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EFTS is causing many banking concepts and practices to be rethought—including branching.

Branch Planning in the Age of EFTS

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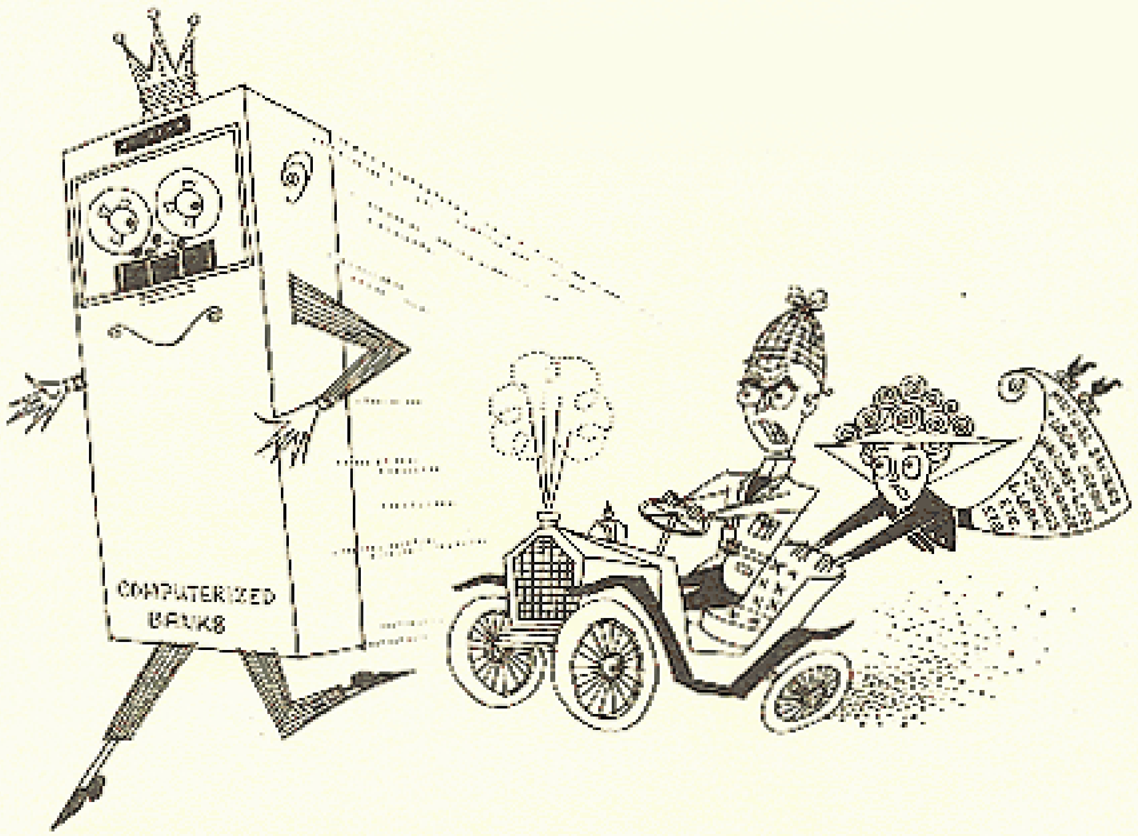

WILL EFTS MAKE BRANCHES OBSOLETE? Another way of asking this question is: Does a cashless or checkless society mean a branchless society?

Our answer to the question is *no*, especially when we consider the range of financial services which potentially can be offered through branches. EFTS does not mean a branchless society, but, rather, one in which existing and projected facilities will play a very important role relative to both on- and off-premise electronic service units.

Of course, much will depend on the reason for a branch in the first place, and in what a bank can do to realize its goals.

OBJECTIVES OF BRANCHES

According to the Federal Reserve Board's branch application form, one *reason* for branching is to relieve "head-office congestion." Another reason, according to the Comptroller of the Currency's branch application form, is related to the more efficient servicing of a bank's existing business. However, as most bankers will probably agree, the ultimate motivation for branching, which certainly encompasses these and other reasons, should be to maximize profitability and return on investment. In technical terms, this objective involves the application of risk-adjusted capital-budgeting techniques.

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It is essential that the branching decision for a bank be put into proper perspective. This leads to one key point: *Branching is but one avenue to profitable growth.*

According to the "marketing" concept, profitable operations are the result of efforts to satisfy consumer needs. This involves the development of separate but integrated strategies for an organization's product, the promotion of it, its pricing, and, finally, its distribution. In banking, the distribution of the service is primarily a question of branch or service unit location strategy. Thus, the development of an optimal *branch* system involves one of the four marketing-mix variables.

Another way to see this point is through considering a bank's area of effective market coverage or its "sphere of influence." In the case of a one-office bank, this sphere of influence is equivalent to its primary service area or that geographic region from which the largest portion (say, 75 percent) of its business is generated. While this is sometimes referred to as an office's "trading area" or "market area," it is conceptually different from the usually larger area of a "banking market."

In the case of a bank with more than one office, its sphere of influence is the sum of all the trading areas of its existing offices. A statewide institution or a bank holding company that views its affiliates as part of one large system may have a sphere of influence that covers a large portion of the state.

One avenue to profitable growth concerns the development of a bank's existing sphere of influence to its fullest potential. The second avenue concerns the expansion of the bank's sphere of influence. One way to accomplish this is through the creation of new branches.

The specific reasons why banks do branch are oftentimes dichotomized as either defensive or offensive ones. While defensive reasons are related to the maintenance of present market share and the protection of existing business which may be jeopardized by a competitor, offensive reasons for branching are directed specifically at increasing market share and opening up new markets.

Some branches are said to be established for other reasons, such as the maximization of spatial representation—i.e., a bank wants an office in every market within its legal branching area so as to virtually cover the map. This may be done without consideration of potential branch profitability and return on investment.

THE EFTS PLAN

The objectives of a branch system exist regardless of electronics funds transfer systems, though certainly EFTS may have a modifying effect. And, for a specific bank, the following question must be considered—a question many board members and chief executive officers have already asked themselves: Is EFTS right for us? The only way to scientifically answer this question (and it must be emphasized that there is an answer for each bank) is for a bank to have its own comprehensive EFTS plan.

Most authoritative sources on the subject of marketing planning consider several elements in any plan. The following elements of an EFTS plan include items and related questions which are of tremendous importance to a bank's existing and future role in the world of EFTS (these are, incidentally, the same elements that would be included as a part of an institution's branching plan):

(1) *Diagnosis*—Where is the bank now in terms of EFTS?

(2) *Prognosis*—Where is the bank going in terms of EFTS?

(3) *Objectives*—Where should the bank be headed in terms of EFTS?

(4) *Strategy*—What is the best way to get there?

(5) *Tactics*—What specific actions should be undertaken, by whom, and when?

(6) *Control*—What success or performance measures should be evaluated?

The concentration here will be mainly on the strategic aspects of an EFTS plan as they are related to the service unit mix. An important concept in the determination of the optimal service unit strategy is the nature of the electronic service unit mix—the different types of possible electronic service facilities. They can be summarized this way:

The Electronic Service Unit Mix

(1) Off-premise electronic service units (CBCT)
- (a) CDM (Unmanned)
- (b) ATM (Unmanned)
- (c) MOT (Manned)—One service unit per store

(d) POS (Manned)—One service point per check-out counter

(2) On-premise electronic service points (unmanned)

(a) Through-wall CDM or ATM installation

(b) In-lobby CDM or ATM installation (Free-standing or desk-top)

(c) Drive-in CDM or ATM installation

The term "electronic service point" is utilized to describe a single CDM, ATM, MOT, or a manned or unmanned POS terminal. By the same token, teller windows and drive-in windows within a main office or branch also represent separate and traditional service points.

An electronic service unit, rather than an electronic service point, refers to the same thing, except that when there is more than one service point at one location, it is referred to as a service unit. Thus, a supermarket with ten POS terminals, one at each check-out counter, would represent one off-premise electronic service unit but ten service points. The importance of this distinction is related to the fact that the primary service area or similar such concept has meaning for electronic service units.

We use the term *branch* to refer to all types of traditional and electronic service units. This has been a controversial question from the legal perspective. However, from the marketing viewpoint, electronic service units, like branch offices, represent alternative methods or channels of distribution of a bank's services. Thus, it is clear why electronic service points and units are not to be looked upon as a new service, but just as alternative means of providing an existing service.

The total "service unit mix" available to a bank is therefore comprised of both the electronic service unit mixes (see above) and the traditional:

The Traditional Service Unit Mix

(1) Full-service facility (branch)

(2) Limited facility

(3) Mobile facility

(4) Drive-in facility

(5) Pedestrian facility

Considering the entire service unit mix in each possible situation is most important.

Roles of Units and Point

Looking at electronic service units and points, it is possible to identify certain major roles they can potentially play in a branch system. The first role such equipment can play is purely of a supportive type, in terms of the enhancement of performance of the main office or a particular facility, such as a "problem branch."

Branching is but one avenue to profitable growth.

Electronic service points in this instance may be established as in-lobby, through-wall, drive-in, or parking-lot installations on the premises of the facility. The vast majority (over 90 percent) of existing CDMs and ATMs are on the premises of existing facilities. The purpose of these units is the ultimate enhancement of performance of not only a particular office but, more importantly, the improvement of the bank's bottom line as per the system's view.

A second role of such equipment is both supportive and generative in nature, and is primarily related to increasing the market share in an area already served by the bank. CDMs and ATMs, in this case, are located off premises, but within the primary service area of an existing facility.

In many respects, however, the greatest profit potential of electronic service units lies in the development of new business in areas not now being served by the bank. This is the third role of such equipment—a purely generative role. Here, off-premise CDMs and ATMs are established outside of the primary service area of an existing facility.

Of course, banks in branching states with a large branching system established over several years did not have the opportunity of planning their existing branch network with the roles and potentials of electronic service units in mind. However, upon considering these factors, it appears that numerous decisions regarding the location and characteristics of a bank's existing and proposed traditional facilities will certainly be affected by the advent of EFTS. This suggests that those banks that consider the impact of EFTS on their existing and planned traditional branches and service units will be in the best position to maximize profitability and return on investment.

Alternative Strategies

Before discussing alternative branching strategies in the age of EFTS, let us consider a key tactical question which must be answered regarding electronic service units: Should a bank share these units with another institution? While mandatory sharing is required in certain situations (i.e., merchant locations) in the statutes of various states, some retailers may also require some types of sharing for their locations. In the absence of a sharing constraint, a bank may find that a nonshared MOT or POS arrangement can be quite valuable. However, the required investment by a single bank for such a system may preclude consideration of such nonshared arrangements by all but the large institutions.

Though the investment is clearly much lower on a shared ATM project, a bank should be particularly careful when considering shared arrangements for off-premise ATM installations. Of course, the exception here is a sharing arrangement with affiliate holding company banks.

The reason why a close look at nonaffiliate sharing is required is that, in terms of a systems approach, the location of such an ATM in, say, a shopping mall or employment center must be made relative to the bank's existing distribution of business and its particular objectives. Therefore, what clearly may be an optimal ATM location for one institution may not be the case for another.

Although much remains to be settled and seen regarding the development of EFTS in this country, we are increasingly able to foresee its impact on traditional branch operations. One general trend regarding these operations in the age of EFTS will be the continued automation of routine transactions that account for much lobby space today. While this means less area for teller windows, counter space, and forms area, it also means more area for other services in which banks may become more active. For example, increased personal financial services and financial counseling by banks is generally expected. Overall, the office space for the average office may decrease and become more efficient in this type of scenario.

The implications of these possible developments must be viewed in a systems framework in conjunction with overall locational considerations. Specifically, how should electronic service units be located relative to traditional ones? One possible service unit strategy involves the use of electronic service units for defensive purposes and traditional service units for offensive ones. However, this particular strategy ignores the purely generative (third) role of electronic service units, since they are typically placed either on-premises or off-premises within the primary service area of an existing facility.

THE HUB CONCEPT

An alternative service unit strategy which takes advantage of the full off-premise potential of electronic service units employs the "hub" concept. Electronic service units here may be located anywhere.

EFTS does not mean a branchless society.

In this scheme, a traditional full-service branch acts as a primary hub to electronic service units and limited facilities. These limited facilities, in turn, act as secondary hubs for additional electronic service units. The placement of traditional service units within a given area following this strategy is a function of the major focal points in a region. These offices (particularly the full-service ones) will handle all types of financial transactions, but will focus on those specialized or "shopping" type transactions (say, certain types of loans and counseling) that may be required on an infrequent basis. Convenience and routine activities, such as deposit transactions and some loans, will be primarily handled by the electronic service units.

A bank with a large branching system in an urban area would probably have to close or relocate some branches and scale down others (to limited facilities) in order to accommodate this concept. However, banks and holding companies in certain states that are in the formative stages of branch development (i.e., Florida) are in a position now to evaluate which branches or offices would ultimately function as primary or secondary hubs. The decision to establish full-service branches in areas within a reasonably close distance to other existing or proposed full-service offices of the bank or the holding company affiliates might be reevaluated in this regard.

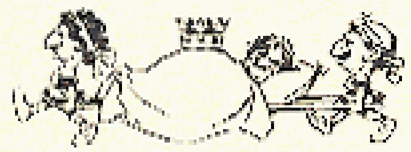
The possibility that some full-service branches might ultimately be relocated or converted to limited ones indicates the advisability of carefully evaluating the extent of the capital outlay and branch design in branching plans. Also, the purchasing and/or long-term leasing of traditional branches and the construction of an office with little internal flexibility should also be closely examined in this light. Furthermore, the strategy of utilizing a traditional facility as the hub for smaller facilities or electronic service units in a given area emphasizes the key role well-qualified branch personnel will play in the system in the future.

What One Study Found

A brief description of a pilot study, which resulted in an optimal five-year service unit strategy for one institution, demonstrates the application of this hub concept.

Although a much broader geographical area was considered as part of the total analysis, one particular market segment was focused upon which was ranked quite favorably in terms of its potential. This particular market segment was in a non-SMSA area where the institution had no existing representation. The traditional branching strategy which might be dictated for such a market segment would have been the establishment of two full-service branches during the planning period. However, the optimal service unit mix based upon the mathematical programming routine was determined to be one full-service facility within the CBD of the core municipality, which would act as a hub for two electronic service units. One full-function ATM was recommended for a particular location in an outlying shopping mall, while another was recommended for the student union at a local university.

Specific timing recommendations called for the initial establishment of the branch facility to create a satisfactory degree of consumer awareness of the institution prior to the electronic service unit entries. It was also recommended that the institution consider the possibilities of a limited POS arrangement with a certain supermarket chain in the area whose store network complemented the institution's proposed service strategy well.



With a much more modest investment than would traditionally be the case, the potentials of this particular market segment would still be obtained. Consequently, the resultant profits and return on investment to the institution would be that much greater.

COPING WITH THE AGE OF EFTS

The importance of a systems approach with respect to branching and electronic service unit strategy in the age of EFTS cannot be stressed too much. As new competitive facilities and service units are established, and you can be absolutely sure they will be, a bank's service unit strategy must be dictated by a carefully thought out branching plan. And a plan of action, rather than one of reaction, is the key to profitable branch expansion.

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