



Transform the Branch Model— Before It's Too Late

BY DAVE KAYTES

The physical distribution network remains critical to banking, but old-style branches may soon go the way of the corner bookstore.

Despite a difficult outlook, branches are not dead. However, the events of the past few years may have dealt a death blow to traditional branch strategy.

More than 40% of U.S. branches are financially underwater today, and most of these will not become profitable under almost any conceivable economic scenario. More concerning is that even among the profitable 60% of branches, most newly originated customer relationships are unlikely to ever become profitable. In turn, branch profitability becomes increasingly dependent on an ebbing base of legacy customers.

Some of these issues stem from tougher regulations, fee restrictions and the current rate environment. This situation calls for more than hunkering down and making small changes around the perimeter. Rather, renewal will require a fundamental change in the distribution of banking products and services.

The traditional branch has started down the road traveled by full service gas stations, corner drugstores and airline counter reservationists. Banking may remain a branch-delivered product, but the day-to-day role of branches will evolve into something quite different.

Historically, branches functioned as deposit gathering centers with transaction services support. In the current environment, deposits are neither in high demand, nor do they provide much margin. And the cost of providing counter service personnel for branch-based transactions has become prohibitive. The traditional branch network is failing to deliver profits, yet for most banks, the branch system is simply too big to fail.

We believe this gridlock will be broken by new models of branch networks that are evolving today and will inevitably dominate the banking market. Each model will face challenges, and it is not yet apparent which will prove the best fit.

One emerging model is based on a locally dense, multi-product distribution network, with such outlets being steadily introduced by HSBC Bank USA along the East Coast. In Potomac, Maryland, for example, a spacious new HSBC facility offers a full range of financial services to both consumers and businesses, including mortgages, loans and wealth management (including private banking), staffed by seven banking professionals.

Increasingly, personnel in such multi-line branches will be primarily responsible for consultative sales, rather than teller functions. Some representatives may assist customers in using branch technology to conduct transactions, but they will also capitalize on interactions to deepen and extend the banking relationship.

Under this scenario, rather than a source of transaction volume, customer traffic provides entrée to present the best products and services to prospective buyers. A rich menu of offerings includes loans, lines of credit, investments, payments, financial advice, brokerage services and insurance, both for consumers and businesses.

This operating model presents its own challenges. In the past, branches were located to optimize service traffic patterns. In the future, they will need to be distributed with sales traffic in mind. Banks also need to determine how to deploy and manage a new expertise-based sales force. As it would be too costly to staff each branch with personnel that could expertly sell each type of product, there likely branches will need to utilize a rotating sales force, akin to department stores. In this case, business would be transacted both on a walk-in basis and by appointment.

A different approach is the low-density superstore model supported by distributed technologies. Think Apple Store: a few select high-touch centers, complemented by a dense network of ATMs with extensive mobile services. According to a recent report by the Financial Times, Citigroup will pursue the Apple Store distribution model in Western Europe, “with a slim network of flagship outlets” supported by a robust online banking capability. Closer to home, ING Direct Cafés can be seen in select sites in major U.S. cities, putting a visible face on a vast online banking operation.

Here too, the objective is to generate traffic and capitalize on each customer interaction to create cross-sales. But unlike the first model, where the brand promise is established through ubiquitous locations, these branches create brand splash through technology, personnel expertise and marketing pizzazz.

While distinctly different, we see these two models as the future of branch banking. As they begin to dominate high potential markets, traditional branches will be steadily phased out.

Such changes spell opportunity for innovation leaders. New-style branches in high potential markets would generate significantly higher balances, margins and profitability than today's branches. On average, local markets would have fewer branches with greater capabilities, fostering a richer customer interaction and a more positive customer experience.

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