



Key Note

Retail Branch Banking

Digest

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Executive Summary

Shifting customer demographics and developments in new technology are bringing major changes to retail banking. This is a market where traditional branch banks face a surge of competition from other financial services providers wishing to expand into banking, and from new market entrants from outside the financial sector.

As technology makes the dissemination of information easier, an increasing variety of distribution channels is starting to make the source of retail banking products transparent. Throughout the world, financial service providers are looking towards a new concept of 'anytime, anywhere, anyhow' banking, which demands that retail banks of the future find better ways of delivering a complete set of lifestyle-based financial services which simplify their customers' lives and allow them more personal time — an increasingly precious commodity.

The UK market for retail banking products and services is very large, and the provision of such services is not limited to retail banks and building societies, insurance and loan companies being part of the market. Key Note estimates the market's value in 1996 to have been £173.71bn. As yet, much of the business is conducted within separate, specialised financial services sectors; but as retail banking expands to provide a wider and more complete customer service, many of these separate businesses will converge.

Several of the companies in the market do not at the moment separately file the value of their retail banking services as defined in this market report. But Key Note estimates that in 1997 at current prices, £94.37bn of business will be transacted by strictly-defined retail banks, telephone banks and the converted building societies, and over the next 5 years, volumes will increase dramatically, reaching £136.01bn in the year 2001.

During the period of market transition, traditional retail branch banks must finance the costs of change, ward off increasingly serious competition and continue to earn profits if they are to survive. Their ability to successfully manage their businesses through such a difficult period is likely to prove a significant challenge.

Market Size

Retail banking services are now being offered by a much wider spectrum of organisations. For this reason, in order to assess the size of the total UK market, it is no longer possible to simply consider the personal sector deposits and lending taking place within the major UK banking groups and the other smaller retail banks. Covering market activity through all financial institutions, not merely the retail banks and building societies, the total market was valued at £155.14bn in 1995 and £173.71bn in 1996.

CASH MANAGEMENT

M4 is the statistical term for sterling notes and coins, and all sterling deposits at UK banks and building societies held by the M4 private sector. The sector comprises private individuals and small companies.

RISK MANAGEMENT

Customers need to be sold what they want to buy, rather than what the retail bank might want to sell them. Banks must hold on to their existing customers by providing them with the personalised services they will need at different stages in their life cycle; hence the recent trends towards diversification. Key products in the risk management sector are: life insurance; motor insurance; domestic property and contents insurance; health and unemployment insurance.

INVESTMENTS FOR WEALTH AND FUTURE INCOME

Financial services is a market in which, over the past 5 years, all the major retail banks, building societies and insurers have invested heavily. Many experienced a backlash when consumers finally lost patience and rejected the high-pressure sales methods and mis-selling which occurred.

In spite of the difficulties suffered by the industry, the inadequate pensions provision offered by government and many corporate pension schemes creates an ongoing opportunity for the development and mass sale of attractive private pensions.

LENDING

Lending largely consists of net mortgage lending and other loans — most of which are included within the national figures for consumer credit. The sale of mortgages forms an integral part of retail banking, whether sold over a counter, via the telephone or through other media.

Other personal sector lending includes lending by banks, building societies and other specialist lenders (including finance houses), retailers and insurance companies. Bank lending comprises: credit card lending; overdrafts; and all other loans and advances to individuals which do not qualify as 'secured'. Other specialist lenders comprise non-bank credit granters and specialist mortgage lenders extending consumer credit.

Industry Structure

DISTRIBUTION

The choice of delivery channels is already extensive, and over the coming years will become larger, as a result of the increasing developments in technology. For routine transactions, bank branches are likely to lose their traditional role and shrink dramatically. Customers wishing to meet branch personnel will increasingly be served by express banking shops in offices, shopping malls and leisure areas. Remote services, which today are largely based on the telephone, will expand to include PCs, digital televisions (TVs), enhanced automatic teller machines (ATMs) and kiosks.

The numbers of staff employed full-time in retail banks, already reducing rapidly, will continue to shrink as a result of the centralisation of functions, outsourcing, and the shift towards self-service distribution channels.

Owing to rationalisation, it is possible that some branches transferring to banks will be closed, and the estimates have taken this into account. Branch numbers for banks include the major UK banking groups, Clydesdale Bank PLC, The Co-operative Bank PLC, Yorkshire Bank PLC and other banking groups.

Even though the total number of retail outlets under the 'banks' category increased sharply in 1996, as a result of the conversions from building societies, the combined total of retail outlets continues to show a steady decline. Over the period 1992 to 1996 it amounts to 12.8%, a fall from a total of 18,554 to 16,182.

As the number of retail branch outlets declines, so the number of installed cash dispensers and ATMs has increased. Particularly important is the dramatic growth of those being installed away from retail branches, in shops, stations, petrol stations and other convenient locations. In 1992 there was a total of 18,461 ATMs, of which 1,250 were in locations other than branches. In 1996 these figures were 26,360 and 3,254 respectively.

EMPLOYMENT

In 1996, staff numbers continued to decline, with particular concentration of reductions in the retail sector. Branches in small towns have either been closed altogether, or have become satellites of the nearest large town branch, which has taken over the management control.

Employment in major banks and building societies decreased from 415,737 in 1992 to an estimated 368,178 in 1996. Within these figures, there has been a distinct increase in part-time employment. In the major banks, between 1992 and 1996, full-time male employment has declined by 16%, and full-time female by 10%. Part-time male employment has increased by 64%, but in 1996 represented only 0.7% of total staff. Part-time female employment, over

the same period, increased by 11% and in 1996 represented 19.5% of total staff.

TRADE ASSOCIATIONS

The **British Bankers' Association (BBA)** was formed in 1919 to provide facilities for the discussion of matters of interest to UK banks, and to make representation on their behalf. The BBA issues an Annual Abstract of Banking Statistics, organises conferences and meetings, and is engaged in research. The Association is affiliated to the **European Union Banking Federation**, and has around 346 full members. A press and information service is provided.

The **Association for Payment Clearing Services (APACS)** is the body responsible for matters relating to money transmission and payment clearing activities in the UK. Membership of APACS includes all those financial institutions playing a significant part in the provision of such services. In addition to managing the UK's payment clearance systems, APACS is responsible for the future development of the clearings and for examining the developments taking place in appropriate new technologies, particularly in the areas of plastic cards and anti-fraud measures. Above all, APACS is the forum for the discussion and resolution of issues relating to money transmission, and as such is recognised throughout the world as the authority for the payments industry in the UK.

The **Building Societies Association (BSA)** acts on behalf of the building society industry. It is run by a council of members which are appointed from building societies and which represent the industry's interests to government. The BSA runs a statistical service and offers guidance on key issues. The BSA and **Council of Mortgage Lenders (CML)** operate from the same building and share information.

The **Building Societies Commission (BSC)** is a regulatory body which ensures that building societies conform to the provisions of the 1986 Building Societies Act. It also functions as an industry watchdog, to ensure that societies invest money and use investors' funds prudently. The Commission is funded by a levy on building societies, but operates independently.

The **Building Societies Ombudsman** deals with complaints from members of the public who are having difficulties with their building society accounts.

Major Players

- Arising from the acquisition of the Cheltenham & Gloucester Building Society in 1995, and the merger between Lloyds Bank PLC and TSB Bank PLC, which took place in 1996, the business of **Lloyds TSB Group PLC** has now been grouped into the five main divisions of: Retail Banking; Mortgages; Insurance; Wholesale Markets; and International Banking. Current initiatives being pursued by Lloyds TSB Group PLC include: TSB PC Banking (an online real-time personal computer (PC) banking service, offered through CompuServe (UK) Ltd); TV Banking (a joint venture with Video Networks Ltd, which will allow customers to access their bank account from their television sets); and TSB's and Lloyds Bank's telephone banking services.
- In 1992, **Midland Bank PLC** was acquired by The Hong Kong and Shanghai Banking Corporation Ltd (HSBC), one of the largest banking and financial services organisations in the world. First Direct Ltd, which is a division of Midland Bank, claims leadership in the UK market for telephone banking. Current Midland initiatives in retail banking include:
 - membership of the Mondex electronic smart card scheme and the Mondex student card being tested at the University of York
 - the Hexagon PC-based banking system
 - Internet banking via an Internet-style version of Hexagon with an easy-to-use connection to Microsoft Money 97
 - ownership of 20% of British Interactive Broadcasting Ltd (BIB), with BT (32.5%), British Sky Broadcasting Group PLC (32.5%) and Matsushita Electric (15%). BIB is an independent company created to deliver digital interactive services to television viewers in the UK.
- In August 1997, **Barclays Bank PLC** announced an 11% improvement in first-half operating profits to £1.33bn, as a result of which, the Bank believes it may have scope for a further £400m share buyback. With the £290m it has already bought back, this would make a total of £690m for the year. In April 1997, Barclays PC Banking Service was launched initially offering two services:
 - a link with Microsoft Money 97, for customers to carry out personal banking and manage financial affairs via a single piece of software
 - a stand-alone Barclays PC Banking Service, which allows customers to pay bills, check balances and transfer money between accounts.

A third service for customers with access to the Internet is planned.
- In May 1996, **National Westminster Bank PLC (NatWest)** announced its plan to create a new retail bank because, it said: "The financial services marketplace is becoming increasingly competitive and the way our customers want to do business with us is changing fast — with the growth of cash machines, telephone banking and electronic access such as the PC and the Internet."

- Current initiatives in Retail Banking Services include:
 - the Primeline premium telephone banking service with over 40,000 customers
 - the continuing trials of NatWest Online PC banking service to 2,000 personal and small business customers
 - participation in the Mondex electronic smart card pilot.
- **The Halifax Building Society** achieved the completion of its conversion to PLC status, and achieved listing on the Stock Exchange, on 2nd June 1997. Its goal is to become the UK's leading provider of personal financial services. The Retail Operations business includes: mortgages; liquid savings; current accounts; consumer credit, which includes unsecured and secured personal loans and credit card lending; personal insurance; and long-term savings and protection, including Halifax Financial Services Ltd. Distribution is through a network of retail branches, business centres, estate agency outlets, financial advisers and Halifax Direct. Investment in new delivery channels is seen a crucial to ongoing competitiveness.
- **Abbey National PLC** was the first large building society to convert into a bank, and perhaps can be taken as an example as to what might happen to those others which have recently followed suit. In 1997, UK retail banking accounted for over 73% of its total operating income. Much of this was taken up with growth in mortgage assets (through acquisition) and in liquid savings. It also includes a relaunch of the Abbey National bank account. The company now operates more than 1.4 million bank accounts. The bank offers a 24-hour telephone banking service on its Abbey National bank account and Instant Plus account, and is expanding its distribution via representation in Safeway PLC supermarkets.
- **The Nationwide Building Society** is the leading proponent of mutuality. In February 1996, the Society unveiled plans to pass on £200m of profits to its 7 million members in the form of higher savings rates and a lower standard variable mortgage rate. The move was taken to demonstrate the extra value that a building society can deliver to customers by retaining mutual status.
- **Alliance & Leicester PLC** is another converted building society, and the owner of Girobank PLC. Girobank launched Telecare telephone banking in 1986, and in doing so became a pioneer of telephone banking in the UK. Alliance & Leicester PLC now claims to be the largest telephone banking operation in the country. It offers current account banking and is attracting 10,000 new accounts year each and handling around a million calls a month. The company is also piloting a Home PC Banking Service, after which it will be offered to all personal banking customers.
- **Woolwich PLC** is the UK's third largest building society, which converted to corporate status in 1997. Woolwich Direct was launched in January 1996, to market a range of mortgage products by telephone. Later that year, the service was extended to include a postal account, and pilots for the sale of personal equity plans (PEPs) and life assurance products over the telephone. In September 1997, it introduced a Lifestyle Loan for customers with a mortgage with another lender (on which Woolwich would take a second

charge). The company has an interest-bearing current account, which is not yet offered via Woolwich Direct.

- The announcement of the **Bank of Scotland's** significant joint venture with **J Sainsbury PLC**, which has now started trading as **Sainsbury's Bank PLC**, attracted a lot of attention. The Bank also pioneered computer banking in the UK with the introduction of its Home and Office Banking System (HOBS). The latest enhancement to HOBS is HOBS for Windows — a communications package for Windows developed to run on a standard PC, which means that an account can be accessed at almost any time and the cost of linking up is charged at local telephone call rates. Alongside its branch network, the Bank offers its customers PhoneLine — a 24-hour personal telephone banking service. Sainsbury's Bank is quoted as being 'an exciting new development in the use of our telephone banking skills'.
- Launched in March 1995, **Virgin Direct Ltd** claims it moved into financial services because 'of the vast gulf between existing companies and the customers whose needs they were supposed to be meeting'. It conducts all of its business over the telephone, and claims over 200,000 customers with over £1bn invested in the company's products.
- **Other companies** which are involved in banking include The Royal Bank of Scotland PLC, The Co-operative Bank PLC, National Australia Bank, Tesco PLC, Marks & Spencer Financial Services Ltd, Northern Rock PLC, Legal & General Bank Ltd, Norwich Union PLC, Save & Prosper Group Ltd, Prudential Banking PLC, Pearl Assurance PLC, Commercial Union Assurance Company PLC, Citibank International PLC, and British Interactive Broadcasting Ltd.

Strengths, Weaknesses, Opportunities and Threats (SWOT)

STRENGTHS

- Existing retail banks and building societies have large databases of customer information, with which to develop their revised marketing strategies.
- Existing banks and building societies have large networks of automatic teller machines (ATMs) in place, and many millions of cardholders.
- The majority of the customers who have personal savings, mortgages and investments with existing banks and building societies will be reluctant to suffer the inconvenience of moving their accounts.
- New entrants to the market can bring with them fresh thinking, and develop new ideas which are not hampered by several layers of traditionally-minded management.
- Retailers wishing to develop into banks generally have good reputations on which to build.
- Retailers have a regular flow of customers visiting their stores two or three times a week, to whom they can regularly merchandise new banking services. It is the retailers who control the primary flow of transactions, either in cash or electronic form.
- Retailers and building societies generally enjoy a better image with the public than banks and insurance companies.
- Retail banking is a very large and attractive market. The largest banks and financial organisations have access to massive financial resources.

WEAKNESSES

- Some of the existing retail banks have yet to fully adopt a user-friendly approach to customers.
- Smaller organisations will find it hard to keep pace with the technological investment needed to remain in the marketplace.
- While customers want convenience, they resent being given the hard sell, or being bombarded with sales literature.
- Existing investment in staff and branch networks makes it difficult to introduce change quickly. Union resistance to staff reduction poses a major problem.
- Management immersed in many years of traditional banking practice is slow to adapt to new ideas.

- Many of the larger banks and building societies still have enormous investments in outdated computer systems, which are in urgent need of modernisation.
- Building societies have a less extensive distribution of ATMs and branch outlets than banks.
- Some of the voice response systems currently being used are unreliable. Instead of speeding connection, they place a barrier between the customer and the bank, in some cases making it almost impossible to get access to account information.

OPPORTUNITIES

- Retail banking, under the new diverse pattern, is a relatively new market, with many opportunities for innovation and new 'lifestyle' product development.
- The use of new technology to improve customer interfaces.
- There are opportunities for the development of home banking via digital television.
- There are opportunities for liaison between banks and retailers to provide shop-based banking services.
- There are opportunities for the development of banking facilities in areas of specialised retailing, such as petrol stations. There will be increased use of non-bank locations for the installation of ATMs and kiosks
- As new generations of computer-literate customers reach adulthood and their most productive years, the demand for convenient banking will increase.
- The sale of personal pensions and healthcare is a major opportunity, as successive governments have reduced Department of Social Security (DSS) support.
- Large retailers wishing to offer independent banking services are likely to apply for their own banking licences.

THREATS

- There are likely to be many new market entrants from the non-financial sector.
- The retail financial services market is in danger of becoming over supplied, bringing the probability of future casualties, mergers and acquisitions.
- There is likely to be increasing competition from large overseas banking corporations.
- Banks, burdened by heavy overheads, may experience trouble attempting

to maintain competitive pricing against new market entrants bringing specialised products to the market.

- Future customers are unlikely to develop the same degree of loyalty to an institution as has been the case with their 20th century counterparts.
- There will be continued government pressure to provide free or low-cost banking services to all customers.

What's Happening?

SUPERMARKET BANKING

According to *The Grocer* of 19th April 1997, the younger generation of people in the UK are more flexible than the older generation, when it comes to accepting the idea of obtaining financial support from non-traditional sources. They are more interested in supermarket bank accounts and credit cards.

- **Lloyds TSB Group PLC** is to pilot five bank branches and an insurance shop in **ASDA Group PLC** supermarkets, under the TSB brand name. The in-store branches will provide cheque cashing and bill payment facilities, and staff will be available to give advice on all TSB products, including savings, credit cards, personal loans and insurance. There will be a telephone link to TSB's PhoneBank for telephone banking. Unlike Tesco PLC and Sainsbury's Bank PLC, Lloyds says it is following the trend for banks to open branches in supermarkets, a formula which is working well in the US.
- **Tesco PLC** plans to become a 'retail destination' rather than just a supermarket, and its two biggest investments are in overseas expansion and financial services. In September 1997, it launched an instant access savings account. The company is very excited about its prospects in direct target marketing. Tesco has one of the largest customer databases in existence, and Direct Line is very skilled at constructing products that match customers' requirements precisely and in communicating with them effectively. Tesco says it will be designing whole new product ranges to meet its customers' needs precisely.
- **Sainsbury's Bank PLC** has announced it is to combine with **Standard Life Bank Ltd** to offer mortgages. The supermarket claims it has already attracted £500m of investment from savers in its low-interest accounts, and is now moving into the mortgage market which it believes to be expanding. Sainsbury's mortgages offer options of payment suspension for 6 months; increasing or reducing monthly payments, and paying over 10 months rather than 12.

NEW STYLE OF BRANCH BANKING

In September 1997, **NatWest** opened the first of a new generation of branches for major High Streets at Kingston-upon-Thames, Surrey. An open-plan layout with soft furnishings and warm colours has been designed to be more welcoming and comfortable. Staff are freed from routine processing tasks, so they can concentrate on discussing people's financial needs. In addition, new cash machines with extra features will handle the usual day-to-day transactions, and the branch is open longer during weekdays and for the first time on Sundays. A phone point gives access to the Card Loss centre, to car and household insurance quotes, and to Actionline, an automated service for paying bills, transferring funds and balance enquiries.

AUTOMATIC TELLER MACHINES

Over the next few months, **NatWest** plans to install some 300 new IBM cash machines which use Windows Open Service Architecture (WOSA). The new architecture will allow the automatic teller machines (ATMs) to do much more than simply dispense cash, meaning that customers can expect a better level of service, because banks using the system will be able to deliver new functions and technologies more quickly.

OTHER DEVELOPMENTS

- As an innovative step in cutting the cost of retail cross-border transfers, **Citibank International PLC** has introduced a **dollar current account** which operates in the UK, but which clears in the US. Called the Citibank US Dollar Account, the checking facility works by allowing customers in Britain to open a US currency current account locally. Dollar cheques drawn on the account can be sent to the US to settle bills, pay individuals, etc. Clearing takes 3 days including the New York settlement process.
- **Nationwide Building Society** has launched its new **Internet banking service**, called Flexaccount. The new site allows Flexaccount customers access to their accounts for: balance information; paying bills; obtaining mini-statements; ordering full postal statements; and transferring money. The site also features mortgage offers, and Nationwide's Football League results.
- In January 1997, **Nissan Motor (GB) Ltd** announced it would be establishing a **sales banking firm** in the UK; with operations beginning from April 1998. Currently, a company affiliated with NatWest manages the sales and financing for Nissan, but these functions will be transferred to a new company allowing fluid adjustment of interest rates on auto loans. The venture will be based in Rickmansworth, Hertfordshire.
- **Virgin Group Ltd** has announced that it was launching a **banking service**, in collaboration with **The Royal Bank of Scotland PLC**. Its expansion plans have the backing of Australian life insurer, Australian Mutual Provident Society, which already owns Pearl Assurance PLC, and has increased its investment in Virgin Direct Ltd from £290m to £445m.

MORTGAGE CODE

From 1st July 1997, consumers taking out mortgages are protected by the new Code of Mortgage Lending Practice, issued by the Council of Mortgage Lenders (CML). The new code sets out minimum standards for the selling of mortgages and the operation of mortgage accounts by lenders.

The code sets out three different levels of service which may be provided by lenders in the selling of mortgages. These are: information only on the mortgage product chosen by the borrower; information on a range of the lender's products; or advice and a product recommendation. The code will be

monitored by an independent group, the Independent Review Body for the Banking and Mortgage Codes, which is responsible for ensuring that subscribing organisations adhere to the code.

The Future

FORECASTS 1997 TO 2001

The market size figures indicated in the Executive Summary and Market Size sections of this Digest include business conducted through all financial institutions. The following forecasts are based solely on the estimated share of the total retail banking and financial services business likely to be conducted through the new-style retail banks as the market develops — £94.37bn in 1997, rising to £136bn by 2001.

2005 AND BEYOND

The leading retail banks of the year 2005 will almost certainly be different from those of 1997. To be successful, and in some cases even to survive, banks need to begin managing a period of rapid transition. According to The Economist Intelligence Unit study, 'Building Tomorrow's Leading Retail Bank' many of the world's leading banks have already begun this process in a number of key areas.

By the year 2005, to meet the demand for personalised services and products that meet a lifetime needs, customers must increasingly be recognised as individuals, not as market segments. The successful retail bank will know which customers require which products, and through which distribution channels at the different stages of their life cycle. They will also be able to differentiate profitable clients from those who are marginal or loss making.

MORE FLEXIBILITY

Distribution channels will be critical, and these must be able to provide the right products anytime, anywhere and anyhow. The choice of distribution channels in 1997 is already large, but will increase further. Flexibility will be important to match changing customer preferences, and retail banks are likely to increase their use of franchises.

FEWER BRANCHES AND STAFF

As the Millennium approaches, the relative importance of delivery channels for routine transactions is likely to change dramatically. The number and size of bank branches will shrink and lose their traditional role. Customers wishing to meet branch personnel will be served increasingly by express banking shops in offices, shopping malls and leisure areas. Remote services options will include screen-based services, using personal computers (PCs), televisions, enhanced automatic teller machines (ATMs) and kiosks.

Far fewer staff will be needed, and with re-engineered back-office and branch operations will come new demands in work skills. Branch staff will need to become less clerically oriented, adopting instead a more friendly sales approach.

MANAGEMENT CHALLENGE

Finally, while moving through this period of transition, the retail banks must stay open and finance the costs of change. The ability to successfully manage the business through such a difficult period, while at the same time warding off increasingly serious competition, will prove a significant challenge.