NOVANTAS STRATEGY & MANAGEMENT

Acute pressure for branch cost reduction is much more than a temporary operating challenge. Instead, new strategies will be needed for a permanently changed market.

Strategies for the New Future of Branch Banking

BY RICK SPITLER AND KEVIN TRAVIS

Like a bulldozer through a forest, the recession has plowed a barren swath straight through the middle of retail branch banking. The principal casualties are all-purpose branches, the cookie-cutter outlets seen on street corners all across the U.S.

On the one hand, these branches aren't sufficiently positioned for multi-line service supported by a consultative sales culture, limiting the revenue potential. On the other hand, they are over-weighted in floor space and manual transaction-handling activities, limiting the efficiency potential. These squeezed outlets are prominent among the estimated 40% of U.S. branches that are financially underwater today.

Intensifying the challenge, customer online migration is accelerating, with eroding emphasis on the physical branch as the primary destination – definitely for a variety of basics and progressively even for higher-value services. The bulldozer is gaining momentum, in other words, with even more branches at risk of losing customer relevance and financial viability.

The acute pressure for branch cost reduction is much more than a temporary operating challenge. New strategies will be needed that will help to reposition retail banking distribution for future healthy growth in a permanently changed market.

One priority will be harnessing the bifurcation that already has occurred in branch banking, and turning it to advantage. High-traffic, high-potential locales will need to provide the robust, multi-line service needed to tap the fullest possible relationship potential with each customer. At the other end of the spectrum, branches in low-traffic locales will need to decisively reduce the burden of traditional manual processing.

As part of this transition, technology must become more of a transaction *substitute*, not just a *supplement*. In any kind of branch, there will be less justification for manual processing. Fortunately, as seen in the airline industry, many customers have proved quite willing to adopt electronic alternatives – online and kiosk – as the "official" destination for everyday transactions. Replicating this customer orientation in retail branch banking is critical.

Meanwhile, online banking now commands its own substantial customer center of

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gravity, as confirmed by recent Novantas research. This channel deserves studied attention and a much greater developmental resource commitment going forward. Banks can't stand by passively as more high-value retail business moves online. Also, a progressive online offer is essential to support the emerging mobile space.

Customer segments will shape the future market. A recent national consumer survey conducted by Novantas found distinct differences in channel usage patterns among major customer groups. Detailed knowledge of these trends is essential in re-shaping distribution in accordance with what customers want and actually will pay for (not always neatly or rationally aligned in the customer's mind).

NETWORK RATIONALIZATION

This year going into next, retail bankers are facing a potential 10% to 20% revenue shortfall, for a variety of reasons including depressed customer demand, margin contraction, and fee revenue shortfalls associated with restrictive new regulations. With the branch system representing the single largest cost component of retail banking, many institutions will be taking a serious look at network rationalization.

In pressing circumstances, there is a strong tendency to view cost as an operating problem to be primarily addressed by team members in finance and facilities management. But previous eras of contraction and consolidation have taught that aggressive network rationalization can be a risky exercise, one that potentially disaffects many good customers and many good employees as well. Also, pure cost-cuts aren't that helpful in repositioning the retail bank for a permanently changed marketplace, as is now required. Finally, even in the near-term, there are at least a few innovative steps that can be taken to address the larger question of branch productivity.

For all of these reasons, we believe that executive management will need to stay firmly involved in the unfolding era of network rationalization. Actions need to be taken within a strategic context, supporting the future direction of the company. In turn, decisions need to be strongly grounded in the market, including variations in local market potential and the strength and shape of demand in various major customer segments.

One critical exercise is probing within the overall branch network to identify the local markets and trade areas that hold the strongest long-term revenue potential, both by virtue of high density and customer traffic, and a strong presence relative to competitors. Part of this is in the spirit of avoiding a potentially big mistake. In the past, bankers have strongly centered on high-density markets as the place to cut costs, given the proliferation of branches and seeming potential for consolidation. But they lived to regret aggressive action as closures ending up sending a powerful negative signal to an entire region.

A better approach is to frame the question around future revenue potential, and develop appropriate treatments for various parts of the network that either may need to be carefully protected (perhaps even augmented) or, at the opposite end of the spectrum, that more definitely are in need of stringent cost reduction in light of insufficient customer demand and/or competitive stance. In our experience, many banks are greatly in need of improved network diagnostics to more precisely the market potential and customer requirements in each cluster of local branches within the overall network.

The network analysis should be supplemented with a thorough exploration of staffing possibilities. Improved product cross-training, for example, enables the branch to maintain full service with a leaner staff. Also there are substantial opportunities for flexible staffing arrangements that lower the FTE burden while providing quality part-time employment. Hours of operation also can be artfully trimmed.

Even for branches at the edge of viability, there may be options that avoid flat-out closure and market retreat. Typically there are possibilities to merge nearby branches in select locales, for example. Idle floor space can be sub-leased. Some leases can be renegotiated on far better terms, instead of cancelled at their renewal dates.

It wasn't that long ago in banking when hard-pressed chief executives occasionally resorted to

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across-the-board cost cuts. That's not going to be helpful in the current circumstance, especially in light of a changing market. Banks will need something more than a tighter rendition of yesterday's obsolete network configuration.

MULTI-LINE BRANCH STRATEGY

Most banks already are conscious of the fact that their local branch networks tend to perform best in densely populated, high-traffic markets where they have a strong presence relative to the competition. These outlets already deliver the bulk of revenues in retail branch banking. What most banks have not yet done, however, is to capture the full retailing potential in their prime locales.

In a well-positioned multi-line branch supported by an authentic sales culture, the goal is to deepen the relationship with each individual, household and small business. Under this scenario, rather than a source of transaction volume, customer traffic provides entrée to present the best products and services to prospective buyers. There is a rich menu of offerings, including loans, lines of credit, investments, payments, financial advice, brokerage services and insurance.

This scenario is in keeping with Novantas research showing that consumers still have a powerful branch orientation for high-value banking activities. Seventy-six percent of consumers view the branch as the primary place to open new accounts, for example, and 65% look there first when they buy banking products. Meanwhile, 59% of consumers look first to the branch when seeking financial advice, and 36% still turn first to branches to resolve issues. Even among the heaviest users of alternative channels, there is a strong appetite for branch-delivered products and services.

Among various major regional banking companies, we estimate that from 50% to 75% of the current branch network is eligible for the multi-line model. A locally dense, multi-product distribution network will feature more outlets of the type 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 primarily will be 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. Along with improved customer satisfaction, the multi-line model offers one of the best opportunities to gain share in a tight market.

Branch culture and staffing are huge success factors with the multi-line model. Instead of passively processing product orders largely generated by mass marketing, the multi-line branch staff must adopt an authentic sales culture, and play a much more proactive role in identifying and serving the fullest possible range of customer needs.

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Innovation will be needed to provide required on-site expertise in an efficient manner. It simply won't be possible to station dedicated product specialists at each location, all day every day.

One priority is to ramp up product cross-training, so that full time staff can flow expertise where needed to meet various customer needs. Also, as already seen with small business banking specialists, there will be a greater need for floating specialists who can serve a cluster of branch locations, possibly by appointment. There also will be opportunities to drive customer referrals to regional teams of specialists, such as with investments and insurance, possibly operating through the call center.

Such transitions will require a higher level of staff talent in the retail branch, with implications for the chain of activities that support workforce management. Strong collaboration between the retail banking and human resources teams will be needed to clarify emerging branch staffing requirements and implications for recruiting, training, coaching and incentives.

Retail banks also will need a comprehensive understanding of the various local markets within the overall network, as a basis for important decisions about where to emphasize multi-line branch strategy and how to optimize local configurations. Longer term, there's a need for a migratory path in branch location and design, so that outlets take better advantage of the sales opportunity in dense markets and also make greater use of technology substitutes that further lower the need for manual transaction services.

THIN NETWORK STRATEGY

In many markets, there are plenty of customers with high-value needs, but simply not in sufficient quantity to justify an elaborate physical branch presence. By marrying a thin network of attractive branches with a strong network of ATMs and a robust online and mobile offering, it may be possible to establish a new network paradigm that not only offers unprecedented efficiency, but also strongly appeals to customers.

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 major U.S. cities, putting a visible face on an extensive online banking operation.

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

Based on the recent Novantas consumer survey, there already are customer segments that likely would be receptive to a thin retail banking network. But realistically, this is more of a departure from traditional branch banking, moving both the institution and the retail banking customer into a new space.

One thing is quite certain even at this stage, however – online banking is facing a two-fold challenge. First, further progress in technology innovation and customer adaptation is needed, so that significant numbers of individuals, households and small businesses use the online channel as a true substitute for basic transaction services formerly delivered through the physical branch. The Internet becomes the safety net. Otherwise, how will banks permanently consolidate low-traffic local branch networks without losing myriad customer relationships altogether?

Second, the online offering must be strengthened to compete for high-value transactions, such as opening new deposit accounts and accessing retail bank credit, and the customer relevance and revenues they represent. When people go out into the local community, the selection of competing branches, while perhaps not restrictive, is usually limited. When they go online, by contrast, the banking options are virtually unlimited. Also, online retailers are finding more ways to insinuate financing options into their web site offerings, both bank and non-bank.

The point is that excellent functionality ultimately will be table stakes in capturing fair share of the retail banking revenue stream that is migrating online. Build it and they may not come. While beyond the scope of this article, we believe there is a whole set of strategy and marketing questions that require much fuller management attention, centered on strengthening the online proposition for high-value retail banking services.

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INFLECTION POINT

Retail branch networks have reached an inflection point, both from the perspective of changing economics and changing customer preferences. Thus the actions that banks take now will influence success not only this year, but five years out as well, given the time horizon required to make structural changes to the physical network.

Retail and distribution executives should focus on five key priorities:

1) Reducing costs by transforming the transaction environment, using self-service and other customer-friendly technology, concurrently improving the customer experience by providing more alternative channel choices.

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2) Aligning staffing skills, roles and activities with new, multi-line branch models, in keeping with customer demand, both in terms of hours of operation and types of activity and required service.

3) Concentrating multi-line sales offerings in markets with high opportunity, served by larger, full service installations that are able to leverage all of the bank's offerings.

4) Rationalizing local branch networks in a balanced way that aligns access and cost with actual usage, but also maximizes the visibility of remaining outlets to supporting marketing and branding with potential customers.

5) Developing new and much more accurate usage and preference profiles of different groups of customers to facilitate more accurate planning, targeting and cost reduction efforts.

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