A Quarterly Journal

BANCOLOGY

OCTOBER 2012 VOLUME 44

THE ART OF POSITIONING
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BRANCH PRODUCT RESEARCH BRAND

Alternative Channels: Increased Usage

Bancography's Customer Service, Satisfaction and Loyalty tracking studies measure how often customers use the alternative channels – ATM, Internet Banking and the Call Center. The frequency scale features seven choices, beginning at *multiple times daily* and ending at *rarely* using the channel at all. The significant changes from 2010 in the frequency of usage occurred at the middle range of the scale.

Usage of the ATM, Internet Banking and speaking to a Call Center representative increased significantly for those who formerly accessed it *once a week*. They now reportedly use it *multiple times weekly*. *(continued on page two)*

In order to avail themselves of as many opportunities as possible, financial institutions must build a portfolio of service models (the combination of branch size, technology and staffing that defines how the branch operates).

Branch Service Models: A Portfolio Approach

In developing branch deployment strategies, financial institutions often focus on the "where" without consideration to the "what." That is, they identify market opportunities and deem those opportunities viable or not viable depending on whether the market's projected balances can support the institution's standard branch configuration (usually around 3,500 square feet, with six to eight full-time employees). But this approach can cause an institution to bypass markets that could still operate profitably – if it employed a lower cost service model.

Few markets are inherently unviable; rather markets appear unviable when branches employ incompatible service models. In actuality, there is a service model that could prove profitable in just about any type of market. In order to avail themselves of as many opportunities as possible, financial institutions must build a portfolio of service models (the combination of branch size, technology and staffing that defines how the branch operates). Then, in any situation, an institution can select the service model that best aligns with the balance potential available in the selected market.

Retailers of many types use the portfolio approach to store configuration. For example, a fast food chain will have a freestanding model, but also models for strip center, mall food court, airport kiosk and other configurations. For banks and credit unions, the service model portfolio should include five basic options, though each can certainly vary:

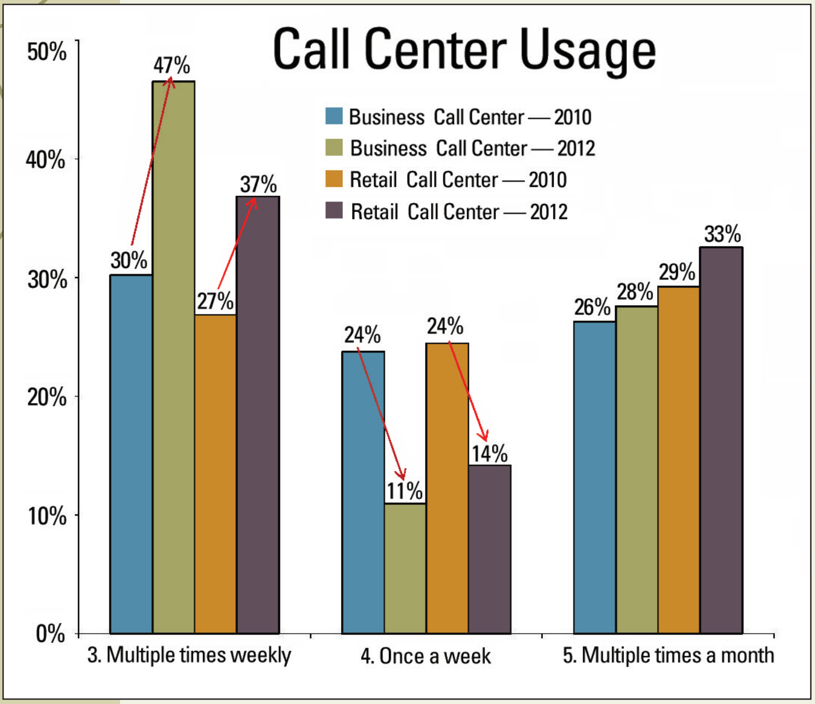
The **hub branch**, or main office (this can apply to city or regional main offices, not just corporate main offices), is the largest service model and is distinguished by several characteristics. Typically 4,000 square feet or more, the hub model features space and staffing for all lines of business, including mortgage banking, business banking, wealth management and specialty lines (e.g., insurance). The hub branch offers one-stop shopping for the financial needs of any consumer or small business. The branch needs capacity for traditional teller transactions, including cash-heavy commercial transactions, in both walk-up and drive-in modes; it also requires a traditional vault with safe deposit boxes. Staffing consists of dedicated tellers and customer service representatives, a branch manager and an assistant manager (since the branch manager at a hub branch is active in business development), as well as the aforementioned line of business specialists.

The base **freestanding branch** is smaller than the hub, likely 2,500 – 3,600 square feet, and is more appropriate in a residential neighborhood than in the mixed-use areas dense with office and retail development that warrant the hub office. While any freestanding branch still requires capacity for lobby and drive-in transactions and the ability to open core deposit and loan accounts, the branch does not need on-site personnel for ancillary business lines. Business lenders, investment counselors or mortgage bankers can be called to the branch from a nearby hub office as needed, and can use a single shared office to meet with customers. Further distinguishing the freestanding branch, its more residential environment often indicates lower transaction demand, allowing the use of universal agents in lieu of traditional teller and CSR roles. *(continued on page two)*

Alternative Channels: Increased Usage continued from page one

Bancography's research found that those who utilized the ATM for transactions remained steady at 50% for consumers and about 33% for businesses since 2010. However, the rate of recurrence for both groups has tremendously increased, which bodes well for any associated fee income. While advanced function ATMs experience greater usage and frequency of visits, few institutions have invested in such expensive technology. Bancography expects that once more of these "super" ATMs are in production, usage and, most importantly, frequency will continue to increase.

Consumers who use Internet Banking remained unchanged since 2010 at 36%. In that same time frame, roughly 41% of businesses reportedly utilized this channel. As with the ATM, the frequency of customers visiting the institutions' websites has greatly increased. Comfort with the web, improved online banking platforms and the rise in Bill Pay usage were most likely responsible.



Bancography research also identified that approximately 20% of consumers and businesses speak to a telephone representative at the Call Center. This percentage has not varied since 2010. As with the other channels, the frequency of these calls has increased dramatically, especially for businesses. Unfortunately this escalation in utilizing Call Center agents results in increased personnel, which is expensive. See the chart to the left for Call Center channel usage.

No alternative channel replaces another; the channels give the customer more avenues in which to transact. And they are using these alternative channels more often.

To see the exhibits presenting the frequency of use for all three channels by line of business, please visit www.bancography/bancology.html.

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Branch Service Models: A Portfolio Approach continued from page one

The **inline or storefront model** is appropriate in areas with lower overall demand yet offering sufficient current customer concentrations or market household bases to warrant some level of delivery. Well suited for infill markets, i.e., those gaps in between current branches, an inline branch sits in a shopping center or amidst a 'Main Street' group of stores in a space of 1,800 – 2,400 square feet. The small configuration mandates the use of universal agents and teller cash recyclers; precludes the installation of safe deposit boxes; relies on a cash safe rather than a traditional vault; and depends on nearby branches for line of business specialists. The inline model can prove effective in low-income markets where aggregate balance demand is constrained, and allows banks to address Community Reinvestment Act compliance without sacrificing profitability standards. The branch can include a drive-in, but its primary function is more for account opening and problem resolution than for transactions; therefore, it may use self-service technology to address transaction needs.

In-store branches can extend the reach of an institution by allowing it to increase its share of locations and hours at a reduced capital cost. Usually occupying about 400 square feet within the premises of a grocer or other retailer, in-store branches usually employ a universal agent operating model. The in-store branch can operate with three employees at any given time, though FTE counts may be higher as the branch operates 55 – 70 hours per week. In-store branches can prove effective in rural

The State of the U.S. Economic Recovery: Facts and Figures

With presidential and congressional elections looming, Americans are being bombarded by claims about the economy: some optimistic, some pessimistic, some heralding improvements in recent years, others lamenting disappointments. Given the raft of conflicting claims, it is an opportune time for an objective look at the state of the U.S. economy. Few times in recent memory have the indicators been so mixed as to the health and direction of the overall economy; however, we strive below to place some context around the discussion.

Unemployment

Unemployment may be the single most tangible indicator of economic health and is critical for bankers, as there is a direct correlation between market employment levels and deposit growth.

The unemployment rate reached 10% in the fourth quarter of 2009, a level not seen in the prior 20 years. Since then, the rate has steadily but slowly declined to 8.1% as of August 2012. Employment levels improved in every state but New York over the past 12 months.

Note though, in comparison, that unemployment remained at 5% or below from the fourth quarter of 2005 to the first quarter of 2008.

The size of the workforce varies as residents reach retirement age, rising adults join the job market, immigrants enter the country, and seasonal peaks and lulls in hiring occur. The absolute number of unemployed residents peaked at 15.4 million in October 2009 and now sits at 12.8 million; conversely, there are now 142.2 million employed Americans, up 4.2 million since the trough of late 2009 but still 4.4 million below the peak of late 2007.

Interestingly, private sector employment is now slightly higher than at the start of 2009; but total employment is still down due to contractions in the government sector.

Economic growth

Gross domestic product (the output of goods and services produced by labor and property located in the United States) may be the most commonly cited measure of overall economic growth, and is highly correlated with credit demand. GDP increased at a 4% - 5% annual pace from 1996 – 2000, and at a 2.5% - 3.5% pace from 2003 – 2006. But GDP was flat in 2008, declined by 3% in 2009, and has hovered in the 2% range over the past two years.

Housing starts reached an annual pace of 750,000 in August 2012, the highest rate since October 2008, but still well below the peak 2.3 million annual pace recorded in late 2005 – early 2006.

Housing prices

Mean home sale prices increased by 1.8% in the second quarter of 2012, the third increase in the last four quarters after 17 consecutive quarterly declines since the second quarter of 2007.

Nationwide, mean housing prices are now at the same level as in June 2004.

Some of the hardest-hit areas are now rebounding: prices in Phoenix, Boise, Fort Myers, Miami and Detroit increased at an 8% - 12% annual pace; but mean prices still remain 25% - 40% below market peaks in those MSAs.

Other areas continue to show declines, including Atlanta, Jacksonville and New York.

Inflation

A slow economy limits demand and thus can restrain inflation. The strong expansion of 2004 – 2007 brought with it annualized inflation in the 3% - 5% range; this has abated to the 2% range throughout most of the recession and post-recession period.

The inflation rate as of August 2012 was 1.7% and has trended downward over the past 12 months; this held for both the overall rate and the rate minus the more volatile food and energy sectors.

Stock market

Whether measured by the Dow Jones Industrial Average, S&P 500 or broader measures, the stock market has doubled since the lows of 2009, is up more than 30% since the start of 2010, and is approaching the all-time highs of October 2007.

However, only 15% of U.S. households directly own unrestricted stocks (and less than 5% of households with below-median net worth), limiting the impact the rise in the stock market has on consumer spending in the typical American household.

But more than half of all households still have some interest in the stock market, mostly through restricted retirement accounts (pensions, 401(k)s, etc.) or indirect holdings (stock mutual funds); the market's rise may affect the restricted *(continued on page four)*

markets that lack the household base to sustain a more expensive service model, or in residential suburbs to address after-hours and weekend demand from commuters not present in the market during standard workday hours.

Finally, in an age of evolving consumer preferences, financial institutions should consider a **self-service option** for neighborhoods with younger household bases, or near university campuses or military bases. Self-service branches can include advanced-function ATMs, coin counters, and video links to specialists in a centralized call center. Though referred to as "self-service," an attendant can prove beneficial during peak hours to educate consumers about the new technologies, answer questions, resolve equipment issues, and even provide simple account opening or maintenance functions. However, self-service facilities should not include cash handling, for both security and cost reasons.

If an institution can develop a portfolio of the five service models outlined above, it can then serve markets of nearly any demand level. By choosing the model best aligned with demand, the institution can also insure that all branches generate a viable return on expenses. The portfolio approach does not preclude customization though, and smart bankers will adjust service models for specific demographic factors. For example, a branch in a market with an older household base requires sit-down teller stations; an inline branch in an area with dense retail concentration needs an 'end cap' position to allow a drive-in. Finish levels can also vary within a specific model. For example, a branch serving a market with higher income levels may merit granite teller counters, whereas the lower balance potential of a less affluent market may force a trade down to laminate counters. If an institution defines two finish levels, base and upscale, either can be used across the hub, freestanding and inline service models, yielding eight options instead of five. But by predefining the service model portfolio, the institution will open more prospective locations for consideration, as nearly any targeted market will sustain at least one of the service models in the portfolio.

Data sources include U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, U.S. Census Bureau, Federal Housing Finance Agency, Federal Reserve Board.

owners in terms of confidence and spending / savings habits, even though most are too young to withdraw and spend their gains.

Stock ownership remains highly skewed, with the top decile of households by wealth holding nearly 70% of stocks by value, and the top quartile of households owning nearly 90% of all equity balances.

The data yield a few defined conclusions. First, the economy is definitely reviving, as nearly all indicators have improved in the past two years after significant troubles in 2007 - 2009. Second, the pace of the recovery is slow, with most indicators except the stock market showing only modest gains relative to prior recovery periods. Third, almost all indicators still remain below pre-recession levels. The data are irrefutable, though interpretations can vary. In evaluating the economy in the context of the pending elections, acknowledge that the economy has improved but still needs improvement; consider if the pace of improvement would have been better or worse under a different legislative and executive agenda; and consider how the varying proposals being offered by congressional and presidential candidates would sustain and accelerate the pace of recovery. And most importantly, just as with branching decisions, as you evaluate the options, set intuition aside and start with the data.

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