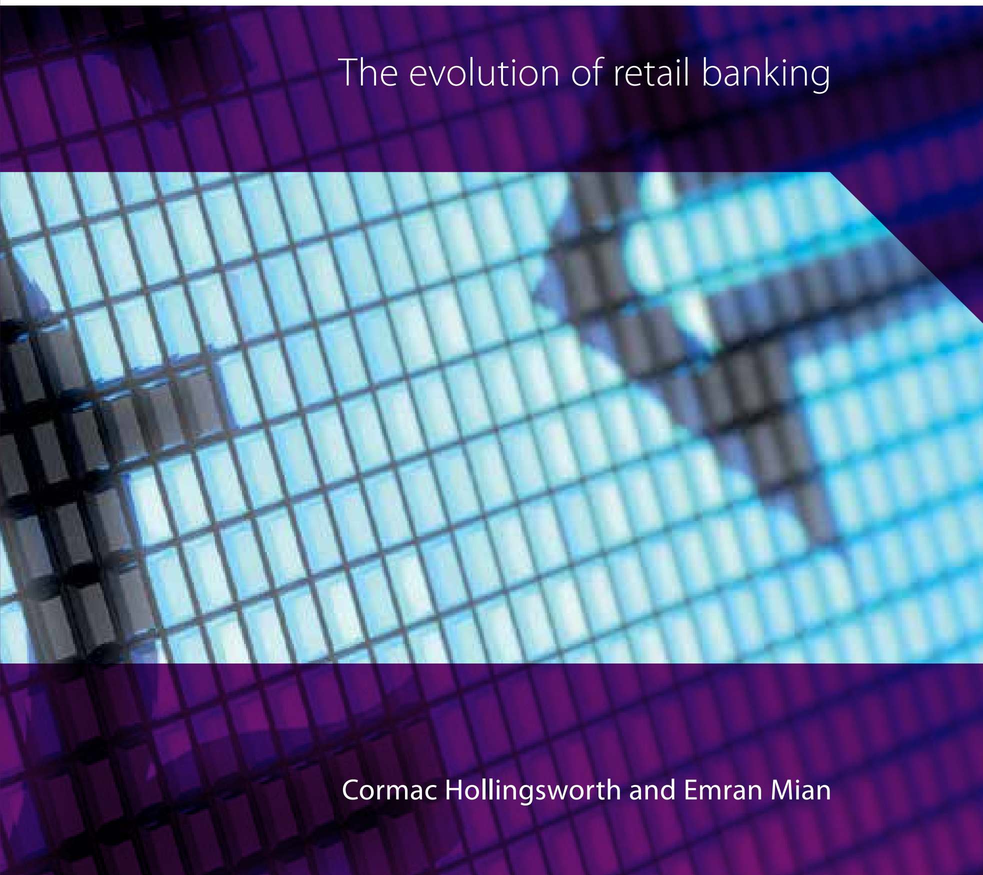
Social Market Foundation

BRANCHING OUT



The evolution of retail banking

Cormac Hollingsworth and Emran Mian

ISBN: 978-1-904899-87-7
£10.00

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Kindly supported by

FIRST PUBLISHED BY
The Social Market Foundation, March 2014
ISBN: 978-1-904899-87-7

11 Tufton Street, London SW1P 3QB

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DESIGN AND PRODUCTION
Soapbox
www.soapbox.co.uk

PRINTED BY
Hobs Reprographics plc
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CONTENTS

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ACKNOWLEDGEMENTS

We have benefitted from the insight and experience of Professor James Devlin of Nottingham University, John Vines and Paul Dunphy at Newcastle University, Robin Brownsell and Brett King. Grateful thanks to our respondents Adrian Harvey, Adam Marshall, Mark Mullen, Ged Nichols and Steve Cooper. Thanks to Amanda Brown, Ken Penton and especially Esme Harwood for helping bring this together.

EXECUTIVE SUMMARY

In December 1983, the Nottingham Building Society launched the first electronic home banking service. Five years before the invention of the World Wide Web, the users of this Homelink Service could, according to the Society's Managing Director, John Webster, "transfer money between accounts, pay bills, arrange loans . . . compare prices and order goods from a few major retailers, check local restaurant menus or real estate listings, arrange vacations through the Thomas Cook Group, enter bids in Homelink's regular auctions and send electronic mail to other Homelink users."[1] It was an impressive offer and, not surprisingly, Webster thought that his innovation "could make a profound difference in the economics of branch banking."

Thirty years on, branch banking has changed but our new opinion research shows that face to face service in a branch is still the preferred mode of accessing bank services for 62% of people.[2] While we might be comparing prices and ordering goods online, and certainly that is where we are checking real estate listings, eight out of ten people would prefer to go to a branch to seek financial advice; almost seven out of ten to open or upgrade a current account; and it's only when we ask about simpler payments transactions, that other channels – primarily online banking – become a common preference.

Yet, while people on the whole prefer bank branches, only a minority profess to knowing the name of someone in the branch they use most often; and the affluent (AB social class) and the young (25–34 year olds) have a weaker preference for the branch than others, with more than half of these groups preferring other channels. This trend in their attitudes is significant because the affluent, by way of their higher deposits, contribute the

1 Barnaby Feder, "British move fast in home banking", *New York Times*, 2 January 1984

2 Social Market Foundation/ComRes 'Future of Branch Banking Survey' 24–26 January 2014

most to banks' net interest income; and the young acquire the highest number of financial products and services in these years, contributing the most to banks' fee-based income.

Overall, the number of branches is declining. The change is most striking in disadvantaged areas, where access to banking services is already likely to be limited. Equally, bank branches are an expensive way to provide basic financial services compared to online and mobile; as access to those alternatives expands, people may be able to benefit from cheaper services than they have had before, either via existing banks or new entrants to the market.

The changing market raises important questions for banking regulation. While promoting competition is critical, capping market share or the number of branches is likely to worsen the access of the poorest people. If banks cannot grow beyond a specified size, then their competitive strategy will be to serve the premium customers.

Already competition in payments is proving hard to find. Among the new entrants to the market in recent years, only Metrobank and Handelsbanken offer current accounts. At the time of writing neither Virgin nor Tesco Bank do so, though both are due to launch them shortly. Other challengers, together with the almost thirty banks preparing to launch, are lending or taking deposits for saving only.[3] Unless we reorient the market towards innovators in payments and away from new entrants in lending we risk repeating the mistakes of the previous decade. Then there were fifteen new entrants to the mortgage market, nineteen to the savings market but only five to current accounts; this unbalanced competition encouraged poorer lending, eroding margins and bringing the banking system to the brink of collapse, while failing to reverse the broader trend in the closure of branches.

3 Independent Commission on Banking, Final Report (London: HMSO, 2011), 174

Creating a new wave of competition in retail banking that does not compromise the safety of the system and enhances financial inclusion may require looking further afield to PayPal, Google and Apple as well as looking more deeply at the potential of peer to peer networks, from the traditional ones such as credit unions, whom could offer current accounts as well as lending, to the new online tools such as Zopa, which is already matching funders to lenders in the volume of a top ten building society. That's not all. In Hong Kong, the equivalent of the Oyster card has been granted a banking license – after all it is a tried and tested pre-paid debit card with a large branch network of places where it can be topped up, there is no reason to restrict its use to paying for travel.

In this report we describe the latest consumer attitudes drawn from our new survey; the disruptive innovation that online and mobile channels have already created in other retail sectors; the potential new developments in banking; and the challenges involved in securing these.

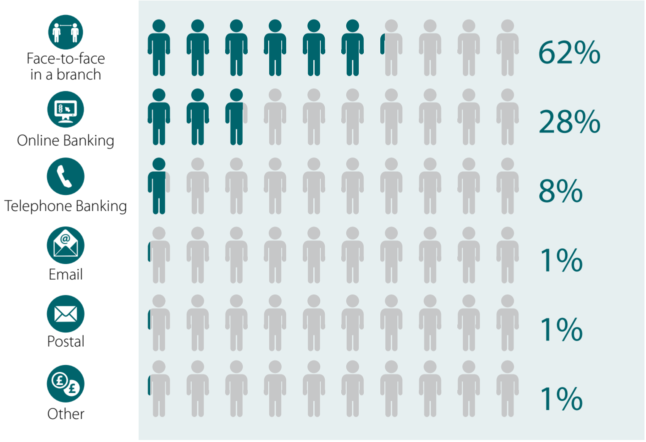
We conclude that branches will change over the next decade prompting greater use of self-service on simple transactions and allowing bank staff to be focused on more personalised service. There will be fewer branches but a higher proportion of visitors will be likely to know the name of someone who works at the one they use. This recasting of the relationship between banks and their customers will bring the new restrictions on banks to offer advice into focus.

At the same time, the entry of new providers from the technology and telecommunications sector – and potentially elsewhere – to payment services will produce a new wave of innovation and competition, so long as the regulator permits that to happen and the new services meet the expectations of customers. Ensuring that no one is left behind – the perpetual challenge in access to financial services – will be a challenge and may require banks to take new steps to engage with customers, for example, offering them smartphones to encourage them to access banking services online rather than in the branch. The question for the regulator will be whether the objective of extending access to everyone should require all retail banks to operate current accounts or even the sharing of branches between incumbents and new entrants.

CHAPTER 1: THE WAY WE BANK NOW

To inform this study we carried out opinion research with ComRes interviewing 1,008 adults on 24–26 January. This survey was carried out over the telephone so as to be as inclusive as possible. The data is weighted to be representative of adults aged over 18. What we found is that British adults on the whole prefer the branch as the channel to access bank services, with six in ten people telling us that they value the face-to-face service.

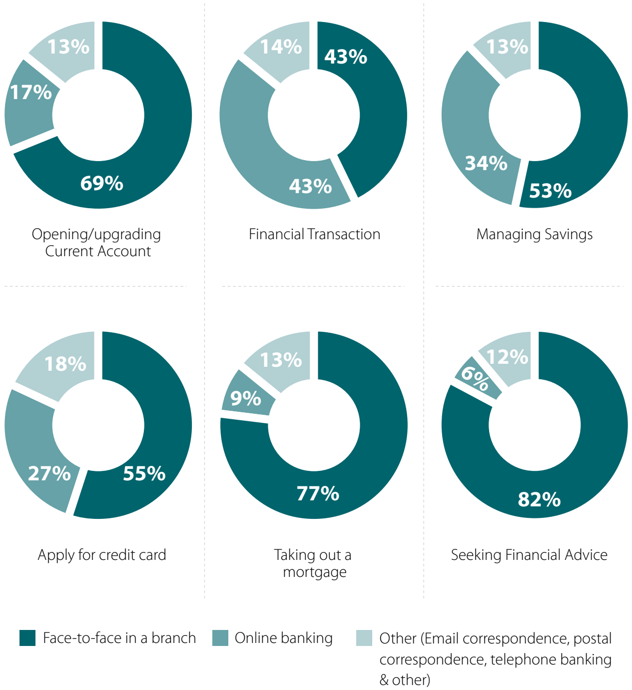
Chart 1: Preferred channel to access bank services



Source: Social Market Foundation/ComRes, Future of branch banking survey, January 24-26 2014

When we ask about specific services, the preferences vary. As many as eight out of ten people prefer the branch when they are seeking financial advice; however this drops to just over half when applying for a credit card or managing savings and falls further to two in five for financial transactions like setting up a direct debit.

Chart 2: Preferred channel to access individual bank services



Source: SMF/ComRes, Future of branch banking survey, January 2014

What is more the preference for the branch is localised to a specific branch. Three quarters of people say they always go to the same branch and more than three fifths say that they trust their local branch advisor to advise on the best products for them. By contrast though, only a quarter strongly agree that they know the name of somebody at their local branch.

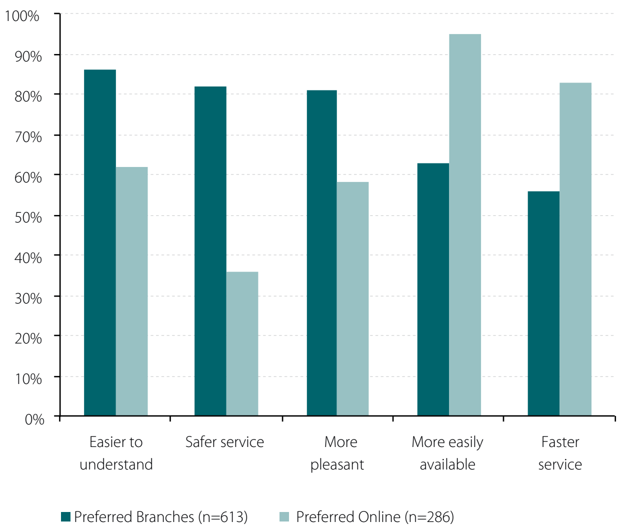
When the Office for Fair Trading (OFT) studied these issues they concluded that, "while internet and mobile banking are growing in importance, they largely remain, especially for personal current accounts and business current accounts, complements to, rather than substitutes for, branches."[4] Our data bears this out: 78% of

4 Office of Fair Trading, *Review of barriers to expansion and exit in banking*, (London, HMSO, 2010), 160

customers would not consider a bank without branches as their main bank and 80% said that their experience of customer service in the branch affects their view of the bank as a whole.

However, there are some changes underway. In deciding which channel to use, especially the choice between a branch and going online, convenience vies with quality as the determining factor. Services in branches, people say, are easier to understand, safer and more pleasant; whereas online services are more easily available and faster. It is these characteristics which are driving change.

Chart 3: Attitudes behind preferred service channel



Source: SMF/ComRes, Future of branch banking survey, January 2014

Data from the Bank of International Settlements shows the doubling of internet linked accounts since 2004, both as an absolute number and as a proportion of the total number of accounts.

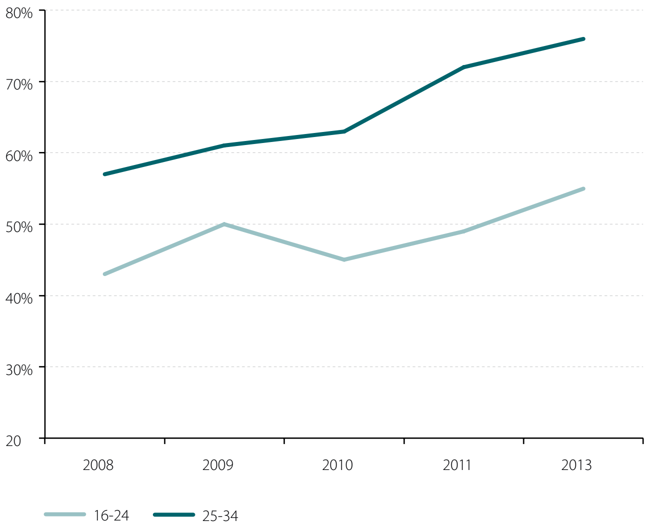
Table 1: UK online bank accounts double since 2004

	Personal Computer Linked Bank Accounts	Total Number of Bank Accounts	% of Total number of Bank Accounts PC linked
2004	20,786,000	129,790,000	16%
2011	44,800,000	128,000,000	35%

Source: Bank for International Settlements, *CPSS Red Book*

The increase is driven by younger people who are much more likely to adopt internet banking. Figures from the Office of National Statistics (ONS) show that adoption among 16–24 and 25–34 year olds is spiking.

Chart 4: The changing demographics of Internet Banking Adoption.



Source: ONS, Internet access – households and individuals, 2008-13

The corollary of the higher uptake of online banking among the young is that their preference for the bank branch is weaker than other groups and they are more willing to access services online:

behavior in using different channels and attitudes towards them are closely interlinked.

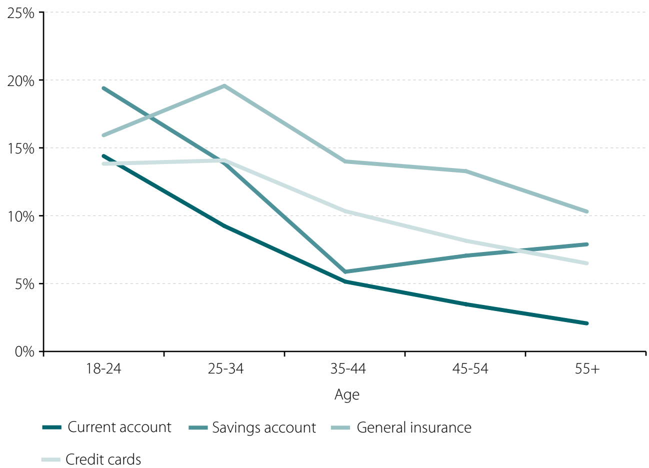
Table 2: Age preference for Online Banking 2014

	18–24 (n=117)	25–34 (n=156)	35–44 (n=179)	45–54 (n=182)	55–64 (n=173)	65+ (n=201)
Account Opening	15%	28%	20%	20%	13%	8%
Transactions	54%	61%	54%	45%	32%	19%
Managing Savings	37%	51%	45%	35%	28%	13%

Source: SMF/ComRes, Future of branch banking survey, January 2014

These differences in usage and attitudes are significant because those aged 18–35 are the most active in taking up new financial services, making choices about products and institutions as they start earning and saving for the first time which they then stick to for the rest of their lives.

Chart 5: Proportion of consumers who took up various financial products in the last two years, by age



Source: SMF/YouGov, Trust in financial services survey, January 2011

The upshot of young peoples' attitudes is that, if they are increasingly going to make their critical choices about which bank to use and which products and services to buy outside the bank branch, then this really does begin to change the economics of branch banking. The relationship between their behavior and attitudes also suggests that the same shift in attitudes may take place for older age cohorts as they too are tempted by the convenience of other service channels into using the branch less and less for simple transactions.

There are other fissures in the broad preference for branch banking too. Those in the higher socio-economic groups are more inclined to use online than others. Over a half prefer online for financial transactions, almost half for managing savings and as many as 27% would consider having their main current account with a bank that does not have any branches. This is important because they are the highest value customers for banks.

Table 3: Social Class preference for Online Banking 2014

	A/B (n=359)	C1 (n=221)	C2 (n=161)	D/E (n=267)
Account Opening	26%	20%	11%	11%
Transactions	58%	50%	36%	25%
Managing Savings	46%	39%	29%	19%

Source: SMF/ComRes, Future of Branch Banking survey, January 2014

Put the two trends together – more young people willing to bank outside the branch, and more affluent people too – then what may be happening is that the critical customers for the traditional business strategy of banks are gradually turning away from the branch, raising the biggest questions about its future.

These trends are reinforced by the rise of mobile, putting banking services literally in the hands of the user; and the decline of cash and cheques as a means of payment – as these vanish, the role of the branch diminishes too.

In terms of mobile, access to the internet through mobile devices grew from 24% in 2010 to 51% in 2012 according to the ONS. Mobile banking apps were downloaded by 36% of mobile phone users in 2012 and 70% of those that had an app rated it as good or excellent; 68% do some form of mobile banking every week. According to Ofcom the amounts people spend on goods and services on a monthly basis using the mobile internet are growing. While 40% spend below £50 per month, 20% now spend between £50–£100 and 9% of people spend above £300 a month.[5] Indeed 38% of UK consumers report that they would replace their payments cards with payments via a mobile phone.[6] The worldwide volume of mobile payments was estimated to surpass $170bn in 2012, up over 60% in one year alone, with future growth forecast at 40% annually.[7]

Alongside this shift, cash and cheques – the two forms of payment which rely most obviously on the prevalence of bank branches, to withdraw cash and to deposit cash and cheques – are declining as a mode of making payments in the UK.

The OFT found in 2007 that 44% of Small and Medium-sized Enterprises (SMEs) received payments through cheques and 66% made payments using this method. But the fall in the use of cheques is precipitous, down by 40% in the period 2003–08 and, given the rate of decline reported in the first half of 2013, likely to have fallen a further 40% in the period 2008–13.[8]

The main source of competition for cheques has been the faster payments service available online. A recent survey of SMEs

5 Ofcom *Communications Market Report*, (London, HMSO, 2013), 305

6 Ron Shevlin, The Global Rise of Smartphonatics, (Boston, MA: Aite Group, 2012), 18

7 Gartner "Gartner says mobile payment transaction value to surpass $234 billion in 2013" www.gartner.com/newsroom/id/2504915

8 Payments Council, Clearing Statistics January 2014

showed them shifting payments away from cheques to online. Since 2008, 75% more SMEs are using online banking and 68% of all SMEs predict that they will use online banking in 3 years' time. Only 12% of SMEs prefer using cheques to pay suppliers.[9]

Equally cash is becoming a smaller part of transactions in our economy. The proportion of consumers who withdraw from a cash machine at least once a month remains very high at 90%. However, the average cash transaction is £9.30 and the median value is even lower (£3.50). Most cash spending takes place in retail (48%) and only 25% in supermarkets. So small is the amount of cash used to pay for transactions involving savings and investments, for example, that it is equivalent to the amount of cash now used in restaurants.[10] All of this suggests that the future of cash is limited, especially if innovations in payment services mean that the cost to business in taking payments by other means keeps falling.

What we see overall then is a more mixed picture than the headline finding about the persistence of the bank branch might suggest. People like the quality of service in the branch but the young and the more affluent are starting to prefer the convenience of going online. The convenience is increasing through the rise of mobile banking services; and the forms of payment that anchored people to the branch – cash and cheques – are in decline.

The next question is how banks will combine the different services in the branch and online; there are lessons to learn here from other retail sectors.

9 Bacs Payments Schemes, *Understanding SMEs' attitudes to payments methods, Trends preferences and behaviours.* (London: Bacs Payment Schemes, 2013), 2

10 Payments Council, *The Future for Cash in the UK,* (London: Payments Council, 2010), 7

CHAPTER 2: COMBINING CHANNELS IN OTHER RETAIL SECTORS

All retailers are contending with how to run their business across both the high street and online. The rise in online commerce is well known – it represented 11.8% of all retail sales in December 2013 – and critically online is beginning to drive sales across all channels. McKinsey has recently reported that "the number of consumers who use their computers to conduct online research has already seen a significant rise from 41 percent in 2010 to 50 percent in 2012." Book retailers are among those that have been hit particularly hard by the move online but equally we are seeing independent book shops engaging strongly with their customer base via twitter and the chain book store Waterstones is using social media in innovative ways, e.g. via its twinterviews and creating separate twitter accounts for each store.[11]

This omni-channel approach to retailing is becoming the watchword for growth.

Among larger retailers John Lewis is the best example of how to use online to drive sales, especially following the success of its Christmas campaign. Its Christmas advert received 86,000 mentions on twitter and 4.7 million Youtube viewings over its first weekend. By mid-January 2014, when John Lewis announced that sales had risen 1.2% in stores and 23% online over Christmas, the number of viewings had risen to 12 million (versus 1.5 million for the 2013 Christmas number one music single). John Lewis also saw demand for its click and collect service grow 60% over the Christmas season, having grown by 70% the previous year. Those growth rates have become in recent years more associated with purely online services; John Lewis is demonstrating that the high street is far from terminal decline and the real challenge is in creating a seamless experience that connects the branch network to online and mobile.

11 Eric Hazan and Nicola Wagener "Purchase portal: The Internet as the shoppers tool" in *iConsumers: Life online*, ed. Jürgen Meffert et al. (New York: McKinsey & Company, 2013)

The abiding importance of the high street is exemplified by the behavior of the major technology companies such as Apple, Google and Microsoft. While some in banking worry about the entry from these technology giants into online and mobile banking services, at the moment they are developing their own branch strategies. Apple's CEO, Tim Cook, is highly focused on how the branch could complement Apple's other sales channels and has hired Angela Ahrendts, the head of Burberry with its very successful retail business, for that purpose. A large part of the prize for Apple is cross-selling: among customers who bought iPhones from Apple stores, 52% of them own iPads and 30% own other Macs as well, those are much higher proportions compared to those who bought iPhones elsewhere, only 37% of whom own iPads and 20% other Macs.[12]

The importance of the retail store for sales is emphasised by the success of Tesco's Express stores. Tesco has 3,146 stores – a network slightly larger than Lloyds Bank's 2,940 branches – and 1,547 are the smaller Tesco Express stores of below 2,000sqft. Tesco Express was developed from the observation that peoples' lives were becoming more hectic, and some did not have time to go to out of town stores, so Tesco stores got smaller with sales volumes supported by data mining of Tesco Clubcard records.

More broadly the success of the supermarkets has been just as much driven by their ability to outcompete other high street retailers. Comet, GAME and Blockbuster may all have failed – with the loss of almost 16,000 jobs in total and the closure of 1,350 stores – through failing to follow their customers online. But Clintons, Woolworth and HMV – representing the loss of 36,500 jobs in total and the closure of 1,800 stores – not only failed to compete effectively online, they also failed to compete against other bricks-and-mortar retailers, including the supermarkets.

12 As reported in Jeff Chu "Can Angela Ahrendts spark a retail revolution?" *Fast Company*

CHAPTER 3: THE POTENTIAL FOR CHANGE IN BANKING

In this section we assess the new entrants expected to create disruptive change in banking; and the incipient changes in the prominence of the branch.

Banking services as we know them are actually three services bundled together. The first is handling transactions, or the payments service. The second is the deposit taking and lending, or what economists call intermediation. There is a third service that financial services firms tend to offer and that is insuring against risk, but we do not consider it here, because that is a less significant part of the branch offer in the UK.[13]

Banking services are accessed through a number of channels. Looking at the channels together with the services allows us to define how new entrants could enter banking.

Table 4: Innovators in different service areas

	Service channels			
	Branch	**Online**	**Mobile**	**Peer-to-peer**
Payments	Metro Bank	Google Wallet	Google Wallet	Bitcoin
	Handelsbanken	Paypal	V.me	
Deposit taking and lending	Virgin Bank	Paypal Prepaid		Zopa
	Tesco Bank	Paragon Bank		Crowd Mortgage
	Retail prepaid cards	Aldermore		
	Bank on Dave	Cambridgeshire and Counties Bank		
		Shawbrook Bank		

13 Richard Davis et al., "Evolution of the UK Banking System", *Bank of England Quarterly Bulletin 2010 Q4*, 321

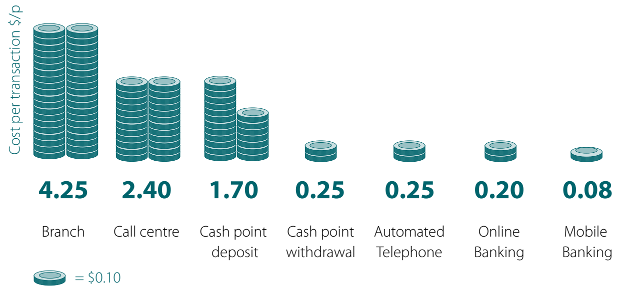
Three of the access channels are familiar ways of accessing bank services: the branch, online and mobile. The fourth is new peer-to-peer networks enabled by technology. Peer-to-peer networks are important to the future of the banking sector because they provide a new source of competition that potentially localises risk within networks rather than have the taxpayer carry the ultimate responsibility. Their scale is also increasing. Zopa has already brought together lenders and borrowers in an amount equivalent to the lending of a top 10 building society.

Many of the other names in the table of innovators are familiar. According to the European banking organisation, EFMA, the average bank already views Web 2.0 companies such as Google as a big competitor. Paypal globally is doing business equivalent to half of Citigroup's transaction services, and it continues to grow at around 16% a year. Visa Europe predicts that by 2020 a third of all its European customers will be using V.me.[14] Rumours persist that Apple – already a massively important online retailer due to the iTunes store – will soon be seeking to facilitate online and mobile payments. It is thought likely that Amazon will want to make a similar move.

The potential of these innovations is that they transform the transactional end of the banking offer, reducing cost – to providers, and hence eventually to customers – as well as improving service. The cost differential between the branch and other channels is striking: according to a US study, the cost per transaction in a branch may be up to 50 times higher than on mobile.

14 EFMA, *Innovation in Retail Banking*, (Paris: EFMA, 2013), 8

Chart 6: Cost per transaction (USD $)



Source: Diebold, 2010

While new channels perform exceptionally well on cost, they need further development to provide equivalent service quality. Cheque use is declining but the power of this mode of payment is that it allows the user to control the timing as well as amount of payment. Direct debits, by comparison, involve a ceding of control over timing and sometimes the amount is fixed on a monthly or quarterly basis as well. This reduces the scope for the individual to manage his or her own money, important for someone seeking for example to maximise their savings and especially so for someone on a low income.

What a powerful mobile application should be able to offer is the same level of control that the cheque provided previously but in the palm of your hand. There are also data benefits, e.g. knowing at a glance when you buy a coffee how much you have spent in that store during the past month – the kind of service that US mobile banking innovator Moven offers. When customers wield that information, all providers of goods and services will be forced to compete more strongly to win and retain their business.

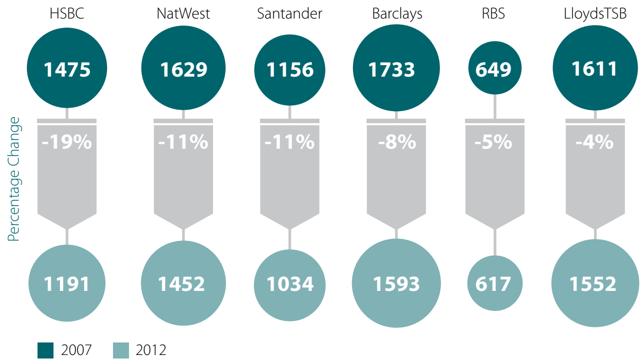
Exercising better control over personal finances may also suggest the scope for prepaid debit cards. These have yet to make a big impact in the UK but they are the fastest growing deposit product in the US, so much so that the Occupy movement has created its own low cost prepaid card as part of their mission to create alternatives to traditional finance. In Hong Kong, the regulator has granted a banking licence to the equivalent of the Oyster card. Eight million Oyster cards are used regularly. Londoners can top it up at any one of 4,000 Oyster ticket shops, as well as the 500 points in stations or online. Oyster handles securely, and with high user satisfaction, nearly all of Transport for London's £3.5 billion of fare revenue – 90% of bus journeys and 80% of Tube journeys.

Expanding the use of Oyster as a payment device beyond public transport replacing cash purchases or other forms of card payment should be relatively easy to achieve. If that is done without any transaction charges for the businesses accepting payment in this form, in contrast to other forms of card payment, then It is obvious to see why this would be a significant innovation in banking services.

But it is important to keep these innovations in perspective, not least because they bring challenges of their own – to be discussed in the next section – and because previous waves of innovation have done surprisingly little to change the structure of retail banking. First Direct failed to disrupt the market significantly when it piloted an exclusively telephone banking service 25 years ago, and Smile and Egg had the same experience as internet providers of banking services 15 years ago. The contrast to motor insurance is striking. The 1985 telephone-only service entrant, Direct Line, was a disruptive entrant that grew from nothing to being the largest motor insurer in nine years. The following decade saw the entry of the comparison websites. Today almost 50% of motor insurance is now obtained from those sites.

The abiding preference for the bank branch we observed in the first section has a lot to do with the failed hopes of previous innovation. Indeed, for the moment, the new entrants to retail banking are using branches. Metro Bank – named bank of the year 2013 by CityAM – entered the market in 2010, aiming to differentiate itself through offering high service levels in branches. By the beginning of 2014, it operated 25 branches across Greater London and the South East of England and it has a target of having 200 or more branches by 2020. Handelsbanken has grown from 62 branches in 2009 to 133 branches in 2012 and 166 branches by the end of 2013. In the end though, these are quite small numbers and both of these retail entrants are catering to quite specific groups of consumers. The broader picture on numbers of branches is clear, though with some differentiation between the major players.

Chart 7: Branch closures by bank 2007–2012



Source: Barclays UK

The pattern in the US has been different though is now beginning to shift. According to a study using data from the Federal Deposit Insurance Corporation and the US Census Bureau, the ratio of people to branches declined from 9,340 in 1970 to 3,683 in 2008.[15] But the end of this period has proven to be the peak in branch banking. Numbers are beginning to fall though as yet are lagging the decline in transactions numbers – the average

15 FDIC and US Census Bureau data as used in FMSI, *Teller Line Study* (Georgia: FMSI, 2013)

number of transactions per branch is already down 25% in the last 5 years.

Overall then, branches are not disappearing but numbers are declining. This suggests that banks face the same issue as other retailers in building an offer for the customer that combines the various channels – especially online and the branch – to provide the best possible service. This strategic question is brought further into focus by changes in the attitudes of young and affluent customers – who account for a large proportion of the revenues in retail banking yet have the weakest preference for the branch – and the threat of innovation from new entrants.

In the next and final section we look at the policy challenges that have to be met by the banks, the new entrants and critically also by the regulator to create a vibrant, competitive and inclusive market in retail banking.

CHAPTER 4: CHALLENGES IN MAKING THE SHIFT

What we have described in this essay is a changing context for retail banking: a shift in customer attitudes, combined with the potential for innovation. Change is already underway but it raises questions that we have to address if the new wave of competition is to succeed in providing benefits to everyone.

CHALLENGE 1 – GETTING AN INNOVATION MENTALITY FROM THE REGULATOR

John Fingleton, formerly head of the OFT, mooted the idea to the Tyrie Commission on Banking that mobile payments regulation should be given to Ofcom because the banking regulator was unlikely to think like an e-commerce regulator when it comes to considering the changing frontier of banking.

There are two key issues for the regulator to consider in enabling innovation: the first is that we may currently be seeing the 'wrong kind of competition' in retail banking, that is, the majority of the new entrants will be providing lending and savings products, not current account or payment services. If the competitive strategy of new entrants is to take on more risk than the incumbents, repeating the pattern we saw before the financial crisis, then the value they create will be limited and the costs of failure may be significant and systemic. Creating the conditions for more wide-ranging competition is important. Current accounts are in many ways simpler and less risky products than the others yet offering them depends on getting a full banking license – the regulatory thresholds should be reversed.

Alongside this, the regulator should be prioritising entry from peer to peer providers who do not create risk for the system as a whole. What regulation should do in particular is to provide the foundation for building trust in the new services without stifling innovation.

One way to achieve this balance may be to allow small-value transactions in peer to peer services to take place without significant regulation and enhance regulation above a threshold transaction value. There is already such a 'safe harbour' for crowd-funding in the US; businesses using crowd-funding platforms can raise up to $5,000 a year from someone whose income or net worth is less than $100,000, but no more. The Financial Conduct Authority already has a similar rule for Community Benefit Societies in the UK, with their members allowed to invest a maximum of £20,000. These rules allow new entrants to emerge in peer to peer lending without the advent of excessive risk.

The second issue for the regulator is that the new payment services are likely to look very different from previous services. It is important that the regulator is not averse to them because of their novelty. That said, our purpose in mentioning the potential of giving Oyster a banking license is to suggest that new payment services are more familiar than we might think. To take another example, Apple already handles payments for its customers across a wide range of products and services: books, magazines, music, movies and gaming. The possibility of transferring a proportion of your income directly to your Apple ID every month and then using it for an ever fuller range of payments may be neither far off in the future nor countercultural.

There is though a real issue about security: 80% of people in our survey reported concern about online fraud when using the internet; and 74% were concerned about privacy. Even among those that prefer to use online banking only 36% said that it was safer. But confronting these concerns does not mean backing away from online services; rather it means creating an identity assurance service in banking. This is, for example, a core component of the government's digital strategy and it enables access to services that would otherwise need an interaction in a government office or by post.

The question for banking will equally be what form of online identity assurance resolves peoples' concerns and may even make it possible to open an account or switch an account without signing a document and providing identification in person or by post – reducing such frictions will lead to higher adoption of online alternatives. A recent survey found that an additional 40% of mobile phone users would use a mobile-based payment system if there were no additional registration requirements. And there are emerging examples in banking of how this can be done. In the US, Moven allows customers to pay to their Facebook friends rather than asking them to know their friends' account details, emails or telephone numbers.

CHALLENGE 2 – PERSISTENCE OF CASH

The British Retail Consortium's Cost of Payment Collection Survey 2012 shows that, while over half of transactions by volume (54.4 per cent) are paid in cash, use has declined as a percentage both of number of transactions (down 6.7 per cent) and money spent (down 9.7 per cent). This is the first time in the survey's 13-year history that both measures have seen a decline.

However, the average cost to a retailer of having a credit or charge card payment processed was 25 times higher than for a cash payment: 38p versus 1.5p. Credit and charge cards account for only 10.6 per cent of transactions but half of costs and total costs associated with those cards went up by 7 per cent in 2012, even though use was down on the previous year.

This is a challenge given that cash, both for individuals as well as for businesses – as we discussed above – serves to sustain the requirement for branches and bakes in costs for service providers as well as customers.

The question for retail banks to consider will be whether they can cut the cost of card payments and make it possible for all individuals, including those with basic bank accounts, to use cards to make payments simply. Again this is an area where a single large innovation – such as giving a banking license to Oyster – would create the potential for major change. Oyster may be cost-less for retailers hence forcing all the other payments providers to reduce the cost of other modes of payments, accelerating the decline of cash.

CHALLENGE 3 – REFORMING THE BANK BRANCH

While we have highlighted the potential for innovation in retail banking, our survey results also make it clear that there is a high level of satisfaction with the services provided in the branch – 92% say this of financial services, while 84% say this of opening or upgrading an account. If online and mobile channels increasingly provide the simpler services then the branch will be the hub for the more complex ones.

Recent analysis from Deloitte suggests that the role of the branch will vary in different communities. In poorer communities, they say, it is quite likely that there will be "streamlined branch formats focused on efficient self service and remote support". There will likely be some rationalization of branches in larger cities, perhaps by adopting "larger contemporary retail formats." And for commuter towns and urban areas there are likely to be branches "with contemporary retail format, extended opening hours and dedicated customer service."[16] It looks likely that some of these will be within supermarkets – HSBC has a 50% share in M&S Bank and Barclays bank has said it intends opening services in ASDA stores – or in other retailers with some of the features of convenience and accessibility.

Examples of change in the functionality of traditional bank branches are emerging as well. For example, Barclays has tellers

16 Deloitte Insight, *Bricks and clicks, mapping the future of branches*, (London: Deloitte, 2014) 21

with iPads helping people with their personal banking and it is piloting a Skybranch concept providing a video link with a personal banker; users of interactive tellers in the US report a satisfaction level of 90%. In terms of communities without a local bank, RBS has nineteen mobile branches that cover 7,000 miles, making 425 stops, serving 357 communities.

The multi-channel approach of retailers such as John Lewis may also suggest that banks will consider a service offering whereby customers are prompted into the branch from online and mobile interactions: the banking equivalent of the 'click and collect' service.

The driver for this will be that people prefer a branch – by a large margin, as our survey results in the earlier section show – for accessing more complex services such as seeking financial advice or taking out a mortgage. These services represent a large proportion of banks' revenues and hence the higher transaction costs of providing them within a branch will be justified, though only if banks are enabled by the regulatory framework to offer them in branches. The initial implementation of the new restrictions on providing advice suggests that banks are providing products that are execution only and limiting the provision of advice.

In sum, over the next ten years, branches will not disappear but they will change, focusing on a quicker service for basic transactions using the potential of new technology in the branch itself and more personalised service using trained staff where the demand for this exists. There may be fewer branches but it is likely that a higher proportion of visitors will know the name of someone in the branch they use most often.

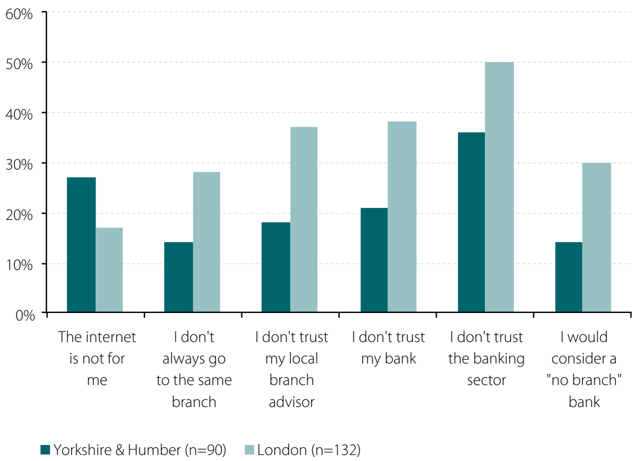
CHALLENGE 4 – ENSURING NO ONE IS LEFT BEHIND

Lloyds Bank has made a commitment not to close any branches until 2015; Santander has said that there will be no net change in the total number of their branches; and RBS will maintain services where it is the last bank in town. Despite these developments though, the overall trend in branch numbers is clear; and it is uneven.

Recent research by Nottingham University found that traditional manufacturing areas have seen a 22% reduction in branches versus a nationwide closure rate of 12%. These areas contain 11.7% of the UK population and have unemployment and low-skilled occupation rates that are higher than the national average.[17]

Put alongside this, the preference for using a branch is stronger in some areas of the country compared to others. The chart below, for example, exemplifies the difference between attitudes in London and those in Yorkshire and Humber.

Chart 8: Regional differences in banking preference



Source: SMF/ComRes, Future of Branch Banking survey, January 2014

17 Shaun French, et al., 'The Changing Geography of British Bank and Building Society Branch Networks, 2003- 2012', University of Nottingham, 2013

The challenge of financial inclusion therefore is that banks may be more likely to close branches in the areas where the demand for them is the strongest. The new entrants to branch banking service do not have a legacy branch network and can cherry pick the areas they compete in, putting further pressure on the branch network in poorer areas. Policy may make this situation worse. Capping the market share of banks, for example, may accelerate the trend of closing branches in the least profitable areas.

A different possibility may be sharing branches. This would maximise the value of branches in all areas of the country and potentially provide a forum for competition between different service providers. However, this will cut right across the strategy of a unified brand. It is like asking Sainsbury's to offer Tesco Finest products as well as Aldi ones. It is likely that the only way to ensure that this happens will be if new entrants to retail banking are required not only to offer current accounts but to complement that offer with an in-branch service. This has the risk of functioning as a barrier to entry. One way to ease that negative impact, and keep access to branch banking as broad as possible, may be to encourage new entrants to seek partnerships with incumbents, providing branch services by paying for use of their existing network. Alongside this, the Post Office Bank may be able to make some inroads to the inclusion issue. Indeed, if the Post Office Bank Account was offered throughout its 12,000 post offices, this would double the number of bank branches in the UK.

One option for better anchoring banks in all communities may be to review the operation of the new rules on financial advice. So far they seem to mean that banks believe it is only economic to offer advice to wealthier customers. This may hasten their withdrawal from poorer areas, i.e. if simpler transactions can be enabled online and by mobile and they cannot offer the more complex ones in the branch without much higher cost, then the business case for keeping the branch is very limited. Changing the rules on advice to make it easier for banks and other providers to offer it when the annual or lifetime cost of the products for the customer is below a specified threshold may rebuild the economic case for the branch while still providing protection for the individual.

Looking more broadly at how services will be provided in future and the role of mobile in particular, only 38% of the DE socio-economic class have smartphones compared to 60% for AB. For those not intending to switch over, over 30% said that smartphones are too expensive.[18]

These disparities in smartphone usage pose a challenge for switching services to mobile but perhaps not an insurmountable one. The OFT has found that the average revenue per account for banks is £148 for a standard account and £300 for a packaged account; hence the economic case for offering incentives to customers – either for switching or staying with the same bank – is already there and these could be provided in the form of a smartphone with the bank's service apps already loaded. It is worth noting that, while 29% of the UK population reported in a recent survey that they "liked to change their mobile phone frequently", 69% of those who used mobile banking answered yes to this question.

18 Ofcom, *Communications Market Report*, 279

CONCLUSION

We started this research with a focus on the bank branch. Our survey research shows that the branch is important for people, as a means of accessing high quality services and as an anchor for trust in banking more broadly. Attitudes are beginning to change, led by the convenience of other channels in shaping behavior. The wave of innovation created by the internet and mobile will continue, taking payment services increasingly out of the branch and into our hands via cards and mobile phones.

The orientation of the regulator will determine whether this change happens quickly or whether banking falls behind other services in using the full potential of new technology to increase competition and reduce cost for customers and businesses. There is an urgent need to rebalance competition in banking to drive innovation in payments to improve banking services and to create more current account providers rather than prioritising more competition in lending.

The opportunity for the branch in the evolution of retail banking is to complement the other channels and to provide the widest possible access to banking services. This will require reform of bank branches; and a regulatory approach that is alert to the challenges facing them.

RESPONSES

We asked a range of organisations and individuals to respond to the analysis provided in this essay.

ADRIAN HARVEY, Head of Consumer and Public Services Policy, Citizens Advice Bureau

Developments in online and mobile banking have undoubtedly created opportunities for more personalised and accessible banking services. However, the widespread bank closures accompanying new banking technology have caused concern that people who struggle to use the new channels face further financial exclusion.

We know the importance of bank branches to Citizens Advice Bureau clients. Our clients use bank branches for a variety of services from cashing cheques to discussing mortgages, as well as getting copies of bank statements as references for landlords, or to provide evidence in benefit overpayment cases. Some of these needs are difficult to meet through newer channels such as online and mobile banking.

One of the most crucial aspects of local bank branches is having a trusted, personal relationship with local bank staff. This is particularly important for vulnerable consumers such as pensioners, those with mental health problems or those with learning disabilities. Many of our clients need this support from bank staff to be able to fully use their bank accounts. For example:

A Citizens Advice bureau in the south saw a vulnerable 53 year old man who was easily influenced and persuaded to buy goods or services that he did not need. His local bank branch staff knew him and had been sympathetic by cancelling unwanted direct debits and issuing new account cards when necessary. However, he was no longer able to call his local branch and had to contact a national telephone number meaning he had less access to branch staff. This resulted in him getting into further financial difficulties.

Although the closure of bank branches is not a new problem, with a recent study finding that nearly 7,500 bank branches in the UK closed between 1989 and 2012[19], we are concerned about recent reports of an accelerating trend of closures[20]. Meanwhile, our clients continue to come to us with concerns about bank closures in their local areas:

A bureau in the north east saw a 55 year old unemployed woman whose benefits were paid into her bank account. She could only access her money from her local bank branch ATM as other bank ATMs charged her. Recently two major banks had closed their branches in her small town and she was worried about her bank closing their branch. Her nearest branch would then be 15 miles away and it would cost her £6.50 return in bus fare, a significant amount on her tight budget.

Branch closures are often concentrated in places with already existing financial and social exclusion. The study mentioned above found areas of high unemployment have lost bank branches at a faster rate than other more affluent places[21].

This is a particular concern as people living in these areas are more likely to be reliant on bank counter and bank ATM cash withdrawal. Some may be limited to cash if they only have a basic account with a cash card and no access to credit or debit cards.

19 Shaun French, et al., 'The Changing Geography of British Bank and Building Society Branch Networks, 2003–2012', University of Nottingham, 2013, www.nottingham.ac.uk/business/forum/documents/crbfs-reports/crbfs-paper3.pdf

20 BBC, 'Barclays to cut hundreds of investment banking jobs', 2014, www.bbc.co.uk/news/business-25939803

21 Shaun French, et al., 'The Changing Geography of British Bank and Building Society Branch Networks, 2003–2012'

Some people who currently use branches to meet their banking needs will migrate to other channels, like mobile banking, but people who cannot use them because of digital exclusion, for example, will be left with very few banking options. Our fear is that many of these people could retreat from the banking world entirely. With the advent of universal credit over the next few years, this could prove disastrous for people on low incomes.

Digital exclusion is still a significant problem, with 4 million households in Great Britain lacking internet access in 2013.[22] Moreover, half of GB adults do not use internet banking.[23] Households without internet access are concentrated in households on lower incomes, with 65% of households in the DE socioeconomic group having access to the internet compared to 80% for the whole population.[24] Without continued efforts to tackle digital exclusion, many of the most disadvantaged will be simply unable to benefit from advances in banking.

The issues around financial and digital exclusion are compounded by geographic issues. A lack of public transport and often patchy mobile phone and internet connections can make accessing new banking services tricky even with the best will in the world.

A bureau in the south west saw a 28 year old self-employed builder living in rural Dorset who did not have access to the internet. His local bank had recently closed their branch in his nearest town meaning he has to travel 13 miles to get to a branch to pay in his cash earnings. This is particularly difficult as he works full time so cannot get to the bank during opening hours. He has been incurring bank charges for exceeding his overdraft limit as he cannot pay in his wages.

22 Office of National Statistics (ONS), 'Internet Access – Households and Individuals 2013', Figure 9, 2013 www.ons.gov.uk/ons/dcp171778_322713.pdf

23 ONS, 'Internet Access – Households and Individuals 2013', Table 3

24 Ofcom, *Communications Market Report*, 274

One potential means of meeting branch counter needs in the context of a diminishing branch network is already partially in place, with the majority of banks allowing customers to carry out transactions over Post Office counters. If this was expanded to allow all transactions, including printouts of statements and even assisting with account opening, it could kill two birds with one stone: helping meet the banking needs of people who rely on counter access whilst providing the Post Office with much needed revenue and foot fall.

In general, internet and mobile banking have opened up opportunities for increased access and for banks to meet the needs of their customers in a more tailored way. However, the banking needs of those who do not have access to or cannot use new technologies still need to be met. We believe banks bear a responsibility to ensure that no one is left behind by innovations in retail banking.

Citizens Advice bureaux deliver advice services from over 3,300 community locations in England and Wales, run by 338 individual charities. We dealt with over 6.6 million problems in 2012–2013. Of these 118,000 were about financial services and 16,300 were about bank, building societies and post office accounts.

ADAM MARSHALL, Executive Director Of Policy And External Affairs, British Chambers Of Commerce

Historically, bank branches have served two crucial functions for businesses in Britain. In cities, towns and villages across the country, bank branches have long facilitated transactions, greasing the wheels of commerce by giving businesses a place to store their takings, receive payment, or exchange currency when trading internationally.

Branches were, for many decades, also the place where businesses went to seek ways to invest their profits or secure the financing needed for expansion and growth. Many companies still yearn for a return to the days when the branch manager was a key figure in the local business community – building relationships, extending loans and facilities, and backing local growth. Captain Mainwaring may be long gone, but amongst many companies he is not forgotten.

In an era of electronic payments and 24/7 internet banking, the role of the branch has changed. For many businesses today, bank branches are becoming like public libraries are to voters – services they use rarely, but want to keep in their communities. Chambers of Commerce throughout the UK report dogged local campaigns to retain branch services, particularly in rural areas, and in places where companies have a higher propensity to use cash, such as high streets. Yet Chambers also tell us that the digitisation of banking has allowed the vast majority of small- and medium-sized businesses to cut costs and manage their cash flow more effectively than ever before.

The 'thinning out' of the bank branch estate across Britain is not occurring in isolation, however. Changes to the branch network are irretrievably bound up in the debate over the future of the UK banking system as a whole.

Businesses have long been frustrated by the UK's centralised banking culture, which has seen decision-making moved from branch level to faceless corporate offices over decades. During the recent recession, many companies found their facilities curtailed, their terms and conditions changed, and long-standing relationships with their banks substantively damaged. In many cases, due to the decline of the importance of the bank branch, these companies felt they had nowhere to turn to air their grievances or seek resolution. I have elsewhere called this a crisis of relationships, transparency and trust – a crisis that will take years, if not decades, to resolve to the satisfaction of businesses across Britain.

This crisis has, however, opened up opportunities for new market entrants to challenge the titans of Britain's banking sector. Amongst the challengers, banks like Handelsbanken and Metro Bank stand out for their use of branches to attract new business customers. Others, like Aldermore, rely on a mix of digital tools and regional SME offices. Yet all are aware that capturing business clients requires some sort of on-the-ground presence, with highly-skilled individuals available for SME customers to speak with.

A mixture of public opprobrium and unexpected competition has also prompted the "big five" banks to rethink how they work with SMEs. Even as they develop more and more online services for business banking, they have also thought again about how businesses use their branches. RBS/NatWest is retraining and accrediting all of its business relationship managers, for example, many of whom sit in local branches. Barclays is supplementing its on-the-ground staff with new social networks and mobile apps. All of the major players in business banking have realised that relationship banking begins locally, and that means maintaining a branch network is important – even if businesses are passed up the chain to regional or national specialists when they need products like trade finance or other forms of more sophisticated intermediation.

So throughout the banking sector, a hybrid strategy – with both bricks-and-mortar and online presence – is seen as a clear route forward.

That hybrid strategy is likely to continue too, as long as the cost of some electronic and card transactions remains high. For many companies, there are still powerful incentives to use both cash and cheques – with their attendant branch requirements. Both cash and cheques offer a lower-cost alternative to businesses than the higher commissions on card payments. For some of the smallest companies, who lack the financial management skills of their larger counterparts, the cheque also affords greater flexibility to manage their cash flow (for better or for worse). As long as the relative financial incentives are skewed in the direction of analogue rather than digital transactions, the bank branch will remain a vital part of many small companies' routines.

My personal view is that these companies should be helped to make the transition away from time-intensive cash and cheque-based banking toward the use of electronic services – and the use of a streamlined branch network as a place to access more complex intermediation and investment services. Yet that view hasn't always gone down well with local companies. When I supported the Payments Council's proposal to abolish the cheque several years back, I received a flurry of angry letters, predominantly from micro-businesses. These same businesses have been at the forefront of many campaigns to retain local branches.

On that basis, I predict that the bank branch network in the UK will continue to evolve gradually. The look and feel of branches will continue to change, and their relevance to business customers re-assessed, but this is a transition that will only proceed as fast as the most recalcitrant (and politically influential) customers allow.

So reports of the demise of the bank branch network have been greatly exaggerated – at least from the business perspective. What that network evolves into over the coming months and years, however, is very much up for debate. If banks succeed in restoring relationships and trust with their business customers, the branches of the future could be hubs of entrepreneurship and exchange. If they fail, branches may continue to serve a transactional purpose for small companies, but continue to decline over time. The story continues.

MARK MULLEN, Chief Executive Officer, first direct

Anyone who uses a computer knows what it's like to receive the "no longer supported" message. It tells you that a piece of software won't run on your operating system or is no longer compatible. Either down-load or install an update or choose a different solution. The same is true of devices themselves. The market for cassette players is non-existent. The market for vinyl is niche at best. Version control, discontinuing lines or closing distribution channels has long been a way of containing costs and complexities. It allows businesses to focus their energies on a smaller number of things and creates intended obsolescence.

The same is not true in banking. We're still accepting cheques. Our credit cards are embossed to allow manual swipe payments. We still have branches even though they are actually no longer needed. There is nothing that can be done in a branch, that can't be done on the phone or on-line. Failure to convince customers that there is actually "a better way" has led to a sustained increase in complexity, in costs and in risk across the Banking industry.

Time and again bankers refer to the challenges of connecting legacy systems and the cost of ensuring that they are all maintained properly. New technologies are added to existing capabilities and it seems that one rarely, if ever, replaces another. For all the years I've been in the business of banking, I have listened to the arguments that branches have not passed their sell-by date and that customers continue to value a face to face experience. Looking at recent CASS switcher data, it seems that these arguments are borne out. Geographical location of branch continues to influence choice of bank and so too does the bank where a parental account is held. In the face of facts, it's hard to argue that these results have rather more to do with sentiment and emotion than practicalities.

The truth of course is that some customers value a face-to-face experience whereas others do not. I consider the perpetuation of out-dated or obsolete systems and processes as a failure of persuasion. It suggests that the discontinuation of a particular product or service will lead to the loss of revenue or to customer dissatisfaction at a time when the industry is struggling to improve its image. In the short-term this may well be true, but ultimately the bank that invests in the future, not once, but perpetually, will find itself with an enduring appeal and relevance in the present. There is always a market for the new and that market tends to be highly attractive because innovations appeal to independent, self-directed human beings. The sort that find their own way in life, lead businesses or generally achieve success.

For almost 25 years first direct has demonstrated that outstanding levels of customer satisfaction can be achieved without face-to-face contact. Our customers use branches but they are content that the branch doesn't carry the brand. For first direct customers, the branch and the ATM are utilities. They are required because our industry clings on to out-moded practices and our society maintains its love affair with cash (albeit the balance is shifting towards digital payments by the hour). Just as dematerialisation has transformed the music industry, its impact upon banking will be similarly transformational. In order that we transition successfully from a model that was conceived in the 19th century towards one that will carry us towards the 22nd, we need to do rather better than introduce new ideas and then leave consumers, old and young alike, to figure out how to use it on their own. We need to turn the tables on the conventional wisdom of the innovation adoption curve.

Our industry needs to substantively revise its approach to introducing new technologies and if necessary start with the laggards and move in reverse (the "innovators" will take care of themselves). If it is willing to take this approach and really invest in adoption, it will soon find itself in a position where it can simplify itself and, in doing so, become a better industry and profession.

GED NICHOLS, General Secretary, Accord

I welcome the opportunity to respond to this timely and important report. UK banks and building societies (from here on in people should read any references to banks as covering building societies also) have a proud record of seeking to improve the service to existing and potential customers via the development of new products and new technologies. The report highlights that it was the Nottingham Building Society that launched the world's first electronic home banking service and, let us not forget, it was the UK which rolled out the world's first electronic cash dispensers in 1967.

However the last few years have also revealed that UK retail banks have a not-so proud record of pressurised-selling practices which has come back to haunt an industry which was already on the back foot after the financial crisis on 2008. Even though many of Accord's members believe that they sold PPI, for instance, to meet customer need we cannot ignore the evidence that there was significant mis-selling which has caused already low customer confidence to drop further.

It seems clear to me that the trend towards greater use of online and mobile banking is one that is irreversible. People want to be able to access their bank accounts and pay for their purchases when and how is convenient for them, not when is convenient for retail banks. This "e-commerce" trend is one that we have already seen amongst many of the retail operators that banks share the high street.

However, whilst it is abundantly clear that banks have improved customer service a great deal by learning lessons from successful retailers, the report makes it clear that customers put an extremely high value on the knowledge that, whilst they may not need to use every a bank branch every week – or even every month, they want to have access to the specialised and personal service and support that only a human interaction can provide. The fact that 78% of respondents to the SMF/ComRes survey would not consider a bank without branches as their main bank speaks volumes.

This, I would argue, brings to the fore "the elephant in the room": a discussion about the possible evolution of consumer banking in the UK over the next decade cannot take place in a vacuum that ignores what the purpose of banking is and what the culture of it needs to reflect. The huge negative impact of the financial crisis on British citizens demands no less.

In the past three years we have seen three commissions looking at the UK banking industry: the Which? Future of Banking Commission, the Independent Commission on Banking and the Parliamentary Commission on Banking Standards. All three of them reflected concerns about the negative consequences of a sales-based "whatever is legal" culture replacing a more professional advisory culture.

In fact, what all three of these commissions showed unequivocally is that whilst some of the practices and techniques banks have imported from the retail sector have been positive, some have undoubtedly upset and angered bank customers: what customers say they want is a source of advice and a level of service they can trust. What they hate is pressure to buy new products whenever they are in a branch, on a telephone call or online. Accord members in retail banking share their concerns.

Of course tension between sales and service in banking has always existed and will always exist. However it does appear that, over the past 25 years, it did tip too far onto the sales side of the scales and that this needs to be addressed. In particular, if this tension is be managed in a way which doesn't further undermine public trust in the sector then banks are going to have be very careful about how new technology works in harness with their branch network *really* serve customers better, not just cuts costs.

This is particularly the case given that, following 2008, the UK public, and the politicians that represent them, appear to have made up their minds that they want retail banking regulated as a utility, not as a general retail sector. I believe that bank branches have a key role to play in restoring and maintaining retail banks' reputation for professional customer service support and advice – as well as product sales centres – which differentiates them from retail outlets. The fact that bank branches are also so popular with customers, as the report shows and, as I am pleased to say, both Lloyds and Santander appear to have recognised, seems to make it good business sense to maintain a healthy branch network too.

STEVE COOPER, Head of Personal and Business Banking, Barclays

Rex Redstone, 85, is the UK's oldest known Instagrammer. The self-confessed 'Instagram-pa' has started a movement to create the oldest collection of personal photos on the social photo community site through his own digital timeline. The initiative started with a conversation with one of Barclays Digital Eagles, experts around the country helping build familiarity with all things online. This is important in a population which is doing more digitally.

Befitting a nation of internet shoppers, online and mobile banking has grown rapidly in the UK. Our digitally savvy customers are pushing us to go further, faster. This is not age specific. A recent Deloitte report finds that "*older people are turning to digital channels in ever-greater numbers… Internet use and online banking in retirement areas is growing at one of the fastest rates*". At the same time, local branches remain very important to most people. One size no longer fits all. The challenge for Barclays is to meet higher customer expectations on all fronts – to be at the forefront of innovation while maintaining a local presence in communities. Balancing these priorities will require changes inside and outside of our branches.

Outside of branches, we will continue to invest in innovative technology to make banking effortless – such as contactless cards, mobile payment services and cheque imaging – and to develop our digital offering. In some countries, most notably the Nordics, use of online banking grew alongside use of the internet more generally. Both figures are lower in the UK, but the trend is clear.

At Barclays, over 2 million individuals regularly use our mobile banking service which has led in turn to an 8.4% reduction in call centre volumes. Almost half of our consumer lending last month was transacted by customers without visiting a branch and, at current rates of growth, it won't be long before an average of over £1 million per day is flowing through our pioneering mobile payments app, Pingit. SME preferences are changing too. Our pre-approved loans for SMEs will soon be available via our mobile app, which is already regularly used by more than half of our small business customers.

The trend towards digital doesn't mean an end to branches, but there will be some changes. Barclays has more branches in the UK than any other high street bank. We have more branches than Sainsbury's has stores. While the overall number will reduce over time, we will continue to have hundreds of branches for decades to come. Locations and formats of branches will vary as we explore different ways of working, such as our new link up with Asda. Increasingly, customers in one branch will be able to see and talk to experts in another; and it will be become more natural to move seamlessly between service channels, aided by the free wifi already in place across our branch network.

As technology develops, straightforward transactions like taking out cash or paying a bill will become more automated and quicker for customers. It now takes just three minutes to open a current account on an iPad in a branch, compared to an hour previously. This frees up our colleagues to focus on helping customers with the bigger things that matter – important life moments such as taking out a mortgage, opening a savings account for a child, or simply checking a transaction a customer doesn't recognise. The Social Market Foundation research rightly emphasises the trust people place in their branches. That's because people like dealing with people. And although formats of branches might change, there will always be colleagues to speak to directly.

Where it becomes necessary to close a branch, our objective is never to leave a community without the ability to transact. In addition to our own direct provision of services – such as "workplace banking", "mini branches" and "talking ATMs" – we have an agreement with the Post Office to enable customers to carry out essential transactions. Arrangements will depend on local circumstances and the feedback of our colleagues who are closest to the community.

The future of retail banking is exciting and emotive. As in other sectors, consumers are demanding change. In a highly competitive and global environment, we need to keep pace with challengers. I know there will be some who disagree with the changes we make. But lessons from other industries demonstrate the need for businesses, like ours, to adapt to be sustainable. I endeavour to listen, to consult and to communicate wherever we try new things. But it's incumbent on us to move with the times. The market is dynamic and fluid; we must be too.

Retail banking has changed in recent decades. The rise of the internet and prevalence of smartphones have provided customers with alternative ways to access bank services previously only available in-branch. While face to face is still the preferred way of accessing bank services for many people, the take up of alternative methods among the affluent and young – groups contributing the most to consumer banking's current and future income – suggests that online and mobile technologies have the potential to unlock cheaper services for consumers, either at their existing banks or by allowing new banks to enter the market and increase competition.

Branching Out draws on a new SMF/ComRes survey of attitudes towards retail banking. The report explores the disruptive innovation that online and mobile channels have already created in other retail sectors; the potential new developments in banking, including increased competition; and the challenges involved in securing these.

The report contains responses to its analysis from Adrian Harvey (Citizens Advice), Adam Marshall (British Chambers of Commerce), Mark Mullen (first direct), Ged Nichols (Accord) and Steve Cooper (Barclays UK).

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