Rob Rubin

The Banking & Payments Show: Counting on bricks—When banks stick to their branches

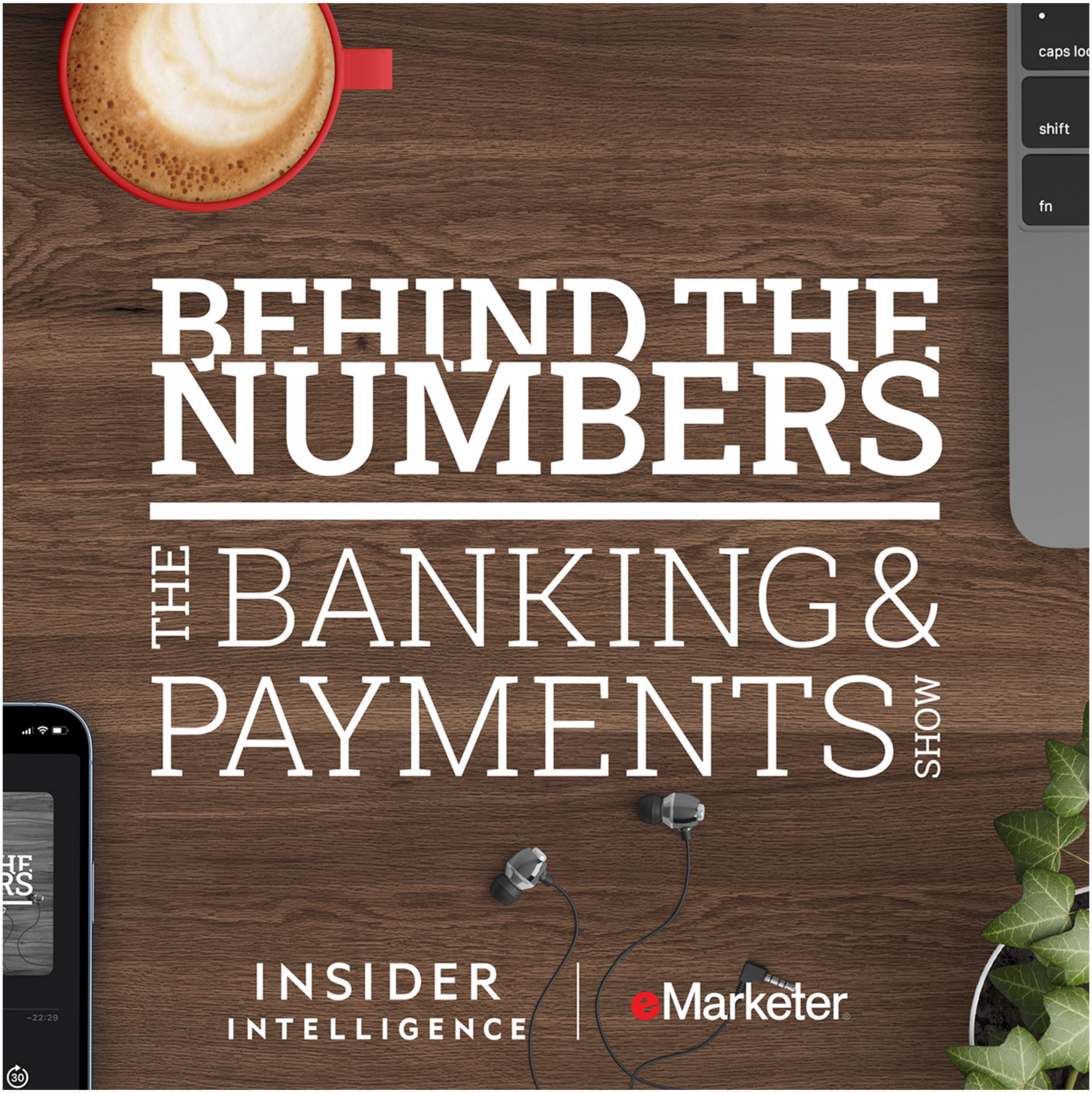
Audio

On today's podcast episode, we discuss the future of the bank branch.

• In our “Headlines” segment, we chat about why banks are closing so many branches and how consumers want more digital experiences.

• In “Story by Numbers,” we explain what Curinos defines as branch share and why it used to account for more primary new accounts than it does today. We also discuss the value of closing a branch in order to save operating expenses in a low-rate versus high-rate environment.

• In “Pretend CEO,” we look at regional banks and their deposit portfolios in a high-rate environment. Listen to the discussion with host Rob Rubin and Curinos director Andrew Hovet.



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Episode Transcript:

Rob Rubin:

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Andrew Hovet:

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Rob Rubin:

Hello everyone and welcome to the Banking and Payment Show, a Behind the Numbers podcast from e-Marketer. Today is November 14th. I'm Rob Rubin, GM of Financial Services and your host today. If you enjoy this podcast, please give us a five star rating. We'd love to hear from you. The title of today's episode, Counting on Bricks When Banks Stick to Their Branches and it's going to be a good one. Joining me today is Andrew Hovet, director at Curinos, my former partner at Novantas before it merged with into Curinos. Hey Andrew, how are you? Thanks for joining me today.

Andrew Hovet:

Hey Rob, so great to see you.

Rob Rubin:

It's been really fun. We've worked together for a long time in the past, but our audience doesn't know you yet. So before we get into it, let me ask you a couple of quick fire questions so that the audience can get to know you a little bit better.

Andrew Hovet:

All right. Shoot.

Rob Rubin:

What I know is that you are born, raised in Louisiana, New Orleans.

Andrew Hovet:

Well, my wife grew up in New Orleans. I actually grew up in Seattle.

Rob Rubin:

Oh, I didn't know that because you sound like you're from New Orleans.

Andrew Hovet:

Oh no. I guess it's caught. We lived here for probably a dozen years before I moved to New York City to work with you, Rob at Novantas and I was there for about four years and then the pandemic hit and my wife and I decided to pick up stakes at head back south. So I'm back in New Orleans.

Rob Rubin:

I would agree, especially New York in the beginning of the pandemic was not a fun place. And you had I think your son with you, right?

Andrew Hovet:

We did. I had a middle school son and I had two who were in college and of course with the pandemic then they were shipped home, so there were five of us.

Rob Rubin:

In a New York City apartment.

Andrew Hovet:

In a New York City apartment.

Rob Rubin:

That must've been fun. What was your family's favorite New York food?

Andrew Hovet:

We're a pizza family through and through. Not that we didn't enjoy lots of other food, but I would say pizza was always the top of the list.

Rob Rubin:

Pizza is one of those things where you get it in New York, you can almost go to any corner and it's pretty good. It's really good. Especially compared to other places.

Andrew Hovet:

Absolutely. I mean I think one of our favorites was hit, but we were living in the Upper West Side. Motorino was awesome, but also totally different Sicilian kind of square slice from Mamas too.

Rob Rubin:

I know that place.

Andrew Hovet:

And I would say my longtime favorite, going back to the nineties when I first lived in New York was, I was at John's of Bleecker always, but our place in the Upper West side at least satisfied my boys was like you said, the corner spot was Little Italy, I think one of their many. But it was always good.

Rob Rubin:

Little Italy was always that place you wound up, for me, because I live in the suburbs. I wound up because I'm waiting for the train at late at night. Well that was fun, but we have a lot to cover so let's get right to the headlines. In the headlines we chat about a top story as it relates to our episode. For today I picked two articles, one from American Banker titled why banks are closing so many branches and one from CNBC's website titled supermarket bank branches are closing seven times faster than other locations. I put links in the show notes to those articles.

The AB article gave some members on branch closings. In 2009 there were nearly a hundred thousand bank branches and now there are fewer than 80,000 bank branches. The article cited the obvious factors at play. Consumers want more digital experiences, exacerbated by the pandemic. So banks are investing more in their digital experiences and then also the M&A where banks overlap. So two banks, a bank buys another bank, they have overlapping branches, they close some of the branches. To me it feels like M&A has a lot to do with it because I did some research and I found data from the FDIC that said that there were over

6,800 different banking institutions in 2009 and there's under 4,500 at the end of June 2023. That's more than the branch decline as a percent.

Andrew Hovet:

It's massive.

Rob Rubin:

So there's this huge closure, but the article also cited reasons why these branches still exist. So why don't you help us understand why, and I want to point out that today I think everybody who's listening here should know we are in what would be considered a high interest rate environment, particularly compared to the past where there was zero interest rate or pretty close. So why are bank branches so important in today's high rate environment?

Andrew Hovet:

Yeah, Rob, I mean branches are still important. They have always been kind of a tried and true mechanism for gathering what we would describe as kind of core customer relationships. Those everyday personal operating account. Digital banks can post a high rate and they can gather deposits, but ultimately none of them have been able to translate into that, getting that core kind of customer relationship, which is essentially a zero cost of funds for that checking account. And so at a high rate environment, having that good stable low cost funding is really important. And so bank branches have been able to deliver that time and again.

Rob Rubin:

I think that what's sort of interesting like I look at Chime. Chime is an interesting digital bank because their value prop is get paid two days early. So they're clearly targeting a mass market audience who more paycheck to paycheck and want to have their funds as early as possible. So is that a solution to not having a branch to come up with a trick?

Andrew Hovet:

Yeah, I think really important is having a differentiated value proposition if you want to be able to get that kind of core operating account. Again, if you want to compete on rate, go as high as you can, go and gather deposits, obviously very expensive ones, but it's really been difficult for banks to kind of stand out from others because most consumers view the pretty much of a commodity product. They're all the same. And so innovators Chime who really kind of help differentiate themselves with something unique and different. Now there've been a lot of fast followers. A lot of the traditional banks now have the same features, but they were, if not first market, they were probably first to really capitalize on that innovation.

Rob Rubin:

It's always the first one to capitalize, but then it also, it meets a very targeted niche.

Andrew Hovet:

Yes.

Rob Rubin:

Maybe it's a big niche, but there's only a certain segment that's going to be interested in that. One of the things that was interesting that we did is we looked at the mobile apps of the big banks and we looked at the mobile apps of some of these direct banks like Chime for example. And what we found is the mobile apps on the big banks were significantly better and more sophisticated than the apps from these direct banks, but the direct banks, they build everything around that value prop. So Chime get paid two days early, as long as the mobile app delivered the basics that consumers were expecting, what the person really wanted who signed up for the Chime account was to get paid two days early. So that's like a value prop and I wonder for them, how do they extend to reach a different audience, maybe a more affluent consumer, someone that might buy other banking products.

Andrew Hovet:

I think it'd be very difficult. But you have other players like SoFi who are trying to get a broader set of needs and they really came at it from a lending first perspective. So they are trying to be kind of a digital but kind of full service bank. They also are targeting a particular segment. I think that's important. If you're a fully digital, you can chase a segment. If you are constrained by your physical presence, it's harder to chase after an individual segment. You almost have to serve the whole community in order to be able to get the scale out of the market.

Rob Rubin:

Yeah, and you look at like Discover is offering a cashback debit card to try to win some deposits.

Andrew Hovet:

Right. Absolutely.

Rob Rubin:

I want to jump to the second article. The CNBC article talked about supermarket branches closing at a much faster pace than other footprints and they cited that difficulty selling a range of banking products at those locations compared to full service. But let's just take a step back. Why did banks start opening supermarket branches in the first place?

Andrew Hovet:

They tried to tap into that everyday convenience. And so if you were visiting the grocery store once or even more than once a week, made it very easy for you to stop by and do your banking services. And so that convenience was really important back in the day. Supermarket branches actually, if you look at it on a new customer acquisition basis, performed just as well as traditional banks as gathering those new relationships. The challenge is they had difficulty getting kind of deeper relationships, getting into lending, into mortgage, into investments out of those locations. It was a little harder to get someone to sit down and talk to you about their kind of complex financial needs, but it was not so bad to open a checking account and have the convenience of whatever kind of cash services...

Rob Rubin:

Low cost deposits. Why would they pull that out if they can open a checking account and get someone to put their direct deposit in?

Andrew Hovet:

I think what's changed over time is the importance of that convenience has declined so customers don't visit the branch nearly as frequently as they can do most of their banking on a digital app or maybe at the ATM. And so kind of the value to the customer is a little bit lower. And the other thing is those branches typically tended to attract a little bit more of a mass market customers. And with a lot of the OD NSF reform over the last few years, those mass market relationships are a little less profitable for the banks than before.

Rob Rubin:

Because they can't charge the big overdraft fees.

Andrew Hovet:

Exactly.

Rob Rubin:

Sweet. That is probably a good time to transition. While banks have been shuttering branches for a while, physical network planning in a digital world is certainly much more nuanced about how they would do that. And in a higher rate environment, the need for sort of lower cost retail deposits from consumers and small businesses has to change the calculus for what branches you keep and what branches you don't. So let's dig deeper into that in Story by Numbers.

In Story by Numbers, we pick a number or two that helps us dig into the episode's topic. Today for Story by Numbers, I want to talk about two charts that you showed in a recent Curinos webinar titled network optimization in a high rate environment. There's a link in the show notes. The first chart's title, primary check-in acquisition drivers changes over time and it shows some pretty interesting trends. In 2015, branch share accounted for 58% of new primary accounts and it declined to 36% in 2022. Maybe you can just real high level explain what you mean by branch share.

Andrew Hovet:

Absolutely. What we're essentially looking at there, this analysis was done looking market by market and essentially trying to understand who customers were choosing in a market to change their primary bank relationship. And branch share essentially there is your percentage of branches in a given market. So a kind of dominant share provider might have 12 to 15% of the branches in a market. Maybe some of the national banks will often have that in some of their markets, whereas a more typical regional bank may have more like six to 8% of branch share. But essentially it's your share of the storefronts in the market.

Rob Rubin:

So what we see then is that the value of having a big network in a market has declined. That's basically what those numbers say. It declined from a 58% contribution to a 36% contribution.

Andrew Hovet:

In a world where convenience matters more, and I'm going to the branch semi-frequently, right? I need to have a lot of branches that are convenient to me, part of my kind of live, work, play patterns, right? In a world where I don't go nearly as frequently, I just need to know that there are branches available. I don't necessarily need to have tons of branches available. And I think the flip is some of that is branch becoming more important, but the other part of it is the brand and marketing becoming so much more important in a world of everything is really consumer brand driven these days. Think beyond banking and think how important kind of branding has become. We're really seeing that in banking as well where brands that are able, like you mentioned earlier about the example of Chime, who are able to differentiate themselves, what is it about their brand that is unique and distinctive? And then putting marketing heft behind it to make sure people know about it, right? Those two factors working together have increased in importance while having lots and lots and lots of branches has decreased.

Rob Rubin:

And are there other factors of influence that grew or declined?

Andrew Hovet:

Really interesting thing. Another thing that we've measured as part of this is trying to understand from the consumer's perspective the importance of what we described as kind of leading digital capabilities and what we've seen, especially in the 2022 research, and we're actually going into field again or right now to update for 2023, but what we saw in 2022 is that the importance of leading digital capabilities declined to be relatively small and it's a little surprising in a world that is so digital. But I think the way we've observed this is we've done this research year over year. What we've seen is there have some years digital increased importance and then other times it receded. And what we're really seeing is when there are features or capabilities that are available via digital app that are unique and differentiating for certain banks, it can grow in importance. But in a world where everyone's got more or less similar digital capabilities, everyone's got the table stakes, it doesn't drive as much of the decision-making of consumers. Consumers almost assume that every bank's got everything they need on the digital app.

Rob Rubin:

I hear you. One of the interesting things in that chart to me was that it showed how the influence of marketing as you pointed out and branding is more and more important, but one of the things that we've talked about in this podcast and that we publish is that banks over the last couple of years, they've reduced their marketing budgets overall and a lot of the cuts, not all of them by the way, some have doubled down, but a lot of the banks, particularly like the regional banks and the smaller banks, they've actually cut largely from the top of funnel, the stuff that they can't attribute. They pay for the performance stuff. So it seems like you're saying that marketing and branding has increased in influence, but what we see is that banks are deciding that's what they're going to cut today.

Andrew Hovet:

Exactly. And I think when you start to get there is you're differentiating between ultimately winners and losers, especially in a world where if you are closing some of your bank branches, you're decreasing your ability to attract new customers. You've got to offset that and really because of marketing being such an important driver and you need to feed some up there. The other thing that a bank branch network does is it's an unbelievable marketing capability. You have lots of signs throughout the city that say, work here, we're open for business. And so as you decrease your physical presence, you're reducing what we described as unaided awareness and you need to make sure you're offsetting that with that top of funnel kind of brand marketing.

Rob Rubin:

Right. Didn't Novantas call that the billboard value of a branch?

Andrew Hovet:

We do. We still call it the billboard value.

Rob Rubin:

It is, right? I want to jump to keep on time to the second chart because it's really fascinating and I'm a data person, that's why I think it is. But I think people listening will find it too. It looks at the value of closing a branch in terms of savings on operating expenses. And it compares if you close a branch when the rate environment is low versus today when you have a high rate environment. And the thing that you've pointed out is that we're going to be in a high rate environment. It's not going to go back down anytime soon. It's going to be here for a bit. So the chart analyzes the operating expense savings if you close a branch because branches are quite expensive to operate against the consequences of closing the branch.

So you close a branch, you save some money, right? You save a lot of money, but you also have customers that might be upset that you just close that branch. You also don't acquire any new customers from that branch anymore. So what the chart showed was that in a low rate environment, the negative consequences of closing the branch are about 47% of what they'll actually save by closing it. So they benefit 53% to close the branch is what it sort of says, but then in a high rate environment it jumps to 95% of the savings. In other words, the negative consequences consume 95% of what you save. And that seems a little close to not making any money. So it could cost you more to close a branch than to keep it open in some cases. So maybe you can discuss that. Why is that?

Andrew Hovet:

Absolutely. And if you think about the world we're in right now where everyone is deposit constrained, right? Everybody needs deposits. And as we've described, bank branches are good at attracting that low cost, stable core checking relationships. And so when you close a branch, yes, you get a little bit ahead of attrition of customers who choose to bank elsewhere, but a lot of customers would be happy to continue to bank with you at one of your other physical locations. What you really miss out on is to your point is that future sale, every year there's a new tranche of customers that you're no longer attracting to the bank and those customers were going to give you kind of those kinds of core deposits, those lower cost deposits. In a high rate environment where your deposit constraint, you need to go replace those kinds of foregone deposits.

Rob Rubin:

Because it would be too expensive to buy the money.

Andrew Hovet:

Essentially you have to buy the money because you need the deposits to continue to fund the bank. And so you're now trading off missing out on those kinds of core customers with low cost. You're going to have to go out at wholesale funds or rate driven deposits at five plus percent. And so now that you're trading off, having to go "buy" those deposits relative to the operating cost you save. And so what looked like an easy decision in a lower rate environment might actually be a bad decision. Now it doesn't mean you can't close branches, it just needs to be really surgical about understanding which ones you're going to close and what's the impact and can you offset some of that foregone sales by maybe spending marketing to make sure you continue that kind of core customer growth.

Rob Rubin:

You just created the best transition to our next segment because I just want to cover off because we covered a lot in Story by numbers and we discussed that brand share has had less influence than it used to have and why that is. But one thing we didn't say, which I just want to mention as we walk away is it still accounts for 36%. It's like that's still big. So branches are still super important in that regard even though their influence has gone down. But I thought it was sort of interesting that marketing budgets have declined yet the influence of marketing and branding has increased. And some of the big banks, unfortunately for the regional banks, they know that and they are dropping tons and tons of money into marketing. I think maybe Bank of America's flat, but I know Chase has increased its marketing budget significantly. So that's just the way that is.

So I think that this is a great time to think about a regional bank and move to our final segment today, Pretend CEO. And in Pretend CEO, we are going to pretend that Andrew is the CEO of a regional bank and his team is tasked with optimizing its deposit portfolio given the high rate environment and their branch network. So this is a good one for you, Andrew. At the highest level, what's the strategy that you would have if you're the CEO of a regional bank and figuring out how to do all of that you've just said?

Andrew Hovet:

Well, Rob, first off, thanks for the promotion. Very excited about the new role.

Rob Rubin:

You are right now.

Andrew Hovet:

Ultimately, we really think about these strategies as really kind of market-based strategies. So you need to think about your different markets in which you operate because there are differences between them. There are typically differences in the scale of branches that you have. What's your kind of branch share and market A versus market B? As well as the competitive mix that's going on in those markets. And so if you think about a typical regional bank, they typically have one or maybe a couple, what I'd describe as hometown markets, which were the headquarters for one of the maybe multiple community banks that have come together.

Rob Rubin:

Right. M&T Bank, Buffalo.

Andrew Hovet:

And Baltimore, given its legacy institutions that kind of came together. And so you typically have those hometown markets where you have a lot of branches and a lot of market share and a lot of brand awareness. And then typically what has happened is often led by the commercial business, you've branched out into new markets and sometimes some larger metro markets in order to tap into the real estate lending and the CNI lending in those markets. And maybe there's a thinner branch network that's developed in those markets. So those are very different dynamics.

And so when you're thinking about the dual objectives of one, growing your customer base, customer, that's the lifeblood. So you got to grow your customer base, but also growing your deposits, funding the bank. And in this kind of tight deposit constrained market, that often means using rate. Thinking about which markets I could use best to continue to grow core customers. And those markets where you have higher brand awareness, higher density, your marketing dollars are going to be much more efficient. So continuing to focus on growing your core customers in some of your denser markets. And then in some of those markets where frankly you don't have enough density, you don't have enough branches to really compete across the full spectrum of customers, go ahead and light them up with rate. And the other thing that does is it helps protect your hometown market so you're not pricing up the back book in your hometown market.

Rob Rubin:

So what you're saying is to sort of offer higher rates, that's what you would do as the CEO is I would, in markets where I'm thin, I would have a little bit more expensive deposits because I want to win the customers. And then in our hometown markets where we have all of the attributes necessary to win customers without doing a rate game, not do it.

Andrew Hovet:

Exactly. So you're really being thoughtful. I kind of simplified the answer, but the point is thinking really clearly market by market and what's the objective for the market? Am I thinking about core customer growth or am I thinking about more about a funding mechanism or a deposit growth? And also the efficiency or the effectiveness of my marketing spend and making sure that you're kind of balancing those investment levers appropriately.

Rob Rubin:

Well first, what about market density? Like we talked about hometown market. A hometown market for a bank might be a kind of small metro market, and some of their thin markets might be giant metro markets. So what's the difference when you in the calculus in a low dense market versus a high density market?

Andrew Hovet:

I think the key is if you realize that branches by themselves are only going to attract so many new to bank customers, and then you're going to have to layer marketing on top of that in order to drive customers in and essentially help promote whatever it is that's special or unique about your brand, you want to think about the effectiveness of that marketing. And really what we see is markets where you have relative density, where you already have higher levels of awareness, your marketing spend, your marketing efficiency is really high. In those markets where nobody knows who you are, you're often kind of spitting into the wind. And we see a lot of inefficient marketing spend in some of these big metro markets where banks have limited share.

Rob Rubin:

So do banks focus very carefully on how much revenue each branch therefore brings in? How do they attribute all those other factors that we talked about in Story by Numbers like the marketing spend, the investment in their product?

Andrew Hovet:

Unfortunately, I think banks hold all of their branches to a similar standard and don't always take into account the potential nuances of the different markets and where I am providing marketing support or where I do have higher levels of awareness. Now, the branches often cost about the same, and frankly, even in some of the big metro markets, they may cost even more. So I don't want to say you completely ignore your traditional branch profitability, but I think being really clear around what's my performance objective for my different markets and how do I measure success differently? Given that, I think it's important to think about that nuance.

Rob Rubin:

Would you as the CEO look to sort of relocating branches and markets? We talked a little bit about billboard value. What if you're not the lead chair? Maybe you're in that six to 8% range in a metro market of branch share, but your branches are old, they look like they're from the nineties.

Andrew Hovet:

Or the seventies.

Rob Rubin:

Or the seventies and they're not in the best locations for the environment of today or where that market has gone. Do you change locations? How do you think about that? How do you organize that?

Andrew Hovet:

Yeah, I think over the long haul, it's really important to be thinking about in a world where I probably ultimately need fewer locations, making sure I'm getting kind of the bang for the buck from a marketing value is really important. And what we would think is it's a little bit hard to make a business case just for a straight up relocation because the capital required for that relocation is relatively expensive.

Rob Rubin:

Significant.

Andrew Hovet:

And so often thinking about it more like a two for one, where you can take two kind of B locations and converge in a better place that gives you kind of a A location, you can make that business case often work.

Rob Rubin:

Well, that was a great answer and I would hire you as CEO if I was the chairman of the board.

Andrew Hovet:

Thank you, Rob.

Rob Rubin:

I want to thank you, Andrew. That was all the time we had for today, and I think that in Pretend CEO, that was just such an interesting discussion about why branches are important and how you would think about a brand strategy at a market by market level, really a wise way to work. And I think as we talked about, banks have to really think about how they justify their marketing expense because reducing their marketing budgets in this time, as you point out and we've pointed out is probably a big mistake. So thank you for today. This was so much fun to have you, and I'm going to have you back on the show at some point in the future. So thanks for coming.

Andrew Hovet:

Absolutely, Rob. Looking forward to it.

Rob Rubin:

Yeah, and if I'm in New Orleans, I'm definitely calling you or New Orleans. I say it properly. I want to thank everyone for listening to the Banking and Payment Show, an e-Marketer podcast. And I want to thank our editor, Todd. All right, next episode is on November 28th, so be sure to check it out. See you then. Bye everyone.