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Major Trends In Branch Delivery

As Bancography's consultants visit markets across the United States in support of our branch network optimization engagements, we have the opportunity to observe changes in how banks deliver their products and services through their branch networks. In metros throughout the US, several emerging trends remain consistent. Below, we discuss some of the most dramatic changes:

- **Branch based distribution of formerly centralized lines of business** – In an effort to improve customer convenience, many banks are migrating traditionally centralized lines of business into their branch networks. Banks are co-locating wealth management, commercial banking, and mortgage banking officers with traditional retail branches in submarkets with target demographic characteristics. As more households live and work beyond central business districts, consumers are no longer willing to drive downtown for even an episodic purchase such as a brokerage or mortgage account. Rather, banks are distributing these lines of business in key suburban locales to increase their drawing power to convenience driven consumers.
- **Mass in-store deployments as a means of building outlet share** – In store banking has long been a component of branch delivery systems, but in major markets across the US large regional/national banks are now using in-store banking at an unprecedented level. Rather than deploying in-store branches as a replacement for traditional branches, the large national banks are using marketwide in-store partnerships to insure consumer convenience across a marketplace on an extended hours basis. The scale with which the large banks can branch has crowded smaller banks out of leading grocery chains in some large markets. Bank of America, Wells Fargo, US Bank, JP MorganChase/Bank One, and Citizens are among the large banks that have opened broad in-store networks of at least 30 branches across a single major market in which they already operated significant free standing branch networks.
- **Credit union branching** – As more credit unions convert from Select Employment Group (SEG) charters to Community charters, they are finding the need to add branches to attract clients in these newly defined communities. And even some SEG chartered credit unions are expanding the definition of their target groups, also driving the need for additional branches. Most metropolitan areas now contain two or more community chartered credit unions that are building marketwide branch networks. Although many of these credit unions are starting from a much smaller branch base than their bank competitors, their branching pace is quickly elevating their networks to a level comparable to the leading banks. This additional layer of competition will render deposit growth more difficult for banks and credit unions alike, increasing the premium on well located branches for both institution types.
- **The eroding middle market tier** – Nearly every retail industry has moved toward a dichotomous alignment, with a small number of large national competitors controlling a large portion of the market; a large number of boutique small competitors skimming the most profitable market segments; and the decline of the mid-sized provider.

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Attrition Benchmarks: Retail and Business

The following is an excerpt from Bancography's latest syndicated research study, ***Attrition Benchmarks: Retail and Business***. This benchmark study of 600 interviews from 15 participating institutions (banks and credit unions) examines the reasons behind retail and business attrition. Results also study where the account was relocated, the actual closure experience and the likelihood of the lost customer utilizing the original institution again in the future. Strategic recommendations for mitigating attrition that is within the institution's control as well as case studies are presented.

Excerpt from *Attrition Benchmarks: Retail and Business*

The reasons for attrition varied for each participating institution. Further, the motives between the lines of businesses were very different. What did not change was the consequence associated with the actual reason for closing the account. For instance, the motive for closure influenced not only where the customer moved his account but also the likelihood of the customer to use the institution again in the future. For example, customers lost due to convenience of locations relocated their accounts to national banks and were more likely to consider utilizing the original institution in the future.

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Major Trends in Branch Delivery

Department stores, consumer electronics, toys, and hardware have all experienced this trend, and the financial services sector is following suit. As long as independent regional banks combine or are acquired by true national competitors, they are being replaced not by comparable mid-sized institutions but rather by a larger number of smaller banks, including many de novo institutions. The remaining mid-sized competitors face a difficult environment: they may lack the scale to compete on price/efficiency with the larger banks, yet may have grown too large to offer the personal service and local decision authority of true community banks. In some markets, traditional community banks have combined or expanded in an attempt to fill the vacated middle tier. Their success will turn upon whether these institutions can maintain their service proposition and keep costs reasonable while building the infrastructure to support a larger organization.

Case Study: Branch Clustering – An Alternate Way to Manage Branches

Most banks administer their branch networks geographically. Regional branch administrators maintain responsibility for managing the sales process over a group of branches that may share little in common other than geographically clustered locations. As an alternative, some banks have experimented with grouping branches by market characteristics, and dividing sales management responsibilities along demographic lines.

Bancography recently completed two similar projects in which it performed a clustering analysis of the client bank's branches in support of initiatives to administer sales management across demographically homogenous groups of branches. Demographic clustering allows sales managers to focus on tactics most appropriate for a given market segment and fosters networking among branch managers within their true peer branch group.

In the clustering process, we first defined trade areas for each branch based on the distribution of the branch's customers. Next, we compiled demographic and competitive profiles of each branch trade area. Then we used a statistical technique known as cluster analysis to group the branches with the most similar traits. Cluster analysis is driven by two primary goals: to maximize the similarity of all observations (in this case branches) within each segment; and to maximize the difference between segments.

Our analysis examined several variables in grouping the branches:

- Median household income
- Median age, head of household
- Five year projected household growth and household turnover
- Population density
- Employment to household ratio (this indicates whether the branch market is driven by residents or 'bank at work' employees)
- Percent of homeowners vs. renters
- The number of competitors in the submarket
- Deposit share held by regional/national banks

In one of the projects, we also added the bank's current trade area market share as a variable.

The cluster analysis yields 8 – 10 distinct branch groupings, all with their own common set of demographic characteristics. Results are shown below for some of the clusters, with the statistics indicating the average value for each attribute for the branches in each cluster. Note that each cluster features a different aggregate set of defining traits, and that these dictate different marketing tactics.

By grouping branches with common market characteristics, the bank can assign sales managers by segment rather than by geography, and each sales manager can focus on developing strategies to capture a market with specific demographic and competitive characteristics.

Cluster	1	2	5	6
Branches	8	11	6	4
Regional bank share	10%	46%	62%	2%
Employee / HH ratio	1.14	2.09	0.61	1.21
Five year HH growth	3.1%	3.5%	12.9%	1.2%
Median age, HOH	43.7	49.4	46.1	50.7
Median HH income	37,678	31,831	74,076	40,424
Population density	3,492	980	1,394	570
% Homeowners	53%	59%	86%	66%
Defining traits	Community bank dominant Low growth Moderate income Dense population	Major employment concentrations Low - moderate income Dense competition Older population	High income and homeownership Regional bank dominant Primarily residential High household growth	Community bank dominant Minimal household growth Older age levels, moderate income Lowest population density
Marketing implications	Differentiate from community banks Minimize capital and NIE investments Fee based services Cross-sell vs acquisition	Business and commercial banking Fee based services Retirement services Bank at work initiatives	Wealth management services Newcomer acquisition programs Weekend hours of operation Mortgage and equity lending	Cross-sell vs acquisition Fee based services Differentiate from community banks Mass market retirement products
Branches in cluster	6	14	5	11
Branches	Main Street Northside Maple Grove Shelbyville	Atlantic Grove Park Southside New Town	Cenral Avenue Parkside Mountain View Springfield	West Main Morningside Northbrook Lakeside

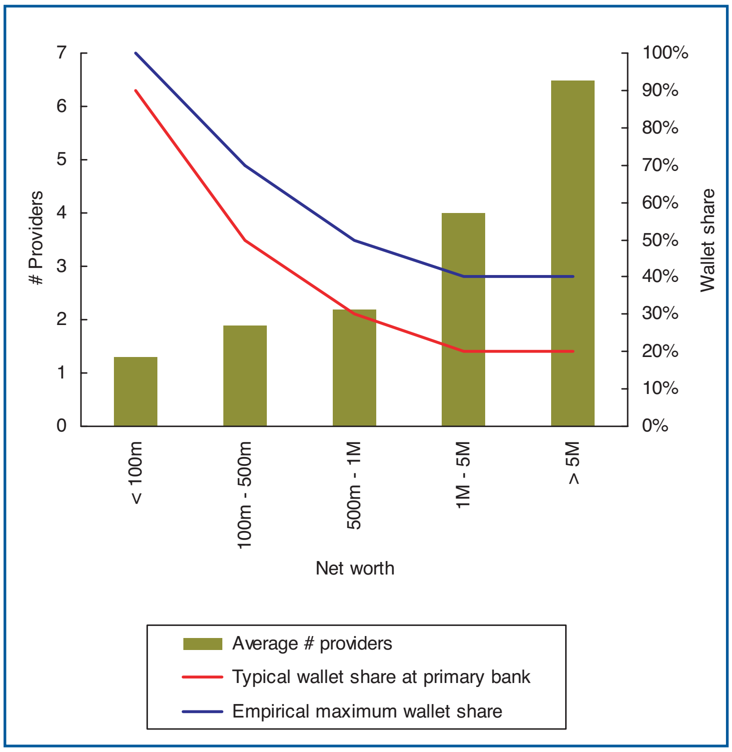
How To Set Realistic Wallet Share Goals

There are several measures by which banks can measure their performance in terms of capturing customers. Market penetration, defined as the proportion of households that maintain a relationship with an institution, is a common measure. But market penetration carries no information about depth of relationship: a single-service safe deposit box household counts the same as a broadly cross-sold household. Wallet share offers an alternate measure that impounds the degree of each household's total holdings that a bank has captured.

If a customer maintains $10,000 in a checking account and $20,000 in CDs at the same bank, but the customer owns total investable assets of $100,000, then the bank would have 30% wallet share of this customer: ($10,000 + $20,000) / $100,000 = 30%. The other $70,000 could be held at other banks or at non-bank financial institutions such as brokerages, direct mutual fund providers, or insurance companies.

Increased wallet share is a primary result of successful cross-selling. Although a bank would obviously wish to attain 100% wallet share, that is unrealistic. Consumers are by nature risk averse and will rarely place all of their assets in a single institution. In general, the more assets a consumer owns, the more the consumer will divide his holdings. The chart below, derived from Bancography primary research and secondary research against the Federal Reserve Board's Survey of Consumer Finances, illustrates this phenomenon.

As consumers' assets grow, they fragment their relationship across more providers, reducing the proportion of assets they keep at any one provider. Thus, a bank should set different wallet share targets for different market segments. The two lines in the chart show, for each asset tier, the maximum amount consumers might realistically place with their primary institution, compared against the wallet share banks typically attain in that asset tier. Note that brokerage providers have historically proven much more able to reach the empirical maximum levels than banks.



The chart above can provide guidelines for setting realistic wallet share goals within your institution. A previous issue of Bancology presented methods for calculating wallet share. To learn more about calculating wallet share against your bank's customer base, visit www.bancography.com and click on the Bancology tab to see Bancology Volume 7 (May 2003).

Attrition Benchmarks: Retail and Business

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The most serious motives for account closure for both retail and businesses in terms of the severe negativity expressed by the customer were service quality and fees or charges. Closure due to these reasons resulted in exiting customers who expressed very low likelihood of returning to the institution again in the future. Unfortunately for management, these two reasons were responsible for about 20% of business and retail closures.

There was a strong correlation between cross-sell and attrition. Nearly 25% of the reasons for account closure for both retail and small business could be attributed to inadequate cross-sell. For instance, a significant proportion of respondents consolidated their accounts elsewhere or at their primary institution. If these lost customers had more holdings or felt a relationship existed with the original institution, they would still be their customer.

More than 70% of retail and business respondents closed their account in person at the branch. In only one half of all cases, did the representative inquire as to the reason for the closure. Of these cases, the employee attempted to prevent the closure in only one fifth of the retail cases and in one third of the business cases.

Businesses were more likely to relocate their account to a regional or community bank, whereas lost retail customers were more apt to surface at a credit union or national bank. Lost business accounts were very unlikely to move to a credit union.

For more information on ***Attrition Benchmarks: Retail and Business,*** contact us at 205.251.6227 or *research@bancography.com*. The price of this study is $960/ $860 for clients.

Bancography exhibited at the **Credit Union Executives Society (CUES) Annual Convention** June 18 - 21 in Vancouver.

Steven Reider taught a course in "Delivery Channel Management" at the American Bankers Association's **Stonier Graduate School of Banking**, June 11-18 in Washington, D.C. Stonier is the only national graduate school for bank executives, and Bancography highly recommends this program to its colleagues.

Kimberly Clay presented **"Going Undercover With Your Customers"** at the 19th Annual **Financial Supermarkets In-Store Banking Conference** May 18 - 20.

Kimberly contributed to the ***"Riding Herd on Attrition"*** article in the May issue of the **American Bankers Association Bank Marketing Magazine.** The article mentions the upcoming Syndicated Study on ***Attrition Benchmarks***, to be released by Bancography this summer.

Bancography presented and exhibited at the **Annual New England BankTech Expo,** presented by the Massachusetts Bankers Association, on June 10, 2005. For more information, visit *www.massbankers.org*.

For the second year in a row, Kimberly is a member of the Advisory Board for the **American Bankers Association's Marketing Conference**, to be held on September 7 - 9 in Miami. Her responsibilities include planning the conference agenda, scheduling speakers and aiding with the coordination of events during the conference.

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