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COMMENT

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The Value of a Branch Is Measured in More than Deposit Ranges

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SANFORD ROSE'S Feb. 17 column entitled "There's Still Hope For the Branch" presents a fairly balanced view of a vitally important retail banking topic, namely, the future of the branch.

The editorial did not dwell on the controversial finding by one consulting firm that around half of all branches are unprofitable and by implication should be closed. Rather, the comments focused on various strategies suggested by another consulting firm to enhance branch performance. Based upon that firm's experience with one regional bank with over 200 branches, those strategies reportedly could result in a remarkable turnaround: The proportion of branches exhibiting negative returns could fall from 48% to 10% or 11%, and the proportion earning less than the corporate hurdle rate could drop from 62% to 21%.

This case study emphasizes the importance of distinguishing between branches that are truly profitable and those that are not. A truly unprofitable (i.e., negative net present value) branch that is a chronic underpertormer may have to be closed, sold, swapped, or otherwise disposed of. This branch disinvestment alternative is usually reserved for those problem or serious problem branches where locational (i.e., the site, immediate area, and market area) factors have been identified as the primary causative agents.

Obviously, there is a whole set of nonlocational determinants of branch performance including the familiar marketing mix "P" variables of pricing, product, promotion, personnel, and other management and operating policies. It appears that the performance-enhancing strategies recommended in the cited case study were primarily of the nonlocational variety such as changes in pricing, personnel, and corporate policies.

A hasty recommendation that the subject bank dispose of 48% to 62% of its branches, which was not made in this instance, would clearly have been totally inappropriate and unjustified. Rather, it seems from that case study that the proportion of truly unprofitable branches that might have to be divested would be between 10% and 21%.

The '80/20 Rule'

Our consulting experience since 1975 as specialists in branch evaluation and location research exclusively for financial institutions has confirmed our version of the familiar "80/20" rule: Approximately 20% of a financial institution's branches cause 80% of its branch problems. The first or lowest 10% are categorized as problem or serious problem offices often requiring branch divestiture; the second 10% are problem, near problem, or potential problem offices sometimes necessitating such extreme action.

We feel that the conservative approach to branch planning dictates use of our 80/20 rule to trim the fat from the retail branch network as appropriate. The case study cited in the editorial would appear to support this rule. However, going upwards to 40% means cutting into the meat, and at or over 50% would mean cutting into the bone.

We would recommend that serious consideration be given to any such plans to drastically reconfigure a retail branch network. Such radical and irreversible surgery on a branch network might be appropriate if management has decided to change the bank's branching objectives or its entire retail orientation. Otherwise, a typical retail bank or thrift closing 40%-60% of its offices would certainly represent an unusual set of circumstances.

The previously referenced study concluded that a bank or thrift branch needs $20 million-$25 million in deposits today just to break even (see "Study Finds Half of Nation's Branches Unprofitable,' *American Banker,* October 10, 1987, page 3). It was noted that the proportion of all U.S. bank and thrift branches that were or were destined to be unprofitable was at least 40% but as high as 60%, since that percentage of branches had $20 million or less in deposits in 1986.

We agree that there is a generally positive relationship between branch profitability and local retail core deposits. However, this is not a perfect relationship, and bankers must be careful not to equate branch profitability and total branch deposits.

Break-even deposit levels differ among banks and among branches within any bank because of different fixed and variable expense structures. For example, we have seen some branches with deposits in excess of $25 million that are unprofitable because of their cost structures.

Profitability Differs from Deposits

Conversely, it has been our experience that many branches in the $10 million-$20 million range are profitable, and any wholesale recommendation to close branches simply because they are in this deposit range would be a mistake.

In fact, we have seen some small branches with deposits of less than $10 million that are profitable because of low overhead and outstanding loan portfolios. Why would we even have loan production offices with technically no deposits if these facilities were not profitable? Different offices can serve different delivery system objectives and still be profitable.