The More The Better

by Steve Brown

There has been an effort in some smaller cities like Omaha, NE to encourage the development of creative communities. These communities are made up of artists, musicians and writers, and then there are businesses that follow such creative types like coffee houses and organic food markets. Artists have traditionally been pioneers in distressed neighborhoods - usually a direct result of their economic circumstances, but artists often end up turning rough neighborhoods into desirable ones. Artists also often end up clustering together in certain areas and this is nothing new. Paris in the early part of the 20th Century housed Picasso, Matisse, Stravinsky and others, and they often were found in each others' company in neighborhood cafes. Does a high density of artists inspire more and better artistic output? To a point the answer is yes, but once past that point, greater density brings about greater competition and therefore lower prices, less demand and economic stress.

Banks too have struggled to find the optimal level of branch density. There must be some density in order for a bank to be engaged in a market area and encourage commerce, but when there too many, generating a positive return grows more challenging. Customer preference has also rapidly moved towards digital channels and this has had an effect. In fact, Harvard Business Review explored this very subject and found that 85% of retail banking transactions are now digital. They also found that 75% of new accounts in 2013 were opened in bank branches. While there are those who decry the bank branch as a relic of old times, some institutions are bucking the trend and opening more. Consider that JP Morgan has closed 325 branches since 2010 but has opened 600 for a net gain.

Why this trend? The Harvard study found that more complex services tend to bring in customers for personal interaction to get answers. Another important factor is the importance of security and trust when it comes to people's money. Most people still like to deal with another person when working with those factors combined. Of course, customers want the convenience of digital as well, so the most successful business model has seamless integration of digital and physical capabilities.

Some other ideas on making branches more successful include: branch specialization with particular expertise in products like mortgages or consumer loans; a hub and spoke arrangement with flagship showrooms for complex products and expert advice (the spokes provide basic services and partially automated interaction); pop-up branches; and even branches with a caf? have been successful for some markets.

Branches are unlikely to completely disappear, but they are transforming in order to meet the needs of customers. Community banks have to judge by their clientele and its preferences on how to place their emphasis and to have an optimal density of branches. Globally, branch density varies a great deal and does not really correlate to economic development. The US has 35.3 commercial bank branches per 100K people. That is close to Japan and Denmark, but Brazil has 47, Mongolia has 69, Ecuador has 81 and Cyprus has 97.

As with branching, the density of artists in various communities can create differing value. For Omaha's indie rock scene, artists found that there was less competition than in a large city like New York or Los Angeles with the highest density of artists. Here, an area filled with like-minded artists was conducive to creativity. Banks should strive to find a similar sweet spot.

BANK NEWS

Customer Impact

In order to pay for increased regulatory and compliance costs and increase performance, large banks have quietly begun charging some customers a flat monthly rate if they don't meet certain profitability hurdles.

Kid Expenses

A survey by Bank of America Merrill Lynch finds people who supported their children over the past 5Ys said the money went to the following: don't know (36%); rent, mortgage, home purchase (20%); cell phone (18%); buy or lease a car (17%); education (15%); health care (15%); insurance (11%); student loans (11%) and credit card bills (10%).

Cyber Attacks

Verizon reports the most common cyber attacks or data fraud attempts against financial services firms from 2011 to 2013 were related to website application attacks (27%), website denial of service (26%), card skimmers (22%), insider fraud (7%), other attacks (6%), miscellaneous errors (5%), virus software (4%) and theft or loss of data (3%).

Uemployment

For those keeping track, the unemployment rate has declined from its peak of 9.9% in Q4 2009 to 9.6% at the end of 2010, 8.6% in 2011, 7.8% in 2012, 7.0% in 2013 and 5.9% as of Q3 2014. At this level, we are close to the CBO's 5.5% estimate of long-term sustainable or "natural" rate of unemployment for the U.S.

Lessons Learned

As community bankers gain traction in commercial real estate (CRE) lending opportunities during the economic recovery, recall that regulators deem banks with total CRE to total risk-based capital > 300% or total construction/land development (CLD) >100% AND that have experienced growth in their CRE portfolio of > 50% over the preceding 36 month period, to be highly concentrated and subject to enhanced oversight, analysis and potentially increased capital requirements. This is considered a high risk factor because regulatory analysis finds more than 35% of banks that were above the CRE threshold at year-end 2005 either failed or merged with another institution.

Housing

The MBA reports that in 2013, refinancing made 66% of single family residential originations or about $1.1T in total.