FEATURE

Building the Sales-Justified Branch Network

BY BRANDON LARSON AND YULIAN FEDULOV

With tons of former branch transaction activity shifting to alternative channels, the decision framework for branch consolidation shifts more solidly to sales.

Stretching back to the 1980s, a key worry with branch consolidation has been customer attrition, or the risk that accountholders will take their business elsewhere if their anchor local branch is closed or merged with another location. This concern has robbed flexibility in rationalizing and repositioning networks, given that each move of a chess piece could potentially disturb customer relationships and compromise future revenues.

Now, however, a new dynamic has emerged with the advent of full multi-channel banking. With tons of transaction activity now shifted to online and mobile channels, customers are far less dependent on everyday branch services. And they are increasingly tolerant when branches are closed are merged, as experienced by banks that have seen much lower attrition rates during recent network consolidation.

This shifts the consolidation decision framework much more solidly to sales, an area where the branch still carries a significant load. For some time to come, branches will remain the top destination when consumers get ready to initiate a new banking relationship or expand their patronage with their current bank. Instead of basic cost rationalization, progressive banks will focus on crafting sales-justified branch networks.

The problem is that most of today's branch consolidation programs are not built on this premise. Unfortunately, out of the roughly 12,000 branch closures/consolidations occurring since 2009, up to a fourth of that effort may have been misplaced. Too much emphasis on preserving nearby branch services that people no longer need; too little emphasis on beefing up the local marketing and sales proposition.

Major corrections are needed going forward. Based on our analysis of branches nationwide, nearly half of the total U.S. network is not strictly needed for the more specialized role that branches will play as digital channels carry ever more of the daily workload for banking transactions and service. Resources that support these branches need to be freed up to support critical investments in digital channels.

The upshot is that most banks need to overhaul the review process for branch consolidation. This includes: 1) a market-by-market view of coverage requirements relative to sales, retention and high-value service; 2) specific consideration of performance levers such as FTE reduction and improved marketing support and signage; and 3) a more robust form of financial modeling that balances the short-term potential for closure-based cost savings with the long-term potential for revenue generation.

WHAT CUSTOMERS WANT

Beginning with the automated teller machine, the longstanding problem with alternative channels has been "layering," or the customer tendency to stack on additional layers of remote transaction activity while insisting on continuing full branch service — increasing the cost to serve. But the tide has turned in recent years and we now have true "substitution," with branch transaction activity steadily falling as people embrace online and mobile banking and imaging-enabled ATMs for remote deposit.

It is a profound shift. According to Novantas research, the consumer preference to deposit a check via a branch teller fell by 35% in just two years (2012-2014), and the incidence of at least one monthly on-site branch visit fell by 22%. Meanwhile the average regional bank transaction volume per branch fell by 23%, and other customer preferences for branch usage fell as well (Figure 1: Falling Transaction Relevance for the Branch).

In turn, bankers have less to fear in considering their network options. In today's financial modeling for potential branch consolidation, often great weight is given to a branch's current book of business — customer relationships, loans and deposits — reflecting the traditional assumption that those attributes are perilously attached to that one location only.

While we would not make a blanket statement to the contrary, tangible trends in channel substitution definitely suggest considerable further potential to streamline local networks with minimal impact on the current book of business.

The catch — and it is a big one — is that the branch continues as the dominant sales engine in retail and small business banking. True, digital marketing and customer online shopping now play major roles in winning customer awareness and consideration. But when people get ready to make a purchase, most still want to sit across the desk from a banker to complete their account applications.

In contrast with sharp ongoing declines in branch traffic and everyday transactions, our research shows a sustained role for the branch in high-value sales and service. According to the Novantas 2014 Multi-Channel Preference Study, the branch still trounces digital channels as the preferred destination to make loan applications, open new deposit accounts, seek financial advice and resolve complex issues.

Narrowed consumer expectations for the branch — dwindling transaction reliance, mostly looking for sales, advice and complex servicing — need to become formal decision drivers as banks re-sculpt their networks.

SALES SKEWS

In building the core of the new sales-justified branch network, the obvious place to start is to identify and nurture the outlets carrying most of the weight today. As illustrated by Novantas research, there are profound skews in branch sales productivity:

- In retail banking, roughly 20% of the branches in a network typically generate 50% of new-to-bank account originations.
- In small business banking, 12.5% of branches account for 27% of commercial customer acquisition system-wide.
- Also in small business banking, a separate 10.7% of branches account for 28% of commercial cross-sell system-wide.

Often these anchor locations can be augmented for even higher productivity, which leads to the question of performance levers and local market context. Both to optimize high-performing branches and thoroughly evaluate keep/close options for units falling in the grey area, at least three major factors should be considered:

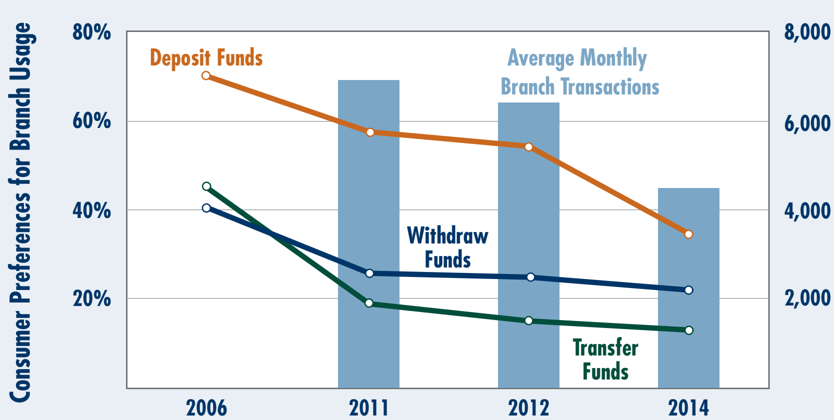
Local position. Options for strengthening or removing a branch will vary based on its juxtaposition in the local network; the strength of that network; and competitive intensity. As an example, positive returns are likely with the consolidation of a marginal branch that has limited visibility in the network and is surrounded by several other locations. On the other hand, consolidation of a branch that is highly visible and fills a critical node in the network will likely be more damaging to performance — both influencing sales in that area and at surrounding locations as well.

Marketing spend. Street corner presence will continue as a self-marketing advantage for branches, but not like before, and local marketing support will have a growing influence on sales success. Absent the appropriate local spend on items such as advertising and special promotions, marginal branches face a much tougher climb to reach required sales relevance going forward. Conversely in areas receiving priority marketing support, a greater proportion of marginal performers will be lifted up.

Staffing, location, facilities. Branch consolidations are often based on static analysis, with keep/close decisions made on units "as they stand." Often, however, changes can be made to improve the profitability of the branch, either through cost savings or revenue improvement. These includes adjustments in staffing, changing the format and/or location, and improving site visibility via signage

Figure 1: Falling Transaction Relevance for the Branch

As customers relocate more transaction activity online, they have less daily reliance on the branch and more tolerance for network consolidation.



Source: Novantas SalesScape Benchmarking, Novantas Multi-Channel Consumer Surveys upgrades. Banks need to systematically investigate these performance levers when considering network revisions.

MODELING AND PLANNING

Many banks have not updated their financial models to reflect how digital banking has lowered the daily customer reliance on the branch, and they continue to overstate the potential for attrition-driven revenue loss with consolidation. The feasibility of consolidation is greater than what many bankers think, and the freed-up resources are urgently needed to support customer acquisition and cross-sell in digital banking.

Financial models also typically give insufficient consideration to the future sales/revenue stream. Stripping away the current book of business, the individual branch sales outlook often offers far less justification for standalone operation. Conversely in other cases, robust modeling clarifies which installations are crucial for future sales success (Figure 2: A Tale of Two Closures). Also as we have mentioned, market and site-specific variables need fuller consideration.

As these factors are corrected, the door is opened to a new range of possibilities. Instead of reviewing keep/close options relative to the schedule of near-term branch lease renewals, as often is the case today, consolidation strategies and decisions should flow from a strengthened network planning process, including:

- A full network planning exercise every one to two years, with a market-by-market evaluation of all performance levers (branches, ATMs, marketing spend, etc.), providing a roadmap for individual markets and the overall network;
- A rolling lease renewal roadmap that looks over the next three years to consider planned actions and market and site-specific variables;
- Regular tracking of branch transaction patterns (both sales and service) to understand how the role and value of the branch network is evolving; and
- A composite understanding of branch consolidations that should be under consideration, including the likely near- and long-term impact, permitting financial comparisons with other investment opportunities within the bank.

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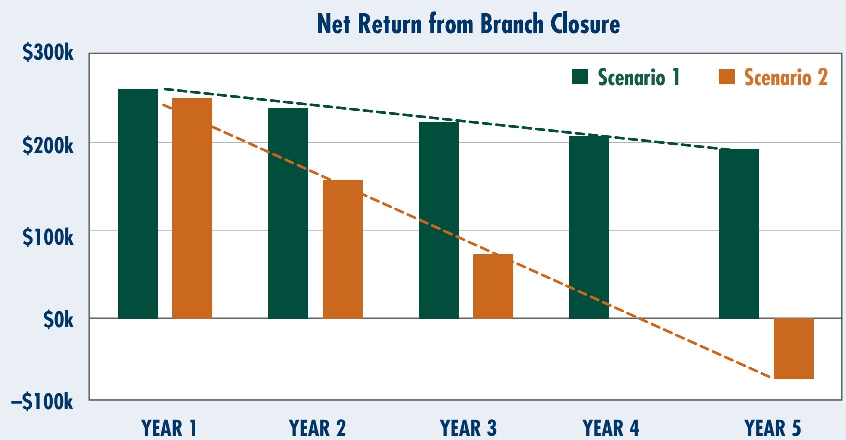
Figure 2: A Tale of Two Closures

While near-term savings are tempting, the long-term payoff from a branch closure is far less clear, depending on the sales outlook.



Scenario 1 - Below Average Sales Outlook; Lower Expense Base
A clear case for closure, given near- and long-term positive returns.

	Year 1	Year 2	Year 3	Year 4	Year 5
Savings on operating expense	$400k	$400k	$400k	$400k	$400k
Revenue attrition on current book	-100k	-95k	-90k	-85k	-81k
OpEx savings net of book attrition	300k	305k	310k	315k	319k
Less lost revenue from sales	-39k	-64k	-87k	-108k	-126k
Closure Benefit	**$261k**	**$241k**	**$223k**	**$207k**	**$193k**

Scenario 2 - Above Average Sales Outlook; Higher Expense Base
Much less clear, what about marketing, signage, FTE reduction?

	Year 1	Year 2	Year 3	Year 4	Year 5
Savings on operating expense	$500k	$500k	$500k	$500k	$500k
Revenue attrition on current book	-100k	-95k	-90k	-85k	-81k
OpEx savings net of book attrition	400k	405k	410k	415k	419k
Less lost revenue from sales	-150k	-248k	-336k	-415k	-486k
Closure Benefit	**$250k**	**$157k**	**$74k**	**$0k**	**-$67k**

Source: Novantas, Inc.