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Viewpoint: Don't Shut the Branch; Change Its Model

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In a recent column, "Branch Reductions Necessary But Not Simple" [Retail Delivery, March 13], Kevin Travis and Robert Vokes make many excellent points about the need for careful analysis when considering options for reducing branch network costs. We entirely concur with their call for "smart network cost reduction."

However, ironically, the opening proposition that "banks have no choice but to condense the elaborate networks" appears to be an unexamined — and, we would argue, unwarranted — presumption. Eliminating underperforming sites is a valid objective. But it is not the most urgent need or the most promising strategic opportunity facing retail bank planners today.

Bankers who hope for meaningful profitability improvement by paring back their networks are bound to be disappointed. Expected near-term savings from branch closings often prove to be illusory.

Personnel expenses, typically the largest category of branch operating costs, often decline only moderately when a branch closes. In cases where a major portion of the customer base is retained and serviced at other branches, staff levels usually rise at those branches. The result is cost shifting rather than actual cost reduction.

Personnel costs show marked declines only when a significant number of affected households leave the institution. In that case, the expense reduction is at least partially offset by revenue losses. Further, if the day-to-day operating model of the remaining branches is unchanged, the difference in staff costs as a percentage of revenue (i.e., the staffing efficiency ratio) is often marginal.

Real estate and other occupancy-related expenses are notoriously difficult to shed quickly. The soft market for commercial property makes a rapid sale or favorable lease buyout unlikely. Moreover, the need to write down the undepreciated book value of assets that are disposed of prematurely can result in a substantial charge against current-period earnings.

Closing an underperforming branch often converts projected future losses into realized ones — hardly a tactic for improving near-term profitability.

If branch reductions do little to improve profitability quickly, they do even less to position the bank for improved long-term results. The remaining branch network is not improved; it is just smaller.

Numerous studies have documented the critical roles of branch location and breadth in customer decision making. Despite expanded utilization of remote channels and changes in how customers actually use branches, the impact of physical market presence on customer acquisition remains paramount. Therefore, the strategically meaningful question is not "How few branches can we get away with?" Rather, the question is "How can we afford the branches we want?" Steps taken today should be guided by a vision of the branch network you want five and 10 years from now. We believe that this future network will be stronger and more profitable if it is larger and has lower-cost outlets. Therefore, the development of operating models that are more cost-effective on a per-branch basis presents a bigger opportunity than determining which branches might be closed with the least collateral damage.

Conventional branch practices require too much capital and consume too much operating costs to serve as a blueprint for the branch network. The old paradigm of enhancing efficiency by increasing staff specialization is at odds with the need for reduced head count. New branch formats must generate efficiency by supporting the flexible response of cross-trained staff to varying circumstances throughout the day. By employing new technologies, staffing practices and design concepts, branches can fulfill their customer acquisition role at substantially reduced costs per site.

Alternatives also need to be explored for reducing the capital outlay per branch, including the use of leased retail space. It is increasingly difficult to produce acceptable returns from branches burdened with fixed assets at currently typical levels.

The greatest opportunity for immediate performance improvement may lie in the application of new operating principles to existing branches. By converting branches that would otherwise reach the "close list" to a leaner operating model, the bank can maintain branches previously deemed unprofitable and enjoy the network-based lift in customer acquisition that those branches will provide. Even branches currently meeting profit goals might benefit from implementing certain elements of a new format.

Such a broad-based change throughout the network will have a more profound and lasting impact than the elimination of a few weak locations.

Progress toward new operating models will help banks move forward in changing times. Together with an expanded analytical tool kit, new thinking about the branch itself will give bankers more freedom of action in exploiting market opportunity while avoiding costly mistakes.

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