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Sherry Fairchok

What the branch means in the age of digital banking

Article

What we've been thinking: One of the most interesting studies of the recent regional banking unrest in the US—completed by The National Bureau of Economic Research—found that during the 1Q crisis, **banks with lower branch density experienced larger deposit outflows and worse stock performance than banks with higher branch density**.

- Branch density correlated positively with deposits flows during Q1 2023. A one standard deviation decrease in branch density is associated with a 4.4% net outflow of uninsured deposits.
- Or as Matt Levine concluded in a recent Bloomberg opinion piece: "**Branches make bank runs harder.**"

Double-edged sword of digital: The study suggested that while digital banking has enabled banks to grow faster and attract large numbers of customers, those deposits often consist of "hot money" that customers yank as soon as economic conditions worsen.

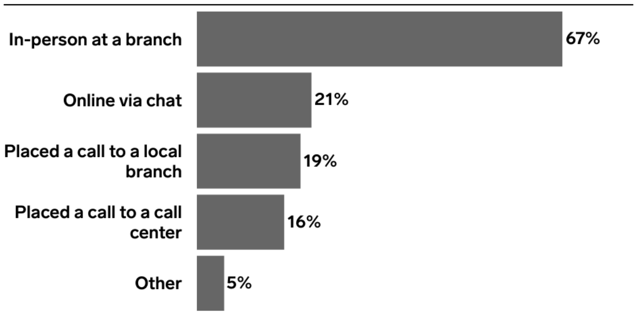
- Digital banking relationships that are purely transactional don't encourage loyalty and stickiness.
- To earn that, banks have to create a better experience and actually engage with their customers on a personal level. And that's what branches are for.

Branches promote relationship banking: When there's a whiff of trouble, the theory goes, if the bank has attracted tech-savvy business customers who are online all day, they won't hesitate to withdraw their money over the internet.

But if a bank builds branches in many small towns and cities, they'll attract "depositors who walk into the branch to deposit their money," according to Levine. "And those are the customers you want when you run into trouble."

- He writes: "If you invested less in branches and more in websites in the past few years, you were able to get a lot of deposits cheaply—but in the spring of 2023, you weren't able to keep them, because nobody was shaking hands with your website."

Channels Used for Assistance with Opening a Checking Account According to New US Checking Account Users, April 2023
% of respondents



Source: Insider Intelligence, "US Account Opening Feature Demand Report 2023," July 2023
350313 InsiderIntelligence.com

The trend: The ever-increasing dominance of digital banking has pushed financial institutions to take a fresh look at where the branch fits into the bank's overall customer experience.

- They're deconstructing what a branch traditionally was used for and rebuilding it to open it up to use cases and consumers that wouldn't have otherwise entered its doors.

The backlash to the 'vanishing branch': It's conventional wisdom that the branch is well on its way to extinction.

- Of consumers polled for a recent Bank Innovation study, 41% said that branches will one day cease to exist. Thirty-seven percent said the future branch will essentially be an ATM with advanced functionality.
- And futurist Brett King goes even further, predicting that the logical conclusion of digital banking is that the bank as an institution will fade away, replaced by banking functions digitally embedded in other processes.

How we got here: With their limited operating hours and long lines of customers waiting for a teller, branches were once just an unavoidable part of banking. Technology disrupted that. Digitization and ATMs meant that when the pandemic shut down branches, banking still happened without them. This didn't go unnoticed by banks.

- More than 10,000 bank branches in the US have closed their doors since the late 2000s—an average of three per day, according to McKinsey & Company.

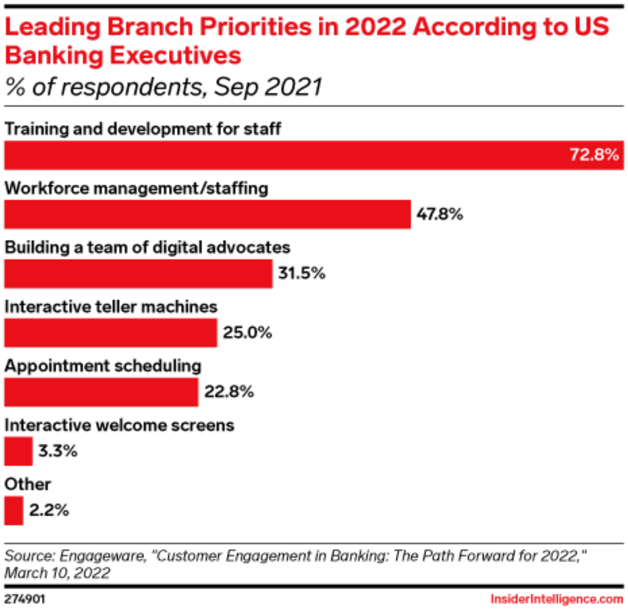
- And in the UK, the Financial Times found that **more than one in eight UK bank branches that were open at the start of 2023 will have closed by December,** with almost three-fifths of the network vanishing since 2015.

Cost cutting and closures: Reducing the geographic footprint and encouraging customers to use only the bank's digital channels has had obvious cost benefits.

- In 2019, banks worldwide spent more than $650 billion maintaining their branch network, per Accenture.
- In 2015, Bain estimated that the typical US branch requires at least 5,000 teller transactions per month to justify the cost of the operation—and said it believed that for a typical US regional bank, one-third of US branches fall below this level.
- Mobile transactions are cheaper, incurring a variable cost of about 10 cents, compared to $4 for a teller or call-agent interaction. Mobile also has half the likelihood of annoying a customer, Bain's analysis shows.

Those savings had a cost: But the cost savings from branch closures have come at the expense of personal relationships, which lead to a deeper understanding of the customer's needs and intent. Without face-to-face interaction, most banks struggle to maintain close, loyal relationships.

- Because banks don't really own any physical or truly differentiated products, digitization has put the industry onto a commodity path. Most people would struggle to explain the differences between one bank and another.
- **Digitization led to depersonalization.** A recent Accenture study points out that while banking apps have made customers more self-reliant, it also made it easier for customers to switch. And it generally made banking a lot less personal—the opposite of what's needed to succeed today. Banks must personalize their customer interactions to improve retention.
- Switching is easy, and likely to get easier when open banking arrives in the US, making loyalty even more paramount.



What it means: Building consumers' confidence in the brand through accessible support, encouraging brand immersion, and creating a hub for learning about finances will help financial institutions keep up with consumers' changing needs and ensure that the physical branch continues to offer a return on investment in banking.

A premature obituary for the branch: This isn't the first time branches have been pronounced dead and defunct. When ATMs were introduced in the 1970s, people thought they'd end the branch. (Spoiler: They didn't.)

- Though there's been a migration from the branch to the ATM to online and then to mobile, these various ways of banking have continued to coexist.

And we expect that to continue. Asking about whether anyone will still go to the bank branch is a lot like asking whether people will continue to shop in brick-and-mortar stores, go to their doctor's office for an appointment, or commute to their workplace.

Yes, they will. But those experiences and the environment in which they happen will be different from what they used to be. And consumers will have more choices when it comes to meeting their various needs.

- In a bifurcated banking environment, straightforward transactions will continue to happen on self-service apps, while branches redefine their role to complement, rather than replace or compete with, digital channels.

- Accenture's study reveals an intriguing insight—**despite the prevalence of digital interactions, nearly 63% of respondents admit that most of their mobile banking log-ins revolve around checking their account balances.** The depth (or lack thereof) of digital relationships risks falling short of fostering true customer engagement.

Where does the branch fit into the digital world? Reviving the branch isn't an exercise in nostalgia or a Luddite victory: Banks won't pivot away from digitalization. Instead, what's recommended is what Accenture calls **a "horses-for-courses approach,"** which plays to the strengths of each channel. Bank branches will be transformed into part of an integrated customer experience that spans multiple banking channels.

- With fewer customers coming into the branch for routine transactions, banks can shift their focus to providing a high-quality customer experience for those who do show up.
- Banks will encourage branch visits for lower frequency, higher-order tasks—such as getting financial or investment advice, taking a loan, and refinancing a home

Branches build relationships: Net deposit outflows for three quarters in a row have made retention critical. Building robust relationships, fostering loyalty, and cultivating trust are the remedy. Financial institutions need to rekindle personal conversations with their customers.

- Bank branches will be an integral part of a new social interchange, a place to build valuable customer relationships, focusing on sales and advice while encouraging customers to go online for routine transactions.
- Treating customers holistically, individually, and intimately can make a huge difference—the value, achieved through building up loyalty and easing the need to compete on price, is significantly greater than the cost.

Enter financial wellness: Banks also will be shifting their emphasis from meeting specific needs and selling individual products to talking about improving customers' general financial well-being. Branches will help banks learn more about their customers, show interest and empathy, offer advice, and build loyalty. They'll show customers how to manage their finances better.

- A focus on advice and education demonstrates to customers that their bank views them as partners in a mutually beneficial relationship.

- Dedicating physical spaces to advice and financial education will also help banks place themselves among industries that no longer view their customers solely as a way to make profits. This gives the bank a larger purpose in the greater community.
- This helps the bank move beyond a transactional marketplace where the value of a customer is equal to the sum of the products they use, to one where a more lucrative multiplier effect is at work.

Financial education has value: Even non-personalized advice or financial education material and staff educators can fill a needed gap for many.

- 77% of Americans admit to some level of financial anxiety, in-branch or digital banking assisted by a consultative expert can be the ideal remedy.
- 45% of consumers indicated their family or friends aren't very confident with finances, including investments, budgeting, managing debt, planning for retirement, or deciding which financial products they need.
- 43% of Americans live paycheck to paycheck, financial literacy and advising is more important than ever.

Our take: Banks that provide a differentiated in-person experience for needs that require a human touch are likely to see more traffic and greater usage of their branches for high-value tasks.

- In many cases, this will include offering nonfinancial products that help customers deal with challenges in housing, mobility, ecommerce, and more (which surveyed consumers want).

Coming next in this series: *A look at what customers think of branches.*