

Bank restructuring: Fewer branches, more efficiency

July 2, 2012

The reform of the Spanish financial system currently under way should extend far beyond merely improving operational and sales efficiency ratios.

The current restructuring of the Spanish financial system has already resulted in the loss of around 10 percent of the sector's jobs (25,481) and a 13 percent reduction in the number of offices (5,662 branches) since 2007.

Most of the changes so far have affected the network of offices: approximately 2 of every 3 jobs were eliminated due to the closure of branches.

This is one of the findings of a report published by the consulting firm A.T. Kearney, which includes contributions from IESE professors [Jorge Soley](#) and [Ahmad Rahnema](#).

While the authors recognize that the closure of offices is inevitable, they claim it will not be enough to bring the industry back to, or even close to, pre-crisis levels of profitability and earnings.

Getting back on track

In 2007-08, the year the global financial crisis broke out, the Spanish financial system was generating earnings before tax (EBT) of almost 30 billion euros and a return on equity of 15 percent. In 2011, the industry's EBT was negative (-2.8 billion euros).

According to the report, in order to return to those levels of profitability, the industry will

have to cut transformation costs (staffing and general spending) by at least 35 percent with respect to 2008 levels.

The restructuring process will most likely entail an additional reduction of 25 percent of the industry's installed capacity as of late 2011.

Those institutions that survive the current crisis should cut not only operating costs but also costs related to central and intermediate structures, before they start slashing their sales outlets.

A "winning" sales model

Spain's commercial banking model still depends heavily on the business done in local branches. Despite the advances in new technology and online banking, 80 percent of the industry's revenues still originate in the branch networks.

Personal contact with customers remains paramount for landing primary accounts, in which customers deposit paychecks and pay bills.

It also serves as a launchpad for getting to know customers and building a steady relationship to ensure the recurrence of income flows and the cross-selling of other financial products, such as mortgages and insurance.

Compared with other European countries, it might seem that Spain has a disproportionate number of branch offices: one for every 1,100 inhabitants, compared with 1,800 in Italy and 2,100 in Germany.

Nonetheless, Spanish branches are smaller and have fewer employees, which means the average number of customers served and business conducted by each employee is significantly higher.

And that, ultimately, is what matters most in terms of business productivity.

Where to make cuts?

The closure of branches reduces direct costs for banking institutions, mainly in terms of staff and facilities.

However, it rarely brings about a simultaneous reduction in the costs of core services, including those of the various operating departments and intermediate territorial structures.

Yet that is precisely where the authors see the greatest potential for redundancies and efficiency enhancements, by outsourcing and optimizing processes that are conducive to technological development.

At present, the most common scenario is to have 60-70 percent of staff working within the branch network and the other 30-40 percent in central services and operations.

Based on other restructuring experiences, the report maintains that the latter percentage is too high and could be reduced to 15 percent of employees.

The best way to reach this level would be by speeding up centralization and outsourcing processes, as well as enhancing the existing models of central and territorial structures.

The report concludes that the resulting level of operating efficiency (a cost-to-income ratio below 45 percent), coupled with improvements in business productivity ratios (revenues per employee) would ensure the survival and profitability of banks even in the worst years of regressive economic cycles.

Implications for institutions

In sum, as financial institutions in Spain continue to face growing liquidity and solvency pressures, they have little choice but to streamline their use of economic, technical and human resources.

As such, each business, operational and management model for the banking industry should be reevaluated and, when necessary, adapted to the new economic realities.

Banks should reassess the allocation of staff in a bid to boost employee productivity. This would imply eliminating or reducing the lower value activities and reassigning resources to activities with greater business potential.

This applies to branch networks, where the process is already under way, as well as to central services and operations, which so far have been largely unaffected.

The restructuring process, which has only just begun, must be approached according to three key criteria: operating efficiency, business growth and employee productivity.

Most importantly, the transformation should be progressive, systematic and aligned with each bank's operational priorities, as there are no one-size-fits-all solutions.

www.iese.edu/insight