Branch... ... of the future?

Key Concepts

- *Right-sizing branches*
- *Reducing branch transaction costs*
- *Separating profitable customers from unprofitable*

Postal banking may not be coming to the U.S. any time soon. But it can teach us plenty about how to make brick-and-mortar work in a digital world.

In 2015, the Office of the Inspector General made waves in the banking industry with a controversial proposal to introduce postal banking to the United States. Its ambitious report, titled *The Road Ahead for Postal Financial Services,* mapped out a plan to move the Post Office into a potentially vast, untapped market for banking. By leveraging the USPS' impressive physical infrastructure, a postal bank would reach millions of new customers – particularly in "banking deserts" where few brick-and-mortar bank branches existed. With a network of more than 30,000 post offices acting as potential "branches," such a bank could have instantly become one of the largest financial institutions in the country.

That plan has faded into uncertainty over the intervening three years, with only flickers of activity to indicate the concept may still be alive. Due to various political realities outlined below, we deem it unlikely that postal banking will take shape in the U.S., at least in the near future.

In the meantime, however, postal banking has rolled along in dozens of countries around the world, oftentimes quite successfully (and profitably). In fact, 3 out of 4 countries worldwide offer some sort of banking option through their post offices, according to the Universal Postal Union – making it the second-most common way for people to access financial services.

The sheer variety of business models used by postal banks – and the varying degrees of public-private partnerships they employ – demonstrate that there is no one "right" way of doing it. However, certain attributes that most of them share tell us that they fill a niche in their respective economies, and that ultimately, it may not matter much whether the post office or someone else is the primary actor.

The real question we seek to answer in this paper, then, is not, "Should the government create a postal bank in the United States?" but rather, "What can we learn from the concept of postal banking and apply to the issues facing the industry today?"

With the right eye, we can pick out answers to many of those critical concerns: Dwindling brick-and-mortar branch networks, declining foot traffic, even what the "Branch of the Future" might look like.

Country Profile

Country: France

Chartered: 2005

Assets: ~$115 billion

Customers: 10.6 million

Branches: 17,000

Income: € 5.6 billion

Profit: € 538 million

Government-Backed Enterprises: A Largely 'Foreign' Concept

Before embarking on that journey, we must address one issue particular to the United States: A near-total unfamiliarity with – and to some extent, an inherent distrust of – the government as an active participant in free-market enterprises. By and large, Americans do business with government agencies as a matter of necessity. We deal with the government when we need permission for something; when we need to pay an obligation; or when it is the sole, monopoly-style provider of a public service, such as water or trash collection.

In other words, the average *American* citizen's experience with these agencies is not the relationship between a business and a customer. Rather, it is the relationship between a regulator and the regulated – and therefore, our expectation is one of inefficiency and of unpleasant inconvenience.

That's not necessarily the case in other countries, where there may be state-run or state-backed enterprises that operate side-by-side with ordinary companies. This happens not only in banking, but potentially in any industry requiring vast capital outlays (e.g., agriculture, oil and gas production, airlines, mining, shipbuilding, telecommunications, or electricity generation). Of course, these government-run companies come in all shapes and sizes, from drab monoliths to ordinary, modern companies that compete alongside their private counterparts as equals.

Again, the purpose of this report is not to advocate one particular model over another; the point is simply that many different public-private systems exist, with varying levels of government involvement from one to the next.

The gist of the above comparison is that in America, we tend to view postal banking (or any government-related enterprise) through a lens of bureaucratic distaste – slow, inefficient, and unpleasant. If we can step around that disposition for a moment – thinking not in terms of how a government-backed bank would run, but rather in terms of what can be learned from the postal branch model itself – then we can begin to arrive at some important proofs-of-concept for what a branch might look like in the private sector as well.

Sidebar: The Obstacles Facing a Postal Bank in the United States

Postal banking works in so many other countries that there's little doubt it would work here too – in theory, at least. But the gap between theory and reality can be quite wide.

In our case, the concept of a postal bank presents a bit of a financial Catch-22. If it's intended as a project for the social good, the natural question to ask is: *Who's going to pay for it?* In the current political climate, there appears to be little appetite for expanding social programs at taxpayer expense; therefore, any such enterprise would require turning an operating profit.

Based on other countries' experiences, it's more than likely that would be possible. However, if a foray into banking would indeed make money for the Post Office, the question then becomes: *Whose market share would the government be taking away?*

This is where the proposition becomes a bit tricky. The U.S. government tends not to enter into direct market competition with established private enterprises (and the private sector is not eager to welcome state-backed competitors, either). In addition to that, an American postal bank would immediately be operating the biggest branch network in the country by far. It is unlikely that the Post Office would jump into such a venture on its own.

It would probably be necessary to award a contract to an existing bank that has the expertise to run a large branch network – but choosing, say, Bank of America instead of Wells Fargo or Citibank could still be perceived as the government putting its thumb on the scale. And that's not only in the sense of favoring one big bank over another. In the United Kingdom – whose post offices do business on behalf of 30 different financial institutions – there have been complaints that the banks are using postal banking as an excuse to close their own branches, effectively using taxpayer money to subsidize a branch network.

So, while it's likely that a postal bank in the United States could be both practical and profitable, at this moment, it would need to answer to too many competing interests to actually materialize. It will likely be quite some time before conditions are right for such a proposal to move ahead.

How Postal Banks Achieve Their Purpose

Broadly speaking, postal banking enterprises leverage their parent agencies' brick-and-mortar presence in one of three ways, ranging from operating a full-fledged bank in-house, to essentially renting space to one or more private-sector financial institutions. Each of these approaches has its own pros and cons, and also illustrates different strengths of the piggybacked-infrastructure strategy.

Full-Service Banking (i.e., Italy, France)
Several European countries provide a full array of financial services at the post office, from basic deposits and withdrawals, to billpay, credit cards, and even loans and mortgages. Generally, these operations will have their own separate counter within the building to conduct banking transactions, and range in their self-promotion efforts from passive to fully competitive. The website of France's Banque Postale, for instance, displays a level of polish and customer focus on par with that of any private-sector bank.

This type of postal bank has a few common characteristics from country to country. First, it tends to attract a customer base with relatively conservative interests, such as general deposit accounts and cards; for more "serious" transactions, such as loans and mortgages, consumers tend to prefer the private-sector banks. Additionally, in most countries where full-service banks exist, the post office usually has a long history of offering financial services in some shape or form, often dating back 100 years or longer. Finally, many of these full-service postal banks have proven steadily profitable, to the tune of a billion dollars a year or more.

Multi-Partner "Agency" Banking (i.e., UK, Australia)
A more measured approach to the postal branch is agency banking, in which the post office carries out transactions on behalf of multiple private-sector partner banks and credit unions. For instance, Australia's Bank@Post program lets customers of more than 70 different financial institutions do business at the post office, while the UK's Post Office Money represents approximately 30 banks at its locations.

There is a bit of a tradeoff with the agency banking model. By definition, the people handling business on behalf of several dozen banks cannot be employees of any one bank; therefore, they are mostly limited to carrying out basic transactions. (Some agents, however, do collect information for transactions such as loans and forward it to the bank.)

On a positive note, the cost of doing business under an agency model is extremely low. Ordinary postal employees handle the transactions, and the bank reimburses the post office on a per-transaction basis. There is no need for a banking license or any of the other operational structure of a financial institution; that is supplied by the partner banks. In this way, citizens of, say, Marble Bar, Western Australia (population: 208), can enjoy access to banking services from multiple institutions, even though they are a two-hour drive from the nearest ATM. A full-service postal branch would almost certainly not be practical there – but agency banking takes the "piggybacking on infrastructure" concept to another level, taking advantage not only of the existing buildings but of the employees themselves. In this way, many banks can project their branch networks into many areas of which they otherwise would not be capable.

Single-Partner Banking (i.e., Brazil)
Brazil provides a unique example of a hybrid approach where public and private entities have combined to solve the tremendous challenge of providing banking access to millions of its citizens spread out over one of the most demanding geographic and demographic landscapes in the world.

Since its foundation in 2002, arguably no postal banking system has risen to prominence more quickly than Brazil's. Its original operating partner, Bradesco, reported an estimated 10 million new accounts opened during its decade-long run as the sole provider of the system. So successful was Bradesco's run that when the contract came up for renewal in 2012, its rival Banco do Brasil paid $1.7 billion to outbid it for the rights to become the exclusive postal banking partner for the country's 6,000 branches.

Postal banking is not the only tool Brazilian banks have in their belt to reach their outsized "banking deserts." Agency banking there is not

Low Foot Traffic?

Western Australia is home to some of the most isolated small towns in the world. However, the cost savings from agency banking enable Australia's Bank@Post to operate freely, even in these extreme conditions where running a full branch would be hopelessly unprofitable.

Country Profile

Country: Australia
Assets: n/a
Participating Institutions: 76
Branches: 3,500

limited to post offices – nearly every retailer is a potential candidate to offer banking services, be it a supermarket, a drugstore, a hardware store, or a bakery. The larger banks have agent networks numbering in the tens of thousands – encompassing, among a few institutions, more locations than there are bank branches in the entire United States.

What This Means for the Branch of the Future

Hopefully, these examples have been viewed not through the lens of "postal/government banking," but rather in terms of "right-sizing branches."

If there is one lesson that the various examples above should have taught us, it is the incredible power of scaling one's branches to meet the market – and that sharing infrastructure allows banks to dip far below the minimum cost "floor" of operating a standalone branch.

A 2015 study by Bain & Co. estimated that a typical U.S. bank branch needs to handle a minimum of 5,000 teller transactions per month to cover its operating costs, which can range from $200,000 to $400,000 annually. With branch visits per customer dropping noticeably over the past decade, ever more branches are brushing up close to that threshold.

It's possible to reduce that operating cost up to a point, simply by running smaller branches wherever the situation calls for it – and many banks do just that. On the other hand, even if a branch is reduced to its smallest possible physical size (and its lowest possible employee count), there still exists a minimum cost to operate the branch.

At some point, with too few customers, it becomes impossible to support a branch of any size. This is the underlying reason why so many rural "banking deserts" exist (and why the Inspector General's Office came up with its postal banking plan). However, while that proposal offered one possible solution by leveraging the Post Office's brick-and-mortar presence, the government's involvement probably distracted public attention from a deeper truth:

It Doesn't Matter Whether You're Piggybacking on the Post Office or Something Else. All That Counts Is The Infrastructure.

The bedrock principle underlying virtually every postal bank in the world is the fact that it's cheaper to leverage existing physical infrastructure than to build your own from the ground up. It's no coincidence that the post office happens to be an excellent stepping stone for that purpose – in most countries, it exists everywhere, doesn't have many competitive conflicts, and carries the aura of "official" presence, even in remote areas.

But as the Brazilians, Australians, and others have demonstrated, ***there's no reason why a microbranch has to be located at a post office.*** It might do just as well at a library, a train station, the general store, a restaurant, the local inn, or even a tavern.

Australia Post, in particular, has pushed this concept to the limit in smaller towns, licensing private shopkeepers as postal operators (or LPOs) in place of opening full post offices – and, in turn, offering agency banking through those on-demand postal counters. The concept of a microbranch operating inside a micro-post office – a "micro-microbranch," if you will – represents an extreme case of doubling up infrastructure, but also a highly effective example of it.

The "Branch of the Future" Is Not About Touchscreens and the Transaction as a Sales Pitch. It's About Right-Sizing and Cutting Through the Noise.

This brings us full-circle to the most important implication of all: What is the future of the brick-and-mortar branch? For that matter, what is the purpose of a branch?

For a long time, that was a simple question to answer. Going to a branch was the main way – sometimes the only way – to carry out basic transactions, until very recently. In fact, despite more and more transactions migrating to online and mobile channels, the majority of visits to a physical bank branch are still made with the primary goal of making deposits and withdrawals, particularly when cash is involved. This is a terribly inefficient use of time, for both the financial institution and the customer.

Agencies Everywhere

In Brazil, almost any kind of retail business can act as an authorized agent for a bank – from grocery stores, to kiosks, to bars and restaurants. More than 100,000 such agents do business in Brazil, providing access to financial services in every municipality in the country.

Country Profile

Country: Brazil

Postal Branches: 6,000

Partner: Banco do Brasil

Agency Branches (non-postal): 100,000+

Many Branch of the Future concepts try to address this with an odd combination of automation and aesthetic branding, making the branch look like a store, a lounge, or a café – in other words, doing their best to make it look like anything *but* a bank branch. The hope is that this will coax the customer out of a strictly "transactional" mentality and into a different mood that's more conducive to hearing about other (higher profit-margin) products.

Unfortunately, studies have shown that despite the popularity of online banking, customers have little interest in fully automated branches. If they can do a transaction on a PC or a touchscreen, they'd sooner use their own than go to a branch. At the same time, the visitors who are there mainly for deposits and withdrawals aren't very interested in hearing sales pitches.

While many envision a bleak future for brick-and-mortar bank branches, the example of postal banks in other countries teaches us that simply right-sizing your physical presence can keep it viable in many varied conditions.

The result is a brutal calculus for the efficiency of brick-and-mortar branches. Most customers are still there for transactions that represent a net cost to the bank. For some reason, the unprofitable customers resist using less-expensive automated channels, and they can't be steered toward profitable transactions. Yet the banks keep trying anyway. Why? Because it's the simplest way to flip the numbers back in their favor.

More accurately, it's the only way to flip the numbers in the bank's favor under the traditional branch model. Currently, there's one fixed cost for an in-person transaction and another for an automated transaction – making it strictly an either/or proposition. Convince those customers to change; otherwise, suffer the full cost of doing it the manual way.

So, the unprofitable customers don't want to change their behavior, and they don't want to become any more profitable – that means we're stuck, right?

As long as we have the same cost per manual transaction, we're absolutely stuck. It's possible to force some of these "bad" transactions out of the branch with policy changes – but that comes with the risk of alienating the customer. (Recall, for example, the short-lived practice of charging fees to visit a teller window in the 1990s, and the consumer backlash that followed.) More to the point, the cost of operating a branch at all would still have a minimum floor.

But what if we could do an in-person teller transaction for half as much? For a third as much? Suddenly, having a strong brick-and-mortar presence becomes a lot more realistic. And that's something that can only be accomplished by re-scaling the branch – not just in terms of square footage and employees, but in terms of functionality as well.

What did the Australian example teach us? In a town of 200 people, there's not enough volume to justify a single postal employee, let alone a dedicated banking counter – and a full bank branch would be preposterous. Yet there they all are, on an on-demand basis.

What about the Brazilian system, where the banks have expanded their collective reach by leveraging around 6,000 post offices and more than 160,000 agency bankers who are paid on a per-transaction basis? They've demonstrated that most business conducted in person doesn't need a specialized teller; it can be handled by a regular cashier with a little extra training. The cost of outsourcing is less than $1 per transaction at the post office, and often half that at independent retail outlets.

Without a doubt, the full-service branch still has a place in every bank's physical network; people still prefer face-to-face interaction for important or complicated transactions. But the viability of a branch depends on how many of those transactions already exist in a given location, not how many more someone thinks can be squeezed out of the same customer base. If the type and cost of the branch do not match the local opportunity, it becomes unviable, and there can be no branch.

The Branch of the Future is not a high-tech showcase that will somehow convert low-value, run-of-the-mill transactions into lucrative loans and investments. The Branch of the Future is the grocery store branch, the coffee shop branch, the agency branch – whatever branch is the right size to match the available market and provide an anchor point to attract deposits. If you don't match the market, the market is not going to make itself more available for you.

Brazil, to its credit, boasts at least one branch or agent office in every single one of its more than 5,500 municipalities. This is possible, despite much more challenging geographic and demographic circumstances than exist in the U.S., by right-sizing, re-using infrastructure and reimagining the branch – not in terms of what changing the branch can do to affect its customers' behavior, but rather in terms of how its customers' behavior should affect the nature of the branch.

Declining foot traffic, higher costs, and "banking deserts" all exist in the United States, but they don't have to. A postal bank may have been one possible way to address those issues, but to ask whether the government should step in is to miss the point – examples abound in other countries of the private sector solving the same problems, either through public-private partnerships or on its own. The same issues will be solved in the United States by the first bank that sees a "banking desert" not as a desert, but as an opportunity.