The branch closure foxtrot

Fast, slow and then fast again

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Just two years ago the big banks were closing lots of branches. This raised concerns at the time – in the press, and from Government – about the impact on customers and particularly their access to cash. The closure rate slowed, but more recently, during the pandemic, they've sped up again.

The question is, should we see the reduction in branches as the inevitable advance of, and customer preference for, digital banking, or is that just a convenient cover story for the banks to cut costs?

Of course, it's no surprise that during the last 12 months foot-flow to branches has reduced and digital banking has increased. This behavioural change in customers is driven by the instruction that they stay at home. And it's not just banks, retailers have experienced exactly the same thing, with a much larger proportion of sales moving online – a trend that is almost certain to continue, even when we're released from the cycle of lockdowns.

The forced changes in behaviour have led customers to try something different, and over the past year reluctance has moved to acceptance, to familiarity and now, for some, active positive choice. In a year, antagonism has shifted to advocacy.

But the on-going debate of digital vs. physical raises two key questions about differentiation:

1. Channel differentiation

   Are the same products and services being offered online and in-branch? And if not, then which channel(s) will customers choose for which services?

2. Brand differentiation

   Will banks 'me too' approach to digital set them apart or play into the hands of the competition? Or to put it another way, if traditional banks and building societies close their branches, will the loss of this key differentiator lose them ground to their digitally native neobank competitors?

Channel differentiation

Online offerings have often been developed in parallel to physical stores, and the cost-to-serve advantages of an online business have led business to incentivise customers to shop online. However, it's not all good news. For example, many media companies have offered free access to online content only to see a drop in physical circulation and a decline in profits.

There are parallels in retailing too, where consumers have experienced clear advantages of shopping online: greater choice, more stock (including your size), 24/7 opening; along with the downside of not being able to examine the items up close, or being able to try them out or try them on.

And so, the high street has been hit hard – from the bottom to the very top.

The recent store closure announcements by John Lewis Partnership are a stark indicator of a growing trend. But it was a long time coming. For many years, their website and app have offered more brands, products and choice than their stores. It will be interesting to see what changes they make now across their large remaining estate, including Waitrose stores.

The warning which banks should heed is that they should take extreme care to consider the longer-term implications of every action, to avoid building a future where they will be poorly placed versus the competition.

Brand differentiation

An important lesson from the recent past is that businesses must take great care with every component of their brand – to make sure that their purpose, products, channels, and their marketing/PR are all aligned with the changing demands of their customers.

Building a successful brand strategy means looking to remain one step ahead of the competitor, by anticipating existing and new customers' expectations. A 'me too' strategy that follows the pack is unlikely to be successful long-term, and risks leaving large banks unable to manoeuvre fast enough to keep up with the more nimble competition.

What's next for the UK bank branch?

Over the past decade, the UK banking industry has seen a sharp reduction of branch networks. The exceptions, like Handelsbanken and Metro Bank, are notable, but rare. The recent acceleration of planned closures raises the question of whether this is short-term cost-cutting or as part of a long-term strategic shift to digital.

	No. of branches		Cost: Income ratio from last available accounts	
	December 2018	December 2020	End of 2020 Financial Year	Latest accounts
Lloyds Group	1700	1,567	55.3%	31/12/20
Barclays	1058	859	68.0%	31/12/20
NatWest (includes RBS)	797	753	72.9%	31/12/20
Santander	766	564	47.0%	31/12/20
Nationwide	c.680	c.650	68.7%	30/09/20
HSBC	626	593	68.3%	31/12/20
TSB	551	454	92.5%	31/12/20
YBS (includes agencies)	c.240	c.240	w60%	31/12/20
Handelsbanken	208	204	54.5%	31/12/20
CYBG Group	159	233 (combined)	59.0% (combined)	30/09/20
Virgin Money	81			
Coventry	86	86	61.2%	31/12/20
Co-operative Bank	68	50	113.8%	31/12/20
Metro Bank	62	77	143%	31/12/20
Principality	53	69	78.8%	30/06/20
	7,135	**6,399**		

Source: Johnston Carmichael research

The 'Big 5' banks – LBG, RBS, Santander, HSBC and Barclays – along with other major financial institutions, have significantly reduced their branch footprint. In total, across the major retail banking and building society brands, the UK ended 2020 with just under 6,400 branches. And there are more closures to come.

According to Which?[1], Barclays plan to close 63 branches in the first quarter of 2021 alone. HSBC are expected to close 82 branches – one in seven of its UK branches – and reduce its branch network from 593 to 511 outlets. All but one of the planned closures are within one mile of a Post Office and HSBC is offering its customers training in how to bank digitally in a safe and effective way.

[1] Source: https://www.which.co.uk/news/2020/09/tsb-to-close-164-bank-branches-in-2021/ - Which?

Meanwhile, Virgin Money is pressing on with plans to restructure their network by closing 22 branches and consolidating 30, while Lloyds Banking Group is expected to close 56 branches in 2021. TSB plans to close a further 164 of its branches in 2021, and this is in addition to the 82 branches that the bank closed in 2020. Plus, in March 2021 Santander announced 111 further branch closures.

Back in 2019, NatWest pledged to close no more branches until at least May 2021 but we could reasonably expect more closures to come from them too.

There's no doubt that cost reduction is one of the banks' objectives, as revealed in the Cost: Income ratios in the table, above. There is significant room for improvement for most but they also face a lack of revenue opportunities in an age of historically low interest rates, coupled with the higher debt provisions that have been put in place in anticipation of higher defaults and losses in the wake of the pandemic.

All these banks will say that branch closures are inevitable because of the growing popularity of banking via smartphones and tablets, which plainly reduces foot-flow in branches. Like retail that has accelerated during the pandemic, it was very telling that as far back as February 2014, Ross McEwan, then RBS CEO, said his busiest branch that year was, "the 7:01 (train) from Reading to Paddington". He said that, "over 167,000 of our customers use our Mobile Banking app between 7am and 8am on their commute to work every day". And even though, right now, the commute isn't quite the event it was, digital banking use has never been higher.

Looking back

Since the 1980s, banks have been encouraging, or at times forcing, customers to use more cost-effective distribution channels – initially through telephone banking and more recently via online and apps.

Although customer dissatisfaction with banks peaked after the financial crisis in 2007/08, switching has been unpopular. This is despite various switching initiatives and with many banks offering substantial 'bounties' for consumers that move their primary bank account to them. The secondary account market is also very popular, and that has fuelled the growth of neobanks customer numbers like Monzo, Starling and Revolut.

Also, over the last 10 years Financial Services regulators have made it increasingly difficult for banks to sell more complex products such as investments, life protection and mortgages with the requirement to evidence the advice given, placing the burden of proof on the banks. Both the Retail Distribution Review (and Mortgage Market Review) have significantly reduced the level of complex products distributed via branches.

Is the end of branch banking inevitable?

According to PWC and the Local Data Company, 17,532 retail outlets closed in the UK last year – an average of 48 per day. There were also 7,655 store openings, resulting in a net loss of 9,877 outlets – the biggest decline for a decade.

City centres have seen the most closures, with fashion retailers and betting shops the worst hit, while takeaways and fast-food outlets saw some growth. The report also highlighted regional differences, with London hit harder than other regions and London and the South East together making up a third of all closures.

So, our high streets have changed, with some big-name retailers like TopShop, Oddbins and HMV failing. This failure rate has accelerated dramatically during the pandemic, as have store closures, including some of the biggest brands of all, like John Lewis Partnership, H&M and Marks & Spencer.

One small glimmer of hope for the high street came when online behemoth Amazon announced plans to open on the high street. The resulting Amazon Fresh store in Ealing, West London, mirrors similar stores in the US, and suggests the digital giant recognises the value of a physical presence. Interestingly, the store supplements rather than replaces its online offering, by providing fresh produce, a click-and-collect point, and a returns service. Also, in a unique customer experience, shoppers check-in to the store using their smart phone, pick up goods and then walk out, rather than check-out, being automatically charged for what they have picked up and packed.

In other research, a report from Self Financial suggests a significant change in US bank branch structures with American bank branches predicted to fall from almost 83,000 in 2012 to less than 16,000 by 2030. Bank branch numbers in the US have fallen by 6.5% since 2012 and based on current trends all bank branches could close by 2034.

This leads us to the key question: are bank branches an endangered species, destined for extinction, or are our big banks overlooking the valuable service they provide to consumers and the banks' investors. To consider this question we need to examine what customers want from their banks and how recent decisions have created a set of paradoxes relating to the decisions taken to close branches.

The paradoxes are grouped in three areas.

Regulators' Need

Paradox 1 - Financial systems integrity

Customers' Need

Paradox 2 - Guidance to cut through the complexity

Paradox 3 - Access to cash

Banks' Need

Paradox 4 - Reliable access to funding

Paradox 5 - New customer acquisition

Paradox 6 - Purpose

Paradox 7 - Differentiation as a brand beacon

Paradox 1 - Financial systems integrity

More and more consumers are becoming digitally active, with mobile devices accounting for as much as 90% of interactions with a bank or building society, and as a consequence, banks and individuals are more exposed to malware and cyber-attacks than ever before.

When digital failures or cyber-attacks occur, and affects a bank's website or app, there is a clear reputational risk. Also, with increasing reliance on cashless payments, any failures represent a bigger risk to the banks' operational resilience, and from a central bank and regulators perspective, systemic failure.

During TSB's platform migration from LBG systems to the platform of their parent, Sabadell, the customers affected were unable to talk to a human via TSB's call centres or branches due to demand far exceeding capacity.

In the event of digital blackout, the lack of branches reduces the option to manage operational resilience and protect against reputational risk. This impacts banks and the integrity of the financial systems that it is the regulators' duty to preserve.

Paradox 2 - Guidance to cut through complexity

Face-to-face interactions are better for handling complex queries or providing advice, yet few banks offer these services in branch.

Increased regulatory scrutiny of banks and requirements imposed, associated with providing customers with advice, have made banks nervous about offering this service. Many banks have courted mortgage brokers to help gain market share and ease their regulatory burden. As a result, the IRESS Mortgage Efficiency Survey 2020 revealed that the broker share of the mortgage market is now 80%.

But not all customers have access to – or want to swap over to – digital banking, and most consumers say they still value face-to-face for complex or higher value transactions such as applying for a loan, reporting the death of a family member, buying a home or retirement planning. This face-to-face support will become increasingly scarce as banks willingly concede part of the value chain to intermediaries and digital channels.

Helping customers with financial products that materially change their lives is something that builds trust and engenders loyalty. The short-termism of banks off-loading part of their regulatory responsibilities to brokers & IFAs and reducing their distribution of advised products, may be something they regret as customers' will buy financial products and services from more providers. The lack of an effective Savings to Investments continuum in the post RDR world, means that banks may well lose the pandemic-induced increased saving balances to other providers that offer investment products.

Paradox 3 - Differentiation

Bank branches have always been places to pay-in and withdraw cash, but with the reduced reliance on cash in the UK, those still reliant are not the target demographics for banks and building societies.

The demise of cash is much vaunted and in 2019, according to UK Finance, card payments represented 51% of all payments whilst cash payments now represent just 23% of all payments.

This data, which predates the pandemic, showed growth in contactless payments that now represent more than 21% of all payments and this will undoubtedly have contributed to less cash in circulation, especially in our urban areas.

Before the pandemic, UK Finance predicted that by 2028 notes and coins would account for just 9% of all payments, however, that could still leave around 2 million adults disadvantaged by the lack of access to cash.

In his budget in March 2021, the Chancellor committed to introducing new laws to make sure that everyone who needs cash can continue to access it. The Treasury will begin talks with industry and regulators including the Bank of England, the Financial Conduct Authority (FCA) and Payment Systems Regulator. Discussions will cover how these groups can work together to ensure customers' payment needs are met and consider ideas such as granting watchdogs new powers to ensure banks continue to support their customers' cash needs properly and creating a new system for moving money around the UK to keep cash accessible.

This builds on the Government's previous efforts to protect cash, including investing in the Post Office to provide everyday banking services, setting up the Payments Systems Regulator to watch over the LINK ATM network and setting up the Joint Authorities Cash Strategy (JACS) group to ensure oversight of the UK cash system.[1]

Research by Pockit, in 2019, calculated that it costs the unbanked in the UK an extra £485 per year not to have a bank account. For example, they cannot take advantage of online mobile phone or energy deals without a bank account and may resort to cash-in-hand 'doorstep loans' as an alternative to traditional credit sources through banks or credit card providers.

We expect banks will continue to provide a community service, but they are also seeking a return for investors whilst operating prudently in the highly regulated environment. Prudence means earning a profit, part of which should be retained as capital, and the cost of branches and managing cash may be detrimental to that.

Another example of a new and alternative way to access cash is a recently launched pilot with OneBanks in Denny, Scotland who have located their shared bank kiosk within a Co-op store there. OneBanks offers a shared branch and ATM infrastructure solution to the banking industry, targeted at communities and retail and SME customers in areas where banks have withdrawn, or are likely to withdraw, branch coverage. Their business model is centred on charging participating banks a subscription fee for using it, while also levying a transaction fee each time a customer uses the kiosk to withdraw and deposit cash, make payments or set up an account on their own bank's online banking platform.

[1] Source: https://www.which.co.uk/news/2020/03/budget-2020-chancellor-poised-to-protect-access-to-cash/ - Which?

Paradox 4 - Reliable access to funding

Branches have typically seen larger deposits and 'stickier' customers. Currently, savings stocks are high and, consequently, banks are not competing for deposits to lend out.

Typically, the customers that use branches are older. They tend to be depositors, rather than borrowers, and currently banks have access to plentiful and cheap funding.

Yet it is not so long ago that banks had to vigorously compete to attract deposits, and with the Bank of England ending the Term Funding Scheme at the end of February 2018 (where banks borrowed £127bn at very low rates and had four years to pay it back) it is likely that customer deposits will be valued more in future. Branches, even for the ring-fenced banks, may in future again be a critical component in attracting and retaining deposits.

Balance Sheet strategy is fundamental for banks yet many still struggle to balance 'deposits in' with 'lending out' and reducing capability on either side of the balance sheet would seem unwise, even if cheap money is currently available. It has long been considered that a branch presence gives customers the impression of solidity and reliability, and also gives the Big 5 banks very public advertising boards. Critically, customers with bigger deposits may be less likely to trust digital banks due to a perceived lack of access to their money, despite the FSCS (Financial Services Compensation Scheme) that compensates £85,000 per person per authorised firm.

Paradox 5 - New customer acquisition

Big banks are better at retaining their existing customers than attracting new customers.

Notable exceptions here, are Handelsbanken and Metro Bank, who have both successfully targeted growth by acquiring 'new to them' customers and leveraging their physical distribution to do so. In their accounts to 31 December 2020, Metro Bank committed to leveraging their network of 77 stores, although flagged that beyond opening new stores in Bradford and Leicester in 2021, future expansion is subject to review and no new stores were planned in 2022 or 2023. Almost in 'stealth mode', Handelsbanken's network has grown from 56 outlets in 2008 to over 200 at the end of 2020.

Simpler accounts like current and savings accounts are now easily opened online and advances in identity and verification checks have made this a seamless, almost pleasant, user experience. However, the more complex the product or the higher value the transaction – like borrowing or investing – the more human interaction becomes of value to consumers (see also Paradox 1). Banks with a physical presence could also leverage this advantage to a greater extent than most do now. Indeed, Ipsos Mori data demonstrates that those organisations that have committed to their branches, and are clear about the role branches play in their strategy, see similar scores for their online and branch 'prepared to recommend' percentages. For example, Metro Bank (85% vs 84%) and Nationwide 81% vs. 77%. These scores compare starkly with the significant lag of 'prepared to recommend scores for the bigger banks that have announced closure programmes e.g. NatWest (75% vs 53%) and HSBC (72% & 65%)[1].

Paradox 6 - Purpose

Bank branches in their current 'multi-purpose' format are not as attractive as they once were but face-to-face is still valued for other reasons.

[1] Source: Ipsos Mori Personal banking service quality – Great Britain | Ipsos MORI

There's no doubt that for most adults there are more convenient ways to transact or apply for the simpler banking products and services, but even as banks rush to close branches, many are simultaneously creating hubs for SME businesses to interact and incubate new businesses. An example of this is the RBS partnership with Entrepreneurial Spark (that RBS took over in June 2018) which has 14 'hubs' where entrepreneurs can collaborate with peers and advisers, to successfully establish and grow their businesses.

If banks are clear on their strategy and the strategic drivers then the purpose of each branch can be aligned to target customer needs.

Paradox 7 - Differentiation as a brand beacon

High Street banks have tried to mimic digital-only neobanks like Revolut, Monzo and Starling in terms of both digital standards and user experience. In doing this, they are competing in an area that favours the newcomers rather than leveraging their own strengths.

The 'challenger banks' are nimble and innovative, and regularly create new functionality for their customers. Despite their resources and customer base, the Big 5 banks are nowhere near as agile, hampered by legacy systems and increased bureaucracy. In closing branches and not providing 'friendly and accessible' human contact, will the big 5 Banks lose the chance to differentiate their offering as a beacon for their own brand of customer service?

In 2019, Nationwide Building Society pledged not to leave any town or city in the UK where it has a branch until at least March 2021 and has more recently extended its pledge until at least 2023. They also acknowledged that branches often act as a bellwether for the health of a high street and can be a catalyst for growth or decline.

Sticking with the Building Society sub-sector, YBS are one of the few financial institutions that use agencies and have plans to increase their footprint as part of a 'digital first' not 'digital only' distribution strategy.

Branches can also enhance trust and a physical presence can make brand promises more tangible for customers.

Strategic considerations & actions

In March 2021, the US bank association (BAI) published a report entitled, 'What's next for Bank Branches', commenting that, "While some have predicted decimation of branch networks after COVID, many branch experts say evolution, not elimination, is the better path". The report also suggests, "financial institutions should view branches not as transactional business centres but as relationship-focused customer experience stores. Branches should be centres of more high-value activities, sophisticated services that are provided on a face-to-face basis can build customer bonds and enhance the brand".

Given the different types of customers they seek to serve in the locations they have a presence, I do not believe that there is one generic purpose that is right for every bank or building society. However, I would urge that every financial institution consider their strategy and take the following steps:

Don't throw away infrastructure until you are sure what distribution of the future should be.

Although the Big 5 banks (LBG, Barclays, HSBC, NatWest and Santander) have more than an 80% share of the UK's current account market, this may not be sustainable going forward. By competing digitally with digital-only banks and closing branches, they are levelling the playing field and may actually be conceding advantage to the new entrants.

Transform segmentation and focus on consumer mindsets.

Traditional segmentation – by income, assets, age, geography – may not be enough and should be overlaid with 'mindsets'. For instance:

- Which customers and non-customers would be attracted to branches for 'financial education' and could this be a source of acquiring loyal customers for the future?
- Which customers and non-customers would seek to collaborate and learn from 'peers' or 'experts' in specific locations and could this build affinity with their bank?
- Which customers and non-customers would come to a branch if a particular product, service, insight and advice was available?
- Which customers and non-customers would find a mobile bank or 'pop-up' useful, for what purpose and when?

Engage with consumers and listen to what they say.

Just as successful retailers will transform their bricks and mortar retail outlets and offer supplementary services to those available digitally, banks also need to adapt their branches.

To be success at this, banks must take more notice of what consumers (and not just their existing customers) want from each location, and match this to their target segments and required return on investment.

Henry Ford famously said, “If I had asked people what they wanted, they would have said faster horses”. The truth is, of course, he never asked them, but had he asked the question skilfully, then the people may have expressed the wish for faster transportation and have acknowledged the need for innovation. Banks now need to have the courage to ask consumers in their target and value-adding demographics, to work with them on designing the branch of the future.

Be prepared to act on the direction of your customers and see the branch differently.

Banks need to ask for – and listen to – customer feedback to see the purpose(s) of a branch differently and then be prepared to take a leap to be different to their competitors. This is true customer focus.

Determine what the purpose(s) of each branch should be.

Designing the branch of the future requires banks to gather and evaluate additional data to help them determine which customer groups or segments to target and in which locations.

It is unlikely that a ‘one size fits all approach’ to designing branch prototypes will match with the customer needs and opportunities. Instead, the banks will need to experiment with different models and approaches and be prepared to adapt their approach in specific locations in line with the differing macro and micro economic conditions and evolving customer needs. The challenge is to determine a clear purpose that makes branches a useful destination.

Amazon think there’s a place for them on the high street and are investing to prove it… and maybe they’re right. Maybe the people who’ve drafted the obituary for bank branches have spoken too soon.

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