THE FUTURE OF BRANCHING AND PROFITABILITY

by Steve Brown

One thing we covered in depth at our annual Executive Management Conference held last week was the future role of branching. While all of us have heard branching is dead many times over the last 10Ys, this time we believe it really is. The rise of the smartphone/tablet app, combined with the internet in general, will serve to reduce branches by 30% in our estimation over the next 5Ys.

Branches are just too expensive to build and to maintain. If you are on our Relationship Profitability system you have access to this data, if not, consider the following. About 63% of the average community bank's branches are currently unprofitable. On a forward-looking basis, if you shift rates up to 3.00%, a whopping 28% are still unprofitable. This is a whole lot of extra overhead to be carrying around. Further, if your bank is average, most likely a majority of customers that use the branch are also the most unprofitable ones.

For the same $1.2mm of construction costs that the average bank branch costs to open, a bank can have a state of the art online banking, bill pay, account opening, budgeting, alert, statementing and customer service application. However, after construction, that online application only costs about $300k to maintain per year versus the $1mm (excluding amortization) that the average branch costs to run. More important, while a good sized branch serves about 2k customers, an online platform can easily handle 20k+. This means that if you add up all your costs and customers over a 10Y period of time and then present value the cost of branch delivery, it works out to about $4,300 per customer. That same online platform works out to be $181.

"Forget it!" you retort, as your bank is built on customer satisfaction driven by good old fashioned face-to-face service. We bluntly counter that by saying if you really cared about customer satisfaction, you would be pushing your bank through digital channels. Last year was the first (primarily because of the iPhone), that customers registered higher satisfaction ratings online than through traditional branch delivery channels. We have also done studies where a bank's Facebook customers register higher Net Promoter Scores than customers that are not followers of the bank thru social media. More to the point, many of those from our focus groups are actually "annoyed" when they have to go into a branch, because it usually means the customer has exhausted other avenues to obtain the product or service they desire (or to handle a problem resolution). If we haven't challenged your thinking enough, consider the bank with the highest satisfaction scores is USAA. They have 1 branch!

Electronic channels are less expensive, more flexible, aid in greater retention and can create customer intimacy in ways that traditional banking channels can't. While remote check capture has proven this concept, remote cash capture is about to put the final nail in the concept of having a large branch network. In addition to common online banking applications, there is a world of online bundled services that can be added to your current product package to increase fees from both retail and business customers. Soon the large banks will begin shedding branches in order to become more efficient. Community banks are urged to rethink their branching strategy and consider paring back on branches that are small or in price sensitive areas that inhibit profitability.

Digital channels are cheaper than traditional branches, so by emphasizing building online banking channels, community banks can offset some of the advantage that the largest banks hold because of their branch network. The tools are there - you just need to take advantage of it.

BANK NEWS

In Play

A group of private equity firms including Blackstone, Thomas H. Lee and TPG Capital are in talks to pay more than $15B for Fidelity National Information Services. Fidelity National processes payments and issues cards for more than 14,000 financial institutions globally.

Contingent Resolution

Taking another step to end Too Big To Fail, the FDIC proposed a rule requiring banks larger than $10B in assets to submit a plan showing how they could be liquidated in the event of another financial crisis.

More Capital Needed

FNMA reported a 1Q loss of $13.1B, its 11th straight quarterly loss. The agency will ask for $8.4B in additional capital from the Treasury.

Failure Cost 2009

Research conducted by SNL Financial finds the FDIC spent $632mm more than originally projected to deal with the banks that failed in 2009, to a total of $37.05B.

Alt A Better

Fitch reported that late payments on higher risk residential Alt-A mortgages fell in Apr to 34.1% compared to 34.4% in Mar. This was the first monthly decline for these mortgages since 2006; however it is important to note the rate remains quite a bit higher than the 27.4% level of Apr 2009.

FF Rate Update

Former Fed Governor Larry Meyer predicted the Fed will keep the benchmark federal funds target rate near zero through the end of the year.

Cap Rejected

The Senate voted nay on the latest piece of reform. The measure would have limited banks to holding a max of 10% of the all US deposits and 2% of GDP for no deposit liabilities, with nonbank financial institutions maxed at 3% of GDP.

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