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THE RETAIL BANKING CONUNDRUM

Facing the branch profitability challenge

In this white paper, two senior consultants, Annette Grooms and Judy Gaffney, examine the changing retail banking landscape and how these challenges can be addressed.

Retail bankers today are faced with important questions about the future profitability of branch banking… will regulatory pressures continue to deplete revenue sources, what are the essentials to staying afloat, and what will it take to return to profitability? Basically, can the retail branch survive??

We at Profit Resources, Inc. (PRI) recognize that branch banking represents a current and future burden for most financial institutions. The brick and mortar has already been built, the staffing structure is in place, but customers are utilizing branches less and less. However, even with the current burden, our findings show that community bankers can deploy specific strategies to compete profitably in the ever-shifting retail banking landscape.

Will Regulatory Pressures Continue to Deplete Revenue Sources?

Before Reg E and the Durbin amendment, deposit account related fee income was very strong and many financial institutions had come to rely on it as a never-ending revenue stream. No one questions that the playing field has changed; but what real modifications are being made to position organizations for a healthy future? Or do we continue to hope the "new normal" becomes a thing of the past and the clocks are turned backed to the good old days? Of course not. We must forge ahead.

The past is forever gone; the competitive landscape has changed and new players continue to enter the banking space. Some of the biggest competition is not from those you see every day and drive by in your local markets. The payments industry is exploding beyond PayPal, and E*TRADE, Scott Trade, Charles Schwab, Capital One, Walmart, etc. continue to vie for share of wallet. What can community banks do to address that competition? Stay in touch with customers; know what they want from their bank and offer it to them. If customers are faced with a product recommended by a trusted banker vs. a product offered from a "big box," customers will likely choose the proven relationship if the trust is already established.

What are the Essentials to Staying Afloat?

Take advantage of the opportunities when customers do come to your branch

Accept and then adapt to the changes – transaction counts have been and are projected to continue trending downwards.

Average In-Branch Transactions per Month	
Year	**Transactions**
2006	11,400
2010	8,550
2015	5,460
Source: Novantas LLC, FDIC	

Declining branch traffic does not mean the importance of bankers is declining – as the products become more and more of commodities, your people can make a difference. Recognize that the role of the branch and the role of branch staff is changing from heavy transactional-based to consultative and problem solving. Leverage the opportunities you have with customers when they are in your branches by allowing staff to focus on higher value sales and service roles.

Address the changing role of the branch staff. It is time to implement a universal branch representative vs. defined teller and customer service representative roles. Fewer transactions means branches can be staffed with fewer people, but the skill level of the people must be expanded. The branch should be staffed with employees who are highly knowledgeable and who are able to hear, understand and support the needs of your customers.

Reconfigure existing branches to allow for more assisted self-service. Customers will adapt when positioned effectively. Don't assume some customers won't use technology-based services, especially if you think it's your older customer base. Grandkids are driving their grandparents' adoption of technology so they can keep in contact—think Skype™, smartphones and texting, etc. Banks can get customers to adapt, too.

Consider your staff's perspective. Does your staff know what the difference is between their job and what they do? A branch person may process a transaction or open a new account or solve a bill pay problem—that is *what they do*. But *their job* is to ensure the customer had a positive experience and feels good about their decision to bank with you. It is not about moving on to the next task.

Make sure your processes are efficient and systems are integrated. Minimize paperwork, unnecessary forms and other processes that take all of the life out of the sales process. Cumbersome processes can also position the bank poorly in the eyes of the customers – no customer understands why it takes 30 minutes to open a new account when the cause appears to be related to excessive paper, computer entries, etc. They do understand and appreciate when it takes 30 minutes or more because the banker took the time to listen to them, provide alternatives and generally give a sense of concern for their financial well-being.

Drive people into your branches

The investment has been made and the branches have been built. So consider what can be done to drive up exposure and lobby traffic. Do not think of your branch as simply a place to transact banking business. Reach out to the local community to give the branch a common gathering purpose.

The branch has a lobby and typically a parking lot – use them. Think mid-day concerts, book club meetings, high school bands and cheerleading before a big game, local fundraisers, educational events, etc.

Highlight not-for-profit organizations in your area by allowing them space in your lobby for a period to "market" their cause. Invite their board of directors for a coffee or event to unveil the display.

Partner with a retailer. Ask yourself if you could share space with a retailer and draw people into your building (e.g. FedEx Office or a local retailer / coffee house). It could be a double win: you rent space in a large branch that is underutilized and generate traffic in the building.

While embracing the technology, don't discourage customers from having personal contact with the bank. Let the customer choose how they want to interact with the bank—every customer contact is an opportunity.

Educate customers on bank technology. Conduct online banking, billpay, internet banking, and mobile banking workshops in the branch.

Educate customers on financial topics. Consider financial counseling workshops such as budgeting, debt management and other "how to" type sessions. These can be targeted to multiple market segments—first time home buyers, those planning for retirement, small business owners, etc.

Offer a *simple, well-defined* product line

Products: keep things simple. This helps your customers as much as it does your employees when trying to understand what they are selling. A simple product suite likely has no more than 3 checking accounts with à la carte services that customers pay for or earn with balances/behavior. Eliminate items that the customers do not use.

The product suite needs to be complete and renamed. Terms like "regular checking" should be removed. In many cases products have morphed over time by adding more and more features but without extensive thought as to why, who the end user is, or what the value proposition is to the customer. Ensure your product value propositions are aligned with the needs of the current market.

Look for opportunities to meet the product needs of demographic or economic shifts. For example, HSA's are growing in popularity and will likely survive the health care changes, so every bank should be offering them. Additionally, the average HSA debit card transaction is typically 3 to 4 times greater than the average consumer card transaction, translating to additional interchange income. Another focus could be on IRAs and investment products to capture the 401k rollover market. It is estimated that there is $1.5 trillion in "orphaned" 401k at former employers with an average balance of $115,000.

Consider other fee income generating products. Additional products include: identity theft insurance, gap insurance, prepaid cards, payroll cards, etc. Prepaid cards for teens and college students can be a very valuable tool for parents to monitor and manage their child's spending. Most programs allow for online viewing of transactions, online card loading, and parental control of usage at certain merchant categories.

Free checking is not dead. There is evidence that the free account with no frills still has some draw. That means, for example: no free bill pay or paper statement (reduced costs and new revenues for requesting a copy) and a limited number of checks to be written each month (promotes debit card usage for additional revenues). The key to this is educating staff on selling the best account to suit the customer's needs, rather than selling the product of least resistance.

Invest in your front-line staff

Clearly define the roles and expectations for the retail staff and provide the support, tools and training to allow them to succeed. The front-line staff must understand why certain products or services are beneficial to specific market segments. New products and services cannot be successfully introduced to the marketplace without ensuring your front-line staff members have received training and have gained a good understanding.

Provide training for front-line staff on how they can add value to their customers' lives, not what they can sell to the customers. Sales training should support the desired sales process / customer interaction. For instance, train staff to ask prospective customers what is important to them: "Are you interested in value or price?" These types of questions support a consultative sales session that uncovers the true needs of the customer.

Design processes that support sales and memorable customer service. Provide tools and job aids such as quick reference guides with "if/then" relationships between needs and products.

Establish a process for sales that allows the customer service representative to determine how the bank can best meet their needs. For instance, with each customer the banker should: 1. Explore and understand the customer's needs. 2. Offer the account that best meets customer needs. 3. Close the sale. 4. Cross-sell other bank offerings based on customer needs revealed in step 1.

Invest in strong branch leadership. Develop and recruit those with the necessary foundation to manage the operation and the skills to generate new business and loans. This includes branch bankers, consumer lenders, and business bankers. It is not the place to economize. Pay-for performance compensation systems allow banks to attract the best candidates. Top notch managers are critical to the success of the branch.

What will it take to Return to Profitability?

For the typical retail bank, the cost of branches and staff represent 65% of the NIE. Some industry players, such as Brett King of MovenBank and author of Branch Today, Gone Tomorrow, say the branch is a dinosaur, a thing of the past. PRI disagrees. The branch of the past is a thing of the past, but the branch itself is as viable as ever. The branch remains a prime banking delivery channel, with branch convenience still a key factor across all market segments for bank selection. Bankers need to leverage all of the investments they have made in technology and reshape the role and service model of their branches.

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Leverage resources and minimize expenses

Review your branch operating hours, specifically focusing on the activity during the early and late hours. Determine if there are opportunities to reduce branch hours without disrupting service levels. Consider if you can implement a hub-and-spoke approach to serving a given market area, with a few branches staying open late and others opening early, versus all of the branches covering all of the hours. Typically a key issue to consider is the traffic / commute patterns or other drivers of volume. For example, consider morning and evening commute traffic flows in relation to a branch's location for an indicator of optimal hours of operation.

Consider if you have underperforming branches that are candidates for closure or consolidation. Depending on the all of the cost variables, these branches can be a major drain on overall profitability. Take a close look at underperforming branches located in declining markets or those where the physical location is no longer viable due to population shifts or something as basic as road changes that now inhibit ease of access to the branch.

Determine if there is an opportunity to share staff resources between branches or even between branches and departments. Some financial institutions have been very successful in sharing staff when neither job requires a full-time resource.

Leverage your branch staff to perform "non-time sensitive" activities to better utilize the excess capacity. This may be a way to reduce some of the staff costs related to functions currently supported by back-office personnel. This needs to be managed closely and should be limited to ONLY when branch staff isn't servicing or calling customers / prospects. Consider tasks such as account maintenance, account opening/verification, etc. All of these functions can be performed in the branch.

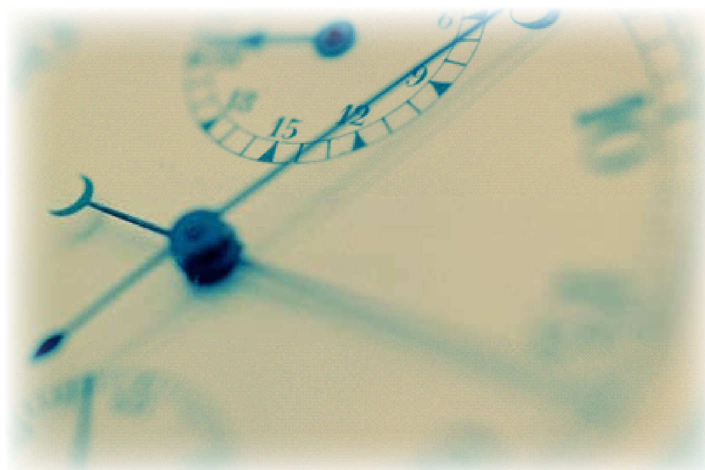
Offer a *profitable* product line

Use a product pricing profitability model. Product and relationship profitability needs to be analyzed so that new products can be developed. Loser relationships should be fee'd or fired.

Have a clear understanding of where your retail profits come from. For many banks the small business market is the most profitable, but not generating the most profits—simply because they don't have enough of it. Interchange on a business credit card and debit card is still strong. Business debit cards typically generate 100+ bp greater interchange than consumer cards; the average ticket is 2x more, net income per transaction is 6x greater and monthly income per card is 5x greater.

Re-think the paradigm that signature-based debit transactions are more profitable than PIN- based. Signature still rules when only considering interchange; but recent industry revenue analyses show PIN transactions generate more total revenue due to NSF's and other fee income. Furthermore, the higher fraud losses on signature-based transactions vs. PIN cannot be ignored. The higher interchange does come at a cost.

And so, we get to the big question…



Can the Retail Branch Survive?

Yes. With the adoption of a stringent profitability tracking system, a detailed review and revision on the product suite, assurance that the right people are empowered to do the right job at the front line and some creative thinking when it comes to brick and mortar, the new branch will emerge to serve community bank customers. But don't wait for the new branch to morph into what it needs to be. Now is the time to proactively make changes to leave a footprint for the future.

About the authors...

Annette Grooms is a banking executive and consulting professional with over 35 years of experience in financial institutions. She is a skilled engagement manager with experience in all areas, including: systems/technology management, revenue production, finance/accounting, customer service delivery and managing all consumer services functions in dynamic environments. Annette's experience includes 25 years of consulting for financial institutions in which she has overseen large community bank change management programs addressing business process improvement, technology, revenue improvement and expense reductions. Annette's expertise means nothing less than bottom line improvement for PRI customers.

Judy Gaffney is a proven expert in her field with over 30 years of experience in banking, including branch administration, human resources, trust, commercial banking, sales and marketing. Judy's demonstrated leadership as a change agent makes her successful in many opportunities, including serving as manager of retail banking for branches going through a four-bank merger. Judy has led banks through expansion, planning and executing aggressive, profitable growth in each case. Judy's diverse experience in regional and community financial institutions in varied markets translates to meaningful, quantifiable recommendations that impact PRI customers' bottom line each time.

About Profit Resources, Inc...

Profit Resources Incorporated (PRI) strengthens financial institutions by improving profitability and efficiency, so that banks can best serve their customers, employees, and shareholders. By taking a hands-on approach to consulting, the PRI team of seasoned banking professionals makes a measurable impact on the bottom line through income enhancement and expense reduction. Established in 1990, PRI's expertise covers most areas of the bank including:

Non-Interest Income	Non-Interest Expense
Mergers and acquisitions	Retail banking
Item processing	Vendor management
Cash management	Lending
Mortgage banking	Operations

By taking a hands-on approach that results in real, quantifiable change, PRI helps good banks get better.

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