

Community Bank Branch Transformation Strategies

Enhancing profitability, do-it-yourself service, and
who is today's customer

December 3, 2015

MBA Bank Management and Directors Conference
Grand Rapids, Michigan



AGENDA – Branch Transformation Strategies

MBA Bank Management & Directors Conference Presentation

December 3, 2015

- Industry Trends Affecting Branches
- The Branch's Impact on Bank Profitability
- Do-it-yourself service
- Today (and tomorrow's) customer
- Transformational Strategies

CHRISTMAS SHOPPING, 2015



CHRISTMAS SHOPPING, 2015

More people
shopped
ON-LINE than
in STORES
during
The Thanksgiving
and Black Friday
weekend, 2015

- National Retail Federation



CHRISTMAS SHOPPING, 2015

Black Friday ON-LINE sales

\$4.45 Billion

Now 27% of total Black Friday Sales

Up 14% from 2014



57% was on MOBILE devices

Up over 100% in one year

- Adobe System Inc.

INDUSTRY TRENDS

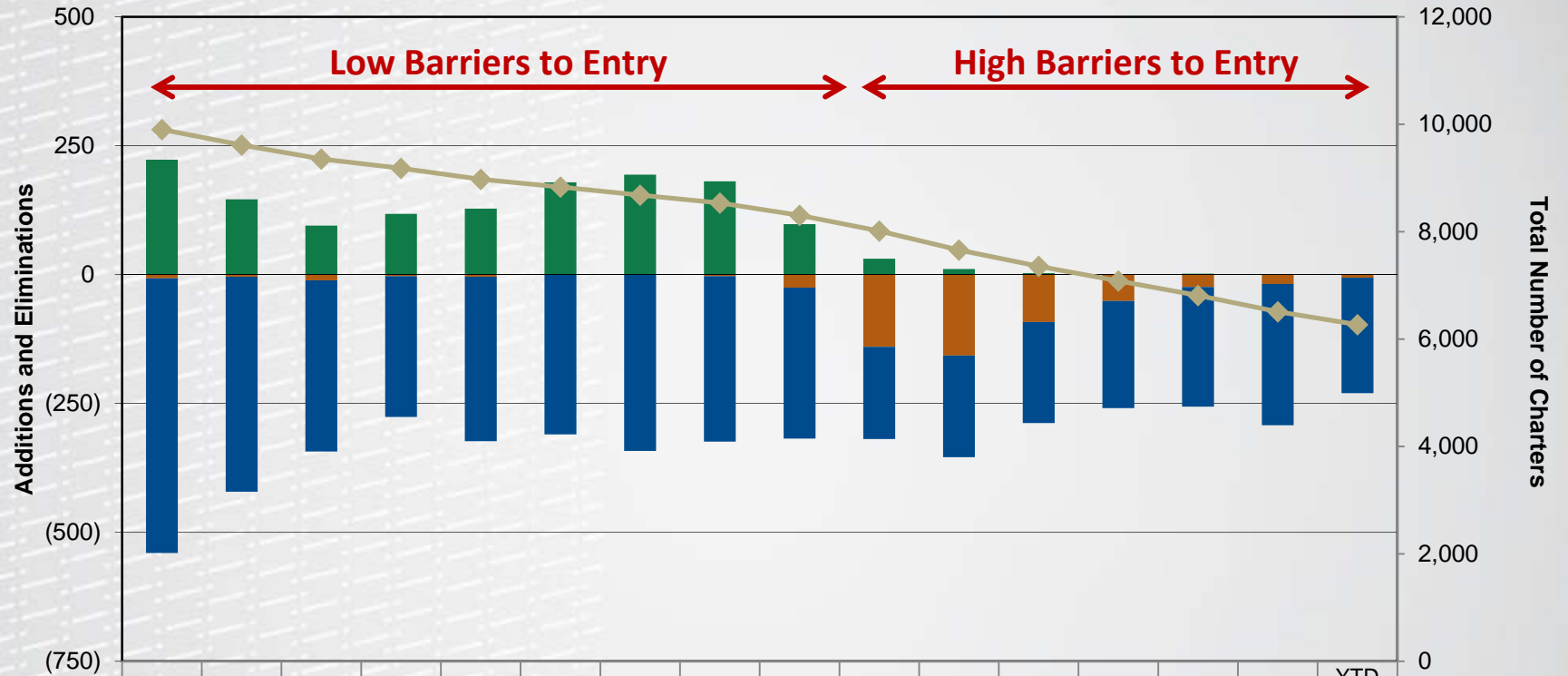
- Increasing competition
 - Other community banks
 - Regional & National Banks
 - Credit Unions
 - Non-bank providers
- Weak economic conditions / low demand
- Persistently low interest rates

INDUSTRY TRENDS

- Industry consolidation
- Increasing regulatory compliance requirements
- Lack of product / service differentiation
- Need for cost savings

CONSOLIDATION TRENDS

Since 2000



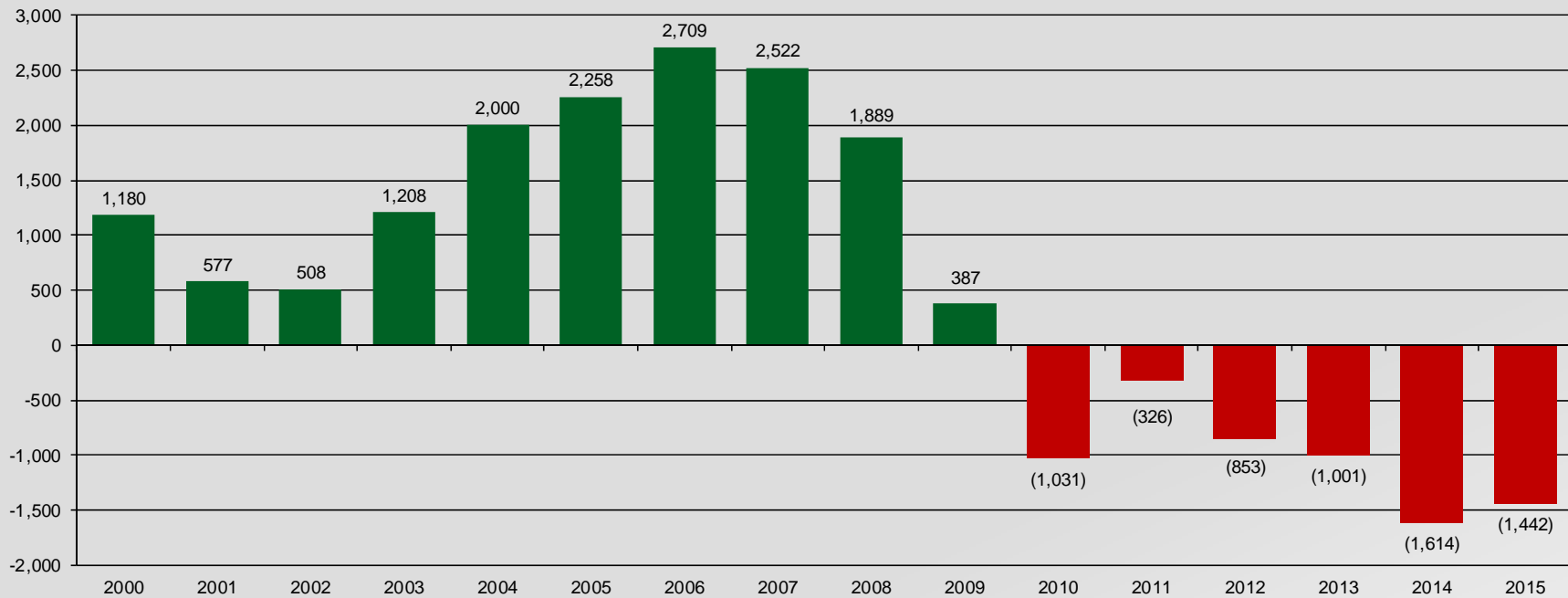
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	YTD 09/15
Mergers	(533)	(417)	(332)	(273)	(319)	(310)	(342)	(321)	(293)	(179)	(197)	(196)	(208)	(232)	(274)	(224)
Failed	(7)	(4)	(11)	(3)	(4)	0	0	(3)	(25)	(140)	(157)	(92)	(51)	(24)	(18)	(6)
New Charter	223	146	95	118	128	179	194	181	98	31	11	3	0	2	0	1
Charters	9,904	9,614	9,354	9,181	8,976	8,833	8,680	8,534	8,305	8,012	7,658	7,357	7,083	6,812	6,509	6,270
Y-Y % Chg.	-3.1%	-2.9%	-2.7%	-1.8%	-2.2%	-1.6%	-1.7%	-1.7%	-2.7%	-3.5%	-4.4%	-3.9%	-3.7%	-3.8%	-4.4%	-4.9%

Source: FDIC.gov

BRANCHING TRENDS

Net Change in Branches Since 2000

National Net Change in Total Branch Offices
(As of June 30)



Source: FDIC – Summary of Deposit information.

BRANCH DYNAMICS IN MICHIGAN

2014 Population of 9.9 Million

55% in Detroit CSA

“UP” = 3%

Various Growth Rates (1990 – 2010)

- Detroit (-31%)
- Flint (-28%)
- Lansing (-10%)
- Grand Rapids (-1%)
- Clinton Township +13%
- Dearborn +10%
- Sterling Heights +10%

- State of Michigan + 6%
(vs All US @ 24%)

- Outside of Top Ten Cities +13%



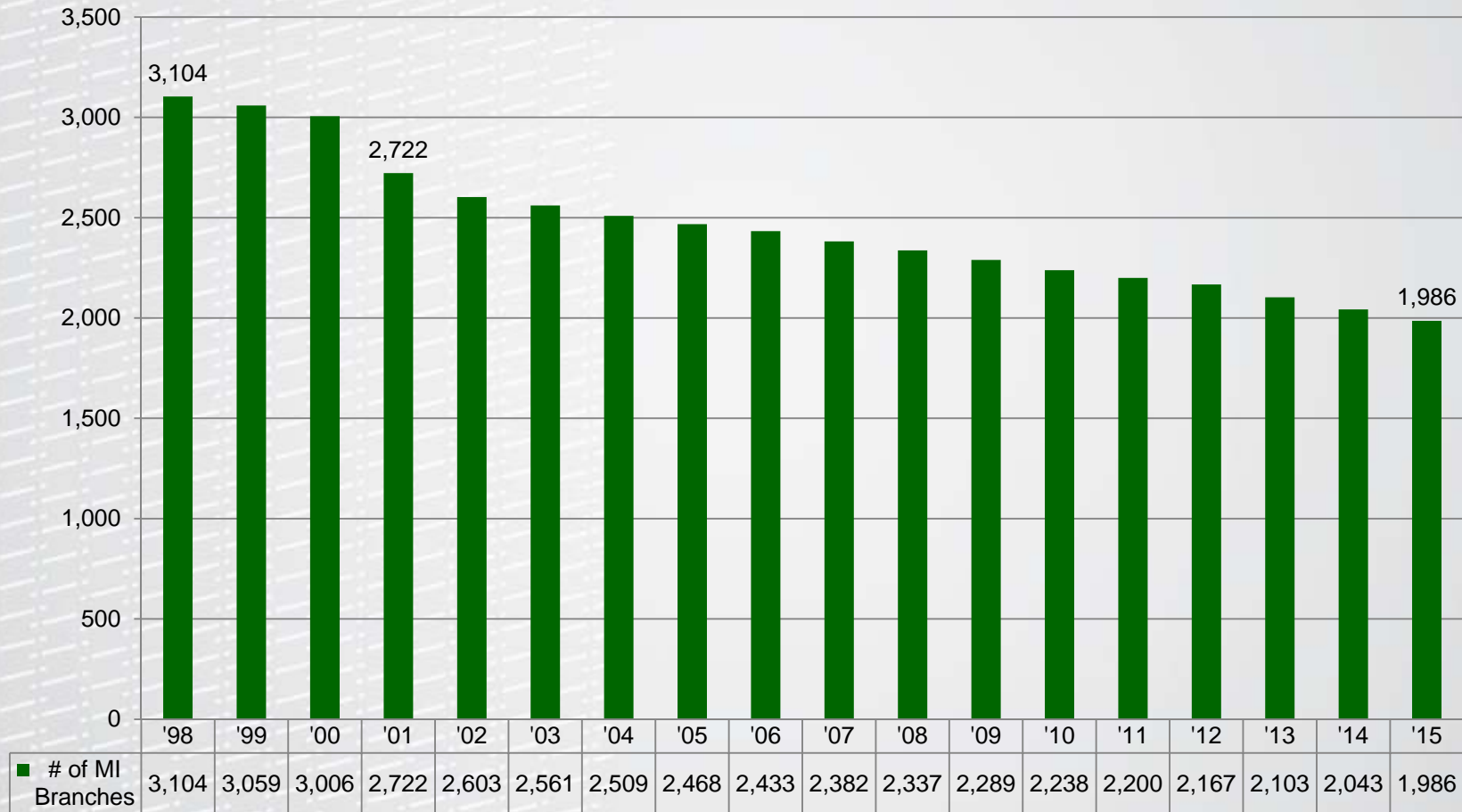
BANKING TRENDS

Banks in Michigan 1990 - Current



BRANCHING TRENDS

Branches in Michigan 1998 - Current

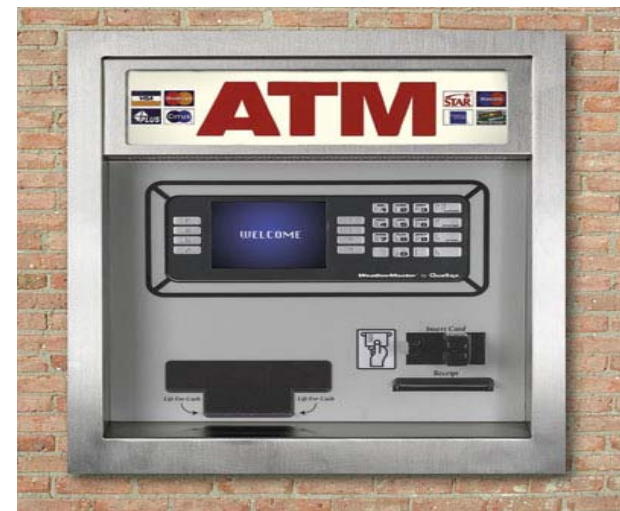


INDUSTRY TRENDS

- Penetration rate of on-line bill pay in the US is **only** 50%
- 90% of US households live within 10 minutes of 3 different FI's
- 75% live within 10 minutes of 6 or more
- By 2020 – 95% of all banking transactions will take place digitally

- McKinsey & Company

THE WAY BANKING GETS DONE IS CHANGING...



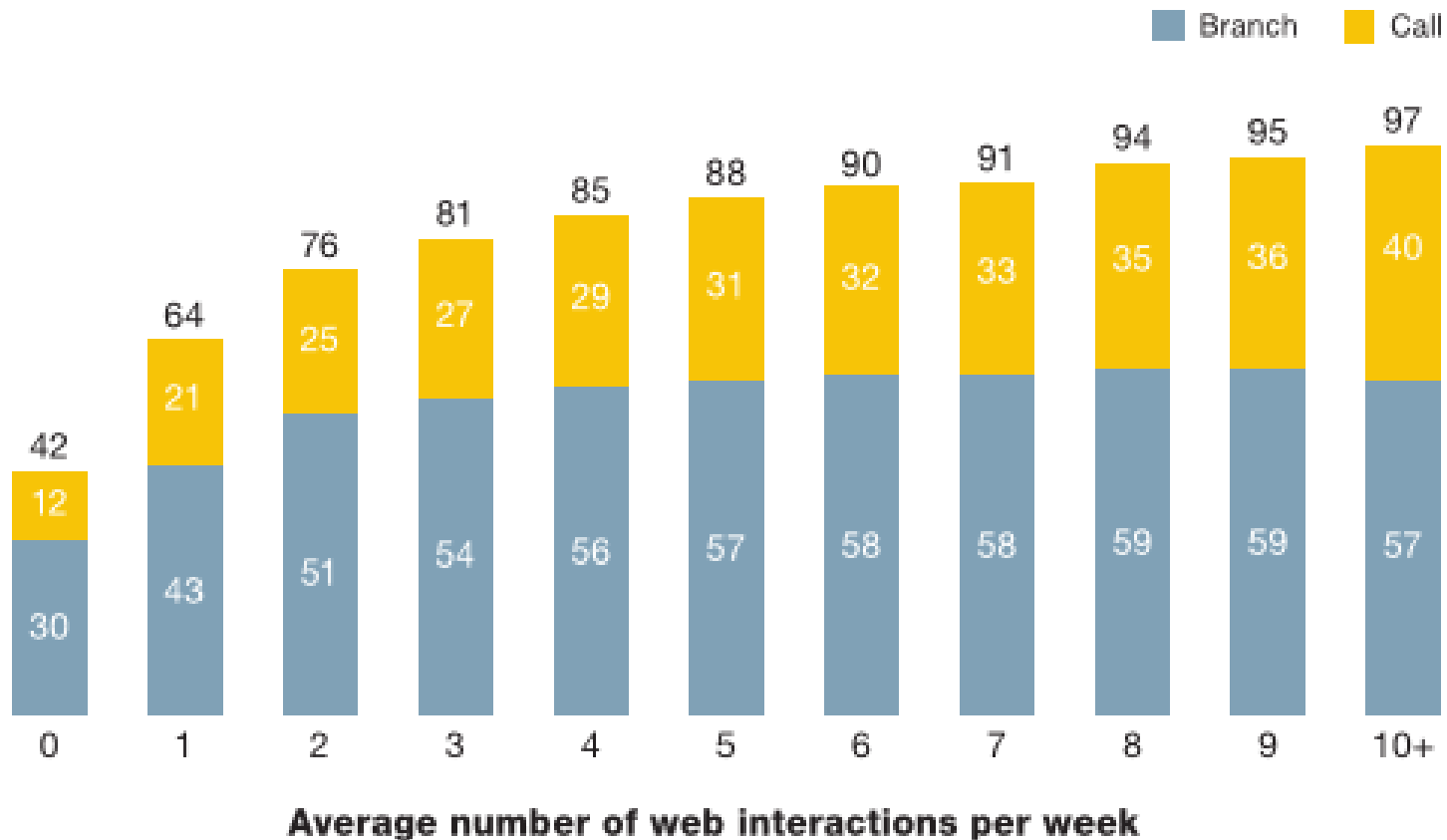
All Self-Service Channels are Growing

HAS YOUR BRANCH NETWORK BECOME A DINOSAUR ?



MULTICHANNEL USAGE PATTERNS

% of US retail-banking customers interacting with branch or call




PROBLEMS WITH EXISTING BRANCHES

- Rapidly decreasing transaction volumes
- Decreasing customer visits
- Larger than currently needed
- Overstaffed
- Expensive / costly
- **Not configured with appropriate technology**

THE PURPOSE OF THE BRANCH

- Branch vs. Sales Office
- Service vs. Sales
- Growth within stagnant markets



What is the cross-selling effectiveness of branch staff vs your on-line or mobile banking app?

NECESSARY CONDITIONS TO SUCCEED

- Right people right place
- Effective incentives

THE FUNCTIONS OF THE BRANCH

- Represents & projects the organizations BRAND to the community
- Provides a physical presence
- **Serves the FULL range of customer needs**
- The heart of the bank's franchise
- A source for revenue generation
- **New business development**

BRANCH MANAGERS ROLE

Traditional

- Lead, motivate & engage the team
- Build & increase customer loyalty
- Mitigate risks through compliance
- Accomplish retail banking goals

Future

- Balancing usage by channel

GOALS FOR THE BRANCH

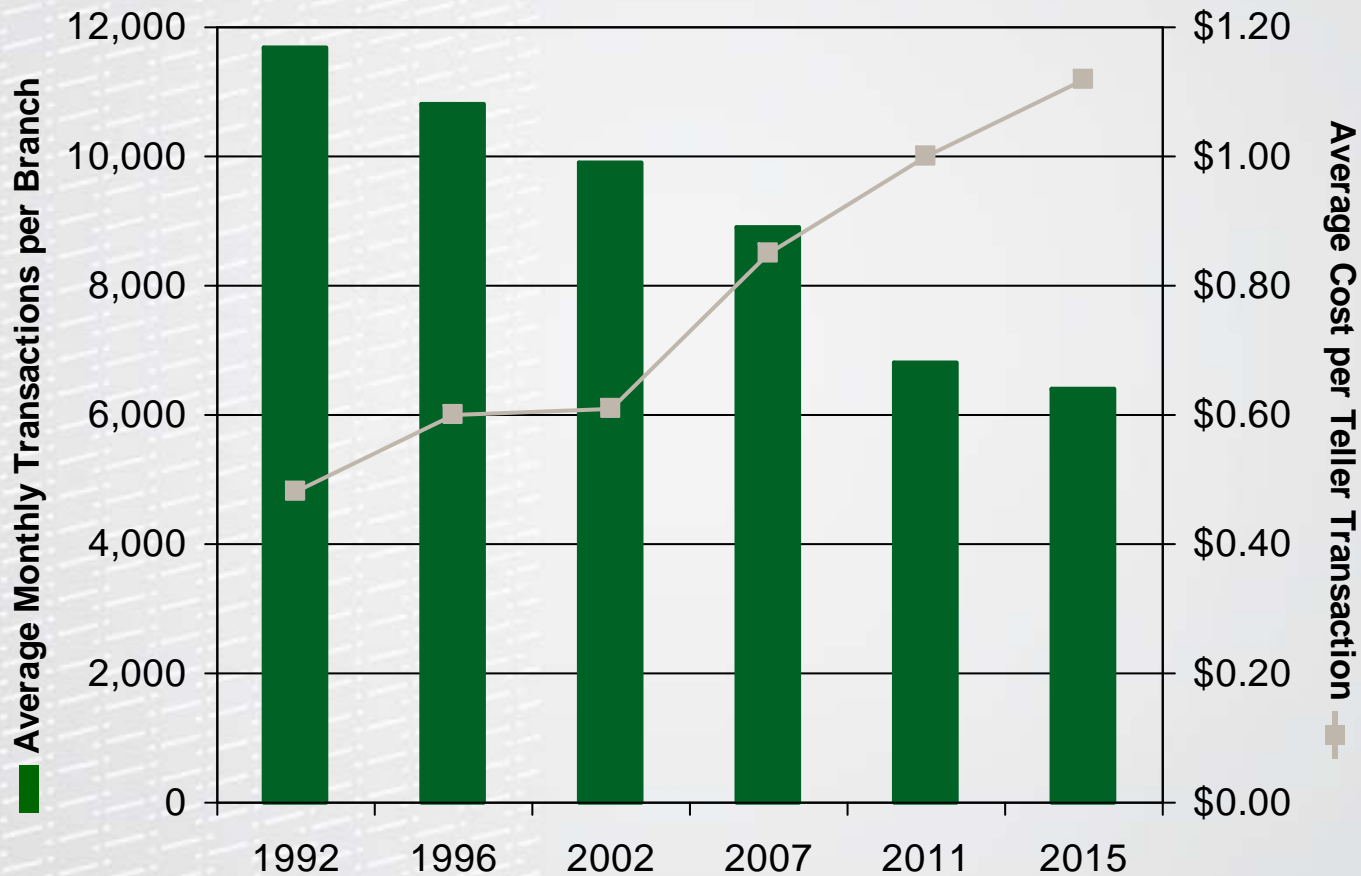
- **Increase sales**
- Service Quality
- Decrease risk
- **Reduce costs**

SELF-SERVICE BANKING OPTIONS

- Traditional ATM 1969
- Telephone banking 1980
- On-line banking 1994
- On-line bill payment 1995
- Mobile banking 1999
- Remote deposit capture 2003

BRANCHING TRENDS

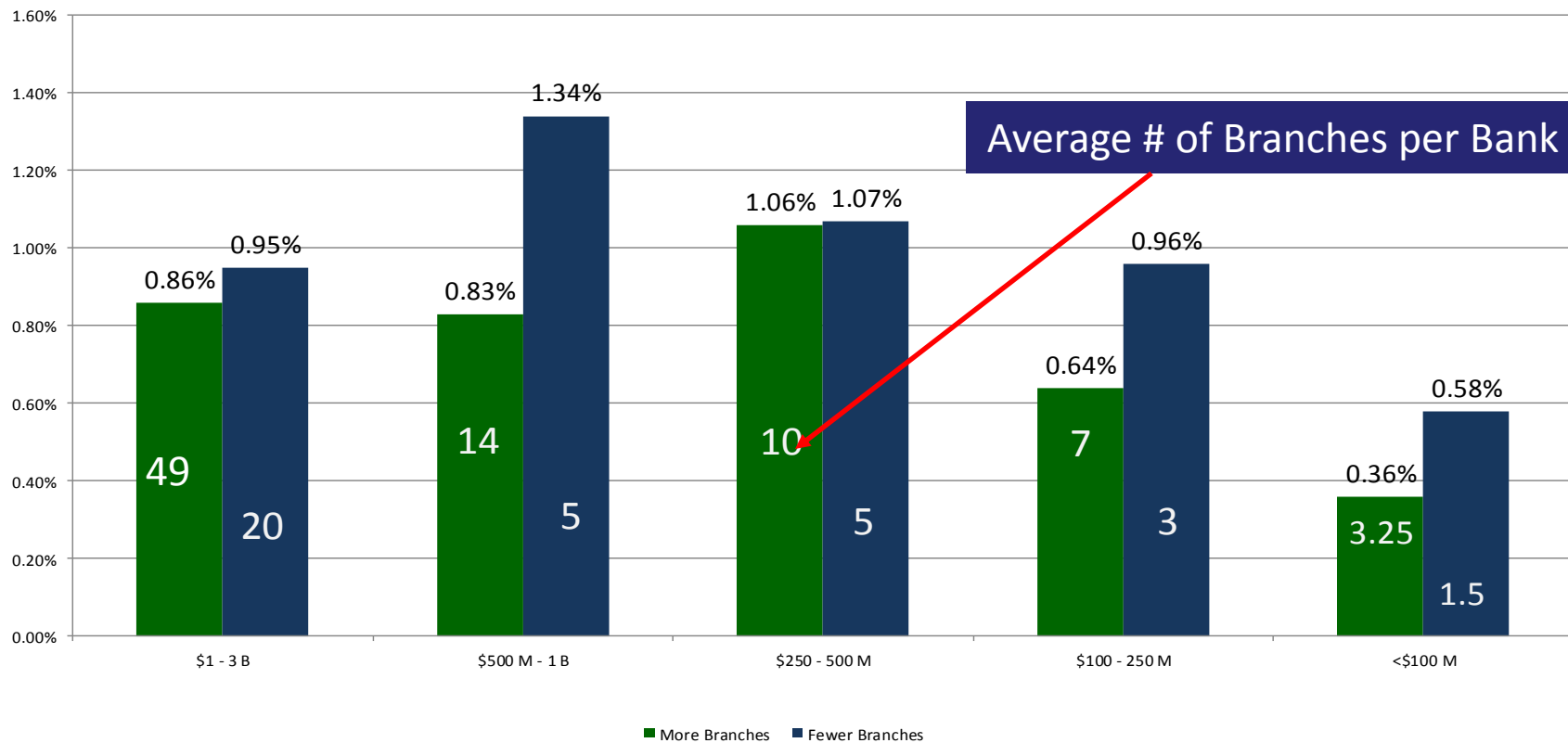
Since 1992: Cost per transaction has doubled
Monthly branch volume is half



Source: 2015 FMSI Teller Line Study – May 2015.

ARE BANKS WITH FEWER BRANCHES MORE PROFITABLE THAN BANKS WITH MORE BRANCHES?

ROA with More vs. Fewer Branches



ATTRIBUTES OF VARIOUS SERVICE DELIVERY METHODS

INTERNET &
MOBILE
BANKING

TRADITIONAL
BRANCH
BANKING

CONVENIENT
FAST
LOW COST

PERSONALIZED
SLOW
EXPENSIVE

PREFERRED BY
MILLENNIALS

PREFERRED BY
BABY-BOOMERS &
SENIORS

TRANSACTIONS THAT NO LONGER REQUIRE A BRANCH

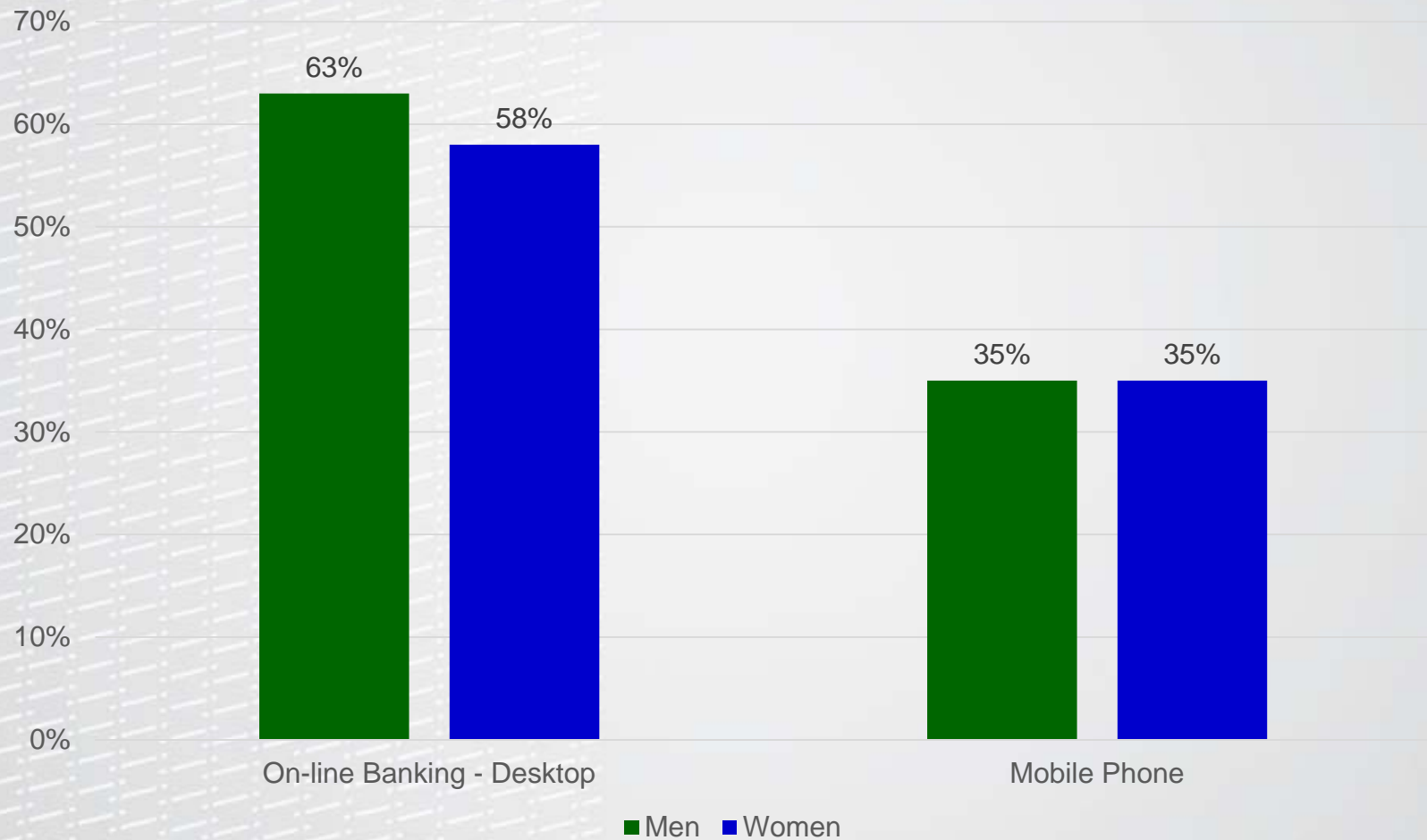
- Cash Deposit
- Cash Withdrawals
- Credit Card Transfers
- Opening of a deposit account
- Personal loan application
- Credit card application

TRANSACTIONS THAT STILL REQUIRE A BRANCH

- Business loans
- Investment advice
- Problem resolution
- Portions of mortgage loan application process
- Retirement planning assistance

WHO IS TODAY'S CUSTOMER?

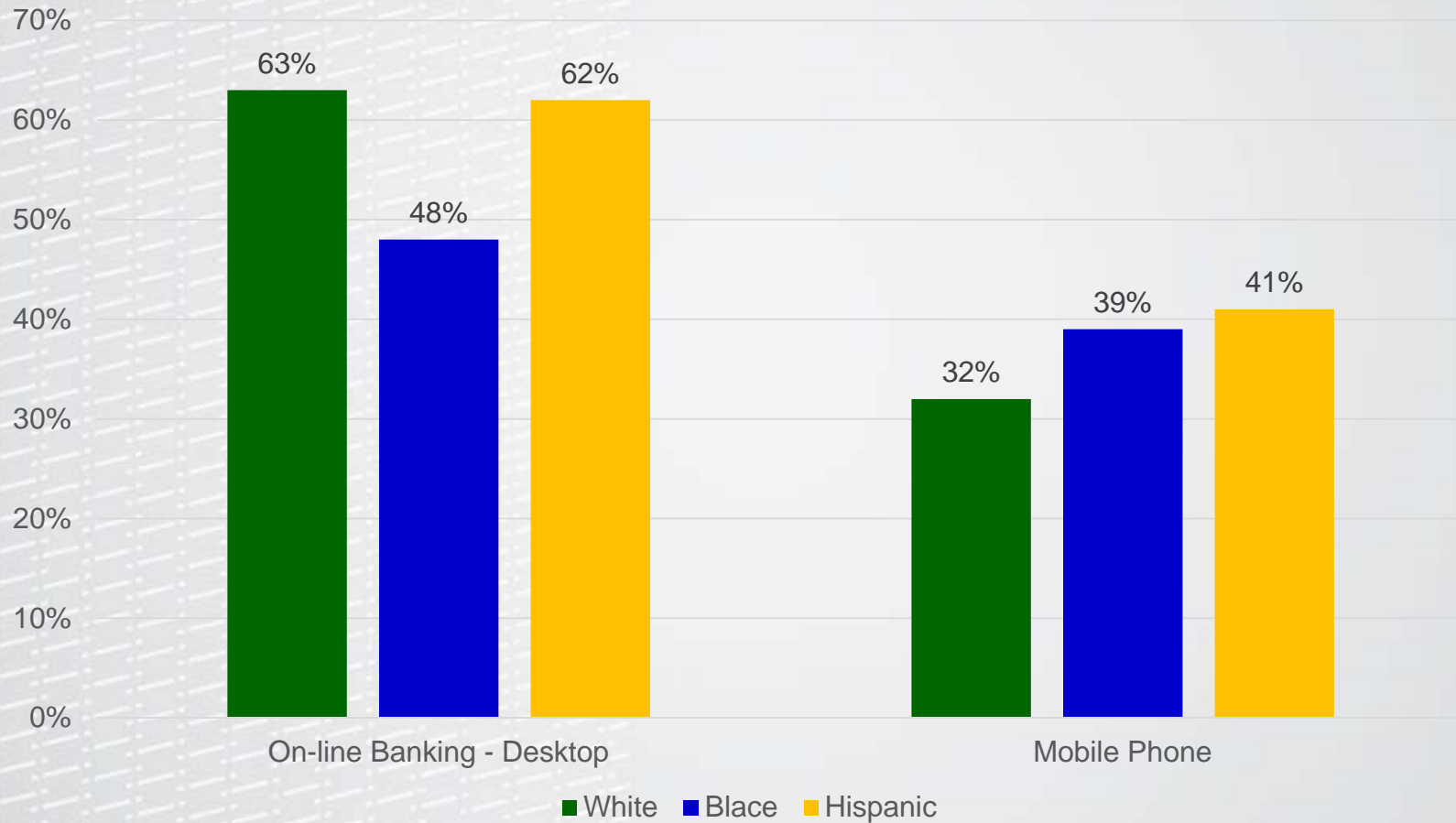
Technology Use by Demographic Group - GENDER



- Pew Research

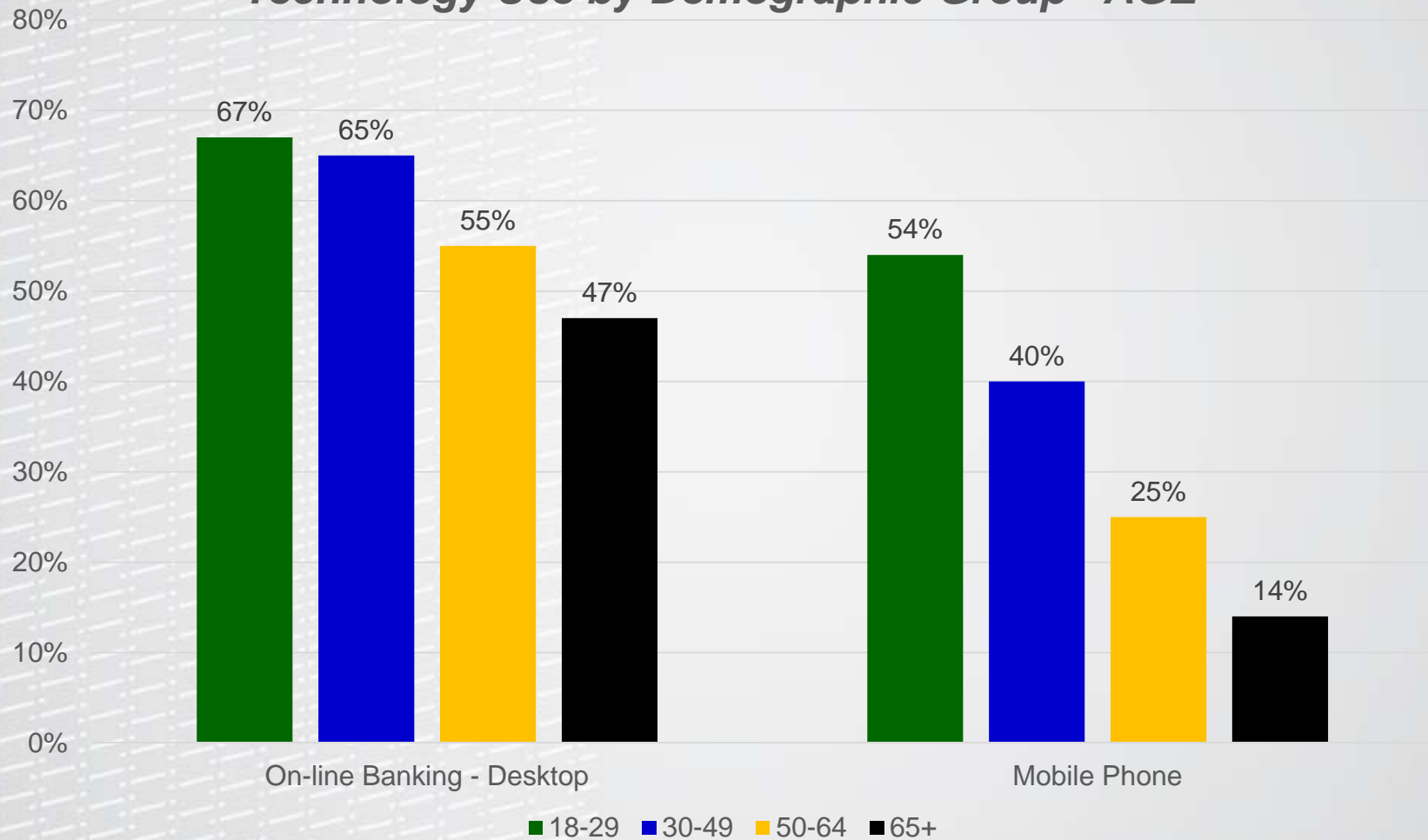
WHO IS TODAY'S CUSTOMER?

Technology Use by Demographic Group - ETHNICITY



WHO IS TODAY'S CUSTOMER?

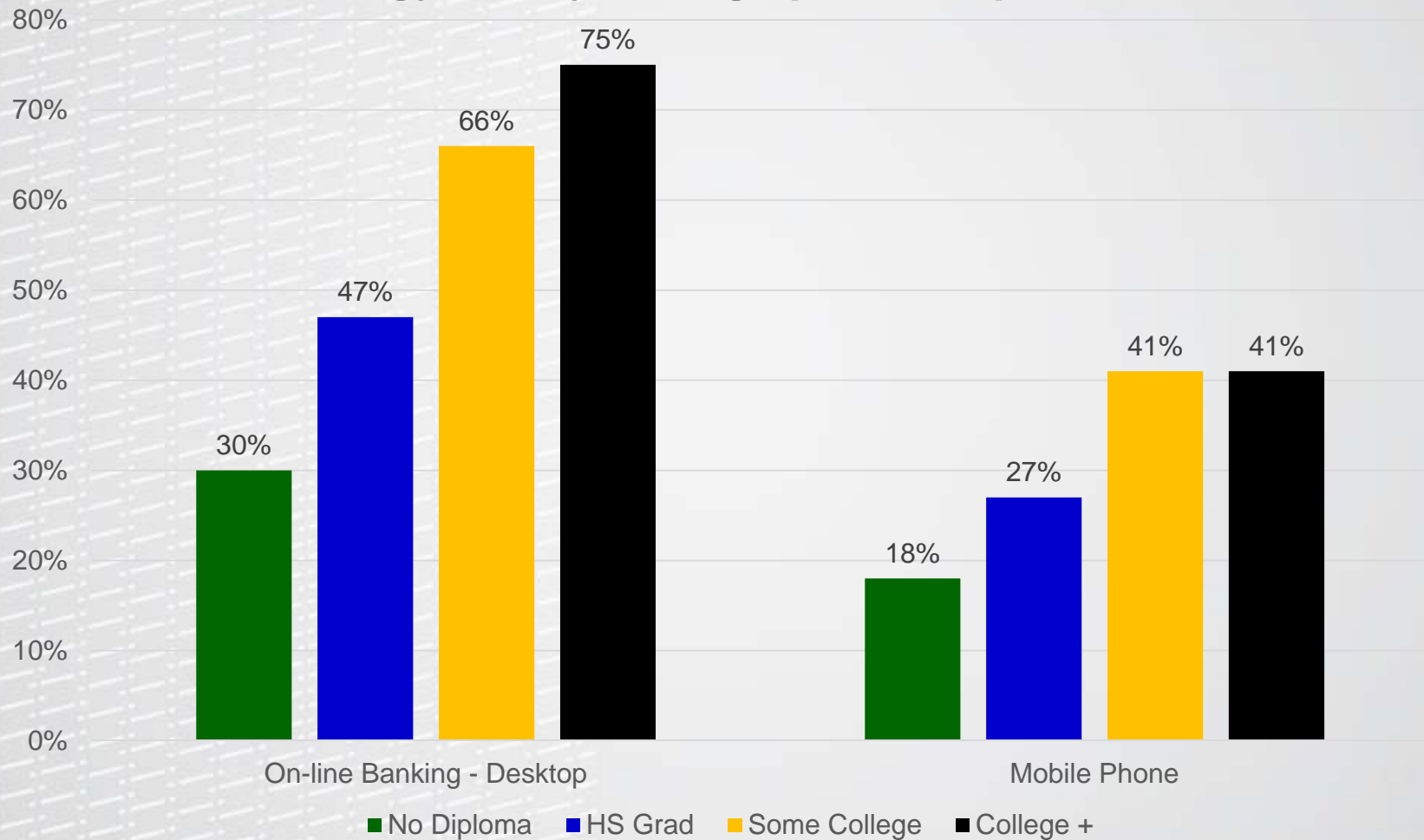
Technology Use by Demographic Group - AGE



- Pew Research

WHO IS TODAY'S CUSTOMER?

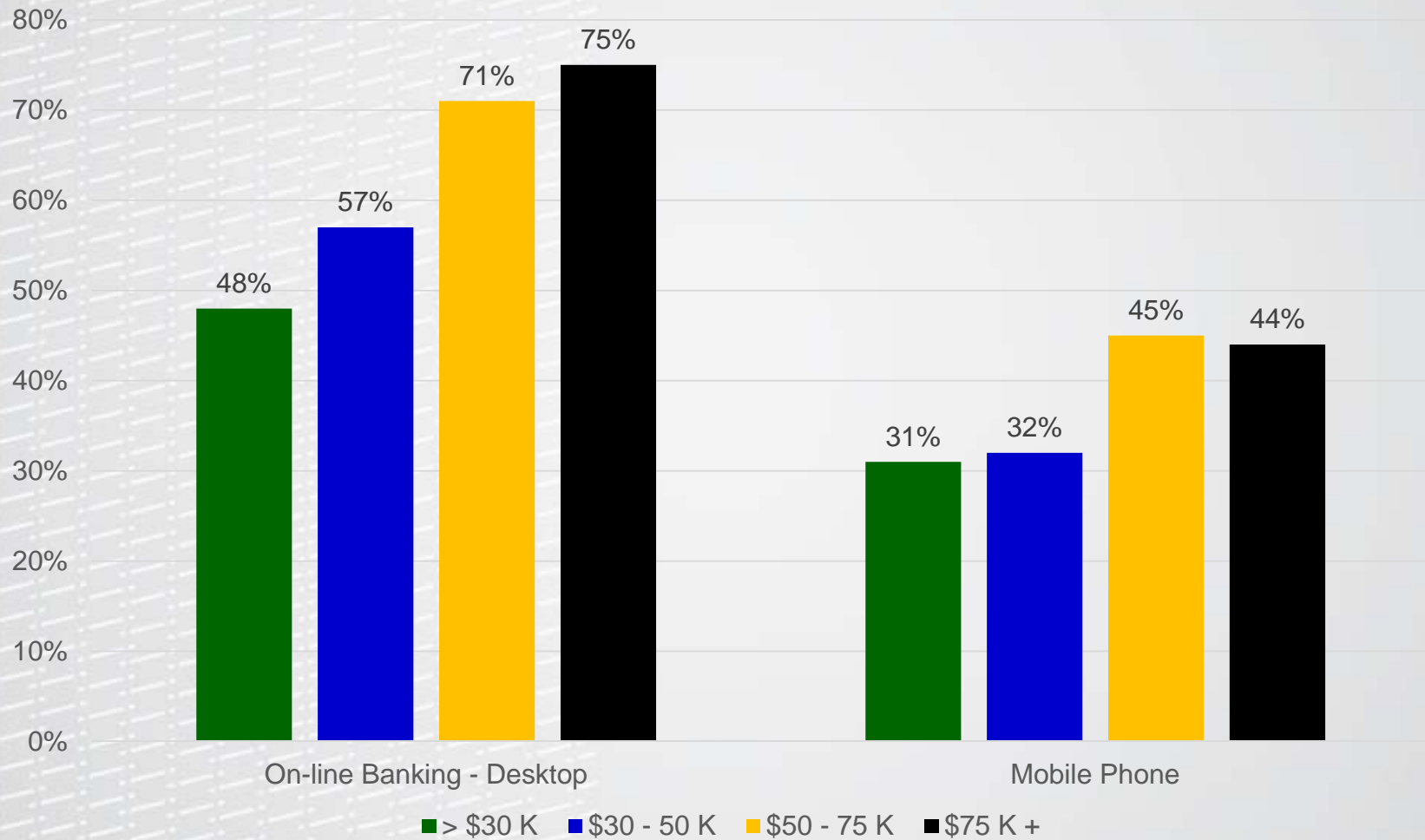
Technology Use by Demographic Group - EDUCATION



- Pew Research

WHO IS TODAY'S CUSTOMER?

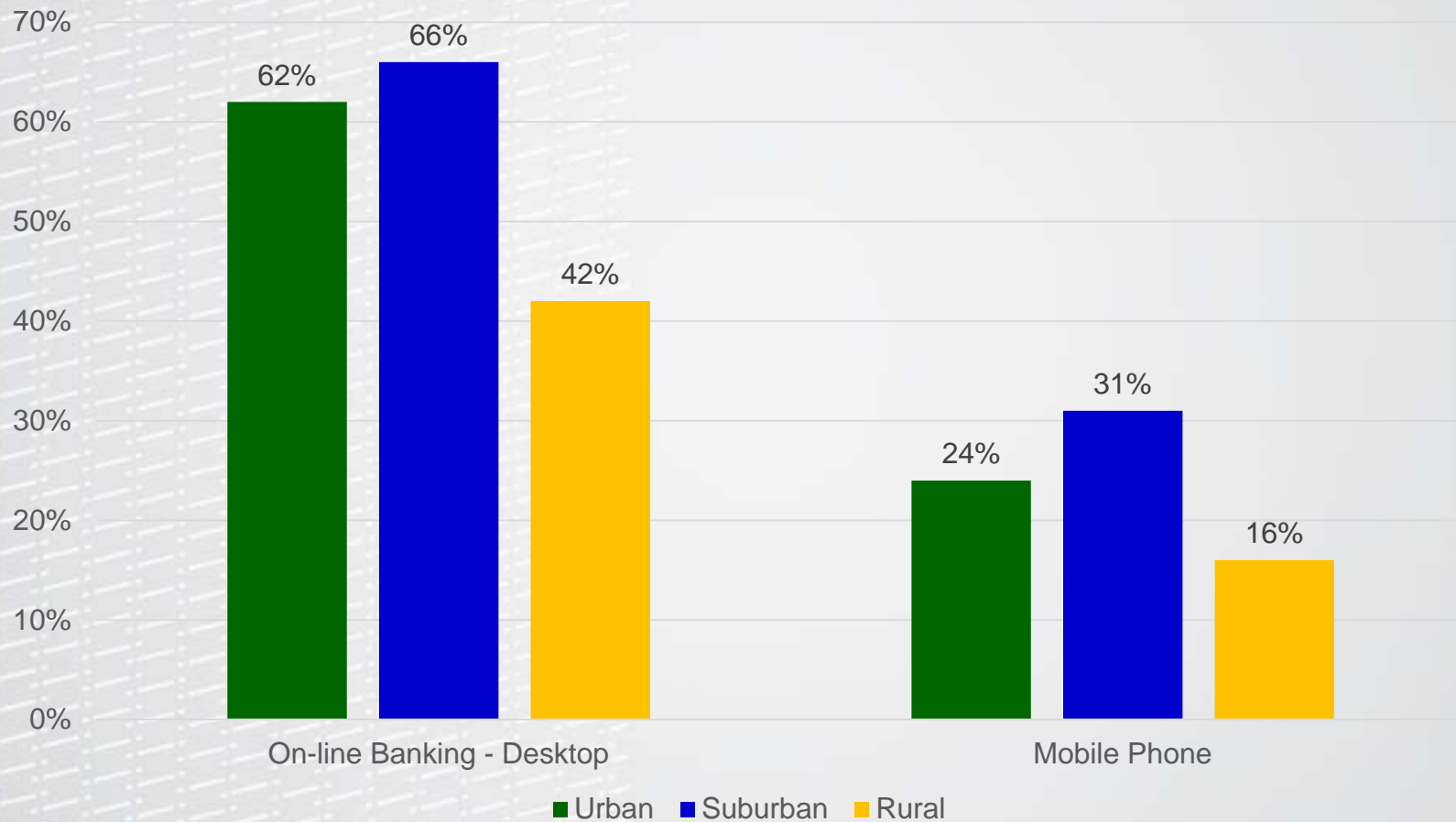
Technology Use by Demographic Group - INCOME



- Pew Research

WHO IS TODAY'S CUSTOMER?

Technology Use by Demographic Group - DWELLING



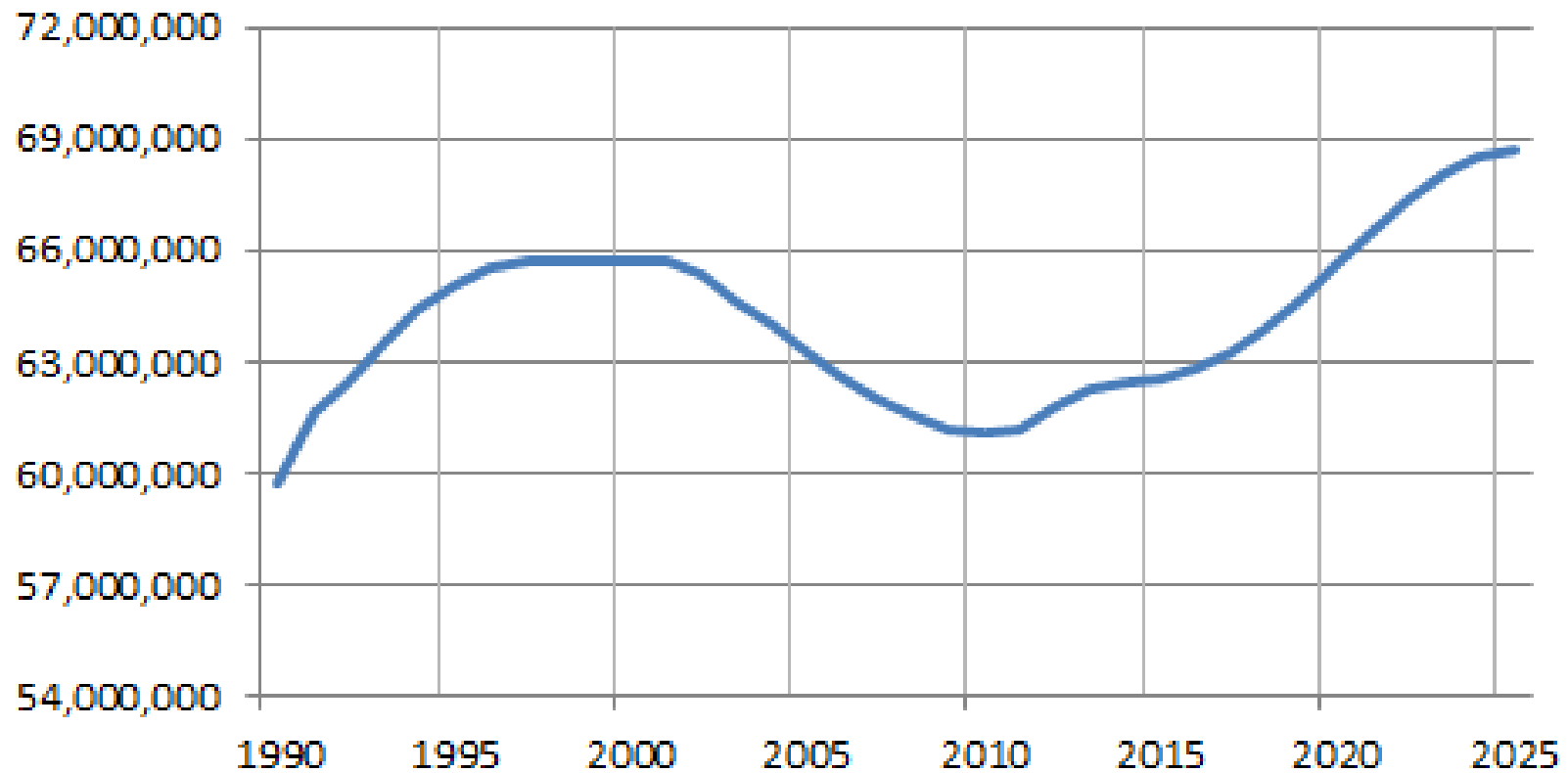
TODAY (AND TOMORROW'S) CUSTOMER

Demographic categories to watch

- **Age** is by far the most important at this point in time
- Followed by **ethnicity** (growth in Hispanics and Asians, foremost)
- **Gender**
- **Income**
- **Educational Level**

TODAY (AND TOMORROW'S) CUSTOMER

U.S. population, age 30-44



TODAY (AND TOMORROW'S) CUSTOMER

Why is the growth in 30 – 44 year olds so important?

- This age group # 1 in new business formation
 - Most new jobs comes from businesses < 5 years old
- They buy a lot of homes
- They also buy a lot of new cars
- This age group is a major driver of the US Economy

TODAY (AND TOMORROW'S) CUSTOMER

The impact of Millennials

- 86% of this group owned a smart phone in 2014
- Desire to do everything on their mobile devices
- Next, they want to digitize all commerce through their mobile camera

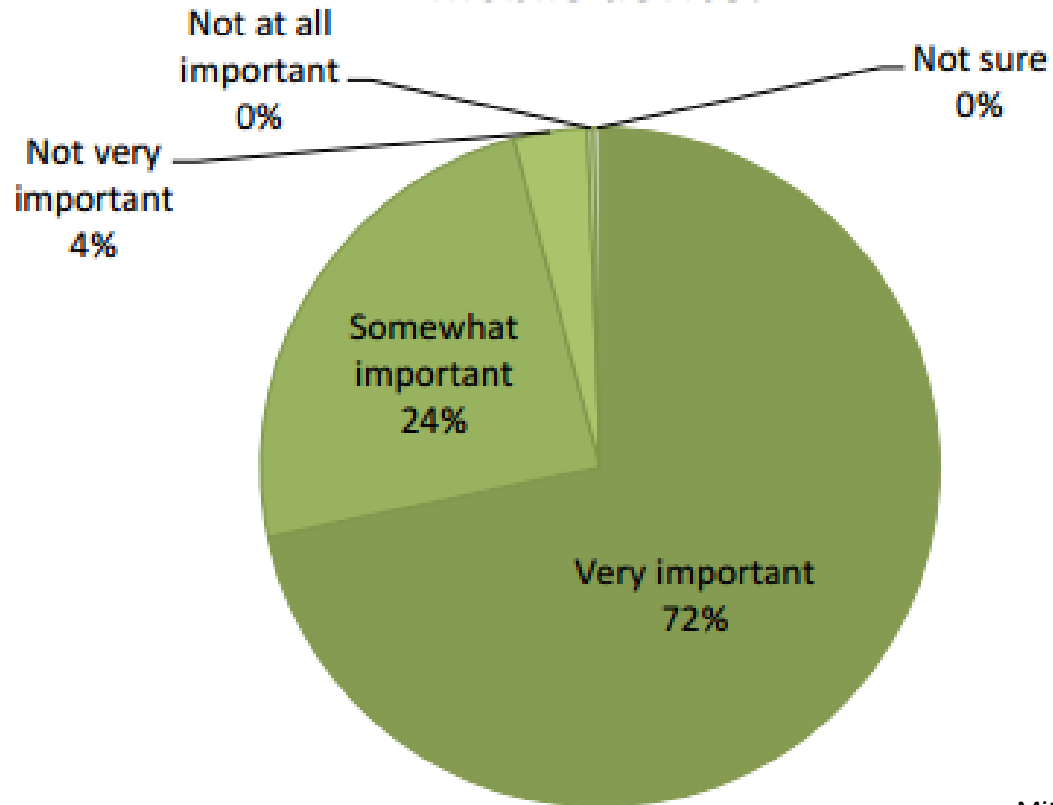


- 86% make purchases with smartphone (11% every day)

- Zogby Analytics

TODAY (AND TOMORROW'S) CUSTOMER

How important to you is the camera function of your mobile device?



- Mitek, eMarketer

TODAY (AND TOMORROW'S) CUSTOMER

The impact of Millennials

- 42% will switch companies based on mobile apps
- 54% report making mobile deposits with smartphone cameras
- 51% have a mobile wallet
- 86% willing to take extra steps for security

- Zogby Analytics

I AM SOOOO NOT ADDICTED
TO MY SMARTPHONE, BECAUSE
I HAVE AN APP THAT WARNS ME
IF I'M TURNING INTO AN ADDICT
AND IT HASN'T GONE OFF YET.



TRANSFORMATION

FROM

BRANCH BASED CUSTOMER RELATIONSHIPS

TO

MULTI-CHANNEL NETWORKS BASED ON TECHNOLOGY
WHICH INCORPORATES THE BRANCH AS SIMPLY ONE
CHANNEL

MAJOR CHALLENGE

IT WILL BE ESSENTIAL THAT THE NEW MULTI-CHANNEL NETWORK BE
MORE EFFICIENT THAN THE BRANCH ONLY NETWORK THAT PRECEDED

BRANCH PROFITABILITY ENHANCEMENT

More recent efforts

- Provide in branch self service options
- Push mobile
- Push on-line banking
- Call center / virtual branch
- Remote teller networks
- Push remote self service options
- Use of CRM to leverage customer knowledge

Traditional efforts

- Reduce hours
- Cut staff
- Smaller offices
- Push ATM use
- Bank by phone
- Close Branches
- Remote deposit
- Import work from other locations

TRANSFORMATION

ESSENTIALLY ALL ROUTINE TRANSACTIONS PUSHED TO ELECTRONIC CHANNELS

FACE TO FACE MEETINGS BECOME ALL ABOUT SALES / ADVICE

BRANCH TRANSFORMATION GOALS

“.....optimizing the channel mix as a part of a multi-channel strategy.....”

“....responding effectively to the changes in consumer behavior....”

RESPONSES TO CHANGING ENVIRONMENT

- Changes in number, size & location of branches
- Increased use of automation
- Greater use of specialist staff
- Private offices – not teller lines (personal advisory services, not transactions)
- Non-staffed (fully automated) branches
- Use of remote advisors

BRANCH TRANSFORMATION IMPACTS

Estimated impact on efficiency ratio for a typical retail bank (efficiency ratio declines as it improves), percentage points

Opportunity

Migrate teller deposit and withdrawal transactions to digital channels

Migrate teller payments and services to digital channels

Increase use of online bill pay

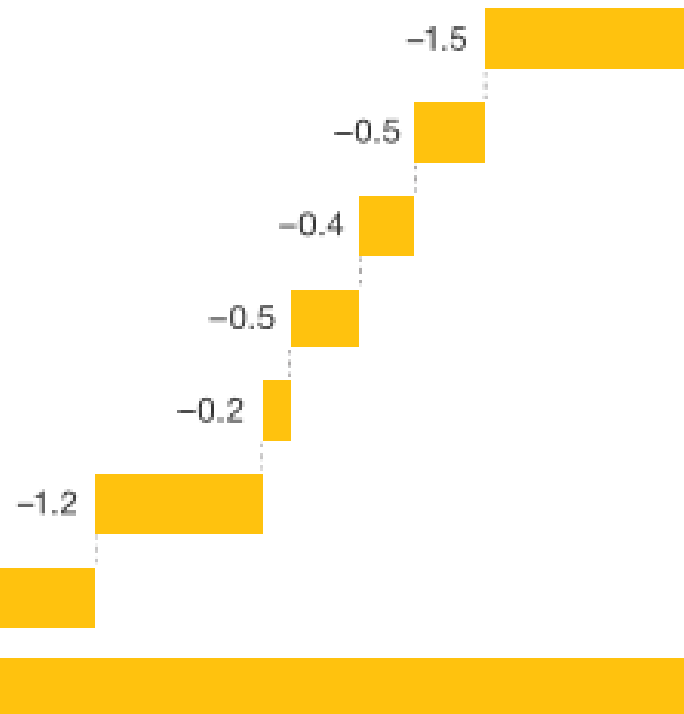
Increase use of debit cards

Increase adoption of online-only statements

Introduce new branch formats with smaller footprints

Thin the branch network -2.8

Total opportunity -7.1

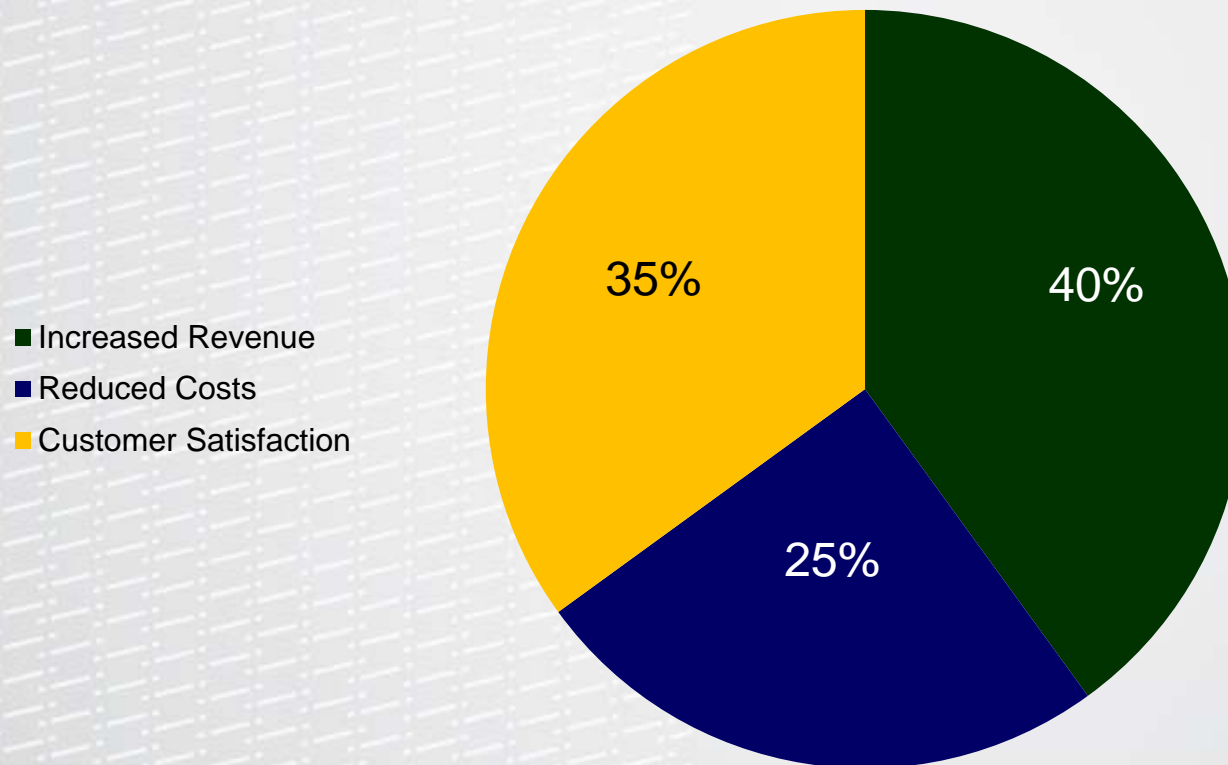


CHANGES IN BRANCH ASSOCIATE EXPERTISE

- More advisory in nature
- Importance of selling over service
- Greater need for education and training
- **You can't transform the Branch without transforming the Branch Staff**

PAYBACK ON BRANCH TRANSFORMATION

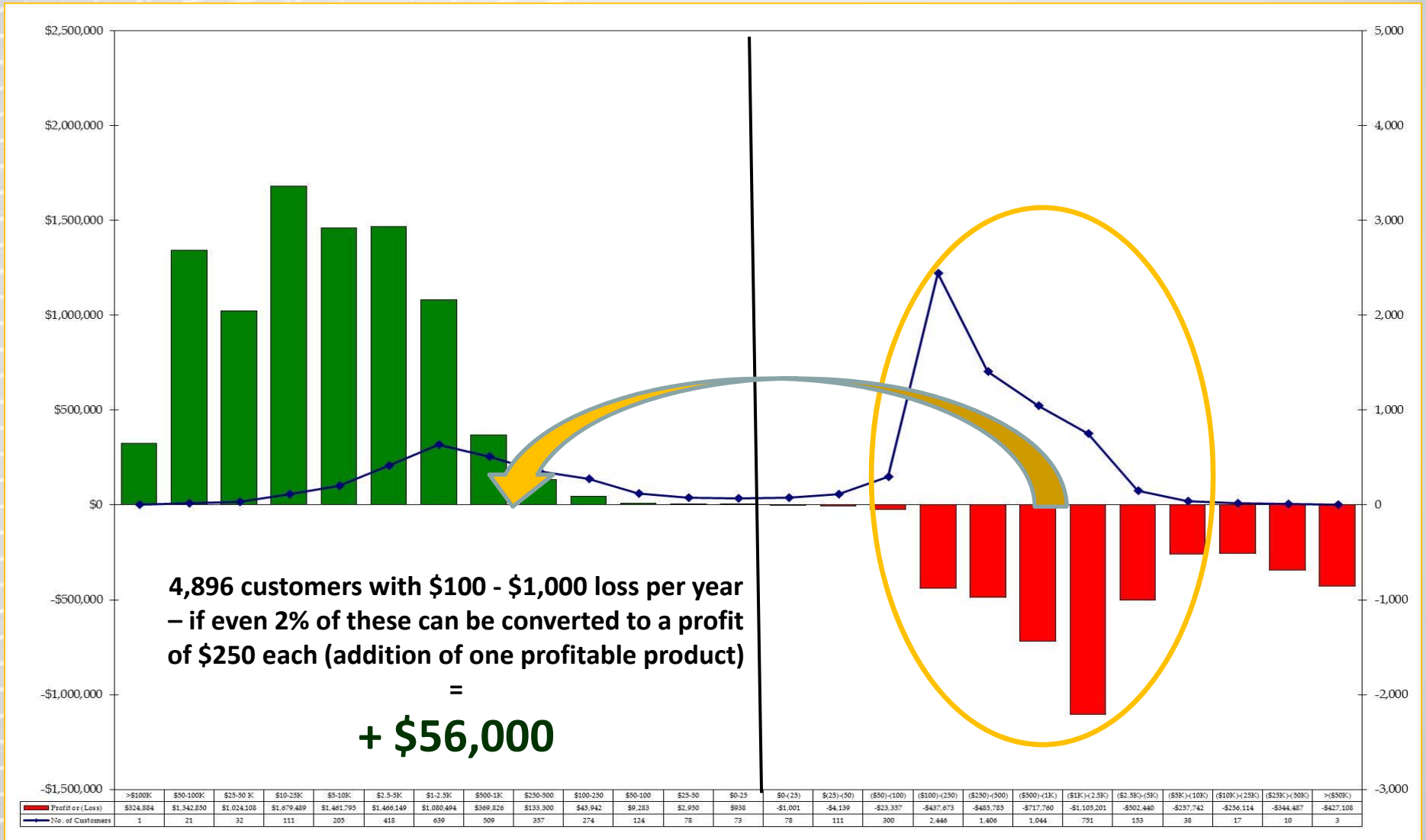
Sources of Payback



McKinsey & Company, August, 2014

CUSTOMER PROFITABILITY

USING BRANCH TRANSFORMATION TO GENERATE IMPROVEMENTS



DASHBOARDS TO MONITOR PROGRESS

KEY PERFORMANCE INDICATORS

AUSTIN EXAMPLE INSTITUTION

CURRENT QUARTER

BRANCH - ABC

ACCOUNTABLE PARTY

EVP - COO

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RETURN ON TIER I CAPITAL (ROE%)



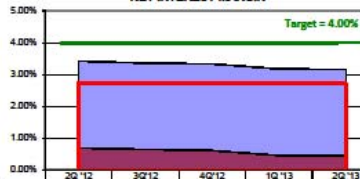
RETURN ON ASSETS (ROA%)



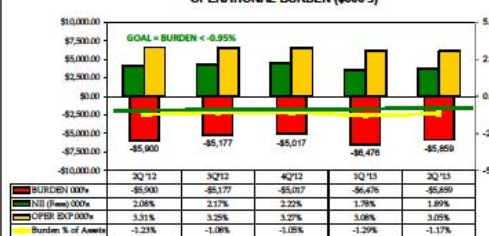
ANNUALIZED NET INCOME (\$000's)



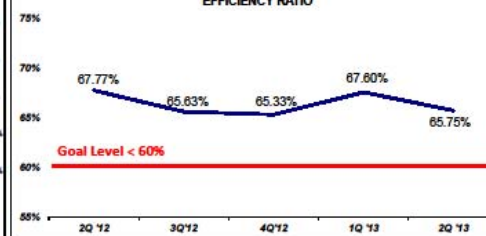
NET INTEREST MARGIN



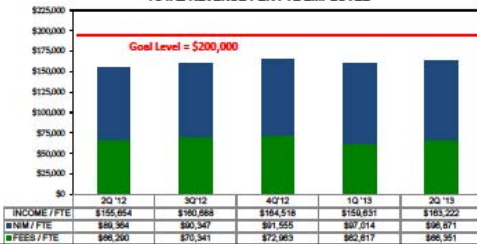
OPERATIONAL BURDEN (\$000's)



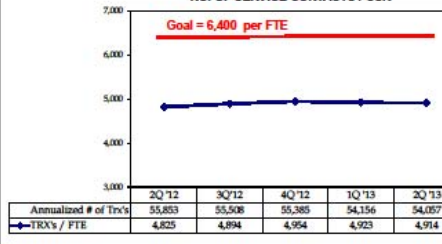
EFFICIENCY RATIO



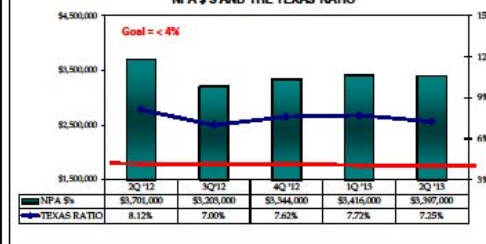
TOTAL REVENUE PER FTE EMPLOYEE



NO. OF SERVICE CONTACTS / CSR



NPA \$'S AND THE TEXAS RATIO



NEW METRICS

- Channel Profitability
 - Volume
 - Cost
 - Revenue
- Proportional use by Customer of each channel

DASHBOARDS TO MONITOR PROGRESS

KEY PERFORMANCE INDICATORS

AUSTIN EXAMPLE INSTITUTION

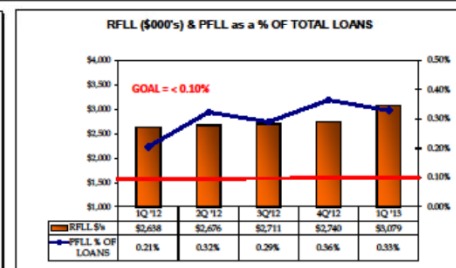
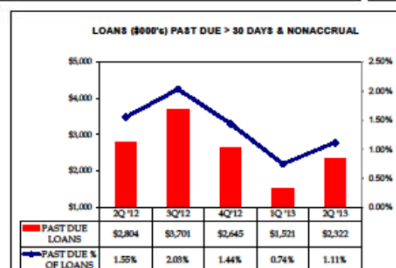
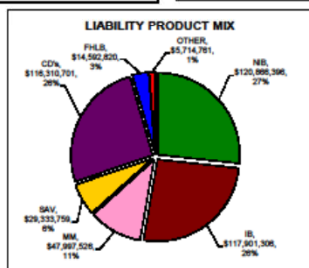
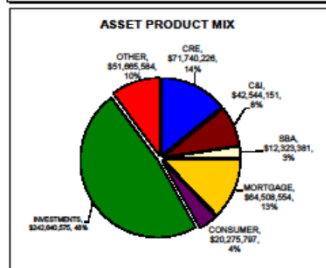
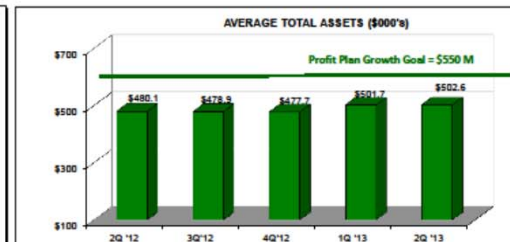
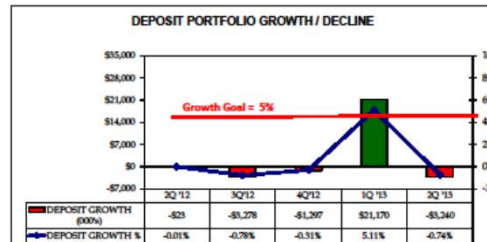
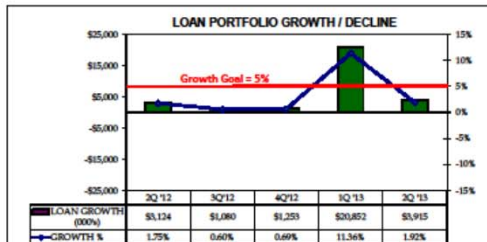
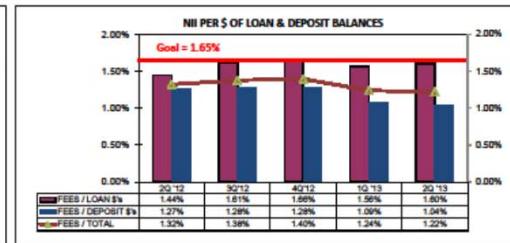
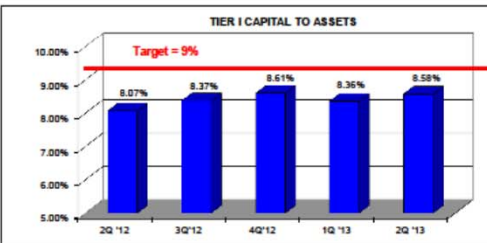
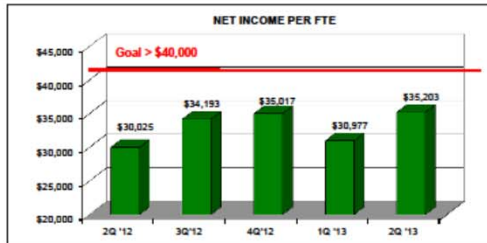
BRANCH - ABC

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CURRENT QUARTER

ACCOUNTABLE PARTY

EVP - COO



NEED FOR TRANSFORMATION

Powerful forces are reshaping the banking industry. Customer expectations, **technological** capabilities, regulatory requirements, **demographics** and economics are together creating an imperative to change.

Banks need to get ahead of these challenges and **retool** to win in the next era. Banks must not only execute on today's imperatives, but also radically innovate and transform themselves for the future.

- PWC Study on banking in 2020

Time for a few questions ?

**THANK YOU FOR ATTENDING TODAY'S
PRESENTATION!**

PRESENTER

Jeff Morris- joined Austin Associates' Financial Management Division in 1998. He is responsible for profitability analysis services and works with clients who utilize the firm's innovative software products, including its proprietary organization/product/customer profitability software and its loan and deposit pricing software, with over 35 years experience in various financial management roles.



Jeff Morris

**Managing Director & Principal
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AUSTIN ASSOCIATES, LLC

Financial Management Consultants for Community Bankers

- Community bank advisors for more than 40 years
- Specialized consulting and advisory services
 - Asset / Liability Management
 - **Profitability Measurement & Improvement**
 - Loan & Relationship Pricing Systems
 - Balance Sheet Structuring
 - Regulatory Compliance
- Current owners are consultants/managers
- Over 200 bank/thrift clients in 2014 in 26 states

CONTACTS

We appreciate hearing from you.

If you have questions or comments, regarding today's presentation, or if you would like to discuss your branch and channel network transformation plans, please feel free to contact us at any time.

We would also be pleased to provide your management team with a personalized demonstration of the Austin Profitability System - simply contact Jeff to arrange a date and time for your demo.

Jeff Morris

Managing Director & Principal
Financial Management & Consulting

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Enhancing profitability

Do-it-yourself service

Who is today's customer

December 3, 2015

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