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Banks – Are they for shareholders or accountholders?

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To deliver real value to customers, banks must reinvent their branch banking strategy. Banks returning attractive returns to their shareholders or increasing the bous pools of their employees whilst providing poor value to customers, do it at their peril.

Record 2004 results from some of the largest banks in the UK have received great interest. They include HBOS whose profit rose 22% to £4.6 billion, Barclays' pre-tax profit rose 20% to £4.6 billion, Royal Bank of Scotland's (RBS) pre-tax profit rose 15% to £8.1 billion and HSBC announced a 37% rise to £9.4 billion. British banks are among the most profitable in Europe, making returns in equity of up to 20%. And the 10 largest banks in Britain make up almost a quarter of the FTSE 100's market capitalisation and half its profits. So, what is the mystery of their success of returning good value to their shareholders? It is partly to do with offering good deals to new customers on mortgages, credit cards and savings and then quietly raising the charges when the deals end and progressively reducing their brick and mortar branches and staff in those branches across the country – particularly since late 1990s as a part of cost cutting programme.

The UK banking industry remains a complex monopoly that has resulted in high prices and poor service for account holders. The lack of transparency has made it very difficult for small businesses to choose between accounts. As a result, customers are getting a bad deal from the big four banks. These banks – Barclays, Lloyds TSB, RBS and HSBC – continue to dominate the market for the UK's 38m current accounts, accounting for over 75% of the market (see Figure 1).

For example, the failure to reform the clearance of cheques and electronic payments system, where it takes three to six days to clear a cheque or standing order, has been the source of growing impatience among account holders for many years. The delays in the UK are longer than almost any other leading industrial nation. Even the chairman of the UK's largest bank acknowledged that banks could run the electronic payments systems more efficiently. It is clear that the UK banks make money from the delays. When bills are paid electronically, money is deducted from a customer's bank account instantly, yet not paid to the recipient for two days. That gives the bank two days to invest and profit from the money. It is estimated that the UK banks make more than £30m a year in interest this way. The big four clearing banks in the UK have little incentive to speed up the payments systems because they make money from it and control the process. The industry bodies that govern the payments systems, such as Cheque and Credit, are dominated by the big four clearing banks, which have a majority of the voting rights. It is, therefore, imperative that swift change is made, so that payment systems meet the needs of accountholders. That means a change in the

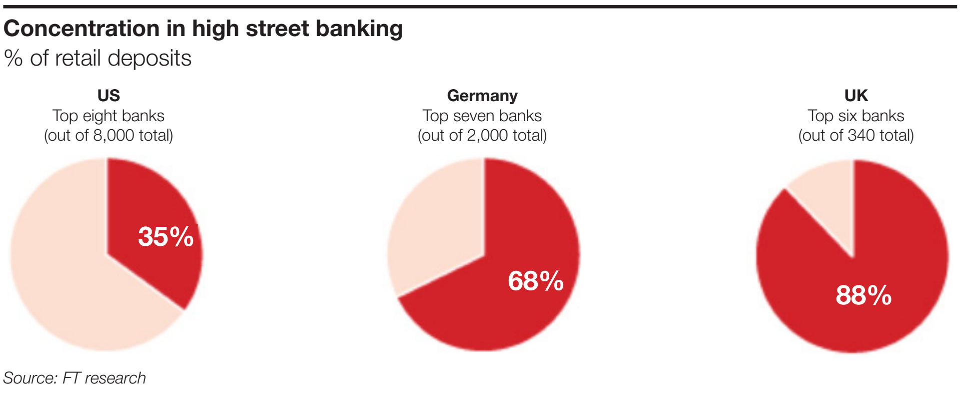

Figure 1: *Boosting competition would prove far more radical for the UK banks*

banks' mindset and a real commitment to take action to achieve faster payment clearing.

Since early 2000, many banks had encouraged their retail customers to use automated teller machines and internet banking rather than the counters and tellers inside a branch. In addition, customers' calls are routinely diverted to banks' offshore call centres when customers would prefer to speak to someone at their branches (see *Offshoring practices in European financial services companies* by Pal). Even in a branch, where there are half-a-dozen counters, customers often find only two are open at peak times. Banks need to be where their customers are located and provide fast and efficient service on a face to face basis – this is not going to be easy as the cost cutting of the late 1990s has taken its toll, as well as outsourcing and offshoring of some key customer facing functions in recent years.

During the dot-com boom, experts predicted that a large percentage of banking customers would carry out all their banking over the internet. However, recent research by Booz Allen Hamilton, the management consultancy firm, found that up to 90% of customer relationships were formed – or lost – in the branches (see Figure 2). Nearly 75% of all saving products were sold through branches, compared with 7% over the phone, or 7% via the internet.

Let's face the reality – we still prefer the human touch. Tomorrow's successful banks are going to be players who strengthen their ties to customers at branch level and sell a broader range of services to them. If this crucial element is not implemented soon then some of today's banks may not be around too long to return value to their shareholders. Banks should readdress the balance and invest in their branches by recruiting the right people, selecting the right locations for outlets, defining roles within branches and providing fast and error-free services to customers.

However, certain banks are now engaging in growth strategies that help to push the number of bank branches to higher levels. For example, RBS, HSBC and Lloyds TSB are putting their branches at the centre of strategy. RBS has spent £150 million on refitting branches and recently announced that it intends to put a further 1,000 people in customer facing roles. Lloyds TSB has one of the largest branch networks, with more than 2,000 branches and announced that the bank had undertaken a number of initiatives to improve branches for customers and investing in refurbishments across the UK and are looking at ways to improve branches to better meet the needs of local communities throughout the country.

How we like to do business with the bank

BRANCH		PHONE		INTERNET	
Information	Sale	Information	Sale	Information	Sale
SAVINGS/TRANSACTIONS					
13%	71%	10%	7%	18%	7%
HOME LOAN					
18%	49%	35%	9%	12%	3%
PERSONAL LOAN					
19%	49%	49%	11%	23%	8%
CREDIT CARD					
14%	45%	40%	5%	20%	13%
MANAGED FUND					
9%	24%	31%	11%	23%	13%

Figure 2: *Percentage of people preferring different channels for information and transactions (Source: Booz Allen Hamilton, April 2004)*

There are several reasons for the change in sentiment. After the collapse of the technology bubble, banks could no longer borrow as cheaply as they had in the past and began turning to deposit holders to finance operations. That meant stepping up or extending branch networks was considered the only surefire way to attract depositors and increase retail revenues by selling account holders the myriad of available add-on services. The mortgage-refinancing boom of the past two years provided the perfect catalyst to spike branch-related sales.

What constitutes a better branch experience in the mind of the customer? What is the financial impact from a bank's perspective? The answers to these questions have far-reaching implications on where banks focus investment to improve customer satisfaction, loyalty and value. To assist with these questions banks need to understand what retail banking customers want from their bank branch, how well banks are meeting those expectations and the financial implication of performing – or not performing – up to those expectations.

In fact, we found that the top reason customers switch banks is poor customer service. Customer service attributes rank highest include, in order of importance:

1. Fast counter and ATM service
2. Convenient locations and long hours
3. Error-free banking
4. Availability of multiple channels

Speed and convenience are essential components of good customer service. Customers want to get in and out of the branch quickly. A strong correlation exists between the amount of time a customer has to wait in line and their likelihood to remain a customer of the bank. Customers also prefer service from a human behind a counter. Customers do not place high importance on the availability of newer banking channels, such as Internet banking kiosks.

Customers value branch formats that facilitate quick service, including high availability of assisted and self-service channels and an easy-to-navigate layout with clear signage. Consistency of the banking experience is critical. Customers would give their bank only two to three chances to fail before considering switching. Overall there is significant room for improvement. Customer service has consistently declined over the past few years whilst profits keep rising.

Whose bank is it anyway?

Do shareholders own the bank? Not in the way that one would own a car or a building. A share of stock is a financial instrument, more akin to a bond than to a car or a building. A share of stock does not confer ownership of the underlying assets owned by the bank. Instead, it provides the shareholder with the right to share in the financial returns produced by the bank's business. The shareholders of a large, listed bank, are part of a "far-flung, diverse and ever-changing group". They come and go, owing no legal obligation to the company and their rights over the bank are not absolute. Yet, in UK banking, these shareholders gain more than the accountholders, who often stay loyal to banks for decades contributing towards healthy profit generations.

So, what should banks do? There are some immediate improvements for branch banking providers:

- Implement and continuously monitor a service level policy that keeps waiting times and counter transaction times, say, less than three minutes.
- Re-evaluate the convenience of existing locations. Consider expanding the number of branches with extended and weekend opening hours, particularly in urban areas.
- Ruthlessly focus on quality in handling customer transactions. Quality improvement approaches, such as Six Sigma, offer rigorous methods of reducing the number of defects in transaction processes.
- Improve the availability and choice of channels. Offer the right mix of assisted and self-service channels to meet local needs. Remove unused teller stations to improve customer perceptions.
- Refocus branch development investments. Create easy-to-navigate layouts that facilitate speed of service.

We believe, the winning banks will offer a value proposition based on consistently delivering speed, convenience, reliability and choice in the branch. Banks can make advocates of existing customers and win new customers by offering a clear choice in the marketplace.

About the author

Sukhendu Pal is the CEO and Managing Partner of Sirius & Company.