FORTRESS PARTNERS
E-Memo

TO: INVESTORS/MEMBERS/PARTNERS AND FRIENDS
FROM: Jon Bruss & Ed Depenbrok
DATE: October 31, 2019
SUBJECT: How *Digital* is Your Bank?

We've been noodling on this subject since we wrote the August *E*-Memo. We know it is a subject community bank managers struggle with—how much *digital* is enough? We know that bank investors are certainly focused on the digital banking world—especially if they are reading blogs about banking and reading bank quarterly earning reports or annual reports. We think bank customers are more focused on digital banking than bank managers believe. Here's an example: Julie Stackhouse, a 40-year veteran bank regulator and executive vice president of the Federal Reserve Bank of St. Louis, noted recently in an *American Banker* interview published October 21, 2019, that when talking about technology and bank management—"technology will be an increasing part of banking even if it may not be evident today . . . and it will be driven by the consumer." However, she points out that bank managers often tell her, "[m]y customer base hasn't asked for things like online loan applications." Her response is "what about the customer you don't have?" She went on to point out that "offering high-touch to one customer while making the necessary investments to attract—or at least avoid losing—the other customer will be a huge challenge for many community banks."

All of us—bank managers, bank investors and bank customers need to come to the realization that digital transformation is happening—rapidly—in some banks more quickly than others. Many community banks have considerable investments in brick and mortar (with drive-ups and ATMs) which, bank managers contend, should be the sum and substance of concession to customer convenience. Furthermore, and stubbornly clinging to the belief that face-to-face contact is critically important for them to retain their customers or expand their relationships, we contend, not so much. As Julie Stackhouse pointed out above, "what about the customer you don't have?" Community bank customers are maturing—many are Baby Boomers , retired, soon to move to retirement and possibly moving to a friendlier tax or temperature climate. The members of community bank Senior Clubs are aging and dying. And being lost as customers. Who will replace those customers? Will our 30-year old brick and mortar branches be as attractive to prospective replacments as to their parents and grandparents?

We think it is time to think about a branch refreshment, a revival. But here's the catch, "even as digital banking gains ground, many customers," according to a recent study by McKinsey & Company, "still prefer human, face to face interaticon for products like mortgages and investments.

So, what is the future for the multiple channels that have developed in banking – Branch (physical), Call Centers and Digital? And how will they be integrated for a seamless, consistent experience for the customer. Or, as Retailing likes to put it: What is the best formula for Omni Channel?

In a recent video in the BAI Banking Strategies Daily, Jason Hendricks, Managing Director of Fin Tech Forge said, "Really interesting innovations in smaller [community banks]—the ones that have woken up to: I can't make the major investments to play catch up—maybe I just need to figure out a different game to play. They're getting hyper-focused on the community, not defined by my branch footprint, but how do I actually define who I serve and how I serve them in a way you are not going to see the major money center banks do, because it is not big enough."

We think there is certainly room for the community bank to provide a unique mix of branch and digital that provides a special, local, high touch feel that can still differentiate them from their larger competitors.

However, this will only come from being thoughtful and active in the digital transformation. It may not be enough to simply be a "fast follower" and try to ride on the coattails of the Core Providers. Instead, community bankers need to be active students of the digital transformation and think creatively about what the needs are of the community they currently serve and wish to serve in the future and be open to new tools to support that effort.

Kirin Analytics sponsored a study entitled "Branch Transformation Rolls On" which surveyed large banks, regional banks and smaller banks with less than 100 branches and credit unions which Kirin considered relevant in the current banking environment. Here's what Kirin found:

- Improving in-branch customer service remains a top priority
- The in-person customer experience needs to optimize and engage its branch workforce to serve as brand builders.
- Surveys are used to assess customer experience and workforce engagement. To measure experience, 70% of banks use surveys, next comes mystery shopping followed by focus groups.
- Bank of all sizes are turning to the universal banker (u-banker) model. Forty percent of the banks in the study have deployed u-bankers successfully. Of the remainder, 25% indicated they are in the early investigation stage, 15% have deployed u-bankers with some issues and 5% have run a pilot and are ready to implement.
- Forecasting tools to anticipate customer demand are not widely used.
- Banks are ramping up investments in branch technology to make interactions smooth and quick
- No one branch model works across the board—one size does NOT fit all (not even in the same financial institution). Now would be a good time to consider redesigning existing branches, testing smaller branches with stronger branding and use of technology.

Granted, those are findings with major implications for community banks. That said, we think that most branches have a distinct customer base which should be analyzed to determine which activities require "high touch" vs. high tech. McKinsey & Company's study we mentioned earlier finds that "the branch remains a key component for long-term relationship building." Clearly every branch revival should start with the customer in mind. But what do customers really want? **EXCEPTIONAL SERVICE WITH MINIMAL WAIT TIMES!** In fact banking customers surveyed by Celent recently found that "long wait times would prompt them to bank elsewhere; and a poor branch experience was the leading reason customers said they'd change banks."

The McKinsey study further found that when customers walk into their branches they "have higher service expectations than when they log on to an account." But, as self-service has become normalized by the retail industry, self-service kiosks should be considered for bank customers who want to do their banking on their terms. ". . .[T]ools [like those] can make a branch a desireable, convenient destination—especially with the added benefit of having personal help steps away if needed."

We see branch revival and self-service changing and even enhancing the role of the teller as well as the skill set the position requires. We like that. Self-service tools can elevate the importance of the role of "teller" to that of a universal banker. We know that the typical "transactional" teller is a high turnover position. By removing the drudgery of routine transaction tasks and replacing those tasks with others requiring higher skills such as giving them additional self-service assistance responsibilities helps the bank by better utilizing its human resources.

We believe that financial institutions can get ahead by going digital. According to the McKinsey study, "Self-service technology has sped up transactions and streamlined branch operations, thus reserving tellers [for] consultative services and higher value transactions. That makes total sense!

We agree with McKinsey that banks "must strategically recalibrate their square footage, staff and technology" to meet today's customer demands. As Julie Stackhouse has pointed out, don't ignore the customer you don't have by listening only to your current customers who say they are not interested in enhanced digital offerings. McKinsey concludes that banks by hitting the right balance for their brand, location and client base they will benefit from:

- Improved customer experience
- Extended banking hours (without adding additional staff)
- Faster, more efficient transactions
- Smaller footprints and reduced real estate needs
- Better staff utilization, resulting in lower full-time employee needs and less turnover

Finally, the McKinsey study concluded that to "revitalize a branch, leaders should't separate their physical and digital strategies. A winning strategy, in every channel, helps customers help themselves—powered by a bank that knows itself."

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