Spotlight

GALAPAGOS LLC

Bricks and Bits

The value of branches in a digital world

Does more technology inevitably lead to fewer bank branches? In some segments of the industry, that seems to be the case.

Bank of America, for instance, pared its branch network by nearly six percent in 2014 alone, citing the growth of mobile banking and a corresponding decrease in branch traffic as the catalyst. If customers can carry our bank in their hand, the thinking goes, why do we need all these expensive branches?

Brett King's "Bank 3.0," a seminal examination of the digital wave that's washing over the industry, captures the gist of the sea change; "… banking is no longer somewhere you go but something you do."

The subtext of King's commentary is hard to miss. If banking is no longer somewhere you go—because technology has changed the calculus of convenience—it must be time to reconsider the viability of bank branches. By and large, the industry has been doing just that, trimming about 1,000 branches a year since the beginning of the decade, with bigger banks being the most aggressive.

For community banks, though, the inverse relationship between technology adoption and branch presence might not be so straightforward. That's the conclusion of research conducted by Galapagos LLC, a community bank marketing consulting firm. Galapagos surveyed bank customers nationwide to better understand how and why they use various delivery channels.

The key takeaway? The role of community bank branches in serving existing customers may well be ripe for reevaluation. When it comes to capturing new customers, though, branches remain indispensable.

"The industry has been trimming about 1,000 branches a year since the beginning of the decade."

A stubborn value proposition

For community banks especially, the tension between delivery channels isn't a question of either-or; it's a question of balance.

Nowadays, after all, there's little point in referring to Web and mobile banking as "alternative" delivery channels. Considering the industry is already serving a legion of youthful customers who have never known life without the Internet, it's clear that yesterday's alternatives have become today's essentials.

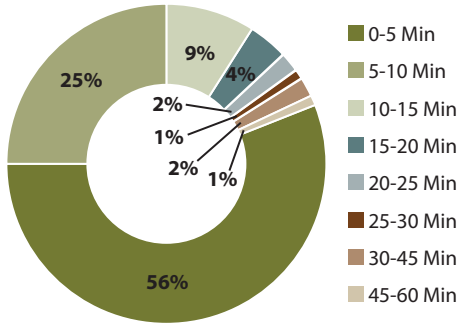
That said, while community banks are doing a reasonable job of keeping up with technology, they'll likely always struggle to stay on the vanguard. They simply can't match the resources of the big guns.

What they can do is recognize that their branch network is a competitive advantage worth nurturing.

Why is it so important? Galapagos research indicates that branch proximity is the main reason people choose where to bank. As **Table 1** shows, more than 80 percent of account holders live within 10 minutes of their nearest branch. Extend the drive time to at least 20 minutes and there are hardly any account holders left.

Table 1

Branches Drive Sales



Average drive time to a branch for a consumer checking is 6.5 minutes.

Source: Galapagos LLC, 2014

On the other hand, whether customers live a minute away or an hour away has little bearing on how likely they are to use electronic services like debit cards, online banking, bill pay and e-statements. Customers might see e-services as a

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nice perk, but they're hardly the controlling factor in deciding where to do business.

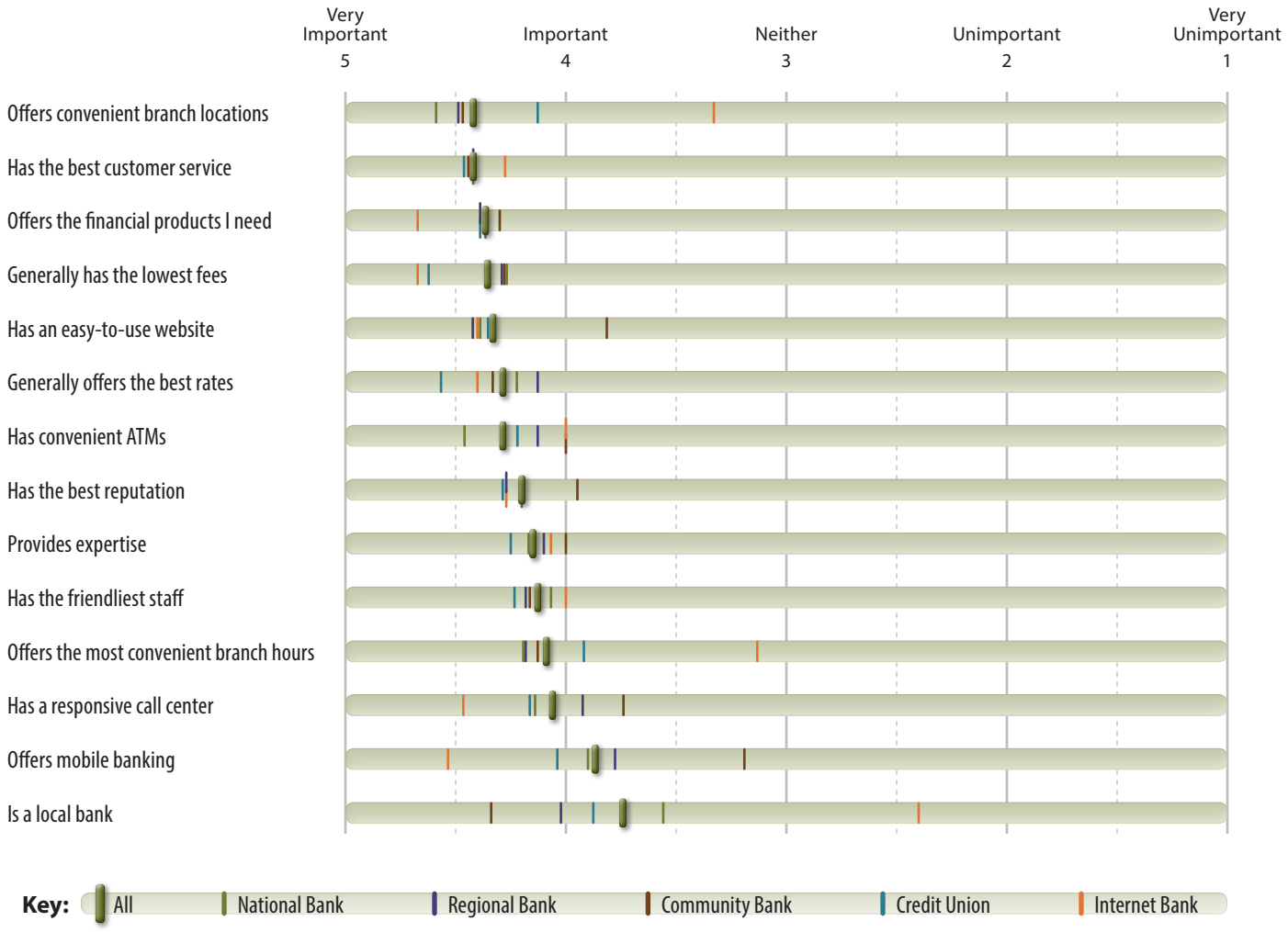
What's more, community bank customers seem especially apt to prefer proximity over technology. Asked to gauge the importance of various attributes when choosing a financial institution, they placed "convenient branch locations" at the top and ranked "working with a local bank" higher than did customers from other types of financial institutions. Meanwhile, they placed a somewhat lower priority on technology services like mobile banking and an easy-to-use website. (Table 2)

Dig deeper into the Galapagos research and you'll find even more data to support the notion that branch obituaries are a bit premature.

- 69% of respondents said having a branch nearby is very important (74% of community bank customers.)
- 22% claimed they would switch banks if the branch most convenient to them closed (30% of community bank customers.)
- An overwhelming majority of respondents (87%) still have a face-to-face interaction with their primary financial institution at least once per month.

Table 2

Importance of Various Attributes by Financial Institution Type



Source: Galapagos LLC, 2012

"The choice between electronic and face-to-face interaction hinges on whether the task at hand is transactional or consultative."

Overall, the findings suggest the fundamental value proposition of brick and mortar still holds: Customers like the reassurance of a physical branch presence and the option of face-to-face interaction. Why such reluctance to part with the personal touch? Table 3 offers some insight.

Clearly, the choice between electronic and face-to-face interaction hinges on whether the task at hand is transactional or consultative. For the most part, bank customers are perfectly comfortable using electronic channels for routine things like transferring money and checking balances. Once things get more complex, though—opening an account, applying for a loan—they express a marked preference for face-to-face.

New branch strategies

This tendency to see value in the consultative role of branches prevails across all age cohorts. How long this attitude will persist, however, is an open question.

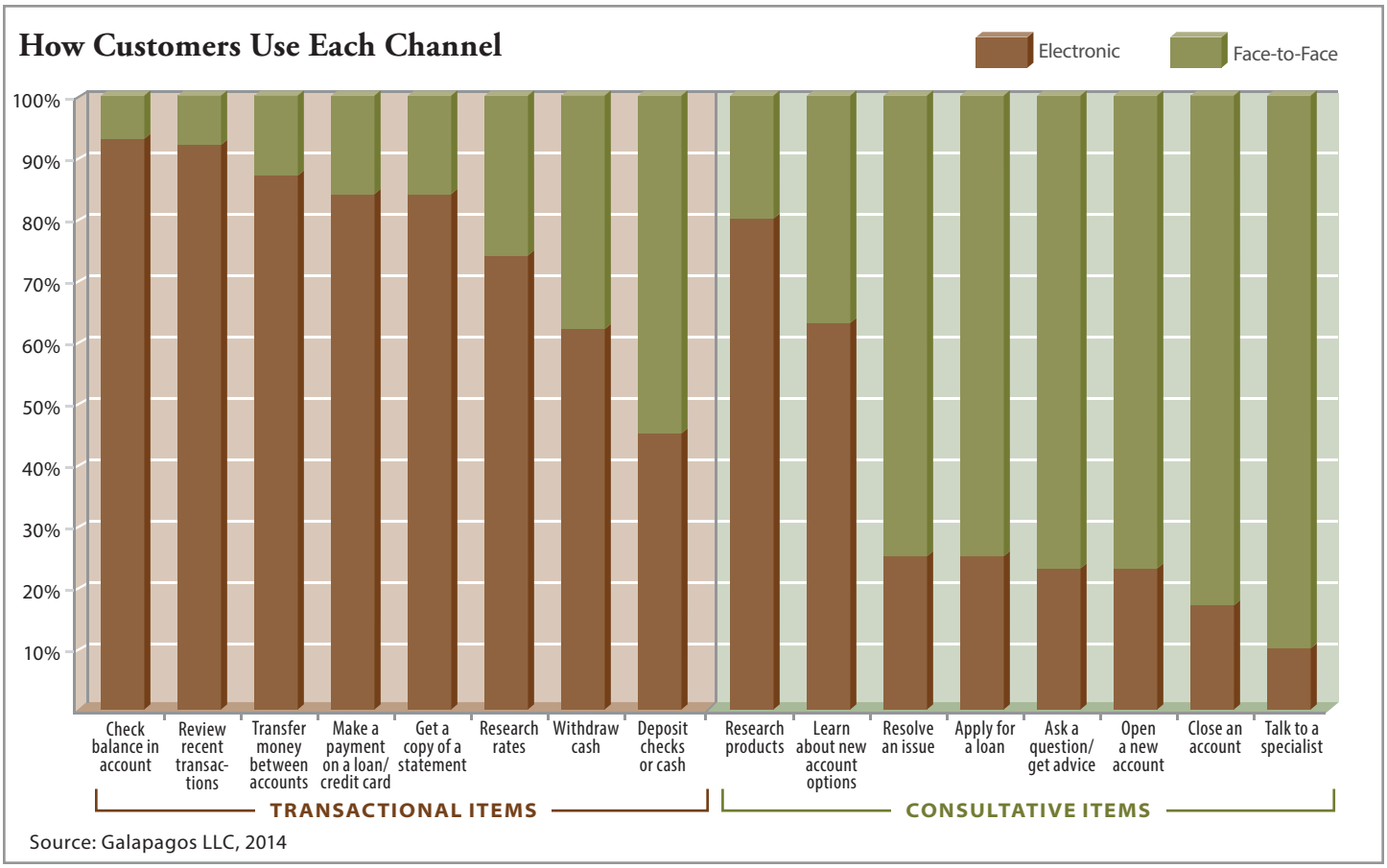
Wander the Web and you'll find plenty of examples of changing times. Online lender Kabbage has funded $400 million worth of small business loans in its first five years. Strictly mobile GoBank snagged $600 million in deposits within two years of launching. And Quicken Loans closed $85 billion dollars worth of mortgages last year with nary a branch.

As consumers become increasingly comfortable clicking for financial products that once required consulting, community banks will find themselves scouring for ways to maintain the competitive advantage of their branches. This new branch strategy could take any number of shapes. Here are three possibilities:

Fewer stores, more choice

Call this one the Walmart model. The retail behemoth might be devoting more resources to eCommerce nowadays, but its stores continue to deliver a distinct value proposition—one that revolves around choice. After all, most customers

Table 3



Source: Galapagos LLC, 2014

can find everything Walmart offers closer to home. They make the drive to Walmart because they prefer the convenience of finding everything in one place.

Community banks could take a similar tack, reducing the cost of delivery by maintaining fewer branches, but expanding the services available in the branches that remain. What might be offered? Perhaps things like tax preparation, wills, travel services… even funeral planning. The Galapagos research found that 83 percent of respondents expressed interest in the idea of branches becoming financial superstores.

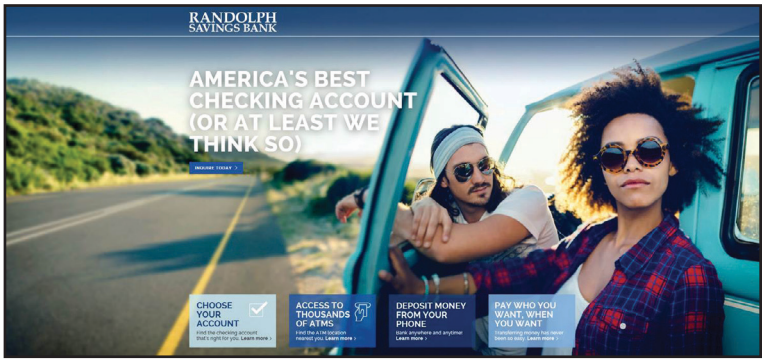
Specialty stores

Instead of expanding services, maybe a narrower focus is the way to go. Look to Edward Jones for inspiration. The sprawling financial firm doesn't try to do everything, but instead targets only investments. It's a winning formula. Edward Jones has been opening offices at a brisk pace since the early '80s and now has nearly 12,000 in North America and plans for many more.

How might specialization work for community banks? One approach might involve crafting specialty branches that focus on serving promising market segments, perhaps small business or pre-retirees. The goal? Fewer visits of higher quality, meaning convenience wouldn't matter as much. Specialty branches would create clear competitive differentiation, while acknowledging that the traditional role of branches is being usurped by digital alternatives. In the Galapagos survey, 57 percent of respondents thought the idea held promise.

"Delivered via a micro-site strategy, banks are able to reinvent and reposition themselves to compete more effectively."

Image 4



Streamlined branching

Huntington Bank has been a pioneer with this strategy, closing scores of traditional branches while opening smaller branches embedded within supermarkets. The advantage? Inexpensive market entrance and broad market coverage. The disadvantage? Relatively rich operating costs, since supermarket branches are open longer hours.

So far, the convenience of supermarket branches hasn't translated into robust account acquisition, perhaps because they lack gravitas. Industrywide, average deposit totals for supermarket branches are less than $6 million after five years, about a third as much as the breakeven benchmark for standalone branches. Perhaps this will change as customers become more comfortable with the idea of banking where they buy groceries.

Of course, there's always another choice for community banks: Decide that virtual banking is the future and go all-in. Resolve to win the mobile channel, while putting branch banking on the back burner.

The problem is that modest IT and marketing staffs and limited resources make this strategy especially difficult. Then, too, it pretty much jettisons the brand advantage of being a local community bank.

One strategy that has traction is developing smaller, more specialized digital storefronts to compete for those customers who have little interest in a traditional branch. Delivered via a micro-site strategy, banks are able to reinvent and reposition themselves to compete more effectively. (Image 4)

The bottom line? Branches are still enormously important to community banks, more for attracting new customers than for the convenience of existing ones. In the current landscape, the branch network remains more asset than liability.

But as technology makes greater inroads—and consumer attitudes change accordingly—the challenge will be to find new ways to deliver a competitive advantage via brick and mortar.

For more information on the Galapagos Channel Usage Research Study or to discuss your omni-channel strategy, contact us at 616-608-7359 or visit www.galapagosmarketing.com.