The Financial Services Cluster of the Twin Cities

Metropolitan Council

prepared by
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Executive Summary

Financial services are the underpinning of any healthy economy as well as a major growth industry in their own right. The Twin Cities, due to a unique combination of historical events and a strong adaptive local economy, has developed into a major financial services center serving markets regionally to internationally. Well positioned with many national leaders in financial services, the Twin Cities has the potential for continued growth into the twenty-first century. Using the writing of Michael Porter, Ph.D., a professor at the Harvard Business School as a framework, this study identifies the following conditions contributing to the vitality of the Twin Cities financial services sector.

Factor conditions. The rich natural resources of the Upper Midwest propelled the economic development of the Twin Cities, the transportation hub of the region, and created a need for financial services. Because financiers from the East Coast were unable or unwilling to invest in the wilderness of the Upper Midwest, area entrepreneurs established local financial service institutions to meet their growing needs for capital. In 1929, as a reaction to rural bank failures and the threats of outside ownership, local bankers organized two bank holding corporations, the First Bank Stock Corporation and the Northwest Bancorporation, which introduced the group banking model to the region and helped the region’s banks to survive through the Depression. From these early beginnings, a healthy supply of educated, hardworking individuals, continued accessibility to markets, and competitive costs of operations, contributed to the success of the financial services community of the Twin Cities.

Home demand. The healthy diverse economy of the Twin Cities, led by many major corporations, creates demand for financial services from both corporations and consumers. Entrepreneurship and start-up companies not only replenish the economy but provide a necessary market for investment banking. The local population has high household incomes, a notable comfort level with new technologies, and a predilection toward saving and financial planning.

Related and supporting industries. Financial services require easy access to professional services such as accountants and attorneys, both of which are plentiful in the Twin Cities. The financial services community of the Twin Cities benefits from the area’s historical foundation in computer technology and an available workforce for software development.

Firm strategy, structure and rivalry. Long-standing rivalries, a multitude of strong local firms, and an inclination to start independent operations have generated an environment of intense competition. To attain an edge over national competitors, local firms emphasize community involvement, customer service, product innovation and cost-saving technologies. A recent flurry of mergers and acquisitions has opened new markets, economies of scale, and alternative methods of distribution.

Government. Government regulation for consumer protection, for safety and soundness, and of the structure of financial services constrains the activities of financial services. Restrictions imposed on interstate banking and bank holding companies protected Minnesota-based bank holding companies from outside competition for many years; relaxations of those restrictions now offer local firms new opportunities. Government fiscal policy, especially Minnesota’s commercial and industrial property taxes, affect the markets and the cost structures financial services face.

Recommendations. To preserve its competitive advantage in financial services, the Twin Cities metropolitan region should create or maintain:
- Educational pipelines for a work-ready labor force;
- A state-of-the-art telecommunications infrastructure;
- Commensurate, consistent and fair regulation;
- Accessible, affordable, attractive and available office space.
Recommendations

To preserve the Twin Cities’ competitive environment for financial services, the metropolitan region should develop strategic investments and long-range plans to protect the following:

♦ *Educational pipelines for a work-ready labor force.*

For many years, the Twin Cities area has been noteworthy for its highly educated and dedicated workforce. Because financial services rely so heavily upon human capital, it is critical to maintain the quantity and quality of the labor supply with skills in basic literacy, mathematics, computer technology and use, and a willingness to work.

♦ *A state-of-the-art telecommunications infrastructure.*

The financial services sector’s increasing reliance upon advanced computer technology requires a backbone of state-of-the-art telecommunications infrastructure. For financial services, access to dispersed markets and centralized information through telecommunications will play a role comparable to that of transportation for nineteenth century manufacturing clusters. While the Twin Cities’ current telecommunications structure is adequate, albeit not outstanding, dedicated planning is necessary to develop competitive edge for the future.

♦ *Commensurate, consistent and fair regulation.*

As a heavily regulated industry, financial services seek a regulatory environment that helps protect consumers, without an over-zealous application of such regulations. Predictability in the regulatory environment allows financial services to better anticipate the costs of regulation. Regulation commensurate with other states helps prevent an exodus of businesses seeking a more lenient operating climate.

♦ *Accessible, affordable, attractive and available office space.*

Financial services tend to locate their executive and administrative headquarters — with large quantities of office space and large clerical staffs — in central business districts. In making their location decisions, financial services look for accessible, affordable, attractive and available office space.

§ *A healthy public transit system.* Healthy public transit systems simplify employees’ commute to work and increase the attractiveness of financial services as places to work particularly for lower wage workers who cannot afford a private automobile. An absent or ill-functioning public transit system could lead to traffic congestion, excessive parking costs, and unnecessary hassles in commuting and encourage employees to find more convenient workplaces elsewhere.

§ *Comparable commercial/industrial property taxes.* Financial services use large quantities of office space and therefore pay a disproportionate share of their operating expenditures toward property taxes. As a large part of the operating costs of financial services, an excessive tax burden can play a major role in encouraging business decisions to relocate and diminishing an area’s attractiveness for the location of a new operation.
§ **Desirable locations.** Maintaining perceptions of personal security in central business districts is important in protecting a competitive edge relative to smaller cities such as Des Moines, Fargo or Madison.

§ **Room for expansion.** While government contributes to industrial development by assembling blocks of vacant land for expansion, financial services require available blocks of office space for relocation or expansion.

These recommendations emerged from personal interviews and focus group discussions rather from the policy development of a steering committee for this project. Others may draw additional recommendations from the text of this document.
Table of Contents

Introduction ......................................................... 1

The Porter Approach ................................................. 1

Overview ............................................................... 3
  Depository institutions ........................................... 3
  Investment services .............................................. 4
  Insurance .......................................................... 4
  Rationale for studying financial services ...................... 5
  Trends and transitions in financial services ................. 6

Factor conditions ................................................... 10
  Natural resources ................................................ 10
  Accessibility ...................................................... 11
  Location .......................................................... 12
  Human resources ................................................ 13
  Overhead costs ................................................. 14

Home demand ....................................................... 15
  The corporate base ............................................. 15
  Entrepreneurial spirit ......................................... 17
  The character of the market ................................... 17

Related and supporting industries ............................... 19

Firm strategy, structure and rivalry ............................. 20
  Local rivalry ..................................................... 20
  Surpassing national competition ............................. 22
  Informal communication networks ......................... 23
  Technology ....................................................... 23

Government .......................................................... 25
  Federal banking regulation ................................... 25
  Federal and state restrictions on interstate banking .... 26
  State regulation and policies ................................ 27

Acknowledgements .................................................. 30

Appendix 1: Employment in Financial Services ............... 33

Appendix 2: The Largest Financial Service Companies by Revenue ............................. 34

Bibliography ......................................................... 35
Introduction

The financial services industry of the Twin Cities has created thousands of jobs, generated billions of dollars of revenue and has been largely responsible for the downtown skylines which define the Twin Cities. Many financial services firms based in the Twin Cities are entering the national financial arena, bringing attention to not only themselves but the Twin Cities as well. Although financial services in the Twin Cities have suffered rough times over the years, they remain a critical underpinning of the economy of the Twin Cities. Understanding the historical development and the modern vitality of financial services is critical to a successful regional economic development strategy.

The financial services cluster, based on the Finance, Insurance and Real Estate (FIRE) division from the Standard Industrial Classification (SIC code) system, is composed of many services whose primary products manage risk and money. Although these industries may seem divergent, they are becoming increasingly interconnected as financial conglomerates maintain subsidiaries across product lines and as federal legislation dissolves the regulatory distinctions between sectors of financial services. Thus, there is strong justification for this attempt to consider these groups collectively. Nevertheless, to address the unique characteristics of industry sectors, some industry sectors will receive additional consideration.

<table>
<thead>
<tr>
<th>Financial Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks</td>
</tr>
<tr>
<td>Savings institutions</td>
</tr>
<tr>
<td>Credit unions</td>
</tr>
<tr>
<td>Functions closely related to banking</td>
</tr>
<tr>
<td>Personal credit institutions</td>
</tr>
<tr>
<td>Business credit institutions</td>
</tr>
<tr>
<td>Mortgage bankers and brokers</td>
</tr>
<tr>
<td>Security brokers and dealers</td>
</tr>
<tr>
<td>Commodity contract brokers and dealers</td>
</tr>
<tr>
<td>Security and commodity services</td>
</tr>
<tr>
<td>Life insurance</td>
</tr>
<tr>
<td>Medical service and health insurance</td>
</tr>
<tr>
<td>Fire, marine and casualty insurance</td>
</tr>
<tr>
<td>Surety insurance</td>
</tr>
<tr>
<td>Title insurance</td>
</tr>
<tr>
<td>Pension, health and welfare funds</td>
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<tr>
<td>Insurance agents, brokers and service</td>
</tr>
<tr>
<td>Real estate operators and lessors</td>
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<tr>
<td>Real estate agents and managers</td>
</tr>
<tr>
<td>Title abstract offices</td>
</tr>
<tr>
<td>Land subdividers and developers</td>
</tr>
<tr>
<td>Holding offices</td>
</tr>
<tr>
<td>Investment offices</td>
</tr>
<tr>
<td>Trusts</td>
</tr>
<tr>
<td>Miscellaneous investing</td>
</tr>
</tbody>
</table>

The Porter Approach

As a framework for understanding the vitality of the financial services cluster, this report uses the work of Michael Porter, Ph.D., a professor at the Harvard Business School. In his 1990 book *The Competitive Advantage of Nations*, Porter proposes a new paradigm for thinking about economic development and argues that economic vitality is a direct product of local industries’ competitiveness, which itself develops out of local conditions. Porter identifies four key determinants of competitiveness, called the "Diamond of Advantage," based on cases from around the world:

1) **factor conditions**, such as a specialized labor pool, specialized infrastructure, and sometimes selective disadvantages that drive innovation;

2) **home demand**, or local customers who push companies to innovate, especially if their tastes or needs anticipate global demand;

3) **related and supporting industries**, internationally competitive supplier industries, creating a high quality, supportive business infrastructure, and spurring innovation and spin-off industries; and
4) **firm strategy, structure and rivalry**, intense local rivalry among local industries that is more motivating than foreign competition and a local "culture" which influences individual industries' attitudes toward innovation and competition.

Porter rounds out his model with two additional factors — the roles of **chance** and **government**. Porter's diamond is illustrated:

![Porter's Diamond Diagram](image)

This research has used Porter's work as a basis for our explorations of the financial services industry. This project is not intended to be a definitive overview of financial services; indeed, we may have ignored many important aspects of financial services in the development of this report. What we do intend this report to be, however, is a summary of conversations with individuals from the business community and what their major concerns are.
Overview

The Twin Cities metropolitan area has one of the nation's major concentrations of activity in financial services. Relative to 6.0 percent in the nation as a whole, 7.4 percent of jobs in the Twin Cities economy are in financial services. Location quotients, a measure of local industry specialization, confirm that the Twin Cities have relatively high concentrations of employment in many different financial services, but most dramatically in medical service and health insurance, functions closely related to banking, mortgage bankers and brokers, holding offices, security brokers and dealers, trust, and life insurance, as defined by SIC codes. (See Appendix 1 (p. 33) for a full listing with location quotients; for information regarding the classifications, refer to the Standard Industrial Classification Manual 1987.)

Depository institutions

The Twin Cities is the home of two of the nation's largest and oldest bank holding companies, Norwest Corporation (originally the Northwest Bancorporation) and First Bank System (originally the First Bank Stock Corporation), both incorporated in 1929. At the end of the 1994, Norwest Corporation was the nation's ninth largest bank holding company in market capitalization with $7.2 billion; First Bank System, including its January 1995 acquisition of Metropolitan Federal Corporation, had a market capitalization of over $5 billion. In addition to being among the largest bank holding companies in the nation, First Bank System and Norwest Corporation have both entered the ranks of the nation's top performers among

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1 If an industry's share of total jobs in the Twin Cities matches the same industry's share of total jobs in the nation, the location quotient is equal to one. If an industry is more concentrated in the Twin Cities than in the nation, the location quotient is greater than one, and the industry is relatively more specialized. Local specialization is important because a relatively higher concentration of employment may signal that the industry serves markets outside the local economy.

2 Ranking from American Banker's 1994 Ranking the Banks, according to assets. Asset size updated to June 30, 1995, according to the companies.


5 Ranking and asset size according to the Norwest Corporation and the First Bank System.
bank holding companies with return on assets and return on equity in the top ten among comparable superregional banks.

Despite, or perhaps because of, their decades of competition with the major bank holding companies, hundreds of independent community banks thrive throughout the state of Minnesota. The seven-county metropolitan area alone has 87 banks with approximately 13,000 employees and $39.4 billion in assets. Statewide, an estimated 41,000 people work in banking.

The thrift industry of the Twin Cities, as in many markets, is rapidly shrinking in the aftermath of failures of the late 1980s and subsequent acquisitions. Midwest Federal Savings and Loan, which had been the second largest thrift of the Upper Midwest, collapsed in 1989 under the weight of poor real estate loans and management problems. In 1994, First Bank System purchased the Metropolitan Federal Corporation, parent to Metropolitan Federal Savings Bank, then the largest savings and loan institution, and Milwaukee-based Firstar Corporation acquired Investors Savings Bank of Wayzata, previously the third largest thrift. Meanwhile, TCF Bank, a savings and loan association, has become the third largest depository institution in Minnesota through dedicated attention to the needs of the small consumer market; an estimated one-fourth of Minnesota families have an account with TCF. Moreover, TCF Bank, like its counterparts among the bank holding companies, has been acquiring other financial institutions both inside and outside of the state of Minnesota.

**Investment services**

The Twin Cities, thirteenth largest U.S. city in population, ranks seventh in the nation in the amount of assets managed and has what is estimated to be the highest number of investment managers per capita after New York City. American Express Financial Advisors (formerly IDS), managing $106 billion in assets as of year-end 1994, is the nation’s largest financial planning company, while both Inter-Regional Financial Group/Dain Bosworth and Piper Jaffray are among the nation’s largest regional brokers. Moreover, many Twin Cities investment managers rank high in national listings of top performers for asset management and mutual funds, including American Express Financial Advisors, IAI, Kopp Investment Advisors, Mairs and Power, and Sit Investment Managers.

**Insurance**

Minnesota’s life and health insurance companies, such as IDS Life Insurance (a product of American Express Financial Advisors), Minnesota Mutual Life and ReliaStar Financial (formerly Northwestern National Life), employ an estimated ten thousand people. Furthermore, the nation’s largest fraternal insurer, Lutheran Brotherhood, is headquartered in downtown Minneapolis. Minnesota-based life insurance companies also tend to be financially healthier than their national counterparts; Best’s Insurance Reports gives four Twin Cities-domiciled life and health insurance companies (12.5%) their highest rating, A++ (Superior), and another six companies (18.75%) an A+ (Superior) rating, relative to 2.52% receiving an A++ and 7.98% receiving an A+ nationally.

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1 Source: *USBanker*, April 1995.
The development of extensive health maintenance organizations in the Twin Cities has largely supplanted traditional indemnity health insurance which covers only 19% of the population. The early multi-specialty group practice clinics, modelled after Rochester’s Mayo Clinic, evolved into the large health maintenance organizations that now dominate the health care market and that have made the Twin Cities a national bellwether for health care management. While the triumvirate of Allina, Blue Cross Blue Shield of Minnesota, and Health Partners control the majority of the Twin Cities market for HMO membership, United HealthCare Corporation has moved into national markets to become the nation’s top-billing managed health-care company.

The St. Paul Companies, the oldest incorporated business in the state of Minnesota, is the nation’s ninth largest property and casualty insurer and the largest medical liability underwriter in the nation. Of property and casualty insurers domiciled in the Twin Cities, Best’s Insurance Reports gives sixteen, or over one third, a rating of A+ (Superior), relative to 21.6% of all the nation’s property and casualty insurers receiving an Superior rating.

Rationale for studying financial services

Despite mergers and consolidations among financial service institutions, there is likely to be significant growth in the financial services sector as firms develop new products and new markets. The historical critical mass in financial services, combined with major national players in all sectors, helps position the Twin Cities well as a beneficiary of future expansion. Financial services are attractive to metropolitan areas because they form a clean, non-polluting industry that provides clerical and professional jobs at good wages and because they provide a critical base of capital for growth and expansion in manufacturing or other industries. Moreover, financial services tend to be desirable places to work because they offer good benefit packages, including educational benefits. Unlike manufacturing and its necessary capital expenditures on specialized equipment, financial services can relocate easily and require only human capital, office space and telecommunications.

Computer technology, economic globalization, and government deregulation are transforming financial services from the model of the community bank and the neighborhood insurance agent to the national or multinational financial service institution. Green Tree Financial, the nation’s largest manufactured housing financier, will do no more than ten percent of its business in any one state; The St. Paul Companies has business in all fifty states and across the globe. Changing government rules have freed financial service institutions from their historic need to domicile themselves within the markets they serve, and the introduction of full interstate banking in 1997 portends further evolution of our national banking structure. Meanwhile, computer technology is creating a boundaryless business and offers financial service institutions the opportunity to locate their physical operations apart from their legal location, even if across state lines.

This combination of flexible location and global markets makes the retention of financial service institutions particularly important. While financial service institutions tend to be committed to their local communities, the Twin Cities dare not rely upon their continued commitment for such an important sector of the overall economic structure especially in the face of active competition from other regional metropolitan centers, including but not limited to Denver, Des Moines, Fargo and Madison.
Trends and transitions in financial services

Uncertainty about the future of government regulation, rapid advances in the technology of information management, and constrained finances have plunged financial services into a period of massive transition. New organizational structures blur the traditional demarcations among sectors of the financial services industry — banks sell mutual funds and annuities, investment firms offer asset management accounts with checking privileges to their customers, insurance companies vend financial planning services. Other financial service firms provide insurance, mortgages, property management and title insurance all under one corporate umbrella. Meanwhile non-banks, such as the Sears Discover card or the captive automobile financing companies (i.e., GMAC), are entering financial services markets and increasing the already fierce level of competition.

Advances in technology allow financial service firms to consolidate yet decentralize their national operations. Rather than distributing back-office operations across the country in order to maintain proximity to the consumers, financial service firms can consolidate these operations into a central location via computer technology. Meanwhile, because computer technology can seamlessly link those back-office operations to corporate headquarters, many financial service firm are moving operations not only off-site but also toward lower-cost areas. ReliaStar Financial Corporation, for example, established a claims-processing center in Jackson, Minnesota, while United HealthCare has claims processing centers in both Duluth and International Falls.

Mergers and acquisitions in the banking industry mark the consolidation of a diffuse diverse sector into a smaller number of major banks. The first eight months of 1995 have seen 235 bank mergers, 1994 saw 400, and 1993 saw 406 in comparison to only 152 in 1988. The relaxation of government banking regulation on markets creates new opportunities for bank holding companies to expand their markets, while the quest for efficiency encourages finding economies of scale and more effective methods of product distribution. In contrast to 14,496 banks in 1984, the US presently has 10,450 FDIC-insured commercial banks. Regionally, First Bank, Norwest, and TCF have led acquisitions. In 1994, First Bank acquired eight banks, trusts or savings and loans to add almost $10.3 billion to its assets, including the acquisition of Metropolitan Federal Corporation, the largest savings and loan association in Minnesota. Meanwhile, the Norwest Corporation in 1994 acquired fourteen banks and bank holding companies to add almost $6 billion in assets.

Financial services have evolved from a sleepy service sold on price and personal relationships into a heavily competitive, consumer-oriented sector. According to traditional stereotypes, Americans deposit savings with their community bank, occasionally purchase stocks from a broker, plan their retirement

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via employee pension plans, buy insurance from their neighborhood insurance agent, and purchase a home through a local real estate agent. Today, however, technological advances, government deregulation, and changing lifestyles have transformed the delivery of financial services so that financial service institutions now try to serve all of the needs of their customers, from liquid deposits and long-term investments, to risk management through insurance. The profits resulting from consumers purchasing multiple financial service products from a single vendor are incentives for financial conglomerates to expand markets and cross-sell aggressively.

The specter of the proposed flat tax is haunting securities firms with its threat to suspend the federal tax-exempt status of municipal bonds. Policymakers in Minnesota have also considered imposing state taxes on municipal bonds. By changing relative after-tax benefits of investment options, either proposal could devastate the securities firms who concentrate in municipal bonds to the benefit of firms focusing on corporate stocks and bonds. Although implementation of a flat tax prior to the year 2000 is unlikely, the anxiety it engenders has already affected the bond market.

New alternative delivery options for services, including computer technology, the Internet\(^6\), and "one stop shopping" financial service institutions, all designed to save the consumer time, are attracting customers. Consequently, in addition to offering personalized service, independent insurance agents and community banks are emphasizing their ability to offer specialized advice on financial planning to maintain their customer base. As a result, this competition between the personalized service and niche marketing strategies of smaller institutions with the technological convenience and mass marketing of the global financial conglomerates may lead to the demise of traditional mid-sized financial service firms across all sectors.

National demographic transitions also affect consumer demand for financial services. The aging Baby Boom is beginning to plan for their retirement and to seek the services of financial planners. Moreover, their distrust of the government-managed Social Security system has accelerated their flow toward seeking the assistance of professional financial planners. Trusts, the traditional method of transferring wealth from generation to generation, are finding new customers as the parents of Baby Boomers are conveying their assets to their children. Individuals interested in saving for their retirement can now choose among traditional bank products such as a certificate of deposit, whole life insurance, annuities, mutual funds, stocks, bonds, etc. Increased information about investment options has encouraged more and more middle class Americans to purchase common stocks or mutual funds instead of certificates of deposit or Treasury bills; more and more individual investors are investing in mutual funds with total assets well over $2 trillion. Moreover, many employers, in a quest to minimize costs, are discontinuing their sponsorship of employee pension plans, returning retirement fund investments as lump sums to their employees, and thus creating new demand for financial planning.

Uncertainty about federal health care policy and pressure to cut health care costs has strengthened the position of health maintenance organizations (HMOs) relative to traditional indemnity insurance. By

\(^6\) The Internet now allows consumers to research real estate for sale, particularly in the higher-priced corporate relocation market, without the intermediation of a real estate agent. Local real estate resources accessible through the World Wide Web include ACCNET, Buyer's Resource Realtors and Coldwell Banker Heartland. The Internet also offers the inquisitive consumer a wealth of information about insurance and investment options.
reaching critical volume, health maintenance organizations are now able to assess statistically their care and accountability for their patients. While the HMOs are increasing market share relative to health insurance, particularly in the Twin Cities health care market, self-insured major employers are challenging their numerical and political dominance. Major self-insurers, such as 3M and Dayton Hudson, have created the 24-member Business Health Care Action Group (BHCAG), which works directly with health care providers, removing the role of the health insurer or health maintenance company; however, innovative health maintenance organizations are developing management products to sell to self-insurers to maintain their business.
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<tr>
<th>Selected Industries</th>
<th>Companies</th>
<th>Employees (1992)</th>
<th>% of TC Employment</th>
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<td>Depository institutions (banks and S&amp;Ls)</td>
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<td>Mortgage bankers and brokers</td>
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* Largest determined by assets, annual revenue, mortgage volume, business written, or premiums.
Factor conditions

- The region’s natural resources propelled the economic development of the Upper Midwest and created business activity requiring capital.
- The location of the Twin Cities as a railroad terminus helped to centralize the financial services of the Upper Midwest region (including the Federal Reserve Bank of the Ninth District) into the Twin Cities.
- The early unwillingness of East Coast financiers to meet the capital needs of the growing but wild Upper Midwest led to the creation of area financial service institutions; the later unwillingness of local business to accept outsiders protected area financial service firms from intense outside competition for many years.
- The two major bank holding companies, originally called the First Bank Stock Corporation and the Northwest Bancorporation, developed in early 1929 as a response to rural bank failure in depressed agricultural areas and the attempts of outsiders to purchase local banks.
- Accessibility to both outside markets and employees — through extensive railroad networks, hub airports, advanced telecommunications, and convenient public transit — are a critical component of the location decisions of financial service firms.
- The Twin Cities’ supply of human resources — people with basic skills who are willing to work at reasonable wages — is the backbone of the financial services industry.
- Competitive costs of operations, including labor, employee benefits, office space, and taxes, help to retain financial services developing out of the local economy.

Natural resources

The first white settlers of the Upper Midwest in the nineteenth century discovered abundant forests, mineral deposits, and rivers which could provide both transportation and power. After early capitalists made their fortunes stripping the timber of the Minnesota forests, immigrant farmers quickly settled this newly cleared agricultural land and began to grow wheat. As the head of navigation for Mississippi River, the Twin Cities became a natural destination for these agricultural products, particularly after the construction of railroad lines throughout Minnesota and the Dakotas. Moreover, entrepreneurs taking advantage of water power from the Mississippi River established flour mills in Minneapolis to process the region’s wheat prior to shipment. With the railroad lines concentrating the region’s economic activity into the Twin Cities and the mills adding additional value, the Twin Cities soon became the economic hub of the Upper Midwest.

Although most of these early entrepreneurs originally hailed from the East Coast and shipped most of their products to the East Coast, the East Coast was unable or unwilling to meet the area’s needs for financial services. East Coast banks, unable to understand this pioneer region’s enormous potential for creating wealth, were unwilling to lend the capital necessary for new enterprises. Meanwhile, the winter freezing of the Mississippi River, the primary transportation out of the Upper Midwest prior to the mass construction of the railroads, left the emerging Twin Cities isolated almost one-fourth of every year. Consequently, to exploit this area’s natural resources, Minnesota businessmen began their own financial services to meet their needs. An early example of this financial entrepreneurship was the St. Paul Fire and Marine Insurance Company, the oldest incorporated business enterprise in Minnesota, which was established in 1853 when seventeen local businessmen and community leaders donated $10,000 each to capitalize an insurance company to protect the wooden buildings in St. Paul from fire. Similarly, the accumulation of wealth in conjunction with the needs of growing
establishments for equity capital helped create the investment banking community of the Twin Cities. With the economic development of the Twin Cities and a self-sustaining financial services community, local leaders were loathe to accept the newly offered intercession of outsiders who had previously refused to help this growing area. The wealthy companies and major firms of the Twin Cities, who comfortably controlled much of the transportation throughout the Upper Midwest and therefore its economic prosperity, enjoyed this sense of power and led the development of a civic pride to encourage the rejection of external intervention.

In contrast to this earlier prosperity, the 1920s brought deep depression to the rural areas of the Upper Midwest after the sudden collapse of a boom in land speculation. As a result, over two thousand rural banks in Minnesota and neighboring states closed their doors when farmers were unable to repay speculative loans. Meanwhile, major Twin Cities-based banks, already aware of their dependence on the health of the rural banks, began to be concerned about the intentions of A. P. Giannini, the head of Bancitaly, to develop a nationwide bank and his purchases of stock in the First National Bank of Minneapolis and the First National Bank of St. Paul. In a move designed to create strength through union, the leaders of the First National Bank of Minneapolis and the First National Bank of St. Paul, and the Northwestern Bank of Minneapolis organized and incorporated in 1929 the First Bank Stock Corporation and the Northwest Bancorporation, two bank holding companies owning the stock of both urban and rural banks. Through 1929 and into the Depression, these bank holding companies continued to purchase rural banks throughout the Upper Midwest and helped preserve many smaller banks through the Depression. By virtue of their early creation, these two bank holding companies were grandfathered in through subsequent legislative restrictions on group banking, such as the Bank Holding Company Act of 1956, and could therefore strengthen their holdings with little outside competition until recently.

Accessibility

Transportation networks have long played a critical role in focusing economic activity from the Upper Midwest into the Twin Cities. Railroad lines — such as James J. Hill’s Great Northern Railroad — throughout the Upper Midwest travelled to the Twin Cities en route to Chicago and points south. Serving as the Upper shipping terminus for the Mississippi River, the Twin Cities have been a major intermodal transportation point with barge traffic as well as rail. More recently, however, while barges, railroads and trucking have maintained their control over freight transportation, air travel has become the preferred mode of passenger transportation, particularly for business purposes. As a major hub of Northwest Airlines, the Minneapolis-St. Paul airport provides frequent and easy access to the nation, generally in less than half a day of flight time. Additionally, Northwest and Amsterdam-based KLM have the nation’s only international open-skies agreement which helps position the Twin Cities to be a gateway to international markets. The frequency of hub city service combined with the convenience of the Minneapolis-St. Paul Airport, less than ten miles from both downtowns, provides financial services easy access to national and international markets. The benefits of air accessibility represent one of the Twin Cities’ major competitive advantages as a financial services center relative to smaller cities such as Des Moines.

The public transit system is vital to maintaining the accessibility of financial service institutions located in the central business districts of Minneapolis and St. Paul. The availability of public transit eases the commute of employees to work daily and make downtown locations particularly attractive to labor-intensive financial service operations. Furthermore, the combination of adequate transit and downtown workplaces can allow two-earner families, unusually common in the Twin Cities, to save on
commuting costs; thus, financial services hope that their accessible and convenient central business
district locations will help them attract and maintain a quality workforce. Conversely, among financial
services institutions which relocated to suburban locations (primarily along I-494), their major regret
about leaving downtown was losing easy access via public transit for their employees.

For the economic activity of the twenty-first century, telecommunications will replace the traditional
transportation infrastructure as the primary access to markets. Financial services already rely heavily
upon computer technology for access to and management of information, but continued access to
telecommunications and the necessary fiber optics infrastructure will be vital to the future financial
services industry. Presently, there is the perception that, while the Twin Cities now has an adequate
telecommunications infrastructure, concentrated attention on the future of telecommunications will be
necessary for maintaining a competitive advantage in telecommunications.

Location

As the major transportation focus of the Upper Midwest, the Twin Cities has developed into the
primary financial services center of the region. Other metropolitan areas in the region tend not to
compete directly with the Twin Cities in the provision of financial services: Chicago financial
services, due in part to Illinois' former restriction to unit banking, tended not to attempt expansion;
Milwaukee has been too close to Chicago to develop significant strength in financial services; their
reliance on the Twin Cities for transportation access has hindered the Dakotas' development of
financial services. An early recognition of the Twin Cities as the economic hub of the Upper
Midwest was the 1914 selection of Minneapolis as the location of the Federal Reserve Bank of the
Ninth Federal Reserve District, including Minnesota, Montana, North Dakota, South Dakota, western
Wisconsin and the upper peninsula of Michigan. The presence of the Federal Reserve Bank has also
made it easier and more convenient to do banking in the Twin Cities through its distribution of
currency and coin, nationwide payments system, and regulation of bank holding companies.

Aside from financial services targeting a limited market such as credit unions or community banks,
financial services domiciled in the Twin Cities consider the region of the Upper Midwest to be their
primary market and source of their economic stability. Bank holding companies and investment banks
based in the metropolitan area expanded throughout the Upper Midwest region, including Minnesota,
the Dakotas and Montana, originally defined by the nineteenth century railroad lines and later
designated the Ninth Federal Reserve District. Although the western parts of this area may be
geographically closer to Denver or Seattle, nineteenth century settlement patterns tie these areas to the
financial center of the Twin Cities. The historical and financial dependence of the larger region upon
the Twin Cities as an economic center has created an interlocking relationship of mutual reliance
whereby the economic vitality of the Twin Cities depends equally upon the health of the greater
region. This connection, tying the Twin Cities into the greater region, sustains the economic health of

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7 An important exception is South Dakota's evolution into a major credit card processing center and
clearinghouse, led by Sioux Falls' Citibank (South Dakota), N.A., with $2,842 million in deposits (as of June
1993, according to the Federal Reserve Bank of Minneapolis), which opened after a 1980 South Dakota interstate
banking bill allowing out-of-state banks to obtain charters for special-purpose banks.

8 The other sites are Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis,
Kansas City, Dallas and San Francisco.
the Twin Cities and of the many metropolitan area firms who thrive from the area’s overall vitality. Looking to the future, many area firms plan to maintain this regional focus rather than attempting to enter national markets in order to remain leaders in the region rather than supporting players in larger markets.

**Human resources**

While manufacturers often need large capital investments in expensive equipment, financial services rely upon the quality and dedication of their human capital. As one executive commented, his company’s continued success depends upon the willingness of his employees to return the next morning. Across all sectors, financial services need employees with strong written and oral communications skills, math and technical skills, and good “people skills.” As the nature of financial service operation changes into the future, sales skills and knowledge of computer technology are becoming more and more critical to the success of financial service institutions. For many years, the Twin Cities area has been known for the quality of its highly educated workforce. Critical to this reputation has been the availability of people for back-office positions and the willingness of Twin Cities workers to show up consistently for their job for wages of $6 or $7 per hour. Assisting local financial institutions in navigating their transition toward technology, the Twin Cities also has a large pool of individuals with the necessary skills in computers, networking and software development to staff the growing information services departments. Historically, Twin Cities residents have had—or believe themselves to have—a strong work ethic and a dedication to their employers. Helping to maintain this quality in the labor force has been migration from rural areas which replenishes the Twin Cities’ pool of educated people raised with traditional rural values—common sense, a strong work ethic, and a willingness to learn. Furthermore, the tradition of “Minnesota nice”—characterized as honesty and trust in interpersonal and business relationships—makes the Twin Cities a pleasant place in which to do business.

Although there has been an adequate supply of workers in the past, financial service institutions are concerned that this pool of employees may dry up in the future, especially for back office operations which need people with basic skills willing to work clerical positions at moderate wages. Banks in particular face workforce shortages because many of their entry-level positions, such as tellers, tend to be part-time positions. Like other industries, financial service institutions are also facing the problem of illiterate high school graduates. Reflecting growing shortages of workers available at reasonable wages in the Twin Cities, some financial service institutions are taking advantage of the freedom provided by communications and computer technologies and are locating back-office operations centers in rural areas. Financial service firms committed to both global markets and community needs believe that hiring a diverse workforce is a necessary strategy for their future success. However, they are finding themselves unable to attract and retain a sufficient pool of workers from diverse backgrounds. To attract today’s students to financial service careers, several local financial service institutions are involved with urban high schools to create training pipelines to permanent employment; First Bank System is working with North High School (Minneapolis), ReliaStar Financial Corporation with South High School (Minneapolis), and TCF Bank with Henry High School (Minneapolis).

The high quality of life in the Twin Cities—plentiful cultural amenities, numerous recreational opportunities, extensive networks for the provision of health care, strong educational systems,
affordable housing\textsuperscript{5}, and a reasonable cost of living — helps attract quality workers from elsewhere and retain employees locally at economical wage levels. In particular, people perceive the Twin Cities to be a good place for children; native Minnesotans, educated and trained elsewhere, often return to Minnesota to raise a family. While this helps local firms to maintain a stable workforce, locally based corporations find that they are often unable to relocate their employees to other offices across the country because individuals are unwilling to leave the Twin Cities. Several executives commented that, while their companies had always worried about attracting employees from other parts of the country to their offices in Minnesota, they found that they consistently had more problems in asking employees to move away from the Twin Cities.

\textit{Overhead costs}

Competitive costs of operations help to retain local financial services. Labor costs in the Twin Cities, while higher than in rural areas, are lower than in many comparable metropolitan areas; the competition among local health maintenance organizations may also keep the costs of employee health benefit packages reasonable. Because financial services tend to consume large quantities of high quality office space, particularly in prime downtown locations, the costs of office space are especially critical. Although the cost of office space in the Twin Cities compares favorably to that of cities such as Chicago and New York\textsuperscript{10}, the increasingly important cost comparisons would be Des Moines or Fargo, especially for back office operations. Minnesota commercial/industrial property taxes tend to be less advantageous to financial services than taxation elsewhere.

\textsuperscript{5} A survey by the National Association of Home Builders ranked the Twin Cities eighth out of 185 metropolitan areas for housing affordability based on data from the third quarter of 1994 that "measure[d] the percentage of homes sold in the market that a household earning the median income in that market could afford to buy." Source: \textit{Star Tribune}, January 4, 1995.

\textsuperscript{10} According to a 1994 survey by Moran, Stahl & Boyer, a management consulting firm specializing in business location, office rental rates in the Twin Cities are only $19 per square foot, relative to $32 in New York City and $30 in Chicago.
Home demand

- The continued growth of the diverse Twin Cities economy accumulates the capital necessary as a base for financial services.
- The development of major corporations as well as the cycle of entrepreneurship and small start-ups create demand for local financial services and encourage outside investors to consult local investment firms about these firms.
- Corporate headquarters, family legacies of wealth, and two-earner families provide Twin Cities residents the income for savings and investments.
- A long-standing populist tendency maintains demand for community banks and financial cooperatives.
- A high comfort level with computers lets financial institutions experiment with new technology-based products in the Twin Cities.

The corporate base

The Twin Cities area has long had a concentration of major corporate headquarters which contribute to local demand for financial services. In 1995, with 16 firms on the Fortune 500, Minnesota ranks as the fourth state in the nation in the number of Fortune 500 companies per capita; according to Fortune, Minneapolis ties with Dallas and St. Louis for the seventh most Fortune 500 firms. Including the Fortune 1,000 industrial and service firms adds 16 more local firms: Fingerhut (546), Deluxe (589), Pentair (611), Minnesota Mutual Life (619), ReliaStar Financial (632), Music Land Stores (656), Medtronic (685), Bemis (686), Ecolab (748), H.B. Fuller (803), Cray Research (902), Ceridian (905), Jostens (924), Polaris Industries (963), Toro (987), and Valspar (993). In addition, ten of the largest privately owned firms in the nation, as ranked by Forbes magazine by annual revenues, have local headquarters, including top-ranked Cargill. Others on the Forbes list are Carlson Companies (63), Holiday Companies (111), C.H. Robinson (118), Andersen Corporation (148), M.A. Mortenson (230), West Publishing (297), GFI America (376), Kraus-Anderson (416), and Lupient Automotive Group (497). The benefit to the financial services cluster emanates not only from today’s major corporations but also yesterday’s big business as well. Companies which grew to national prominence in the Twin Cities but that have since relocated include Archer-Daniels-

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12 Fortune counts only those firms whose stated mailing address is Minneapolis and does not include firms such as Eden Prairie-based Supervalu in their calculations.
Midland and Weyerhaeuser Corp, while some of the major Minnesota-grown companies now owned by outside organizations are American Express Financial Advisers (the former IDS), Northrup King, and Pillsbury. As evidenced by the representation of a variety of sectors among these local corporate headquarters, the Twin Cities economy has had the diversity to weather economic downturns.

These major corporations contribute thousands of jobs to the local economy and provide area residents with comfortable incomes and the buying power necessary to purchase investments, life insurance policies, and real estate. In 1989, the median household income of the Twin Cities metropolitan area was $36,678, 22 percent higher than the U.S. median household income and 19 percent higher than the Minnesota median household income of $30,909. Thirty-three percent of metropolitan area households had a household income of over $50,000. Furthermore, these major employers also provide convenient fields of membership for area credit unions, particularly because the midwestern region has a long legacy of employer-based (rather than community-based) credit unions.

Privately-owned or family-owned corporations have generated wealth and wealthy families in the Twin Cities area — the Cargills, the Daytons, the Hills, the Pillsburys, etc. As this wealth developed, these families sought a means to manage their money and thus encouraged the development of the trust departments at local banks; railroad magnate James J. Hill established First Trust in 1903 to manage his wealth. While family-owned corporations are less common today than seventy-five years ago, publicly-held corporations contribute to the ongoing accumulation of wealth through executive salaries. Although Twin Cities executives on the whole receive less compensation than their counterparts elsewhere, the ten highest-paid Twin Cities executives of 1994 received total compensation of $75 million. Additionally contributing to local wealth, many Minnesota residents were early stockholders of thriving area corporations such as The St. Paul Companies or 3M and are now millionaires as a result. Norwest Corporation has estimated that approximately one out of every five households in the Twin Cities area has more than $100,000 in assets — 44,900 households with over $500,000 in assets; 51,400 households with $250,000 and $500,000 in assets; and 63,000 households with $100,000 to $250,000 in assets.

While the financial services of the Twin Cities serve the employees of these major corporations, multinational firms today are themselves unlikely to use the local banks or securities firms for their financial needs. When these large corporations require equity capital, they directly contact New York-based establishments rather than the locally based investment houses. Similarly, because the process would be lengthy and costly, large local banks have made little effort to develop the international banking services and expertise necessary to meet the needs of the local multinational corporations.

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14 Examples of employer-based credit unions at major local corporations include NWA Credit Union (67,400 members, $403 million assets), Honeywell/Alliant Techsystems Credit Union (25,000 members, $122 million assets), General Mills Credit Union (7,650 members; $33.8 million assets), and Dayton's Target Credit Union (16,000 members; $24 million assets). Asset and membership data from the Minnesota Credit Union System, Inc., 1994 Statistical Report.

Entrepreneurial spirit

Small emerging growth firms support local financial services and contribute to the future vitality of the area economy. The combination of an entrepreneurial spirit and a new idea to commercialize, often stemming from research at the University of Minnesota, begins the cycle of new capital accumulation. The entrepreneur generally seeks either debt financing through personal loans at banks or, alternatively, venture capital as financing. Venture capital, funded by successful entrepreneurs seeking a new challenge or risk-taking investors, invests in start-up firms at several stages, from the rare initial financing to the mezzanine financing just prior to an initial public offering (IPO), in exchange for an equity position. According to anecdotal evidence, the Twin Cities has some of the best venture capital in the nation, surpassed by only Boston and Silicon Valley in the quantity and quality of the venture capital community; Norwest Venture Capital and Oak Investment Partners, each managing over $700 million, are among the nation's largest venture capital firms.

After venture capital has helped to launch a start-up firm, the successful enterprises generally seek equity capital through public offerings, and a range of local investment firms are ready to assist with business advice and to underwrite the initial public offering. For the securities firms, the more healthy companies there are which have started up and want to go public, the better their market is. Moreover, while all securities brokers can buy and sell most stocks for their customers, securities firms receive additional income from the sale of stocks for which they are the sole underwriter. Additionally, because local investment houses pay close attention to firms based in the area, investors across the globe consult these investment firms for information about regional companies.

The Twin Cities is an unusually strong entrepreneurial risk-taking community, particularly in spin-offs from major computer manufacturers and in the creation of the Medical Alley cluster of medical device manufacturers. In the late 1950s and early 1960s, the Twin Cities were a national leader in "dollar stocks," led by the initial public offering of Control Data Corporation at $1/share. Dollar stocks, which tended to be growing technology-based firms, helped introduce stock ownership to a new income group of the population. In the 1960s, an estimated four to five companies a week held their initial public offerings (IPOs). With the successful launch of new companies, the cycle of venture capital continues as entrepreneurs who benefitted from venture capital are more likely to invest their earnings into venture capital funds and thus expand the pool of venture capital available for subsequent generations of entrepreneurs.

The character of the market

The early agricultural base of the Minnesota economy led to the development of hundreds of small towns scattering the countryside. Despite national trends toward banking consolidation, a populist impulse has helped to sustain over 500 banks throughout Minnesota in comparison to only 10,450 banks in the nation as a whole. Whether through suspicion or civic pride, this populist impulse has encouraged Minnesotans to maintain control over their own financial futures; fear of domination by outside banking interests contributed to the development of Minnesota's bank holding companies. Furthermore, Scandinavian immigrants brought to Minnesota the model of the cooperative which has led to the creation of many producer and consumer cooperatives in Minnesota, including CENEX, Harvest States, and Land'O'Lakes in agricultural production, over two hundred credit unions, mutual insurance companies such as Federated Mutual Insurance Company of Owatonna and Minnesota Mutual Life, and health cooperatives such as Group Health, Inc., now HealthPartners.
The longstanding cluster of strong financial service institutions in the Twin Cities has helped the area to become an unusually quality- and price-conscious market for financial services. In particular, the competition among brokerage firms has created a market in which a company seeking new equity capital has a plethora of options for public offerings. With a strong financial services sector competing for their business, Minnesotans tend to save money on their own accord and like to purchase insurance as protection for their families.

The relatively high educational level of Twin Cities residents, their long-standing interest in technology, and the proliferation of individuals who work in technologically-based businesses such as computer manufacturing or software development has created a region which is unusually willing to use technology to obtain financial services. The Minnesota market for financial services is considered to be a good market in which to test new products, particularly technological innovations. Thus this comfort level with technology has allowed Twin Cities-based financial services to become national leaders in the use of technology for their consumers, including debit cards, phone banking, and home banking.
Related and supporting industries

- Financial services are important consumers of professional services such as accounting and attorneys.
- The growing role of technology in financial service operations requires individuals trained in computer and software development, who are available in the Twin Cities area.

Professional services

All of the "big six" national public accounting firms — Arthur Andersen, Coopers and Lybrand, Deloitte and Touche, Ernst and Young, KPMG Peat Marwick, and Price Waterhouse — have offices in the Twin Cities. Access to these public accounting firms aids financial services for auditing their own records and assessing risk in loans to private businesses or underwriting an emerging growth company. Public accounting firms also serve as a source of trained employees for financial services, particularly for management positions. Furthermore, one investment house noted that its accounting firm would contact them whenever it was auditing a company in need of capital and suggest that the investment house call upon this company.

The legal community helps the financial services community with filing prospectuses, tax opinions, closing documents, and other legal concerns. The graduates of local law schools — the Hamline University School of Law, the University of Minnesota Law School, and the William Mitchell College of Law — contribute to area legal expertise both in independent firms and as employees of financial service institutions.

Computers and software

Alongside Massachusetts and Silicon Valley, the Twin Cities area has been known for a concentration of activity in developing and manufacturing computer technology. Engineering Research Associates (ERA) sold the first commercial computer in 1946 and has created a legacy of vitality and creativity in computer manufacturing and software development that continues into the present. In conjunction with the technological training available at the University of Minnesota, the Minnesota computer industry has led to a familiarity with technology and comfort level with technology that has been beneficial to financial services. While an estimated 22,000 people work in the Minnesota software industry alone, thousands more work in the information services divisions of major financial institutions and are using their training, often obtained in the computer and software sector itself, to develop the information systems necessary for financial services in the twenty-first century. The St. Paul Companies, for example, considers its proprietary information technology a core competency for its success.
Firm strategy, structure and rivalry

- Perennial rivalries among major financial institutions engender an environment of intense competition for market share.
- Although national firms have been strong competitors, local financial service institutions believe that their style of operations have helped to preserve their competitive advantage — their dedication to community involvement; their personal customer service; their innovation; and their sense of business integrity.
- Informal networks of communication create a sense of community among leaders of local financial service institutions.
- Advances in technology offer financial services new opportunities for efficiency yet require substantial capital investment.

Local rivalry

The pairs of competing firms which dominate sectors of the local financial services market distinguish the Twin Cities from other US metropolitan areas. First Bank and Norwest share over half the banking assets of the state, IFG/Dain Bosworth and Piper Jaffray together have over half of the region's revenues from securities brokers and dealers. Edina Realty and Burnet Realty dominate residential real estate, while the triumvirate of Allina, Blue Cross Blue Shield, and Health Partners control the market for health maintenance organizations. Although it would be easy to attribute the development of these pairs to the twin downtowns, evidence suggests that, while the center of the First Bank System was in St. Paul for many years, the center of the financial services community developed primarily in Minneapolis. Outside of the major banking cities of New York, Chicago, and San Francisco, only two cities share the Twin Cities' structure of two dominant and competing bank holding companies. Charlotte, North Carolina, is home to the headquarters of NationsBank Corporation (fourth largest bank holding company by assets on June 30, 1994) and First Union Corporation (ninth largest), while Pittsburgh, Pennsylvania has the headquarters of PNC Bank (eleventh largest) and Mellon Bank (twenty-fourth largest). First Bank System and Norwest Corporation are competitors in not only size but also quality as both are among the top performing banks in the nation in terms of return on assets and return on average equity.

Despite market domination by major local players, intense competition permeates the Twin Cities financial services arena at all levels. One individual commented that his firm was working to "claw the eyes out" of its competitors. Although the two dominant bank holding companies have led the Minnesota banking market for almost seventy years, hundreds of independent banks have survived in this competitive environment. Independent banks often define themselves around a neighborhood or a specific market such as small business lending to attract customers. The larger banks, particularly the bank holding companies, do not view the independent banks as competition —
except when the political agendas of the two groups collide such as with branch banking and interstate banking — but rather as customers. Historically, the Twin Cities banks functioned as the bankers’ banks for check clearing and balance holding; more recently, the major banks and bank holding companies provide smaller banks with credit card servicing or access to automated teller machine networks.

The critical mass of financial services activity in the Twin Cities has also encouraged agglomeration and increased growth in the area. In the years after World War Two, securities brokers from New York began to stop in the Twin Cities on their way to the West Coast in order to meet with IDS and other financial concerns; eventually, some of these individuals decided to stay and to set up their own firms in the Twin Cities.

Investment firms providing equity capital separate market among themselves by the size of the capital offering — offerings over $500 million tend to go to the national New York-based houses, Dain Bosworth and Piper Jaffray battle over offerings between $50 million and $500 million; John G. Kinnard focuses on offerings around $20 million, and smaller firms concentrate on deals of $10 million or less. These firms have developed specialized expertise in capital offerings of these different sizes. In selling securities, various firms have particular expertise in different segments of the market — corporate bonds, municipal bonds, small-capitization stocks or blue chip stocks. Regional firms also tend to emphasize regional stocks more than national firms. Competition among investment firms is especially heated for brokers because of a long-standing, but detrimental, tradition of offering brokers incentives for changing firms.

As the market for financial planning and asset management has expanded over the last fifteen years, individuals trained in established firms (such as Dain Bosworth, First Bank/First Trust, IDS/American Express Financial Advisors, Norwest or Piper Jaffray) have often started their own firms. Successful independent money managers can earn much more money than portfolio managers of larger organizations, and, as entrepreneurs, they enjoy the freedom of business ownership and control. Facilitating this trend toward independence has been the decline of commission-based brokerages and the rise of fee-based financial planning or asset management.

In the quest to maintain and expand market share, financial service institutions are trying to offer their customers more and more services. "Cross-selling" a new product to a current customer allows financial service institutions, from the small credit union to the large bank holding company, to increase their revenues more easily than through attracting new customers. To expand their product offerings, some financial service institutions use mergers and acquisitions to enter new markets and to use new methods of distribution. Mergers and acquisitions also create economies of scale which potentially reduce the cost of operation for a financial service institution.
Surpassing national competition

To explore local opportunities for profit, many national financial service firms, particularly brokerage houses such as Merrill Lynch and Paine Webber, have entered the Twin Cities market over the last twenty years. The presence of these national wirehouses has helped to make the Twin Cities investment community more concerned about customer service and their operations. The first component to the competitive advantage of area institutions is their commitment to involvement in the local community. Regional and local financial service institutions are proud of their dedication to civic contributions, including both corporate donations and employee volunteer activities. In particular, Piper Jaffray has long been a leader in the Minnesota Five Percent Club of corporations which donate five percent of their pretax profits to charity. Local firms believe that their corporate responsibility toward the area increases their attractiveness to clients and customers relative to their nationally-based competition.

The second aspect of advantage is the smaller size of many local firms, particularly in insurance, compared with their national competition. When combined with their central location, the friendlier, less bureaucratic size of these firms makes them more personable and attractive to the consumer. Although smaller firms may not enjoy the same economies of scale as larger institutions, consumers like knowing the people who control their money and their financial future. Moreover, midwestern financial service institutions are convinced that they offer superior personalized service and that this attracts new customers. Local financial service institutions believe that they distinguish themselves from their national competitors through their commitment to honesty and integrity in their business operations. Area firms like to consider themselves distinct from their East Coast counterparts because of their “Midwestern” corporate culture. As an example, the St. Paul Fire and Marine Insurance Company was one of the handful of insurance companies that paid their claims in full following both the Chicago Fire of 1871 and the San Francisco Fire and Earthquake of 1906.

The relative isolation of the Twin Cities from the dominant financial services centers such as New York, San Francisco, and Hartford, the nation’s insurance capital, provides Twin Cities institutions the freedom to try new ways of doing business. The area was one of the earliest in the nation to develop bank holding companies, a financial structure which has since swept the nation. After World War Two, the trust departments of Twin Cities banks began to purchase common stock with trust accounts at a time when it was all but heresy to use anything other than bonds for trust accounts. For years, the insurance industry considered the St. Paul Fire and Marine Insurance Company a healthy and respected renegade for not cooperating with the industry on pooling information and for experimenting with new products, yet The St. Paul Companies continues to thrive while many of its former competitors have gone by the wayside. Similarly, a recent article in The Wall Street Journal called the Norwest Corporation a “banking maverick” for its ongoing commitment to personalized customer service despite its size and resources.

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Informal communication networks

The legacy of leading families has created an informal network among the leaders of the financial community. While the Minnesota Business Partnership, organizing communication among area CEOs, sustains these connections, community fundraising campaigns and governing boards — such as the Guthrie Theater or the United Way — contribute to informal communication and interaction. The confluence of the state capital, the financial services center, and the University of Minnesota, the state's land-grant research university, in the Twin Cities metropolitan area has concentrated Minnesota's political and economic power within one metropolitan area. This geographic proximity facilitates the development of collaborative partnerships and encourages government, business and education to work together for mutual success.

Local trade associations — including the Bank Holding Company Association, the Independent Community Bankers Association of Minnesota, the Insurance Federation of Minnesota, the Minnesota Association of Credit Unions, the Minnesota Bankers Association, the Minnesota League of Credit Unions, the Minnesota Realtors Association — facilitate collaboration and lobby the government to promote the interests of the industry. The Minnesota Bankers Association tends to be larger or more urban banks, while the Independent Community Bankers of Minnesota is composed primarily of small or rural banks. The Insurance Federation of Minnesota, with 115 members, is considered one of the stronger state insurance trade associations in the nation, and serves as the primary state lobbyist for the insurance industry with the mission of "improving the business climate for the Minnesota insurance industry." Although two competing trade associations divide the credit union community, credit unions cooperate extensively because field of membership restrictions severely limit direct competition among credit unions. Larger credit unions frequently offer direct assistance to small or struggling credit unions, and credit unions frequently collaborate on developing and buying new technologies. The securities industry tends to be the least organized on a local level, in part because federal regulation, not state or local, governs its operations.

Technology

Technology has become a major component of financial service institutions' strategy as a means of improving customer satisfaction and reducing costs. The banking and credit union industries have embraced computer technology, including automated teller machines (ATMs), debit cards, direct deposit, electronic funds transfer, and 24-hour phone banking. Over the last ten years, consumers have fallen in love with the flexibility and convenience of ATMs and 24-hour phone banking, which now compose the majority of consumer bank transactions. Twin Cities financial service institutions hold leadership or close to leadership positions in the adoption of new technologies. Phone banking has proven to be a success, and banks, burned by losses in attempting to develop home banking in the 1980s, are wary about whether consumers will want and use online banking. Nevertheless, several local banks are proceeding with home banking for consumers in addition to their existing provision of online banking to corporate clients. Marquette Bank introduced its online banking on August 1, while Norwest is reported to be developing a proprietary personal finance software. Though online home banking now represents only about 1% of all banking transactions, experts anticipate a six-fold increase in its usage by 1997.

The Internet provides financial service institutions both new marketing opportunities as well as new competitors. Several local financial service institutions, including the Norwest Corporation, have established home pages on the World Wide Web as a means of increasing their visibility. Several
national banks are trying to develop banking options using the Internet and must first create adequate security protections for financial transactions. Meanwhile, there are several national banks (i.e., DigiCash, Inc.) whose sole products are financial products, such as "e-cash," designed exclusively for use on the Internet.

Although technology helps financial service institutions reduce their operating expenses by cutting labor costs, personal service is unlikely to disappear in the near future. While technology can add convenience and flexibility, people still like to know who has control over their money and still value that personal relationship with a banker or an insurance agent. The aborted attempt of a Chicago bank to charge customers for teller services was a recognition of both banks' intense desire to redirect customers toward technology and the unwillingness of consumers to give up personal teller interactions. The customers least likely to embrace automated banking technology tend to be older and often wealthier. Although consumers may be willing to use technology for many activities, people like to have personal contact with their banker, to know where their money is.

Across all financial services, the rise of computers has increased the pace of business enormously as accounting practices have advanced from hand calculation to the slide rule to early computers to today's spreadsheets. The speed of information has accelerated enormously. From an administrative perspective, computer technology also helps to limit costs. Banks and credit unions are replacing microfiche copies of checks and share drafts with optical imaging of checks. Computer technology allows financial service firms to centralize back office operations to a single location, often physically separated (for cost savings and security) from the headquarters office. First Bank is planning to implement a computer-based system for job applicants — individuals who are unable to navigate the computerized application process are unlikely to be prepared for the technological environment of today's financial services.
Government

- The federal government has long limited the products which different financial services may sell and regions in which they may operate, but trends toward deregulation portend significant loosening of these restrictions, which may benefit Minnesota financial institutions.
- Government regulation at both the state and federal levels help ensure the financial soundness of the financial services industry but can also introduce time-consuming "administrivia" for individual financial services firms.
- Commercial and industrial property taxes form a significant portion of the operating costs of financial service firms.

Because financial services handle people’s money, their hopes and their dreams, the government extensively regulates financial services. Although banks, credit unions and thrifts have a dual chartering system with both federal and state charters, the federal government oversees much of their regulation, including consumer protection, deposit insurance, safety and soundness regulation, and structural restrictions. The state does have a major role with state-chartered banks. The Federal Reserve Board regulates bank holding companies, while the Securities and Exchange Commission monitors the public trade of stocks and bonds in the securities industry. However, under the McCarran-Ferguson Act of 1945, state governments regulate the insurance industry and can thus directly affect the location decisions of insurance companies with the leniency or severity of their regulatory environment.

Federal banking regulation

Safety and soundness regulation, designed to ensure the safety of consumers’ deposits and the soundness of financial institutions, benefits both the consumer and financial institutions. Without it, rumors of unsound depository institutions could recreate the banking panics of the late 19th century or force banks to pay higher interest rates to consumers. Although safety and soundness regulation itself may impose additional costs upon financial service institutions, they, in general, support strong safety and soundness regulation. To ensure the safety of deposits, the federal government requires commercial banks, credit unions and thrifts (or savings and loans) to participate in national deposit insurance. However, in a move announced on August 7, 1995, the Federal Deposit Insurance Corporation cut the premiums charged to healthy banks to 4 cents per $100 deposits. In contrast, thrifts pay 23 to 31 cents per $100 of deposits to help mend the thrift fund in the aftermath of the numerous thrift failures of the late 1980s. As a result, many thrifts, including Twin Cities-based TCF Bank, are applying for national bank charters. Some thrift leaders have even urged the government to discontinue the separate thrift charter as changing markets have almost eliminated the distinct mission of the thrift charter to provide residential mortgages.

Because consumer protection legislation, such as Truth-in-Lending, Truth-in-Saving, Fair Lending Act, and the Community Reinvestment Act, tends to impose numerous reporting and paperwork requirements upon banks, financial institutions are in general unenthusiastic about it; they perceive that much of the consumer protection legislation subjects them to a multitude of "administrivia." While larger banks enjoy some economies of scale in meeting paperwork requirements, smaller banks often feel that they are drowning in a sea of regulation.
Since the early twentieth century, the federal government has imposed a series of restrictions on the structure of the banking industry in an effort to prevent bank failures. Designed to protect consumer deposits from speculative investments, the Glass-Steagall Act of 1933 prohibited commercial banks from engaging in investment banking, including underwriting or selling securities. Over the last sixty years, however, the structural innovations which blur the distinctions among financial services have transformed the Glass-Steagall Act into a largely irrelevant artifact of the Depression. Already, bank holding companies maintain subsidiaries involved in investment banking under the parent name, while some banks offer money market funds and discount brokerage services. As a result, the President and Congress have once again proposed measures to dissolve the artificial distinctions between banking and investment banking — the Financial Services Competitiveness Act and the Financial Services Modernization Act. A decision by the Congress to dissolve the Glass-Steagall Act would place commercial banks in competition with securities brokers and dealers to the detriment of smaller banks. Although commercial banks have little expertise in investment banking, many larger banks have sufficient assets to be able to purchase expertise. Thus, while large banks and bank holding companies such as First Bank System and Norwest Corporation are anxious for the repeal of the Glass-Steagall Act, smaller banks and investment banks look upon the proposed changes with some trepidation.

**Federal and state restrictions on interstate banking**

The United States has historically been suspicious of branch banking, group banking and interstate banking, all of which populists perceive as excessively separating depositors from their money and the bankers who control it. Bank holding companies, a model of group banking, developed in the Upper Midwest to cement banking relationships endangered by threats of external owners. Because bank holding companies could acquire banks across state lines, both the First Bank Stock Corporation and the Northwest Bancorporation developed extensive banking networks throughout the Upper Midwest. In contrast, Chicago banks, because of their major role as bankers' banks for the region, had little incentive to develop bank holding company networks; moreover, Illinois was one of the last states to remove unit banking restrictions. Consequently, Chicago never developed the model of the bank holding companies to compete directly with the Twin Cities based bank holding companies. The Bank Holding Company Act of 1956 restricted all further bank holding company acquisitions across state lines but allowed multistate bank holding companies to continue pre-existing operations. Thus, by protecting them against outside competitors, the Bank Holding Company Act and the previous prohibition on interstate banking allowed the First Bank Stock Corporation and the Northwest Bancorporation to dominate regional banking.

As non-banks entered financial markets and thrifts expanded across state lines, national bank holding companies began to perceive the restrictions on interstate banking as unnecessary constraints on their ability to expand. In 1985, Minnesota and its neighboring states implemented a five-state banking reciprocity agreement, later expanded to fourteen states in 1988. Later, Minnesota changed its laws to allow national reciprocity banking so that any bank holding company based in any state that allowed acquisition by Minnesota-based bank holding companies could acquire banks in Minnesota. Thus far, only Milwaukee-based Firstar Corporation has taken advantage of reciprocity to make significant acquisitions in Minnesota. On a national level, the Riegle-Neal Interstate Banking and

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17 The five-state reciprocity agreement allowed Minnesota-based bank holding companies to acquire banks in Iowa, North Dakota, South Dakota and Wisconsin and vice versa; the fourteen-state agreement added Colorado, Idaho, Illinois, Kansas, Missouri, Montana, Nebraska, Washington, and Wyoming.
Branching Efficiency Act, signed into law in 1994, repealed the 1927 McFadden Act's prohibition against interstate banking. Under the terms of this act, bank holding companies will be allowed to acquire banks in any state after September 30, 1995 although states do have the option to withdraw, or "opt out," from national interstate banking. In 1997, banks will be permitted to establish branches across state lines without first establishing new legal entities.

State regulation and policies

The Minnesota Department of Commerce regulates the financial services industry. Relative to federal regulation, state-level regulation seems less onerous to financial services simply because the state government is physically and psychologically closer than the federal government. Moreover, the insurance industry has a financial interest in solid government regulation because insurance companies must fund the insurance guaranty fund that covers the losses of a failed insurance company. While the environment for financial services depends in part on the political climate of the administration, regulation has remained generally constructive and relatively consistent across governors. With its intent to promote business and job growth, the Carlson Administration has created a particularly positive climate for financial services; the financial services industry believes that the Department of Commerce respects their needs as well as those of the general public. Even during more challenging political environments, however, the professional workforce of the Department of Commerce offers stability that serves as an antidote to upper level turnover. The fact that Minnesota's Commerce Commissioner is an appointed position also helps preserve beneficial regulation; in contrast, California elects its insurance regulator, who, in order to retain popular support among the electorate, often forces premium costs so low that insurance companies have great difficulty in continuing operations in California.

Financial services are less enthusiastic about the regulatory actions of the Minnesota Legislature. While workers compensation costs are less critical to financial services than to manufacturers, financial service institutions were concerned about the "business climate" in Minnesota. If new business is unwilling to locate in Minnesota, financial services suffer. Thus, the financial services community generally applauded the 1995 change in workers' compensation legislation as a symbol of future improvement in the Legislature's perceived attitude toward the business community. Because financial service institutions consume large quantities of office space, particularly in higher-rent central business districts, commercial and industrial property taxes represent a major component of their operating costs. Twin Cities financial services point out that under the Minnesota property tax system, they pay more in property taxes than their counterparts elsewhere in the country.
Conclusion

Using the Porter approach for understanding the financial services industry of the Twin Cities provides a better view of the interlocking conditions creating competitive advantage. From the initial factor conditions through to the development of a competitive environment, the present situation of the Twin Cities positions the economy well for future vitality in financial services.

The historical basis of the financial services cluster of the Twin Cities lies in the natural resources of the Upper Midwest which transportation lines focused on the Twin Cities. Isolated from the capital contributions from the East Coast, early entrepreneurs of the Twin Cities developed their own financial services and cultivated a civic pride that later discouraged outside involvement. When rural depression threatened the area’s banking independence, innovative local leaders created the two multistate bank holding companies which have developed over the past sixty plus years into leading superregional banks.

Financial services and the local economy exist in an interlocking synergy in which the health of one sector is necessary for the vitality of the other. The longstanding diversity of the Twin Cities economy, led by fifteen Fortune 500 corporations, has helped ensure that area residents have comfortable incomes to invest and created a legacy of wealth requiring management. More recently, the ongoing cycle of entrepreneurship and the establishment of start-up companies helps revitalize the economy for the future and feeds into the demand for investment banking.

The residents of the Twin Cities, with generally comfortable household incomes, a high level of education, familiarity with new technologies, and a preference for financial planning, provide local financial services a convenient and willing market for their products. The residents of the Twin Cities also compose a highly educated, hardworking supply of human resources for area financial service institutions; their experience with computers and software development has allowed Twin Cities financial institutions to be national leaders in the adoption of new technologies. The public transit system helps convey these individuals to their workplaces in the central business districts, while the hub Minneapolis-St. Paul Airport easily transports financial service executives to outside markets.

These positive conditions for financial services have attracted outside financial service institutions and have helped numerous financial service institutions thrive in the Twin Cities. As a result, fierce local competition characterizes most sectors of financial services in the Twin Cities. To expand their market share, local financial service institutions invest in new cost-saving technologies, develop new products, and emphasize their commitment to community involvement. Moreover, while mergers and acquisitions allow larger firms to expand their market and develop economies of scale, smaller institutions focus on personalized customer service for niche markets.

Government regulation, at both the federal and state levels, limits the activities of financial service institutions, but can also offer competitive opportunities. Although prohibitions on interstate banking protected Minnesota-based bank holding companies from outside competition for many years, the introduction of full interstate banking now offers new markets but also new competitors. Proposals to change the Glass-Steagall Act, which created firewalls between investment banking and commercial banking, portend unknown structural evolution for the entire financial services community.
The financial and management strength of local financial service institutions, the vitality of the regional economy, and the willingness of area firms to innovate bode well for the future of the financial services industry in the Twin Cities area. As technology and evolving government regulation transform the structure of financial services, financial service institutions of the Twin Cities are well-positioned to take advantage of new opportunities. Nevertheless, to ensure this continued health, the Twin Cities metropolitan area must be willing to take positive actions to preserve the necessary conditions for success:

♦ Educational pipelines for a work-ready labor force;
♦ A state-of-the-art telecommunications infrastructure;
♦ Commensurate, consistent and fair regulation;
♦ Accessible, affordable, attractive and available office space.
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## Appendix 1: Employment in Financial Services

<table>
<thead>
<tr>
<th>Selected Industries</th>
<th>Employees 1992</th>
<th>1992 LQ&lt;sup&gt;11&lt;/sup&gt;</th>
<th>92 LQ -88 LQ</th>
<th>Average weekly wages</th>
<th>% TC Empl.</th>
</tr>
</thead>
<tbody>
<tr>
<td>602 Commercial banks</td>
<td>12,849</td>
<td>0.709</td>
<td>0.115</td>
<td>560</td>
<td>0.99</td>
</tr>
<tr>
<td>603 Savings institutions</td>
<td>2,021</td>
<td>0.484</td>
<td>-0.137</td>
<td>506</td>
<td>0.16</td>
</tr>
<tr>
<td>606 Credit unions</td>
<td>1,300</td>
<td>0.777</td>
<td>-0.060</td>
<td>394</td>
<td>0.10</td>
</tr>
<tr>
<td>609 Financially related to banks</td>
<td>1,926</td>
<td>2.640</td>
<td>-0.724</td>
<td>610</td>
<td>0.15</td>
</tr>
<tr>
<td>614 Personal credit institutions</td>
<td>1,886</td>
<td>1.223</td>
<td>0.211</td>
<td>716</td>
<td>0.14</td>
</tr>
<tr>
<td>615 Business credit institutions</td>
<td>1,105</td>
<td>1.119</td>
<td>-0.013</td>
<td>918</td>
<td>0.08</td>
</tr>
<tr>
<td>616 Mortgage bankers and brokers</td>
<td>5,207</td>
<td>2.367</td>
<td>0.265</td>
<td>762</td>
<td>0.40</td>
</tr>
<tr>
<td>621 Security brokers and dealers</td>
<td>8,363</td>
<td>2.100</td>
<td>0.162</td>
<td>1,236</td>
<td>0.64</td>
</tr>
<tr>
<td>622 Commodity contract brokers and dealers</td>
<td>139</td>
<td>0.738</td>
<td>-0.006</td>
<td>947</td>
<td>0.01</td>
</tr>
<tr>
<td>628 Security and commodity services</td>
<td>1,287</td>
<td>1.282</td>
<td>0.253</td>
<td>1,756</td>
<td>0.10</td>
</tr>
<tr>
<td>631 Life insurance</td>
<td>10,500</td>
<td>1.904</td>
<td>-0.256</td>
<td>702</td>
<td>0.81</td>
</tr>
<tr>
<td>632 Medical service and health insurance</td>
<td>9,616</td>
<td>2.963</td>
<td>1.362</td>
<td>713</td>
<td>0.74</td>
</tr>
<tr>
<td>633 Fire, marine and casualty insurance</td>
<td>10,736</td>
<td>1.609</td>
<td>0.038</td>
<td>746</td>
<td>0.83</td>
</tr>
<tr>
<td>635 Surety insurance</td>
<td>98</td>
<td>0.488</td>
<td>-1.082</td>
<td>860</td>
<td>0.01</td>
</tr>
<tr>
<td>636 Title insurance</td>
<td>1,328</td>
<td>1.570</td>
<td>0.038</td>
<td>538</td>
<td>0.10</td>
</tr>
<tr>
<td>637 Pension, health and welfare funds</td>
<td>559</td>
<td>1.165</td>
<td>0.381</td>
<td>349</td>
<td>0.04</td>
</tr>
<tr>
<td>641 Insurance agents, brokers and service</td>
<td>8,315</td>
<td>1.031</td>
<td>-0.077</td>
<td>712</td>
<td>0.64</td>
</tr>
<tr>
<td>651 Real estate operators and lessors</td>
<td>6,976</td>
<td>1.048</td>
<td>-0.211</td>
<td>321</td>
<td>0.54</td>
</tr>
<tr>
<td>653 Real estate agents and managers</td>
<td>9,444</td>
<td>1.335</td>
<td>0.245</td>
<td>441</td>
<td>0.73</td>
</tr>
<tr>
<td>654 Title abstract offices</td>
<td>374</td>
<td>0.981</td>
<td>0.619</td>
<td>577</td>
<td>0.03</td>
</tr>
<tr>
<td>655 Land subdividers and developers</td>
<td>482</td>
<td>0.352</td>
<td>-0.013</td>
<td>706</td>
<td>0.04</td>
</tr>
<tr>
<td>671 Holding offices</td>
<td>2,588</td>
<td>2.113</td>
<td>0.323</td>
<td>1,239</td>
<td>0.20</td>
</tr>
<tr>
<td>672 Investment offices</td>
<td>24</td>
<td>0.152</td>
<td>-0.098</td>
<td>1,388</td>
<td>0.01</td>
</tr>
<tr>
<td>673 Trusts</td>
<td>911</td>
<td>1.929</td>
<td>-0.855</td>
<td>617</td>
<td>0.07</td>
</tr>
<tr>
<td>679 Miscellaneous investing</td>
<td>519</td>
<td>1.220</td>
<td>-0.441</td>
<td>837</td>
<td>0.04</td>
</tr>
</tbody>
</table>

<sup>11</sup> Source: Minnesota Department of Economic Security.

<sup>11</sup> LQ = Location Quotient. If an industry's share of total jobs in the Twin Cities matches the same industry's share of total jobs in the nation, the location quotient is equal to one. If an industry is more concentrated in the Twin Cities than in the nation, the location quotient is greater than one, and the industry is relatively more specialized. Local specialization is important because a relatively higher concentration of jobs may signal that the industry serves markets outside the local economy.
Appendix 2: The Largest Financial Service Companies by Revenue

1. Norwest Corporation
2. The St. Paul Companies Inc.
3. American Express Financial Advisors
4. The Prudential Insurance Co. of America
5. Allianz Life Insurance Co. of America
6. First Bank System Inc.
7. ITT Hartford Life and Annuity Insurance
8. Lutheran Brotherhood
9. Minnesota Mutual
10. ReliaStar Financial Corporation
11. AgriBank
12. GE Capital Fleet Services
13. Fortis Financial Group
14. Federated Mutual Insurance Company
15. State Farm Mutual Automobile Insurance
16. Green Tree Financial Corporation
17. Inter-Regional Financial Group, Inc.
18. TCF Financial Corporation
19. Piper Jaffray Companies, Inc.
20. Cargill Financial Markets
21. Northland Insurance Companies
22. Old Republic National Title Insurance
23. MSI Insurance Companies
24. Employee Benefit Plans Inc.
25. Life USA Holding Inc.
26. Residential Funding Corporation (RFC)
27. Bremer Financial Corporation
28. Firstar Bank of Minnesota
29. Fidelity Acceptance Corporation
30. Travelers Express Company
31. Western National Insurance Group
32. Security American Financial Enterprises
33. General Motors Acceptance Corporation
34. American Hardware Insurance Group
35. MidAmerica Mutual Life Insurance
36. Auto Owners Insurance Company
37. Farm Credit Leasing
38. Chubb Group of Insurance Companies
39. E. W. Blanch Holdings Inc.
40. ITT Hartford
41. Financial Life Companies Inc.
42. Marquette Bancshares
43. Winthrop Resources Corporation
44. American Bancorporation Inc.
45. SBM Company
46. National City Bancorporation
47. State Fund Mutual Insurance
48. Knutson Mortgage Corporation
49. Kinnard Investments
50. Health Risk Management Inc.

Locally owned firms are in bold-face; regional branches of outside firms are in normal type.

*Source: Corporate Report Minnesota, June 1995. "Methodology: All for-profit companies operating in Minnesota in the area of financial services for this list. For companies headquartered out-of-state, the regional headquarters is the entity profiled. For banks, revenue is the sum of total interest income (before interest expense) and non-interest income (including fee income). For insurance companies, we count premiums earned plus net investment income plus brokerage and management fees. For other, we use their specific industry's generally accepted practices. All revenue, earnings, and year-end asset figures are from a company's 1994 fiscal year unless otherwise noted. Research for this list took place in April 1995."
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