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Banks count the cost of pruning branches

TO SHED OR to add, that is the question for many banks that have been pushed to revise their branch strategy due to market conditions. The response has been mixed, with banks caught between the pressures of closing branches to cut costs, and keeping them open to give an image of stability and assist in collecting deposits.

"The financial crisis has both positively and negatively affected banks' attitudes toward their branch network. It depends on the specific institution and where they are in terms of financial stability," points out Jamie Eads, a senior project manager at consultancy Bancography.

At one end of the spectrum is UK sub-prime lender Cattles, which announced in September 2009 the closure of 30 retail branches. The decision came as no surprise to the industry, since the lender stopped taking new business in April 2009 and has been winding up since.

Expansive strategy

At the other end of the scale is St. George, the Australian bank that was acquired by Westpac in May 2008 (*see LRBI 2008/09*). The bank's branch strategy was in the news this month when it was reported that St. George is expanding into the state of Victoria, outside of its home territory of New South Wales.

The strategy for Westpac is to keep the St. George brand separate, unlike the decision by Chase in the US to merge Washington Mutual into its own brand. The wave of mergers and acquisitions has brought about branch closures; for example, where previously the competing banks of Chase and WaMu would have stood on the same street, there is now no need to have two Chase branches next to each other.

In the UK, the Lloyds Banking Group has a similar dilemma over what to do with its recent acquisitions, and whether to blend its brands and shed branches. In June 2009, the bank announced that it would be closing the branches of its Cheltenham & Gloucester (C&G) brand. However, two months later the bank said it was reviewing that decision. When pushed for more details by *Lafferty Retail Banking Insider*, a spokeswoman was unable to comment further on the C&G review. When asked about reports that the banking group is planning to cull its Halifax brand, she added that the Lloyds is committed to its network of branches for the other brands in the group – Lloyds TSB, Bank of Scotland and Halifax.

Branch innovation

However, the fortunes of the branch network at Barclays, which has fared well in the crisis compared to its rival Lloyds, are more positive as the bank promotes innovation in its branch strategy. When the bank opened its flagship 'branch of the future' in central London's Piccadilly (*see LRBI 2009/04, pages 10 & 11*), industry observers questioned what this meant for the rest of the bank's branches in the UK.

A spokeswoman for Barclays told *Lafferty Retail Banking Insider* that the bank is part-way through a refurbishment programme. "This has seen 350 branches renovated since 2007, when we first introduced the new design that Piccadilly is based on. Branches are opening every month with different elements of this new design – depending on the size of the branch. Kensington High Street [in London] is the latest flagship design to open," she said.

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HIGHLIGHTS

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"We open new sites each year, but we occasionally close or amalgamate some very small local branches so the number of branches stays roughly the same," she said, explaining that the number of UK branches the bank had at the end of June 2009 was 1,720.

The branching strategies for banks are varied and have been challenged by the stresses of the financial crisis. Bob Meara, a senior analyst at Celent, notes that it is difficult to find general characteristics for the whole industry, given the widely different histories, attitudes and cultures of banks. "However, Celent observes that the financial crisis has, for many banks, exacerbated already declining branch channel profitability. The impact is likely to hasten existing efforts to re-design branch infrastructures to better serve a customer base increasingly preferring self-service channels for routine transactions," he says.

Many large banks have a wide footprint today because they were initially concerned about building market share, points out Scott MacDonald, a banking professor at the Texas-based SMU Cox School of Business. He argues that branches announce the bank's presence, particularly in the case of a regional player going national. "How do you get people to know who you are when there are no physical locations? Banks have added locations not only to gather deposits, but also to advertise that 'we are here' and 'we are available,'" says MacDonald. "Another reason is that it is a way to gather less expensive core deposits," he adds.

MacDonald argues that once a bank has achieved its status as a solid, dependable bank, there is less of a need for the bank to have so many branches. "I would argue that after five or ten years, a bank does not need so many branches," he says.

For the banks with a mass-market strategy of gaining retail deposits, branches had to be convenient – either nearby where the customer opened the account, or everywhere for when the customer accesses it. That strategy, however, is being reconsidered and banks are questioning whether there is a way of gaining deposits without requiring the physical location.

Meara points to the increased difficulty in raising those deposits: "Historically, branch building was a time-tested and low-risk way of growing deposits. In the US, the average branch collects $65 million in deposits over the first five years. The current climate, however, has eroded the business case for doing so." Meara adds that building costs have risen, profitability among retail banking products – such as cards, mortgages and lending – is reduced, and net interest margins on collected deposits have declined. "Thus, we do not expect to see much branch building in the US for the foreseeable future. What action we do see amounts to existing branches changing hands. Long term, we expect branch counts to decline modestly. More significantly, modern branches will be smaller, re-designed, and employ fewer, more skilled employees," he says.

> 'Branch closings send negative signals to consumers that the closures are more about instability than cost-cutting measures'
>
> Jamie Eads, Bancography

If any branches are closed, it could be perceived as a sign of weakness – that a bank is in trouble and needs to cut costs. "In our view, bank branches and the bank brand are closely tied. For that reason, shedding branches will be done very carefully. We do not expect widespread branch closures. Instead, any closures will be 'surgical' in markets where customers can be invited to use other nearby branches," says Meara.

Eads at Bancography estimates that closing one branch can trim $500,000 to $1 million in average annual personnel and operating expenses. "However, branch closings also send negative signals to consumers that the closures are more about instability than cost-cutting measures. You will see larger banks decide to close branches all at once to minimise multiple negative responses, rather than closing some in a market one month and more in a neighbouring market two to three months later," says Eads.

Bank of America (BoA) felt the brunt of this negative response when *The Wall Street Journal* reported in July 2009 that the bank was planning to close 10 percent of its branches. The bank was quick to comment that the branch closures would not be this widespread.

When contacted by *Lafferty Retail Banking Insider*, a BoA spokeswoman clarified the bank's attitude toward its branch network. "Bank of America's banking centres have been and continue to be the cornerstone of the company's distribution model. At the same time, we are continually improving our online banking, mobile banking and ATM capabilities as more of our customers are using these channels for increased convenience," she said.

On the question of whether the ban k would be closing any of its branches in the next few years, the spokeswoman said: "The company continually evaluates its banking centre franchise and decisions regarding its ultimate size have not been made. As we have said in the past, Bank of America actively manages its retail distribution network to meet evolving customer demands, including adding and consolidating banking centres based on needs of various markets. While the number of banking centres may decrease in the future, new locations are being considered or built and additional functionality and services will be offered through the entire network," she said.

MacDonald points to the trend of customers moving to online banking: "Ultimately, the branches have to pay for themselves. The old model of building as many branches as possible to establish a presence is not going to work in the long term. The bottom line is that a lot of the branches do not have many people in them," he says. ●