Are Your Branches Built For Tomorrow?

Branch Transformation in the Digital Era

"There is no conflict between digitalisation and the world's best branch network... it's just the way they work is going to be different."

- Anders Bouvin,
CEO of Handelsbanken

Introduction

Branch transformation is arguably the most challenging, yet rewarding, project a bank can undertake. To enhance your customer's satisfaction, increase revenue, drive operational efficiencies and service innovation, let's explore the three Ds of effective branch transformation: distribution, delivery and digitization.

The State of Branch Banking

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After learning that he was incorrectly reported as grievously ill, American writer and humorist Mark Twain famously commented: “The report of my death was an exaggeration.” The same could be said about branch banking.

Such claims have been made by experts, supported by surveys and further validated by news of branch closures. These experts then point to the successes of digital-only banks such as ING Direct and Hello! Bank and issue stern warnings to weary executives of brick-and-mortar banks: “Banking is being disrupted, just as your local DVD rental store by Netflix, the neighborhood bookstore by Amazon and those yellow cabs by Uber.”

It is difficult to refute the fact that customers are taking their transactions to digital channels. However, before you call the real estate agent to sell the branch buildings, and the landlord to terminate the leases, ask yourself what may happen if you could somehow close all branches tomorrow. Your next quarterly financial report would certainly look fantastic without these branch–related costs, which account for about one third of a retail bank’s operating expenses. However, you would probably also notice that the bank acquired a lot fewer new accounts and on-boarded even fewer new clients. Your lending business would be significantly lower, and even the products that do not rely on branches (such as credit cards) would suffer as customer mindshare plummets.

Key Point

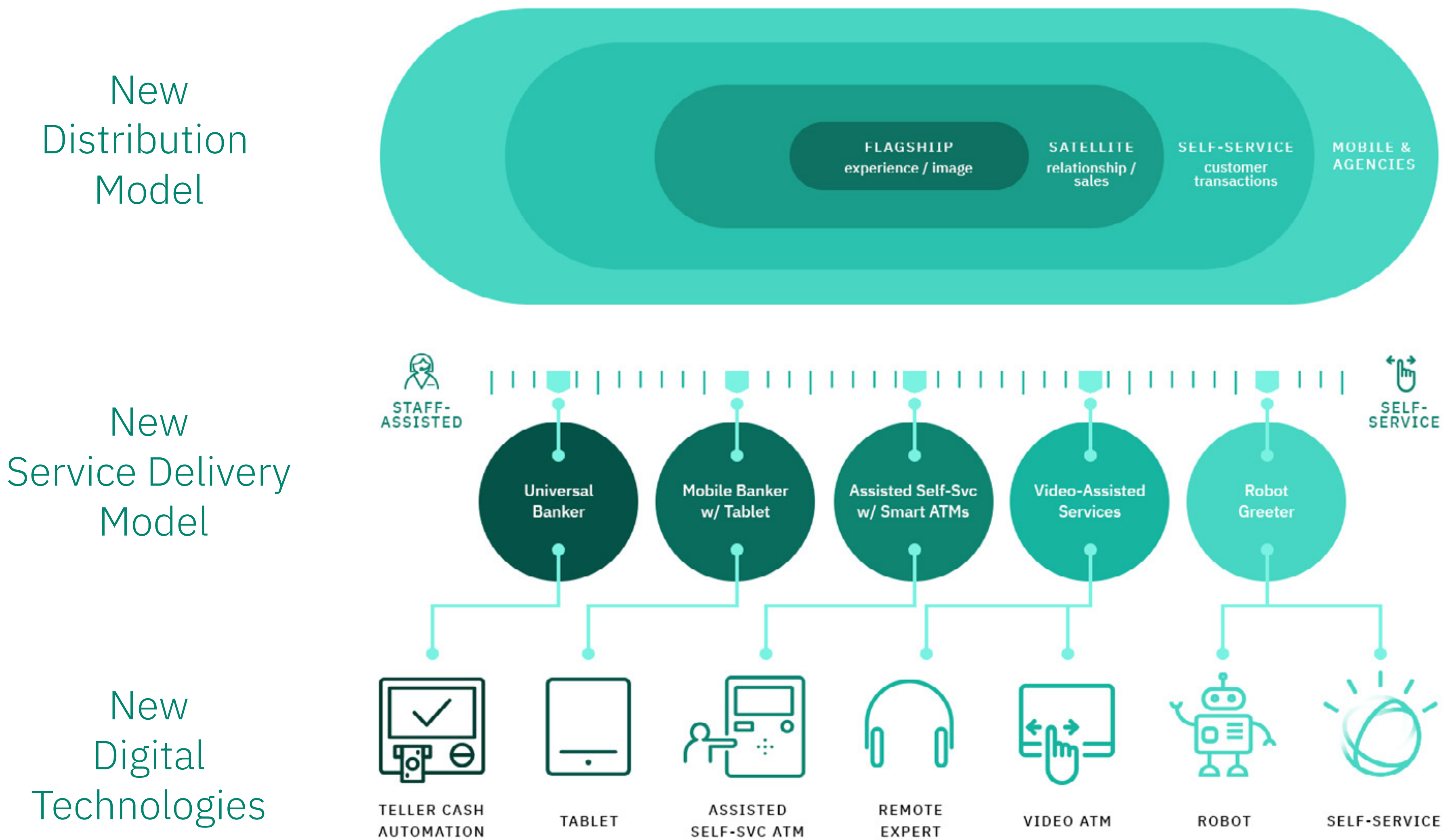
Rather than a threat, digital technologies and declining branch transaction volume should be embraced as an opportunity to reduce cost, increase revenue and enhance customer experience.

Most are struggling to grow. Those that have managed to grow often rely on lower fees and higher interest rates on deposits to attract customers. Even fewer have established a meaningful lending business. The ones that are financially successful have been forced to steer away from high-margin financial products, instead opting for relatively basic, no-frills, lower margin products – the lower margin being supported by a lower cost delivery model.

Human-based banking interaction will never be obsolete as long as money remains a big deal in human life. The fact remains that higher quality banking interactions, leading to higher margin products and services, tend to be facilitated via branch banking. What is becoming obsolete, however, is the current branch service model, which traditionally has been built around teller transactions. Rather than a threat, the ever-improving digital technologies and rapidly declining branch transaction volume should be embraced as an opportunity to reduce cost, increase revenue and enhance customer experience.

Branch transformation is arguably the most challenging project a bank can undertake as it involves premises, processes, and people in addition to technologies. Let's examine the three Ds of branch transformation: distribution, delivery and digitization (Exhibit 1).

Exhibit 1: The three D's of branch transformation



Key Point

At the branch network level, there are two questions to be answered:

What is the optimal logical branch distribution model?

What are the optimal locations to deploy this model?

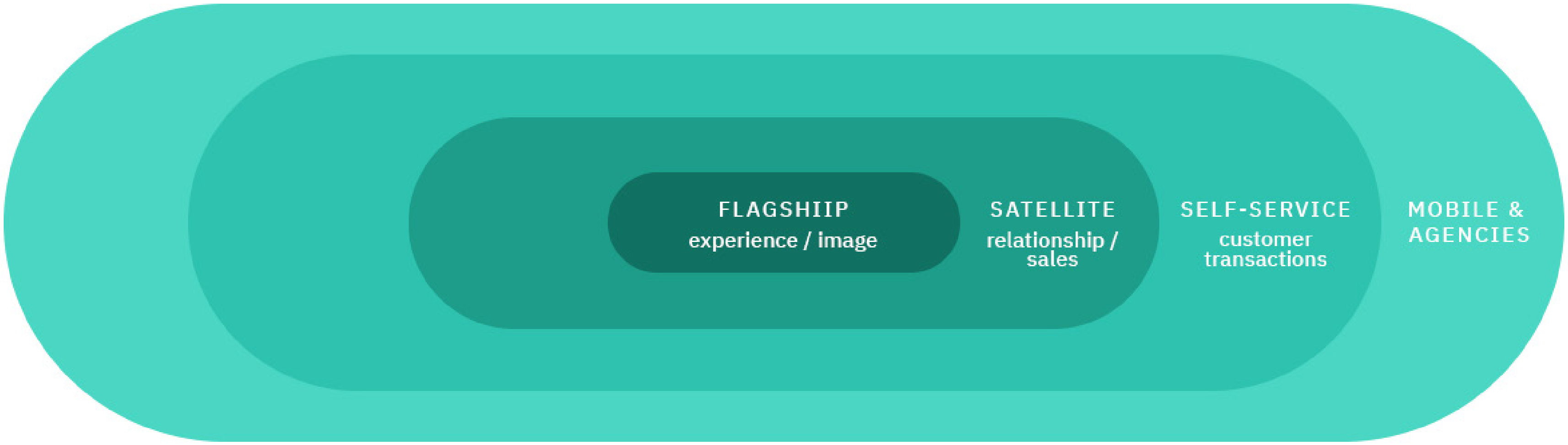
Branch Transformation's 1st D:

Distributing Resources Efficiently

Let's look at what is going on in the branches. There are the tangible interactions: forms filled, cash dispensed, accounts opened, loans applied. There are also the intangibles: hands shaken, eyes met, questions answered, relationships built. Some of them lead to expenses; others may bring in revenue; while many have regulatory implications. What a bank should deploy in each branch is a complex issue. It not only affects customer satisfaction but has a major impact on financial performance.

Leading banks around the world are adopting the hub-and-spoke model. There typically are 4 layers: hub, satellite, self-service centers and mobile services. In each market, there usually is a single hub branch. The hub offers the full set of products and services and is often built as a flagship branch responsible for lifting the banks' image. The hub is surrounded by smaller satellite branches offering the minimum set of products and services relevant to the customers around them. These satellite branches work symbiotically and are supported by the hub. The third layer is self-service centers, mainly composed of offsite ATMs and kiosks. Some banks have a team of mobile employees as a fourth layer to extend their reach beyond the market. In some geographies, banks may even have a network of third party agents operating corollary to the branch network.

New Distribution Model



The benefit of a hub-and-spoke topology is in the clear separation of missions. The hub is focused on customer experiences and corporate image; the satellites are responsible for relationship and sales; self-service centers are where customers transact. The separation of missions allows banks to decide more precisely what to offer in each branch and how to measure their success.

Banks should not see branches as monolithic units of operation, but as an ecosystem of resources. Some of the resources are cost-to-serve items, including tellers and ATMs, while others are costs-of-doing-business such as bankers. Where to place the cost-to-serve resources can be decided by minimizing cost, subject to a satisfaction level acceptable by existing customers.

On the other hand, where to place the bankers and sellers can be decided by maximizing revenue given the staffing level and market potential. Instead of an art or sometimes a political struggle, branch placement is a resource distribution problem that can be optimized mathematically using geographical analytics tools such as IBM's Metro Pulse Powered by Watson.

Metro Pulse Powered by Watson

Helping Banks Optimize Branch and ATM Network

IBM Metro Pulse Powered by Watson, banks can optimize branch and ATM locations in a precise and customizable way.

Cognitive computing allows time-sensitive, hyper-local geographical data to be combined with your enterprise data to reveal block-by-block dynamics and opportunities.

The tool is flexible enough to ingest large quantities of current and historic data from the bank, such as performance, footfall and market share.

External data sources that are often used include the demographics of the local neighborhood, the aggregate flows of people as they go about their daily business, local events and details on facilities and infrastructure around each branch and ATM.

Recommendations can be made on the placement of branches and ATMs, as well as on services to be offered and required resources, such as cash and personnel.

Details can be found here: IBM Metro Pulse by Watson

Key Point

Transforming the model of how services and products are delivered to customers must be the focus of every branch transformation project.

Branch Transformation's 2nd D:

Delivering Products and Services Effectively

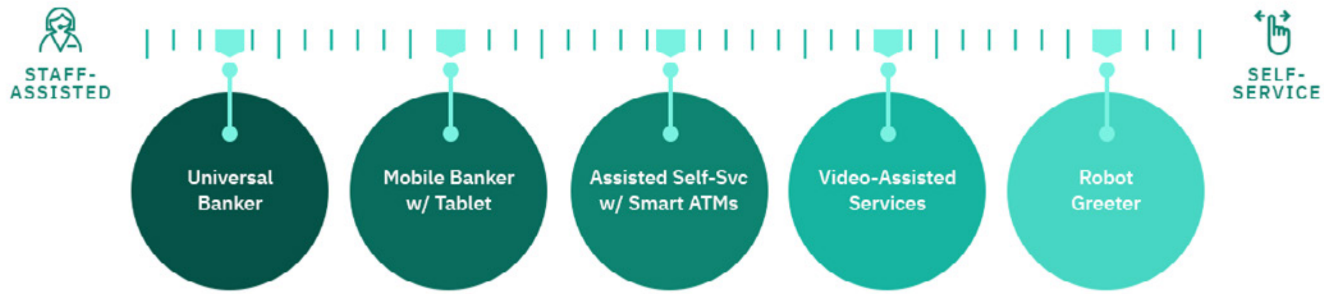
Branches are critical as they are where bank employees and customers interact. At the same time, it is the current model of human-based interaction that makes branch banking expensive, as about two-thirds of branch-related expenses are in personnel. Therefore, transforming the model of how services and products are delivered to customers must be the focus of every branch transformation project.

Decades ago, there was only one service delivery model. Customers were served either over the counter by a teller, or at a desk by a banker. When ATMs were invented, a second service delivery model appeared. Nowadays, technological advancements allow banks to create innovative service delivery models that are "in-betweens," neither purely staff-assisted nor 100 percent self-service.

Real World Example: Express Banking Kiosks

Chase Bank in the U.S. has been transforming its branches around the so-called "Express Banking Kiosks." This is a service delivery model similar to self-check-in at airports. Customers line up to use one in an array of kiosks with an employee standing nearby to offer assistance when needed. It allows Chase to shrink the size of a branch by about 1/3 in both staffing and square footage. The branch transformation program based on this new service delivery model contributed to the reduction of 14,000 branch positions in the first three years since the program's inception. What's more impressive is that rather than seeing customer satisfaction decline – as experienced by many banks running a massive branch closure program – Chase's customer satisfaction during same period actually soared to number one among the largest U.S. financial institutions. This likely is a result of the assistance part of the service delivery model. Customers who require or want assistance actually receive it.

New Service Delivery Model



Like Chase, many banks are also shrinking the size of individual branches. As the number of employees per branch declines, it will no longer be feasible to maintain specialists in every branch. A mortgage advisor may be shared between five branches while a small business banker may cover a micro-market of ten branches.

Video banking is another service delivery model that has become nearly mandatory for small branches. Customers with a need that cannot be fulfilled by staff in the branch at the moment can be served by a remote specialist in a meeting room equipped with video technology. Not having to ask customers to go to another branch or return at another time is an obvious benefit. Per-transaction cost can also be lowered significantly by centralizing staff in lower-cost locations.

Video can also enable other service delivery models. Some banks are embedding video in ATMs, through which remote tellers can help customers with their cash needs even outside of regular branch hours and unaffected by weather. Some banks are also deploying kiosks in shopping centers that allow customers to get a new credit card or apply for a loan via video. These kiosks can be either unmanned or minimally staffed with one or two salespersons during peak hours to answer customer questions.
Another service delivery innovation – using tablets – is a model pioneered by retailers and wireless outlets. Customers are greeted at the door by an employee with a mobile device such as a tablet. Simple transactions can be completed on the spot. Otherwise, customers are entered into a queue to be served by a desk- or counter-based employee. Tablets “untether” employees from their desks and create a more intimate environment. They also enable a “shoulder-to-shoulder” customer experience with much better sense of transparency that customers appreciate.

Key Point

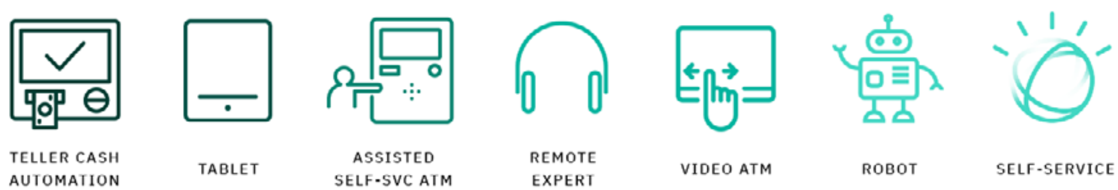
Smart bank executives closely follow the advancement of new digital technologies such as robots, cognitive computing and wearables, as they will make possible new service delivery models that either help banks deliver the same services more efficiently, further shrink the size of branches or improve customer experiences.

Branch Transformation's 3rd D:

Digital Technologies

Branches are about people, not technology – customers foremost and then employees. Therefore, it's not true transformation unless branch service delivery models are transformed. It's easy to get caught up in the trendy devices with new features and functions, but banks should avoid jumping into technology decisions without thinking through the target service delivery model.

New Technologies



Branch Transformation:

Avoid Navigating with a Broken GPS

We have learned that the “where” and “what” of branch transformation is really a resource distribution problem that can be solved mathematically, while the question of “how” can be answered with new service delivery models powered by digital technologies. It would be great if answering where, what and how was all it took to be successful. Unfortunately, for most banks that’s not enough. Branch transformation projects are likely to fail unless three things are understood clearly: customer behavior, customer profitability and branch performance.

Understanding Customer Behavior

Human behavior is very difficult to change. The success of a branch transformation program really depends on whether customers accept and adapt to the new service delivery model. Every retail banker must ask these two questions:

- How do my customers bank with us today?
- How do I want my customers to bank with us in the future?

Only by answering these two questions (preferably quantitatively) can a bank decide the best branch service delivery model.

Understanding Individual Customer Profitability

Another aspect of customers that every bank should understand is each individual customer's contribution to the bank's bottom line. Many branch transformation decisions, including location, products and service delivery models, depend on knowing the profitability of customers around the branch.

Consider this: Alice and Bob both own the same products from your bank with the same deposit and loan amounts. Alice is a mobile user and has not been to a branch in years, while Bob prefers to transact over the counter. Which one is more profitable? Of course Alice is. It may sound obvious, but the truth is that many banks have little clue. Branch-related costs are seldom distributed among customers based on usage. Without a clear understanding of customer profitability, bank executives will inevitably make the wrong decisions.

Studies have shown that typically 10 - 20 percent of customers generate about 60% of branch teller transactions[iii]. It is imperative for banks to understand who these customers are, why they prefer to transact in branches, and what banks can do to shift them to digital or self-service.

Understanding Branch Performance

Closing down an underperforming branch is a routine decision that banks make. Unfortunately, many banks make these decisions in the dark based on antiquated branch performance models. Traditionally, each customer belonged to a particular branch and his or her profit counted toward the branch manager's performance. This model worked 30 years ago. But many customers today rarely go into a branch. They transact digitally and it is the investment in digital channels that maintains the relationship. Branches are still important to them. The branches customers see during their daily commute can offer peace of mind. They don't have a home branch and may go to any one for a new account. So how should branch performance be measured in the digital era? It is our belief that banks must redefine profit centers, revenue centers and cost centers. Tellers are cost-to-serve and, therefore, are cost centers – they are necessary to keep customers satisfied. Bankers are cost-of-doing-business, so they should be revenue centers. You invest in them to generate revenue. A cluster of branches with similar customer profiles makes a profit center. It is up to the manager of this market to decide how the resources should be distributed to maximize profits.

"Bankers recognize that branch banking must change, but there are pitfalls on the branch transformation journey."

Key Point

Branch transformation needs to be based on a clear understanding of customer behavior, customer profitability and branch performance.

Summary

Getting Branch Transformation Right

Branches will not die any time soon; however, the definition of what a branch is, its purpose and how this purpose is delivered, is evolving.

Bankers recognize that branch banking must change, but there are pitfalls on the branch transformation journey. A project that re-paints the wall, installs a coffee machine and upgrades the ATMs is unlikely to fail and may even generate some short-term benefits. But superficial projects such as these do not create sustainable business value.

Branch transformation needs to be based on a clear understanding of customer behavior, customer profitability and branch performance. It allows bankers to design a sound strategy, which can then be executed at three different levels:

Distribution: how resources are distributed geographically across markets

Delivery: how services are delivered inside the branches

Digitization: how digital technologies can enable the new service delivery models.

Branch-related expenses often represent one-third or more of a retail bank's operating expense. They are also where deals are closed and relationships are built. The importance of branches requires banks to see through the hype and carefully design the strategy, service delivery models and enabling technologies. No matter where you are in the branch transformation journey, IBM has the expert resources to help you succeed.

About the Author

Danny Tang is the Leader of Channel Transformation for Banking and Financial Markets at IBM. He advises banks globally on pressing issues including digital and branch transformation.

Danny Tang's linkedIn

Danny Tang's Blog

[i] JPMC 2015 Investor Day Presentation Investor day 2015 (PDF 2.7MB)
[ii] J.D. Power U.S. Retail Banking Satisfaction Survey
[iii] Customer Loyalty in Retail Banking 2016, Bain & Co.