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The Essence of Branching

A philosophical question: If a vault door closes and no one is there to hear it, does it make a sound? While you ponder that variant of an age-old thought experiment, consider another question, this one more tangible: With in-branch transactions continuing to decline, what if all transactions went away? What if no one entered the branch to deposit or cash a check – would we still need branches?

The answer, even in that extreme situation, remains a resounding "yes." Even with waning transaction counts, and the possibility the COVID crisis accelerated a migration away from in-branch transactions, there remains pervasive evidence of the continued importance of branches, especially in institution selection. Ultimately, the branch exists not for check cashing and deposit taking – those are simply necessary cost burdens inherent in the contract with our customers – but for opening new accounts, i.e., the sales function. And irrespective of transaction activity, the institution cannot exist without new-account sales (further, see the article on page three confirming the critical role branches play in consumers' choice of financial providers).

Still, there is empirical evidence of a decline in frequency of branch visits, with median in-branch transactions down 35% from five years ago, and some institutions reporting 50% declines in branch transaction counts. Yet the change in customer behavior reflects only partial-versus-full substitution. Even as consumers migrate a portion of their activity to electronic channels, many continue to reserve some level of activity for the branch channel.

This indicates an imperative to invest in electronic channels; the ability to provide online and mobile banking are now minimum thresholds for consideration, "table stakes" versus differentiators. Yet with a fixed pool of noninterest expenses to allocate across these multiple channels, it is imperative to focus on relentless expense control within each of those channels.

In sum, the question bankers must confront is: How can we maximize sales while minimizing costs? Declining transactions and increasing competition demands relentless attention to sales; every banker today understands this, but few effectively execute against it. To do so, let's first rephrase the aforementioned question to: How can we pare the branch to purely its essential sales function?

The model of every branch as a main office in miniature is an artifact of a prior era. But as an industry, we still need to evaluate what functions belong in the branch's purview, and which can be removed to a more efficient, centralized function. Consider the branch as a machine for sales, and strive to remove any internal obstacles to that role.

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It may help to start in a hypothetical context. Even with reduced transaction levels, tellers remain the most prevalent position in branches and transactions the most frequent activity. How much effort do we expend in the branch hiring, training, and supervising of tellers – effort we could otherwise allocate to sales pursuits?

What if instead, the bank had a subsidiary named TellerCorp? TellerCorp's sole function is to recruit, train, and oversee tellers. Each branch has a service agreement with TellerCorp, say, 95% of customer transaction requests are resolved within three minutes or less. TellerCorp monitors customer inflows and sends the required number of tellers *(continued on page 3)*

The Monoline Challenge

Ask consumers to picture a bank, and they'll generally picture a national or community bank, or perhaps a credit union; but some entity that offers a full array of deposit, loan, and wealth management products from one or more locally domiciled facilities. In that context, the local neighborhood branch may be considered the jack-of-all-financial-trades, and that ability to fulfill the entirety of a consumer's financial needs remains a key selling point in swaying consumer decisions.

Yet there are benefits of specialization within a single product category, in terms of developing operational and risk management expertise, in scale economies that allow superior pricing, and in creating the perception of the best-in-class product offerings that typically accrue to a specialist. In the retail world, specialization is what allowed the 'big box' stores to largely defeat the ultimate generalists of department stores; think Home Depot or Best Buy, for example.

Those benefits of specialization could lead consumers to fragment their financial relationships across myriad providers; and if consumers can obtain better pricing and expertise in one product area, what is the benefit of a local community bank or credit union? And, if the leading product specialists (sometimes referred to as monolines for their emphasis on a single line of business) each 'win' their specific product area, are there sufficient balances remaining for conventional, broad-based financial institutions to pursue?

To confront the challenge of monolines, it is first important to understand that such firms represent competitors in almost every product set. These range from credit cards (e.g., American Express, Discover) to mortgages (Quicken Loans) to auto loans (the manufacturer-owned captive finance companies); and on the deposit side to money markets and CDs (online banks such as Ally and Synchrony, though obviously those deposits fund loans; but the loans are generally not consumer branded, for example, Synchrony funds private-label retailer credit cards). And of course, monolines dominate the product sets that live outside of the balance sheet, such as insurance, investments, and other wealth management offerings.

Adding concern, some monolines leverage their core-product relationships to attempt to cross-sell other services, further impinging on the portfolios of traditional financial institutions. In an environment with increasing challenges

If banks and credit unions can demonstrate the true benefits of relationships, whether in the pricing advantages of multi-product bundles, the personal understanding to holistically address a client's personal and business needs, or through the common bond of local-community investment, they can build irreplicable advantages over single-product, national providers and their purely transactional offerings.

from individual product specialists, it becomes more difficult, and also more critical, for traditional community banks and credit unions to present a differentiating value proposition, to give consumers a reason to sacrifice some level of pricing or product superiority in favor of bundling their relationships with a generalist.

The first sales point lies in that bundling factor; the traditional bank or credit union can offer the benefit of being able to fulfill all of a consumer's financial needs in one, convenient location. But in an era where the Internet has removed many of the barriers to product search, the simple benefit of *(continued on page 4)*

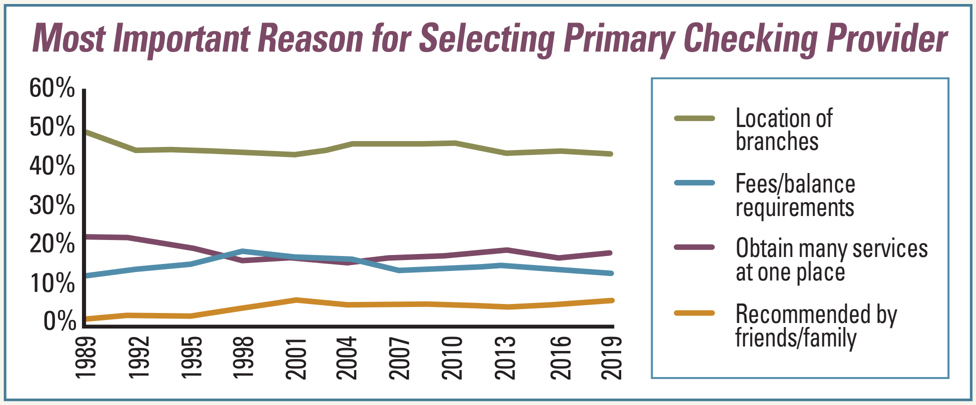
Branches Still Still Matter

Two comprehensive studies released in late 2020 confirm branches continue to play a critical role for consumers. In the Federal Reserve Board's *Survey of Consumer Finances*, 43% of respondents cited *"location of their branches"* as the most important reason for choosing their primary checking provider. Notably, that proportion declined by only one percentage point between the Fed's 2016 and 2019 iterations of the study, and has hovered in the 43%- 46% range for the past 27 years; attesting that even as consumers migrate transaction activity out of branches, branch presence retains a critical role in the initial procurement of their relationships.

Further, in the FDIC's *Survey of Household Use of Banking and Financial Services*, 83% of households with banking relationships (i.e., excluding the unbanked population) visited a branch at least once in 2019. Though down from 86% in 2016, the statistic still shows broad use of in-person services, at least for some activities. Even among households that cited mobile banking as the primary channel through which they accessed their bank account, 80% still visited a branch at least one time during 2019.

Notably, older households and households with volatile income were more likely to visit a branch and to be high-frequency branch users (defined by 10 or more visits in the past 12 months). Still, the study shows a decline in branch activity levels: the proportion of high-frequency branch users overall (10+ visits per year) declined from 35% in the FDIC's 2017 survey to 28% in the 2019 version. Further, the median and mode moved from the 5 - 9 visits tier to the 1 - 4 visits per year tier.

Both the Federal Reserve Board and FDIC studies contain striking data about how Americans save, borrow, invest, and bank. See the full studies at: *https://www.federalreserve.gov/econres/scfindex.htm* and *https://www.fdic.gov/analysis/household-survey/*.



The Essence of Branching (continued from page 1)

to meet the service agreement to each branch. Tellers arrive fully trained and ready to work, and TellerCorp oversees their performance, bears responsibility for balancing any over/short issues, and remediates as needed.

Next, with teller oversight removed, think about other obstacles to the sales process the branch manager must confront. NSF decisions, fee-waiver requests, notary services…consider every non-sales activity that occurs in the branch, and determine how the financial institution can centralize that function, and leave the branch platform staff to focus exclusively on sales.

Where does that leave the branch? Divorced into two discrete functions that happen to share a facility. On the one hand, the facility serves as a collection point for customer deposits and an access point for customer withdrawals; on the other, it serves as the domicile from which account gatherers, or sales staff, pursue that function. By unbundling the sales and service functions, the model frees the sales staff to focus solely on sales, while burdening headquarters with operational responsibilities.

And if there is limited operational responsibility within the branch, do we need a manager at all? Instead, view the remaining officers as sales agents, each with specific geographic territories in which they can pursue sales. Each sales person – and there can be multiple per branch – functions as an independent agent, representing centrally manufactured products to an audience of local buyers. If this model seems implausible, consider that in many ways it mirrors the configuration of the insurance industry, with local sales agents supported by a largely centralized billing and payment infrastructure.

Given the reduced breadth of responsibilities to be supervised within the branch (remember, all transaction processing and similar are supervised externally), there becomes little need for a manager at every branch. Rather, one sales leader can oversee a broad geographic region, including sales efforts inside and outside the branch walls. Instead of each branch requiring a manager who may take a 2:1 divide in administrative versus sales time, we can instead deploy a single sales leader across a cluster of branches, overseeing a sales effort across a corridor.

This approach differs from the hub-and-spoke model, which focuses on removing certain sales functions from each branch; rather, this approach concentrates on removing the operational functions from the branch's administrative purview, while still availing customers of the facility's physical convenience. In doing so, we distill the branch to its essence, the funnel through which the bank gathers new accounts into the system, where the balances therein provide the funding sources and revenues that enable a financial institution's profitability. Though the model in its fullest form remains conceptual, by using the core concept as a guidepost – approached by the centralization of as many non-sales functions as possible – bankers can position branches for sales excellence.

The Monoline Challenge (continued from page 2)

one-stop shopping may no longer prove sufficient to retain consumers' business. However, there are tactics that community banks and credit unions can employ to compete with the monolines within their respective areas of specialization.

First, relationship pricing is imperative. Even if your institution cannot match pricing on an individual product such as a CD or installment loan, consider offering favorable pricing should the consumer establish multiple relationships. For example, premium CD or money market rates available only to consumers holding a certain balance level in other products; installment loan application-fee waivers or rate discounts only if the monthly payment is auto debited from a checking account at your bank.

In an extension of relationship pricing, consider rewards programs to incentivize carrying your bank's credit card versus that of a monoline. These need not be complex systems; a simple points-per-dollar model – with the points translating to either rebates, fee waivers, or merchandise (there are third-party vendors that can administer this option) – can keep credit card balances in-house.

Community presence and branding play a role, too, as monolines have little ability to match your institution's capacity to deliver the benefits of banking locally. In branding and marketing efforts, it is important to display a clear mission and purpose for the institution, to stand for something beyond the product set. Emphasizing the ways in which local banking relationships foster community growth, whether through philanthropy, investment, or educational programming, can sway consumers to trade some level of pricing advantage for the intangible benefit of a local civic bond.

Toward that end, it is important for bankers to quantify the magnitude of pricing disadvantage their clients are willing to tolerate. For example, the consumer may accept 25 basis points below the best online CD rate to keep their funds with a local provider; but would they accept a rate disparity of 100 basis points? Still, at a time when farm-to-market restaurants and craft breweries thrive (pre-COVID, at least, and post-COVID again, we hope), it remains clear that consumers are willing to pay some premium for local authenticity, and that may extend beyond food and drink and into consumers' financial relationships. That noted, simply proclaiming "we're the local bank" is insufficient; the bank must demonstrate that commitment through local development lending, philanthropy, and other community investments.

Even as automated credit scoring platforms supplant some local decision authority, personal knowledge of the client and local relationships can still provide a differentiator for credit products. The ability to waive an appraisal or to speed the title process can sway a consumer's choice of a mortgage or home equity provider. Similarly, the ability to blend business and consumer offerings, whether in credit evaluations (e.g., lending against a home to fund a business startup) or cross-sales (e.g., a personal money market account for the CFO of a commercial client) is easier for local than national providers to pursue. The business-consumer cross-sells represent a sizable audience: according to research in the Federal Reserve Board's *2019 Survey of Consumer Finances,* about one in every eight U.S. households owns a business, and nearly 40% of households in the highest-earning decile of consumers are business owners.

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Many institutions cite relationship banking as a differentiator, but often the term is ill-defined and not backed by tangible benefits. Yet if banks and credit unions can demonstrate the true benefits of relationships, whether in the pricing advantages of multi-product bundles, the personal understanding to holistically address a client's personal and business needs, or through the common bond of local-community investment, they can build irreplicable advantages over single-product, national providers and their purely transactional offerings.