Financial Managers Society

fmswhitepaper

Low transaction-volume branches: An overlooked opportunity

By Michael Scott
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Executive Summary

In 2012 community banks and credit unions face many external conditions, which affect their bottom lines, including:

- Regulation E – a reduction in NSF fees
- Continued loan losses from unemployment, an ailing housing market, and a sluggish economy
- Reduced revenues from loans and associated fees due to the economy
- Rising labor and overhead costs

Among these many challenges lies an often overlooked “internal” condition that shares an equally substantial negative impact on the bottom line - the cost implications of low volume branches (LVB). It is of no surprise for many to learn that LVBs have the highest costs per transaction in a branch network. However, many are surprised by the actual financial impact LVBs are having on the operational efficiency of the entire network of branches.

Defined as a branch with less than 3,000 teller transactions per month, on average, LVBs represent 22% of most retail branch networks, yet only 6% of the total transaction volume, resulting in an average paid labor cost per transaction being 106% higher for LVBs. The resulting operational inefficiency is costing financial institutions enormous amounts of money – every year.

This white paper illustrates how bank and credit union executive management has the opportunity to make decisions, supported by validated data, that can significantly reduce the negative financial impacts that low volume branches are having on their branch networks.

Over the past two decades, the financial institution retail branch environment has experienced many dramatic shifts, including a 40.2% decrease in branch transaction volumes (see figure 1.1) and a 76.1% increase in salary & benefit rates (see figure 1.2), which have both driven the average labor cost per transaction up by 119%. This coupled with uncertain economic times has led many financial institutions towards getting a better handle on branch staffing, which can be an effective way to reduce non-interest operating expenses.

In addition, while we may be starting to see signs of a recovery from the housing bubble, the economy still is offering unique challenges in the financial institution industry. There are also substantial differences in how the younger generations are doing their banking. Generation X, the Millennials, and Generation Z, coupled with new technologies, will completely change the way consumers interact with their financial institutions in the near future and beyond.

figure 1.1

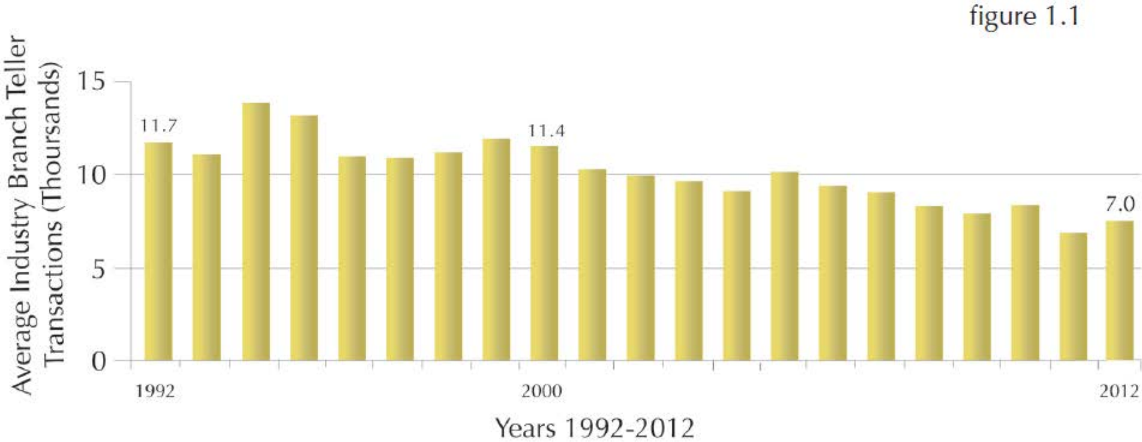
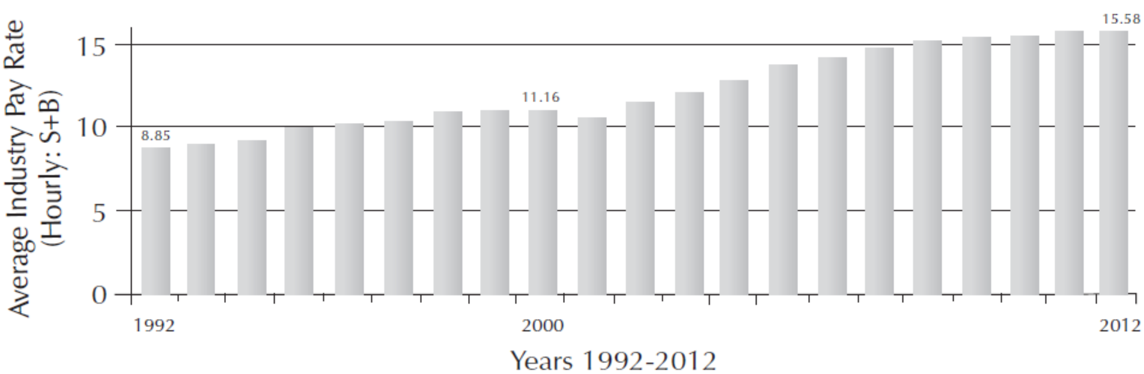


figure 1.2



A November 2010 Teller Transaction Analysis study of 100 financial institutions comprised of both community banks and credit unions conducted by FMSI shows the current environment of low volume branches (LVB) compared to larger volume branches:

LVB Branch Teller Transaction Analysis: November 2010 Data

Figure 1.3

	All	Large/Medium-Volume Branch	Low Volume Branch
1. % of Branches	100%	78.1%	21.9%
2. Weekly Hrs. of Operation	48.8 Hrs	49.6 Hrs	45.9 Hrs
3. Avg. Monthly Teller Transactions	6741	8074	1995
4. % of Volume	100%	93.5%	6.5%
5. Avg. Daily Volume	306.4	367	90.7
6. Avg. Daily Processing Hours	18.4	21.1	8.9
7. Excessive Waiting for Work% (EWFW)	31%	25.2%	51.8%
8. Teller Productivity - Trans Per Hr.	16.65	17.4	10.1
9. Paid Labor Cost Per Transaction	$1.57	$1.34	$2.76

Notes:

1. *LVB represent 21.9% of branches and process 6.5% of the volume.*
2. *Weekly hours of operation are too long for the volume handled causing EWFW by design, amounting to 51.8% under-utilization of staff.*
3. *On average there is one teller transaction every six minutes in a LVB.*
4. *LVB salary and benefit costs per teller transaction of $2.76 is 106% greater than for the non LVB.*

Teller Productivity

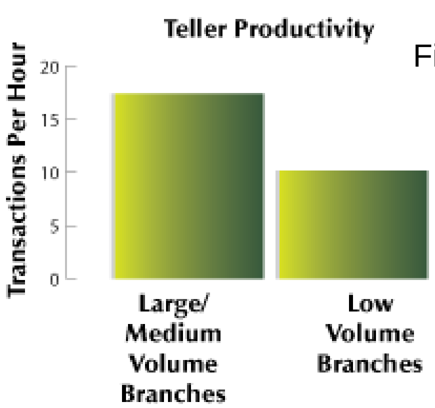


Figure 1.4

What is the business intelligence from these numbers?

As a recap of the LVB Branch Teller Transaction Analysis chart (figure 1.3), 21.9% of the branches are considered LVB (branches with less than 3,000 teller transactions a month), and those branches process only 6% of the total teller transactions. There is a paid labor cost per teller transaction of $2.76 (two FTE with an average annual volume of 24,000 teller transactions), and an average LVB annual paid total branch labor cost per LVB of 3.5 FTEs of $113,000.

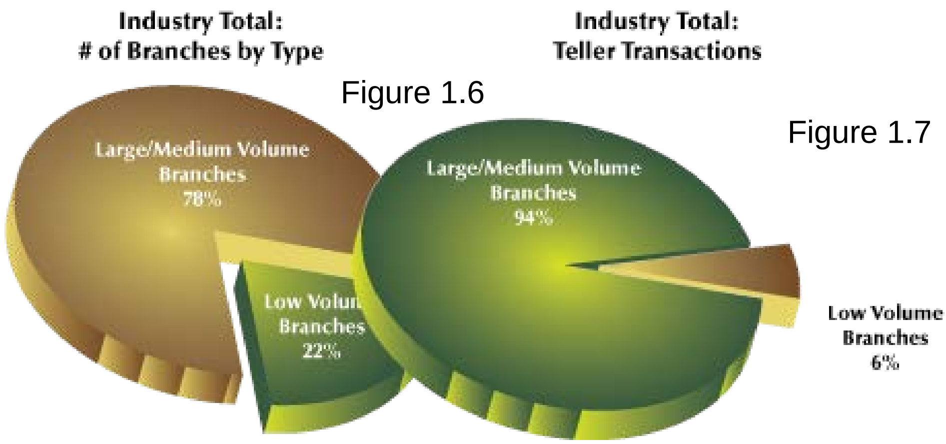


Figure 1.6

Figure 1.7

With the combined cost of labor, utilities, technology, maintenance, and property taxes reaching an annual operating cost at a minimum of $150,000 to $250,000 per LVB, these branches are costly to operate. Another way of looking at this cost is to break even on the operating expenses for a LVB, the branch would have to generate and maintain a collectable loan portfolio, with a net 3% interest rate margin spread, totaling $5,000,000.

Why does this environment exist?

This often overlooked set of branches is many times not noticed because:

- They were inherited from an acquisition.
- They were new branches that never grew as expected.
- They are in a community that would otherwise not be served.
- The focus was on the larger branches.
- The magnitude of the low volume transactions and the costs associated. with them was simply never realized.

Whatever the reasons, now that the impact of LVBs is known, management has the opportunity to make decisions supported by validated data.

What can we do with low volume branches?

If the LVB were to be closed or consolidated into other neighboring branches, history shows there would be little to no volume lost. In closing the LVB and leaving that market, most of the activities would not migrate to other branches.

Below are some possible actions to consider:

- Do nothing, management knows the costs associated and will take the loss as a cost of doing business.
- Reduce the weekly hours of operation. While actual hours of reduction will vary based on your particular branch network environment, FMSI's study suggests, the average weekly hours of operation could be reduced as much as 25-35% from the current study's 45.9 hours per week to a more modest number of 30 (M-F 9 to 3) or 35 (M-F 9 to 4).
- Close LVB Saturday operations. The FMSI study results show closing these branches will result in a minimum impact on branch network transaction volume given these branches average only 50 transactions on a Saturday. While your actual institution impact will vary, the results should closely mirror the FMSI study results.
- Minimize labor intensive dual control with the use of technology. Use cash recyclers and teller image capture. One teller could easily handle this volume of transactions and the use of a cash recycler would take the place of dual control and the cash vault. The teller image capture will eliminate the need for branch capture and provide a good audit trail. These technologies can reduce the teller labor costs by 50%.

What can we do with low volume branches? (continued)

Below are some possible actions to consider:

- Branch consolidation, absorbing these LVB into other nearby branches.
- Close some of the LVB and leave that particular market.
- Install electronic control systems in the LVB to minimize the need for dual control, this is the single most contributor to the LVB overstaffing.
- Have these branches become a customer service call center. If your other branches are taking customer service calls in the branch, have your telephone systems configured to send incoming branch phone calls to these low volume branches to be handled and free up the larger branches to service their onsite customers.
- History repeats itself. We are now seeing the larger banks moving to tiered checking account fees based on averaged balances. In January 2011, Bank of America announced their basic checking accounts would have a monthly service charge of $9. We will see tiered pricing again based on checking account average balances maintained. With the LVB, you could consider offering free checking for those specific branches, to increase market share and better utilize those facilities.
- Some innovative banks are now providing branches with video screens for account holders to use. On the video screen is a remote teller who is virtually helping them in video chat. This approach would eliminate the staffing need at remote locations, while still providing the branch services for the account holders in the area.

Overlook or take action?

Become aware of the cost of LVBs in your organization. As highlighted in this paper, they are costly, not likely to grow in size, and will continue to become more costly over time. Take the right steps to analyze your LVBs and take appropriate actions. Knowing your particular numbers is the first step.

- How many LVBs do you have?
- What are your costs per LVB?
- What is your decision criteria to keep a LVB open?
- Have you conducted an hours of operation analysis?
- Can you consolidate or close any LVBs?
- How will you use technology to conquer this expensive challenge?
- What kind of metrics will you add to your monthly reporting?
- Are you sure you are making a profit on your LVBs?
- What are your other options?

Summary conclusion

Financial institutions will continue to experience the impacts of a constantly changing industry. Transaction volumes will continue to decline while salary and benefits will continue to increase. With a constant threat of federal regulations in the air and an increasingly competitive environment, financial institutions that continue down the same path of inaction as it relates to their low volume branches, will certainly miss out on a critical cost savings initiative. Conversely, financial institutions that implement an initiative that ultimately decides how they handle low volume branches - will achieve great indefinite cost savings.

W. Michael Scott – President / CEO of FMSI (mikes@fmsi.com) began his banking career in 1968 and encompassed 15 years of managing all operational areas of a large financial institution. Since 1983, he has been involved in delivering management consulting services to institutions across the nation. In 1990, Mr. Scott incorporated FMSI as a firm specializing in Performance Management Information Reporting.

Atlanta-based FMSI has assisted over 600 nationwide financial institutions in optimizing their branch networks through applying actionable business intelligence from the analysis of transaction data. The average FMSI client has saved $30,000 per year, per branch. All FMSI clients receive extensive monthly reports—including a ranking report that consists of all their peer's productivity metrics that are utilizing the FMSI solution—for comparison benchmarking purposes. For more information, contact Gordon A. Williams, EVP Business Development, @ 877.887.3022 or gordonw@fmsi.com. www.fmsi.com

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