COMMENTARY

January 10, 2014

Dear clients and colleagues,

Half of the world's population does not have a bank account. Two-thirds of people without bank accounts simply don't have enough money to use a bank. However, in Sub-Saharan Africa, 16% of adults have used a mobile phone to pay bills, send, or receive money in the past year. Technology is helping many countries circumvent the need for the traditional bank branch or even the automated teller machine (ATM).

This week's commentary looks at how non-branch banking delivery channels have evolved and the resultant impact on branch traffic.

The Rise of the ATMs

The reality is, we visit our bank branches much less than we did 10 years ago. With the expansion of mobile technology, ATMs and ebanking services, one can safely assume that our children and grandkids will probably never even enter a branch.

The ATM was introduced in 1969 in the US. The introduction did not have any impact on branch traffic. However, in the late 1990s, there was a marked shift away from utilizing branches for banking transactions. As trust and safety grew, and the reliability of the newer banking delivery channels increased, transactions at branches dropped. Today in the US, 35% of households do their banking using mobile options, while 60% bank online.

In 1966, the US population was around 200M and according to the FDIC, there were about 17,000 branches operated by commercial banks. Bank branches grew at a CAGR of 3.5% from 1966 to 2012. There were about 80,000 branches before the financial crisis in late 2007; a 360% increase in the number of branches since 1966. However, the US population grew only 50% during the same period.

Several notable changes have taken place since the first ATMs of the 70s. For example, we are no longer limited to accessing the ATM at the bank itself but can find machines on any corner. Having 24 hour access provides flexibility and eliminates the need for branch visits. Interbank networks are allowing consumers to use ATMs from other banks. And, most recently, we see ATMs evolving further with the introduction of interactive units that allow users to see, speak and transact with a remote teller. These upgraded, high-tech models are known as Personal Teller Machines (PTMs).

The Importance of Online Banking

The introduction of online banking was the next major innovation to the industry. As customers began to connect and get comfortable with the internet, the need to go to a branch further reduced. Not only can we do most of our banking on our phones, but we can also email money transfers using an online interact service.

Decreased Reliance on Branches Benefits Banks

According to the US banking industry, the number of banking transactions over the last decade has certainly increased, but the majority of them have taken place outside of bank branches. In 2013 an estimated 85% of transactions were done using alternative technology-driven options.

In the US, people interact with a branch approximately five times a quarter. The number is four for Canada and one for the Scandinavian countries. For emerging markets it's seven times a quarter.

This is a positive for banks. Teller costs have more than doubled and a trend away from branch banking is a more cost effective way to service the customer. According to Diebold and PNC, transactions done within a branch cost over $4.00 each. The same transaction completed at a call center costs $2.40, while online and mobile banking just $0.20 and $0.08, respectively.

Customers are also happier when they conduct business away from the branch, according to a survey by GMI NPS. However, this limits the opportunity to cross-sell products for a bank, as 75-80% of new accounts are still opened at a branch in most regional banks.

The overall importance of the branch is lessening in the eyes of the bank and its end user. The shift away is a positive for both as it offers convenience and less cost. How many branches will be closed in the next 10 years is anyone's guess. According to the World Bank, there are 35 branches per 100,000 adults in the US; the same as in Japan. Canada and the UK use 24 branches per 100,000 adults, which is 31% less than the US.

Portfolio Implications

One of our favored investment themes is convenience. Some of the companies in our portfolio that should benefit from the trend are Seven Bank (Operates the biggest ATM network in Japan), ACI Worldwide (a payment company enabling $13 trillion in payments each day), Nice System (Israel - based company whose software prevents financial crime) and Prosegur (Spanish security company, providing bank security globally).

Have a nice weekend.

The Global Alpha Team