

TOO MANY BRANCHES?

by [Steve Brown](#)

For the first time in history, as of June 2006, this nation has over 92,500 bank branches. Branch growth shows little sign of letting up, as the need to bring in cheaper deposits is now more critical than ever. Almost every bank more than 3-years old that we have visited in the last 2 months, has plans to open multiple branches in 2007. Given that most branches need to attract at least \$12mm of new deposits (and with higher costs these days, many branches need closer to \$30mm), at or below their current cost of funds, over a 3-year period of time to be profitable, many banks will struggle with branch profitability. By looking at data of branches that opened in 2002 and 2003, less than 18% of these could be considered clearly successful. 45% of these new branches fall into a middle category that it is difficult to tell and 37% are draining profitability, as they have less than \$10mm of deposits. In attempting to discern what demographic factors lead to a successful branch, we found it interesting that none stood out after looking at more than 20 different variables such as regional disposable income, branches per household, population growth, etc. While high growth and favorable demographics surely help, the strategy has two things working against it. The first is competition. Since most banks analyze the same demographic data when deciding on location, most branch models reach the same conclusion. Those areas that are deemed "under-banked," usually end up being "over-banked" within a 4 year period of time, hurting everyone's path to profitability. Las Vegas, Phoenix, Chicago and Atlanta are all prime examples where most banks looked at static models, not factoring in increasing future branch competition. The 2nd factor in explaining new store success is the fact that branching alone does not generate greater net interest income. In our opinion, even more important to branch location is a bank's "value proposition." If a bank does not have, and articulate, a reason to share a customer's wallet, then branching will only serve to add overhead cost. Independent banks that have consistently produced successful branches all have a "message" that they deliver. These range from superior customer service, a specialty such as wealth management or knowledge of a particular market segment. The best location in the world won't help a branch strategy, as the area will soon be over-banked and the branching bank will once again have to compete on its value proposition. A poor location and a great value proposition are always better than a great location and a poor value proposition. We strongly believe that the customer should have their choice of delivery channels and a nice branch is de rigueur. However, as we look ahead to what is in store for banking over the next 5Ys we are of the opinion that the branch gets deemphasized for electronic means (remote capture, debit card usage, online bill pay, etc.) As such, our conclusion is that many areas are overbranched. Before investing in more infrastructure, top performing banks would do well to examine how their value proposition stacks up against current and potential future bank competition in a given area. Doing so not only helps protect the branch investment, but also helps define the probability of success. After looking at all the demographic data, the best predictor of future branch success, is past branch openings. Management that has a string of successful de novo branches is 70% more likely to repeat that success in the future - no matter what the location.

BANK NEWS

Acquisition

Freedom Mortgage will acquire the mortgage production operations of Irwin Financial (\$6.9B, IN) for an undisclosed sum.

Branch Purchase

First Bank (\$9.4B, MO) will acquire the Beverly Hills banking office of First Bank of Beverly Hills (\$1.4B, CA) for a premium of 5.5x of the branch's total deposits as of the closing. As of 6/30, the branch held \$156.5mm in deposits. The move expands First Bank's CA banking office total count to 53.

Expanding

First Horizon National, the parent company of First Tennessee, said it will open as many as 15 branches in the Baltimore market in coming years as it seeks to leverage its mortgage lending business and acquire new customers.

Competition

Union Bank of California (\$48.8B, CA) announced it has launched a small business application called "OneBiz." The application provides small business owners with access to sales force automation, business plans, CRM, human resource management and other services.

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