank and nonbank provider locations on financial transaction services use are not as large as those associated with key household-level attributes, such as income, education, or race.

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1. Introduction

Participation in mainstream financial markets among U.S. consumers has been increasing over the past few decades. As illustrated in Fig. 1, roughly 85% of families held a transaction account at a bank or other mainstream financial institution in 1989, compared with 91% in 2001 and 93% in 2013.[1] Over the same period, however, the market for nonbank financial services also grew rapidly.[2] As of 2011, an estimated 25% of U.S. households had used an alternative financial service (AFS) such as a money order or check casher within the past year, and among these households roughly 4 out of 5 also had a bank account (FDIC, 2012).[3]

Understanding how households choose to meet their financial transaction services needs is an important issue for public policy. Consumers who obtain financial products from banks or credit unions enjoy certain protections and benefits that may not apply when obtaining products from nonbank providers.[4] For example, consumers who use a checking account held at a bank or credit union enjoy the safety of deposit insurance, are able to obtain statements summarizing account activities, and have the ability to dispute payments made in error. Use of mainstream transaction accounts also improves consumers' ability to access other traditional financial services, such as savings and credit products. To the extent that such products help local residents to weather economic downturns and contribute to economic expansions, facilitating in-

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[1] In the remainder of this paper we use the term "bank" to represent all types of mainstream financial institutions, including banks, thrifts, and credit unions.

[2] Although reliable time series data on AFS use by U.S. consumers nationwide is not available, estimates from various sources indicate that the AFS market has grown substantially over the past few decades. For example, Apgar and Herbert (2004) find that the market for AFS products grew rapidly over the 1990s. *IBISWorld* (2015) reports that the industry is expected to continue to grow and that by 2020 the annual growth rate will reach 3.5% and total revenue will be $12.3 billion.

[3] In this paper we use the terms "nonbank" and "alternative" interchangeably when discussing financial products and services obtained somewhere other than a bank.

[4] Many nonbank financial entities are subject to the enforcement authority of the Federal Trade Commission (FTC) or the Consumer Financial Protection Bureau (CFPB). The Dodd-Frank Act requires the CFPB and the FTC to coordinate their enforcement activities and promote consistent regulatory treatment of consumer financial products and services.

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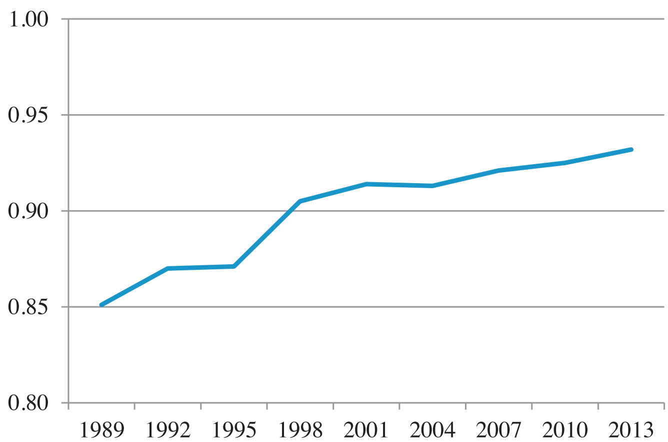

Fig. 1. Share of U.S. Families with a Transaction Account.
Notes: Estimates are based on Survey of Consumer Finance data, published in triennial Federal Reserve Board Bulletin articles between 1989 and 2013. Transaction accounts include checking, savings, and money market deposit accounts; money market mutual funds; and call or cash accounts at brokerages.

tegration of consumers into the financial mainstream may also result in positive externalities at the community level.[5]

Differences across households in the use of financial transaction services are strongly associated with their socioeconomic and demographic characteristics.[6] However, a limitation of most existing empirical work in this literature is that several potentially important factors are not accounted for. For example, some lower-income and minority consumers might use alternative financial transaction services (AFTS) because of a relative scarcity of bank branches in their local neighborhoods (Caskey, 1994). In addition, some households may not qualify for traditional checking accounts due to poor credit history or prior trouble with managing a bank account (Barr, 2004). And households with low levels of liquid assets or high income volatility may place a relatively high value on attributes associated with AFTS, such as same-day access to funds and transparent fee structures.[7] The association between household attributes and use of bank accounts or AFTS might be attributable, at least in part, to such unobserved, correlated factors.

The goal of this study is to evaluate the influence that geographic proximity to bank branches and AFS providers has on household bank account ownership and on use of nonbank financial transaction products. This is a timely issue because, after a long period of growth, the total number of bank branches in the U.S. has been declining since the financial crisis (FDIC, 2015). Media reports suggest that these branch closures have been concentrated in poor and minority neighborhoods (Schwartz, 2011; Bass and Campbell, 2013). In light of these trends, policy makers and consumer advocates have considered ways to ensure that consumers in all areas have access to mainstream financial services. For example, a proposal to allow the U.S. Postal Service (USPS, 2014) to expand its offering of basic banking services has received considerable attention in recent years. A primary justification for this idea is that the USPS can utilize its extensive network of post offices to reach consumers in markets that are not well served by mainstream banks.[8]

Bank branches play an integral role in the financial lives of most U.S. consumers. The FDIC (2014) reports that roughly three in four households used a bank teller at least once in the past 12 months to access a bank account, and one in three used a bank teller as their primary means of account access. In addition to facilitating routine financial transactions, bank branches also offer consumers a variety of services that may be limited or unavailable electronically, such as the ability to open or close an account, and to resolve account problems or disputes.[9] According to the 2013 Survey of Consumer Finances (SCF), 44% of U.S. consumers cite branch locations as the most important reason for choosing the institution that provides their checking account, by far the most cited reason. And despite the introduction of electronic technologies such as mobile and online banking, the subjective importance consumers place on bank branch locations has remained high over the past few decades.[10]

This study is the first to use a large, nationally representative dataset to evaluate the effect of geographic access to financial services providers on household choice over financial transaction services. We build on the work of Barr et al. (2012), who find that among a sample of 938 low- and moderate-income households in the Detroit metropolitan area, having a bank branch (or AFS provider) within one-half mile of the residence has a statistically insignificant effect on use of bank accounts and AFS. The primary contribution of our study is to provide precise estimates that are generalizable to the entire U.S. population. We also take advantage of our large sample to explore heterogeneity in effects, that is, to identify which population subgroups are most affected by access to financial services providers.

We analyze data from the June 2011 Unbanked/Underbanked Supplement to the Current Population Survey (CPS), sponsored by the FDIC and administered by Census. The publicly available dataset includes a rich set of economic and demographic variables, as well as information on household bank account ownership and use of AFTS, including money orders, check cashing, and international remittances.[11] Using restricted-access geographic identifiers, we merge in data on the presence of bank branch and AFS provider locations in the household's "local area", defined as the five-mile radius from the centroid of the household's census tract of resi-

[5] For example, crime rates are lower in neighborhoods with higher rates of bank account ownership, and higher in neighborhoods with a greater concentration of AFS providers (Paulson et al., 2006; Kubrin et al., 2011).

[6] Several studies provide evidence that bank account ownership rates are lower (and/or use of AFS is higher) among households with less income or educational attainment, among younger households and families headed by a single female, and among racial and ethnic minorities. For example, see Rhine and Greene (2013), FDIC (2012), Gross et al. (2012), Hogarth and O'Donnell (1997), Kooce-Lewis, Swagler, and Burton (1996), or Caskey (1994).

[7] Barr (2004) notes that traditional bank accounts may not be well suited for low- and moderate-income households, because of minimum balance requirements and the risk of incurring high fees due to overdrafts. Consumers may perceive that AFS offer greater convenience, faster access to funds, or more transparent fee structures (FDIC, 2012; Gross et al., 2012; FiSCA, 2013).

[8] For example, a white paper from the USPS Office of the Inspector General (2014) argues the USPS is well positioned to provide basic financial services, in part because of their existing infrastructure of post offices in the U.S. The USPS currently offers a limited set of financial products, such as domestic money orders.

[9] The Federal Reserve Board (2016) reports that 86% of U.S. consumers visited a bank branch in the past 12 months, and approximately 25% of these consumers did so to resolve a problem or question or get general information about products or services, and 13% did so to open or close an account.

[10] SCF data indicate that the proportion of households that cited bank branch locations as the most important reason for choosing their checking account institution remained at approximately the same level – between 43 and 49% – over the period 1989 to 2013. (See https://www.federalreserve.gov/econresdata/scf/files/scf2013_tables_internal_real.xls).

[11] The Unbanked/Underbanked supplement to the CPS also includes information on use of AFS credit products such as payday loans, rent-to-own agreements, refund anticipation loans, and pawnshop loans. We exclude credit products from our analysis because household demand for these products is likely driven by fundamentally different factors than for transaction services. And on a practical level, in our data we do not observe whether households use mainstream credit products such as credit cards or short-term personal loans from a bank.