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### Case Study of First National Bank of Phillips County

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CASE STUDY OF FIRST NATIONAL BANK  
OF PHILLIPS COUNTY

PRESENTED IN PARTIAL COMPLETION OF  
THE REQUIREMENTS OF THE HONORS PROGRAM  
OUACHITA BAPTIST UNIVERSITY  
ARKADELPHIA, ARKANSAS

MICHELLE LEIGH EARLY

MAY 13, 1981

CASE STUDY OF FIRST NATIONAL BANK  
OF PHILLIPS COUNTY

First National Bank of Phillips County, located in Helena, Arkansas, is a small commercial bank with assets totaling a little over fifty-one million dollars. A small bank in a small town, First National is not the place to go if you need a loan involving millions of dollars, and they may not offer all the indepth financial services found in large metropolitan banks, but it does serve the basic needs of the citizens of Helena, Arkansas. Farmers need crop loans, businesses need financing, and individuals need personal loans as well as the services such as savings, checking, and certain forms of investing. Through my personal experiences gained while working at First National Bank and through the research I have done on the institution, it will be my purpose in this paper to answer the three following questions:

1. How does First National Bank function?
2. Does it run effectively and efficiently?
3. What can be done to improve the functions of First National Bank?

By answering these questions it is hoped that problems within the structure can be determined and suggestions made to eliminate these problems.

Helena and West Helena, twin communities located in central eastern Arkansas on the Mississippi River, have a total population of about 23,000. There are thirteen manufacturers and producers within the community employing 1834 people. There is one hospital, a public and a private school system, a junior college, as well as the National River Academy. Located in Phillips County, Helena is dependent upon agriculture for much of her economic stability. Phillips County is a large producer of soybeans, cotton, rice, vegetables, and fruit. Last year the income from these products brought over thirty-seven million dollars into Phillips County. There are forty-seven protestant churches, a Catholic church, and a Jewish synagogue. The racial balance of the county is about 58% black, 40% white, and 2% of various other races. There are three banks in Helena and West Helena as well as three savings and loan associations. Politically the county is democratically run with few if any controversial elections taking place, except maybe on the school board level.

In 1980, Phillips County suffered tremendously under the burdens of a national recession. The county's largest industry, Mohawk Rubber Company, closed its doors putting 600 men and women out of work. A severe drought also ravaged crops. In addition, rapidly changing economic conditions played havoc with Arkansas' antiquated usury ceiling. Until federal regulation exempting national banks was handed down, First National Bank found itself

having to lend money at rates lower than their cost of funds. All things considered the economic outlook of the twin cities was not bright.

The historical origins of First National Bank go back to 1931, sometimes referred to as the worst year in the history of American banking. Over 2,300 banks across the nation closed and Phillips County was not spared. But out of the assets of a few defunct banks in Helena, Arkansas, Phillips National Bank was formed. Led by chairman of the board D. T. Hargraves, the bank opened for business on January 27, 1931 with \$100,000 in capital.

On May, 1938 a new building was completed on the present site of the main branch. Major renovations were made in 1962. In 1965 a branch was added. Located on Highway 49, which connects the twin cities, it was able to service both communities even though Arkansas banking laws prevented a branch from being located in West Helena. A big change came in 1972 when stockholders voted to rename Phillips National Bank. At this time it became First National Bank of Phillips County because it was thought that more name recognition would occur with the adoption of a standard name such as First National. In 1974, the branch facility was expanded to provide full service banking. The addition of a branch office loan department meant that there was a new dimension to branch banking in Helena.

At the present time, William Brandon is president and chief executive officer of First National. There are eight directors

on the board, seven senior officers and eight junior officers. Functionally organized, operations which deal with personnel, and the day to day internal workings are headed by vice president #1, as shown on the organizational chart, Figure 1. He is also the cashier and trust officer. Heading the loan division is vice-president #2. Vice-president #3 is over commercial loans and marketing. The president deals with many of the large commercial loans, general good will, as well as the coordinating effort of all other mentioned functions. Each of the vice-presidents is directly responsible to the president.

An analysis of the organizational chart shows that a majority of the personnel are directly or indirectly responsible to vice-president #1. Bookkeeping, teller operations, the trust department, federal reserve operations and branch management are all under his direction. These are the services where many of the banks customers have the most contact with bank operations, they are not necessarily the largest profit centers. Services rendered in these areas include passbook savings accounts, checking accounts, NOW accounts which combine the savings and checking accounts, and various forms of certificates of deposit. Safety deposit boxes are also available along with trust and estate planning.

The profit center for the bank is found in the installment and commercial loan departments. Headed by vice-president #2, the installment loans and farm loans have traditionally provided a large amount of the profit for First National. In recent years though there has been an increase in the amount of funds

invested in securities. This is predominately due to the high returns available from these securities, as compared to the rates of interest paid on loans.

An analysis of the statement of income shows that by far the largest whole segment of income comes from the fees and interest earned from loans, but a close examination of the income statement (Table 1) shows a conglomeration of various forms of investment securities which are also sources of income. In 1980 about 30% of total operating income came from such investments. A comparison with the previous year shows that income attributable to investment securities doubled from 1979 to 1980. This is due in part from the high rates received by these securities, but it is also due to the decreasing profit margin on traditional loans. Since the cost of the sources of funds used by First National has continually increased in recent years, for example certificates of deposit have recently paid as high as 16% and 17%, it is not surprising that they have turned to a method of investment which pays a better rate of return than loans which have regulated interest rates.

An analysis of expenses shows that interest on certificates of deposit is where a large portion of operating income is used. From 1979 to 1980 this figure rose almost 200% due to the rising interest rates paid which have already been mentioned. Wages and employee benefits also make up a large portion of the expense figure, but have remained fairly stable in the past few years.

To answer my second question does First National Bank run effectively and efficiently, references will be made to the income statement, balance sheet, and organizational chart. A functional organization divided according to responsibilities and jobs, First National's organization is very traditional. Close analysis shows that the bank is basically divided into two segments, operations and loans. Operations is considered the management of personnel and their various service departments such as bookkeeping, tellers, and branch services. As referred to earlier, vice-president #1 is responsible for these functions as well as the federal reserve interaction and the trust department. This presents a problem in that vice-president #1 has a span of control that is too broad. His responsibilities overlap into areas that could result in a conflict of interests. For example, the head teller is directly responsible to vice-president #1 as is the assistant cashier in charge of federal reserve accounts. It would seem that this form of direct control over departments with such diverse roles as controlling and handling money could present a problem. The same sort of conflict occurs with the trust department and the tellers. Dormant accounts handled by the trust department lend themselves to the type of manipulation that the tellers as well as the bookkeepers could be involved in due to their relationship to and control over money. Besides the conflict of interests, it also seems burdensome that one person would be responsible for so many



varied activities.

The banks lack of emphasis on marketing is also questionable. The banking industry in recent years has been characterized by heavy advertising, publicity, and public relations activities. Such an effort has mainly been an attempt by the industry to portray themselves as the community helper and friend of the individual. As various institutions other than the commercial bank have developed services and gained expanded responsibilities because of federal regulations, it has been necessary for commercial banks to reposition themselves and their image in the eyes of the public. No longer can the bank take the attitude that they are doing the public a favor by offering their various services. To stay competitive with such institutions as the credit union and the savings and loan it will be necessary to compete for every savings dollar as well as every loan customer. But from the looks of the marketing department, First National has not yet seen the need to change their image. While there is a vice-president for marketing, this appears to be little more than a title in that no one is responsible to this vice-president. In reality he is little more than an advertising officer.

The problem appears to be a circular one. Because the bank has not seen the need to expand the department, they have not increased the number of employees working in this area. This lack of personnel has prevented expansion of services from

occurring. They do not have the capabilities to build the kind of services necessary for the development of a strong marketing department.

An analysis of the income statement shows that First National Bank is presently in fairly good shape. Return on investment for 1980 was 13.6% as compared with 11.2% for 1979 and 1978. This places First National's ROI over 2% above the industry average of 11.6%. Their net profit margin for 1980 was 12.33%, a relatively stable figure compared with 12.21% for 1979 and 13.14% for 1978. Even with the slight decrease in net profit margin from 1978, their rate is significantly above the industry average of 9.4%. Working under the philosophy that reinvesting profits instead of paying them out in dividends is better for the overall growth of the firm, First National has traditionally not paid more than \$1.00 to \$1.50 per share, per quarter. Thus undivided profits have increased at about \$500,000 per year. This reinvestment provides for internal growth which has consistently increased the market value of First National's stock. Presently it is selling at over \$40 per share. An analysis of the balance sheet will show that total stockholder equity has increased at about 10% annually in recent years.

Analysis of operating expenses shows that while expenses relating to the physical plant operation have basically increased with inflation, interest expense on deposits has increased dramatically. In 1978, First National was paying \$245,418 out

in interest payments. This doubled to \$485,247 in 1979. But this was little compared to the 200% increase which occurred in 1980 putting interest payments on certificates of deposit of \$100,000 or more at \$1,258,151. These increases are due to the rate increases on money market certificates which have placed the going rate as high as 17% and 18% in the past year. There has also been a trend for businesses to lower the balances in their checking accounts which have traditionally not paid interest and place this money in short term certificates of deposit. Thus we have the increase shown on the balance sheet in the area of total deposits. There is little remedy for these types of increases in expenses. But what is obvious is that the rates charged by First National for loans have had to increase.

These increases were at first restricted by Arkansas' usury law which restricts loans from being made at over 10%. But because of federal regulations exempting national banks, First National has been able to continue making loans. An obvious problem here though is that because interest rates have reached to such high levels, the bank is not able to service many of their traditional customers. Individuals interested by obtaining a car loan are not willing and in many cases cannot pay the going rate of 15% to 16% for installment loans. Thus one of the purposes of First National Bank is not being fulfilled. Able to receive higher rates of interest from securities on the open market, the bank has resorted to investing large sums of money in other places besides the hometown community. The effect is thus the slowing of an already depressed economy. While the balance sheet and income statement

included do not necessarily show this dramatic increase in money being invested in outside securities, this is because the shift has been slow and gradual over the past 10 years as inflation and rising market interest rates have pushed the banking industry into new methods of profit making.

In the final analysis of First National Bank, in order to answer my third question of What can be done to improve the functions of First National Bank, I have developed the following recommendations.

1. The duties of vice-president #1 should be divided in order to decrease his responsibilities and remove the possibility of a conflict of interest. Realizing that ultimate responsibility does lie with top management, I would recommend that middle management positions be developed to remove the direct control presently held by vice-president #1.
2. The marketing department should be expanded to handle more and better public relations, in order for First National to develop the contemporary image of the modern bank as the public servant of the people. This form of image development can help reinforce the image of commercial banks as full service institutions.
3. The trust department should be removed from the operations section of management, in order for more specialized services to be offered. As time and money permit, it is recommended that an attorney be employed to handle

the day to day operations. At the present time only the final dealings are handled by the bank's attorney. As inflation increases the need for financial planning and estate planning, the expansion of the trust department will probably be justified.

4. In that the money deposited by individuals from the community of Helena and West Helena is best served by using the money for the development of the community through local investing, I feel an injustice has occurred by the increase in funds placed in investment securities. Of course profit is always a high priority, but in that First National's financial position is strong, it does not seem unjustified to feel that more funds should be funneled back into the community. Also the effect of more investment would provide for more growth within the twin cities, thus ultimately serving the bank's best interest.
5. It may be advisable to begin payment of 5% on commercial checking accounts such as being offered for personal accounts in order to prevent the large transfer of funds to certificates of deposit from occurring. While initially costing more, the bottom line will probably be savings, because of the advantage of paying 5% instead of 15%.

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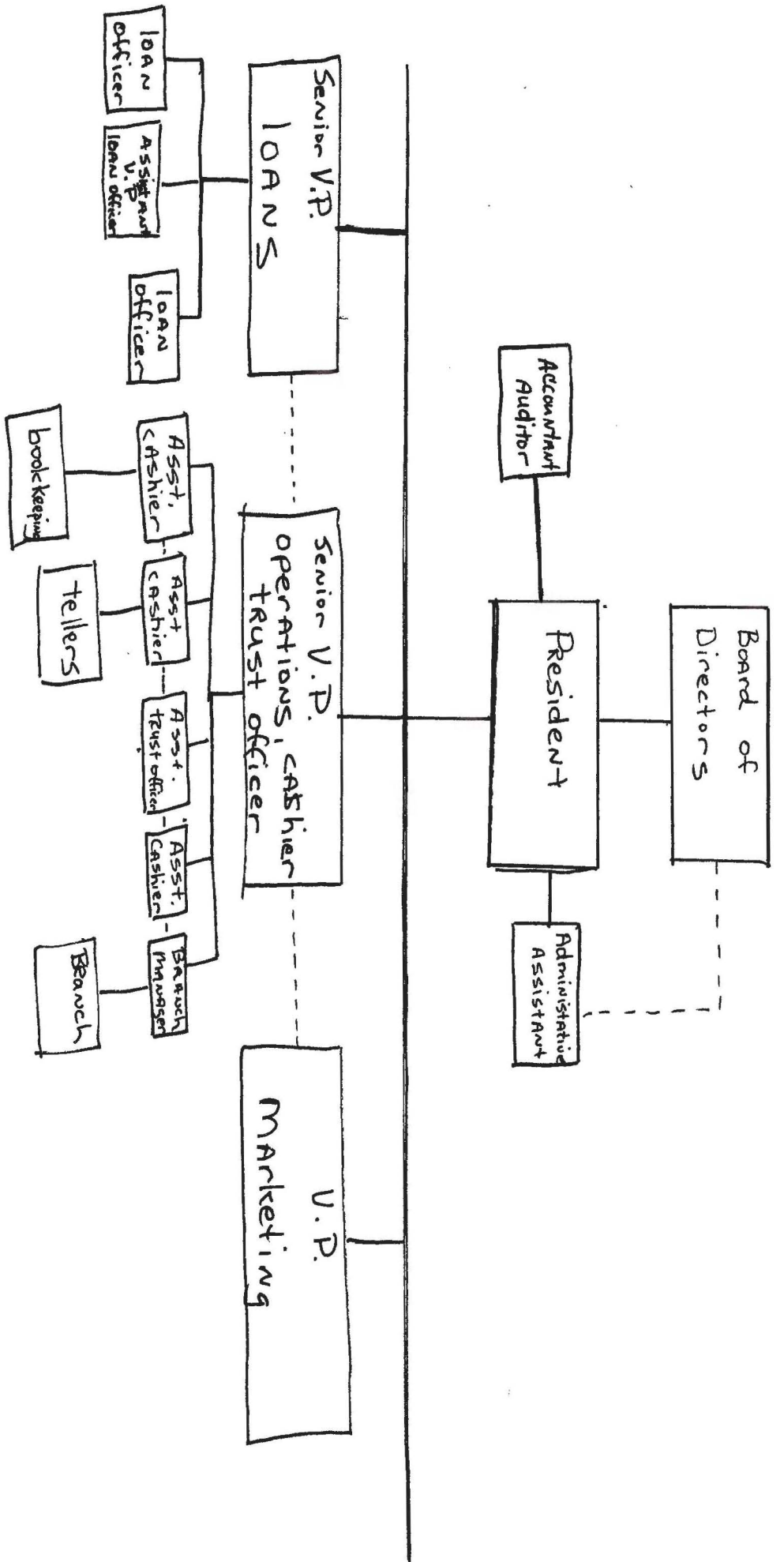
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ORGANIZATIONAL CHART  
 FIRST NATIONAL BANK OF PHILLIPS CO.

Figure 1

## Statements of Income

	Years Ended December 31		1978 (Unaudited)
	1980	1979	
<b>Operating Income</b>			
Interest and fees on loans	\$3,384,431	\$2,771,631	
Interest on federal funds sold	437,152	88,543	\$2,311,051
Interest on time deposits purchased	65,299	-0-	70,578
Interest on investment securities			
U.S. Treasury	182,760	124,930	120,217
U.S. Government agencies and corporations	396,737	199,431	209,762
States and political subdivisions	341,952	311,273	278,860
Other	4,622	5,529	22,853
Service charges on deposit accounts	102,147	134,020	83,911
Other service charges, commissions, and fees	103,738	70,210	39,589
Other operating income	50,292	22,913	23,449
Total operating income	5,069,130	3,728,480	3,160,270
<b>Operating Expenses</b>			
Salaries and wages	649,834	612,394	569,754
Employee benefits (Note 6)	107,304	108,546	67,534
Interest on certificates of deposit of \$100,000 or more	1,258,151	485,247	245,418
Interest on other deposits	1,533,552	1,407,589	1,233,422
Interest on borrowed funds	1,948	16,560	22,569
Occupancy expense	70,768	48,166	46,197
Furniture and equipment expense	116,157	98,621	65,711
Provision for possible loan losses (Note 4)	89,603	47,042	15,412
Other operating expenses	412,328	387,010	355,391
Total operating expenses	4,239,645	3,211,175	2,621,408
Income before income taxes and securities transactions	829,485	517,305	538,862
Applicable income taxes (Note 7)	210,188	55,218	116,124
Income before securities transactions	619,297	462,087	422,738
Net securities gains & losses, less related income taxes of \$5,012 in 1980 and \$5,511 in 1979	5,883	(6,470)	(7,483)
Net income (Note 8)	\$ 625,180	\$ 455,617	\$ 415,255
Income per share			
Income before securities transactions	\$ 6.19	\$ 4.62	\$ 4.23
Net income	\$ 6.25	\$ 4.56	\$ 4.15

See notes to financial statements.



## Balance Sheets

	December 31		
	1980	1979	
<b>Assets</b>			
Cash and due from banks	\$ 5,198,761	\$ 7,012,273	\$ 5,384,957
Investment securities (Note 2)			
U.S. Treasury	1,498,356	2,299,334	1,999,237
U.S. Government agencies and corporations	5,455,954	3,226,345	3,070,821
States and political subdivisions	6,513,840	5,783,648	6,007,818
Other	73,671	69,916	169,819
Total investment securities	13,541,821	11,379,243	11,247,695
Federal funds sold	2,010,000	1,500,000	1,000,000
Loans (Note 3)	29,150,723	26,382,365	26,085,183
Less: Allowance for possible loan losses (Note 4)	370,006	370,006	370,006
Net loans	28,780,717	26,012,359	25,715,177
Premises and equipment (Note 5)	673,102	714,346	659,850
Other assets	955,153	864,358	679,577
Total assets	\$51,159,554	\$47,482,579	\$44,687,256
<b>Liabilities and Stockholders' Equity</b>			
Deposits			
Demand	\$13,535,204	\$15,290,757	\$14,813,139
Certificates of deposit of \$100,000 or more	6,618,817	5,793,916	5,046,814
Other time	25,602,636	21,776,657	20,557,340
Total deposits	45,756,657	42,861,330	40,417,293
Other liabilities (Note 7)	811,796	555,328	559,659
Total liabilities	46,568,453	43,416,658	40,976,952
Stockholders' equity			
Common stock, \$6.25 par value, 100,000 shares authorized, issued, and outstanding	625,000	625,000	625,000
Surplus	1,000,000	1,000,000	1,000,000
Reserve for contingencies	500,000	500,000	500,000
Undivided profits (Note 8)	2,466,101	1,940,921	1,585,304
Total stockholders' equity	4,591,101	4,065,921	3,710,304
Commitments and contingencies (Notes 5 and 9)			
Total liabilities and stockholders' equity	\$51,159,554	\$47,482,579	\$44,687,256

See notes to financial statements