WHITE PAPER

A RATIONAL APPROACH TO BRANCH RATIONALIZATION

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Challenging times accelerate branch closings

The headlines of the banking trade press fill with headlines of bank branch closings – whether through consolidation, sale or outright closures. Given the growth of digital banking and the reluctance of consumers to visit branches in today's world, financial institutions are rationalizing their retail networks to match these continuing trends. This is seen in snippets from recent headlines:

Byline in Chicago joins list of community banks closing branches (American Banker)

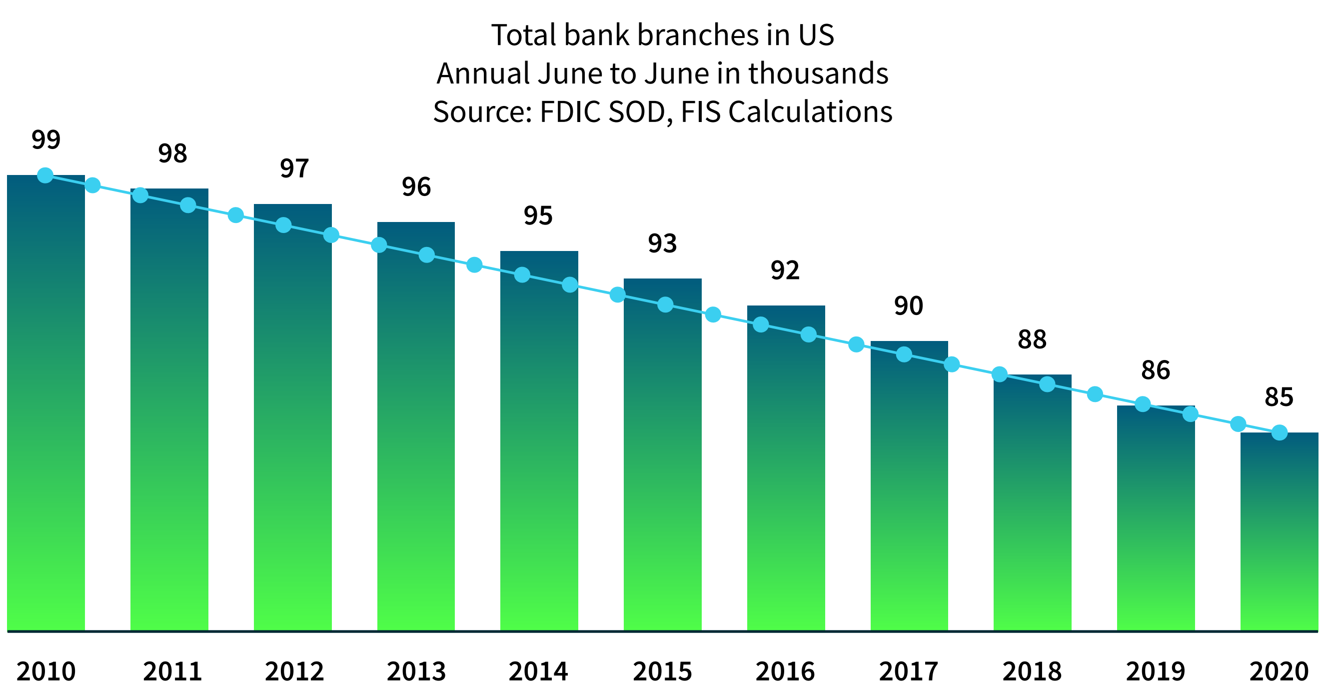
First Commonwealth to close a fifth of its branches (American Banker)

PNC, Key Bank to close more branches (Fox Business)

Englewood Cliffs, N.J.-based ConnectOne Bank intends to close four branches (S&P Global)

Orrstown Financial initiates cost-saving measures (S&P Global)

Industry research supports these headlines. According to data compiled by FIS from the FDIC, the number of overall bank branches was in decline even before COVID. Based on this same data over the past five years, U.S. banks have closed 2.5 times as many branches as opened new branch locations, signifying the extent of the continual restructuring of this traditional delivery channel.



Indeed, the rapid expansion of digital channels in response to COVID-19, and the challenges presented by this expansion, are serving to accelerate implementation of previously planned reductions in branch networks. But the need for personal service and the human touch remains. Users of digital banking still want access to people at their bank.

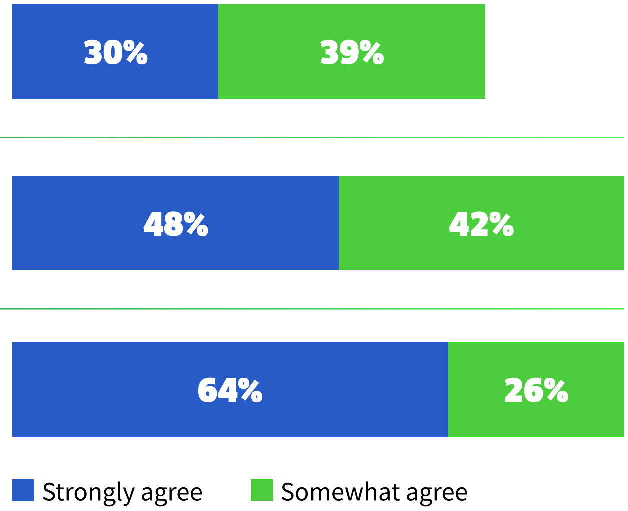
Banks understand that digital customer engagement is more important than ever before, but not to the exclusion of in-person engagement as shown in recent research below.

To win, banks must excel in both digital and in-person customer engagements

The impact of COVID-19 will be much like the financial crisis or other past, significant recessions.

Mandatory shelter in-place will be much like the financial crisis or other past, significant recessions.

Firms that excel in both digital and in-person human-to-human customer engagement will win in the “new normal”.



Source: Celent, September 2020

As banks still need to deliver personal interaction and some advisory services, most find they continue to need branches. The key to profitable, long-term success in any business is taking a rational approach – which stores to close, which to keep open, and which to invest in.

The good news is there is a balanced approach to making these rational decisions.

Where to start a rationalization evaluation

Enabling Technology	Products	• Market potential • Product development • Promotion and advertising • Sales goal targeting
	Personnel	• Recruitment, selection, training • Staff allocation • Incentives and rewards
	Process	• Sales management • Service quality/Customer retention • Administration
	Places	• Expansion • Consolidate/close • Swap • Alternative channel effectiveness

The key to any branch rationalization analysis is to understand current performance and the potential to improve results, given market realities.

The graphic to the left shows the key drivers of branch network performance and highlights the critical considerations to apply when evaluating options to improve overall effectiveness.

The following is a proven framework for evaluating any branch or group of branches to choose an appropriate course of action to enhance an overall cost-effective funding source and revenue generator. Closing a branch is the last step to take and only when other alternatives are evaluated and determined ineffective.

Key to fair share analysis and network rationalization

CONTRIBUTION ANALYSIS

- Evaluate current analytical approach - EVA, marginal cost, profitability
- Ability to satisfy business needs?
- Alternative approach and new analysis

MARKET POTENTIAL ASSESSMENT

- Evaluate market potential and ability to meet potential
- Identify and quantify potential value of obtaining fair share of market
- Establish branch level sales expectations based on potential
- Define periodic reporting to reflect progress versus expectations/targets - progress acceptable

PRODUCTS EVALUATION

- Complete competitive analysis - features, function, T&Cs, etc.
- Evaluate marketing program effectiveness
- If inadequate, develop new programs to support lead generation/campaign management
- Define periodic reporting to reflect progress versus expectations/targets - progress acceptable

PERSONNEL AND CAPACITY ANALYSIS

- Evaluate recruitment, selection, training allocation and enhance if needed
- Assign staff based on skills matched to market needs
- Assign sales targets based on market potential and measure progress acceptable

RATIONALIZATION INITIATIVE

- Identify changes required - relocation, consolidations, sales, swap and closure.
- Complete exit analysis/retention analysis
- Develop communication strategy for all stakeholders
- Develop and execute plan

Step 1: Is the branch or are the branches in question satisfying profit contribution objectives?

The discussion about generating a profit that is at least equal to the risk-adjusted cost of capital deployed to support a branch is critical. Achieving marginal profitability is not the same as enhancing shareholder value (or generating a reasonable dividend/ interest payment to mutual depositor owners).

The efficacy of the financial modeling is also critical and should consider at least the following key elements:

- Account for a branches' physical configuration to include technology such as cash dispensers, ATMs, in-store online access, etc. These activities could continue in a branch that is oriented to sales while also providing a means for those with no digital access to conduct business.

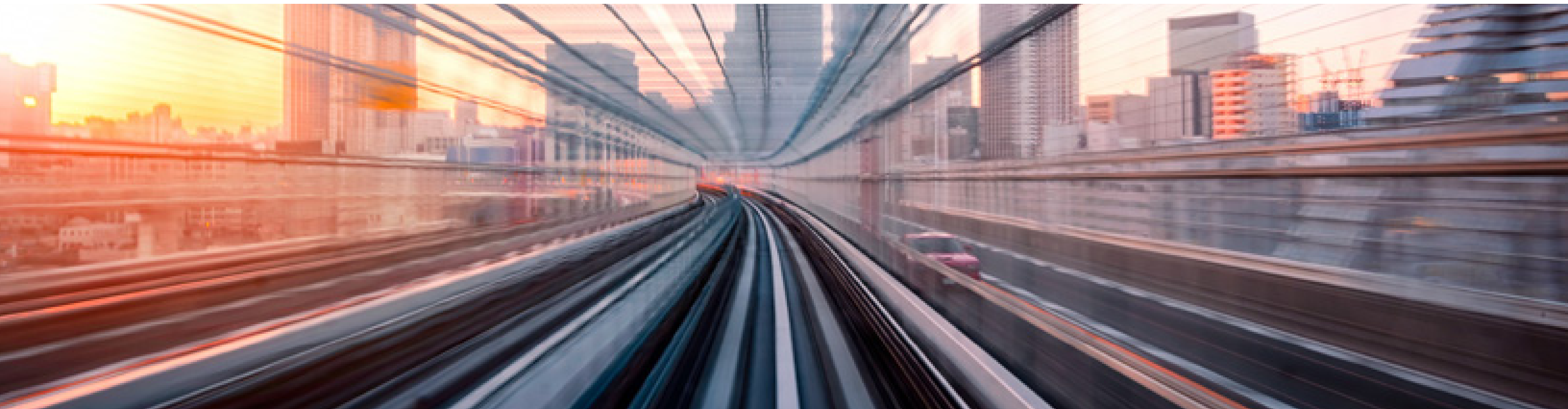
- Credit for services provided to account holders not domiciled in the target office. While many banks re-assign deposits to the locations where the customer is most often serviced, many do not. At least on a pro forma basis, credit for this inter-branch servicing must be made to understand the actual financial contribution of a location. The same information used to determine financial results is also critical to understanding which customers are actually banking in the office and will be impacted by any decision to consolidate or close a location.

- Ensure the interest income earned from branch-based loans is adjusted for loan loss provision expense rather than simply reflecting gross yields.

- Determine a normalized transfer pricing credit rate for excess deposit balances generated in the branch. Today's historically low cost of funds is likely not the long-term value of these deposits, and these extremely low rates distort the value of core deposits over the long run.

- Consider unallocated expenses, particularly overhead costs for administration that are variable. Regional and district personnel are the largest category of such expenses. This staff exists in some relationship to the number of branches in total in most organizations If the number of branches are reduced, this overhead component should also be adjusted. Identify and include other unallocated but variable expenses that fit the same criteria (e.g., in many organizations, telecom expense is difficult to allocate and is absorbed centrally but will clearly decline if the office is closed or consolidated).

- If the running rate contribution of the office is inadequate to satisfy the bank's financial goals, a secondary analysis of the cost to close the facility will eventually be required. This analysis, as with any investment decision, should be viewed as a longer-term decision – otherwise one-time costs (while a cash flow reality) will distort the understanding of the full benefit of existing the location. Consider a five-year net-present value analysis when evaluating a closing decision.



Step 2: Is a branch is falling short of required profit contribution?

The next step in the process involves evaluating the potential of the market served by the branch to support a profitable operation. The objective of the analysis is to understand what a fair share of any given market holds in the way of potential; contrast the share of business already being held by the branch and put a value on the gap between current and future business. A myriad of providers of demographic and customer valuation models service the financial industry. Firms such as Claritas conduct regular statistically valid surveys of market characteristics and provide a range of information that is useful to understand everything from a bank's share of business, to insights about the overall potential to use a full array of financial products and services down to the census tract level.

The key questions to be answered to gain a clear understanding of upside potential include:

- What business does the bank service in each census tract that is supported by a branch today?

- How does that compare to the estimate of available business, assuming that the branch captures a fair share of the potential?

- Will a fair share of the available market potential produce a viable profit contribution from the office?

The foregoing assumes that the bank's customer records and household data are valid and that appropriate geo-codes have been appended to the data to allow comparison at the tract level. Remedial work may be required to address shortcomings in the data before starting the comparative analysis.

Step 3: Competitive Product Evaluation

Deposit and credit products are in their greatest period of change in the past 25 years, thanks to regulatory and statutory changes and the overall credit environment.

In addition to these changes, there is the simple fact of ever-expanding digital channels. This includes even the now unknown alternative channels and evolving customer preferences to layer on top of changes to fundamental underlying products. The unsettled nature of offerings creates both confusion and inertia.

FIS has two observations related to this continuing evolution: First, uncertainty is going to continue and, second, profitability will continue to be under pressure. Waiting for perfect insight is impractical and a deterrent to improving profitability. FIS' point of view is that sufficient insight is available from competitive market surveys to move forward in adjusting products and services to the extent that an evaluation of market trends shows your institution to be lagging with regard to the array of products in demand by the segments evaluated in Step 2.

A large number of quality market research organizations are focused on updating and maintaining current competitive data for banks, thrifts and credit unions.

Step 4: Re-evaluate Personnel Practices

FIS client engagements throughout the country have found the following impediments to improving branch effectiveness to be all too common:

- Inadequate criteria for identifying the characteristics of effective sales staff and recruiting qualified staff
- An emphasis on one-shot sales training seminars as the solution to creating a sales environment
- Failure to align sales staff with appropriate skills and knowledge against quantifiable market potential
- Misalignment of sales goals and incentive programs that fail to consider market potential or reward gross account opening rather than net business growth
- Inadequate management reporting resulting in a lack of visibility to aid sales management
- Inadequate performance evaluations, coaching and remedial action to address short-comings

Each of these can be addressed with proven techniques. In virtually every case we have observed, the changes have improved overall sales effectiveness in markets that have upside potential.

Conclusion

When Steps 2–4 fail to provide the desired improvement opportunity, it is time to consider consolidating, closing, or selling the branch(es) that continue to fall short of a viable credit contribution.

Contact us

For more information on FIS Business Consulting and how a Branch Rationalization engagement can help your bank, contact your FIS Account Executive.

About FIS

FIS is a leading provider of technology solutions for merchants, banks and capital markets firms globally. Our more than 55,000 people are dedicated to advancing the way the world pays, banks and invests by applying our scale, deep expertise and data-driven insights. We help our clients use technology in innovative ways to solve business-critical challenges and deliver superior experiences for their customers. Headquartered in Jacksonville, Florida, FIS is a Fortune 500® company and is a member of Standard & Poor's 500® Index.

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