# Retail banking market investigation

## Barriers to entry and expansion: branches

**13 August 2015**

This is one of a series of consultative working papers which will be published during the course of the investigation. This paper should be read alongside the updated issues statement and the other working papers which accompany it. These papers do not form the inquiry group's provisional findings. The group is carrying forward its information-gathering and analysis work and will proceed to prepare its provisional findings, which are currently scheduled for publication in September 2015, taking into consideration responses to the consultation on the updated issues statement and the working papers. Parties wishing to comment on this paper should send their comments to retailbanking@cma.gsi.gov.uk **by Thursday 27 August 2015**.

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The Competition and Markets Authority has excluded from this published version of the working paper information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂].

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## Background

1. As stated in our Guidelines,[1] entry or expansion by firms, or the prospect of entry or expansion by firms within a short time, will often stimulate competition and can sometimes countervail against features which might otherwise give rise to an adverse effect on competition. A significant source of competitive discipline may therefore be eliminated or reduced if there is any barrier to market entry and/or expansion, whether an absolute barrier or some other form of restriction such as aspects of the market that deter entry.

2. Our Guidelines set out four broad categories of entry barrier: regulatory barriers; natural or intrinsic barriers; strategic advantages of incumbents; and 'first-mover' advantages.[2] Using this categorisation, the potential issues we have identified in the retail banking market are summarised in Table 1 below.

**Table 1: Barriers to entry and expansion**

| *Issue* | *Potential barrier to be investigated* | *What is covered* | *CMA initial findings* |
|---|---|---|---|
| Regulatory barriers | Capital and liquidity requirements | Internal ratings base versus standardised approach | See *Barriers to entry and expansion: capital requirements, IT and payment systems* |
| | Bank authorisation | Access to banking licence; limited and full authorisation | To be reported at provisional findings |
| | Anti-money laundering requirements | Money laundering regulations; systems and controls | To be reported at provisional findings |
| Natural or intrinsic barriers | IT | IT infrastructure build; technology solutions; legacy systems | See *Barriers to entry and expansion: capital requirements, IT and payment systems* |
| | Branches | Branch presence; branch network | This paper. *Barriers to entry and expansion: Branches* |
| | Access to funding | Access to wholesale/private funding | To be reported at provisional findings |
| | Access to payment systems | Direct and indirect access to payment systems | See *Barriers to entry and expansion: capital requirements, IT and payment systems* |
| | Full service provision | Customer acquisition and retention | To be reported at provisional findings |
| Strategic advantages of incumbents | Access to distribution channels | Access to intermediaries; vertical arrangements | To be reported at provisional findings |
| | Activities that increase cost of switching | Tying and bundling; long contracts; exit charges/penalties and delays | To be reported at provisional findings |
| | Proprietary information | Access to information held that might be used for purposes of targeting/cross-selling | To be reported at provisional findings |
| 'First mover' advantages | Brand/reputation | Advertising spend; consumer loyalty | To be reported at provisional findings |

Source: CMA analysis.

[1] *Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3)*, paragraphs 205–236.
[2] *CC3*, paragraphs 205–236.

3. Our Guidelines explain that to assess the impact of barriers to entry and expansion, we will consider how the competitive climate within a market affects the decisions of individual firms to enter or invest in that market, taking into account the advantages of established sellers. This will entail examining the factors influencing entry decisions.

4. On 14 July 2015 we published a working paper entitled *Barriers to entry and expansion: Capital requirements, IT and payment systems*,[3] which set out the evidence we have gathered on capital requirements, IT and payment systems.

5. This working paper is a continuation of our work looking at **natural or intrinsic barriers** to the UK retail banking market. Specifically, it sets out the evidence we have gathered on **bank branches**.

6. Work is ongoing in the remaining areas that are not covered by this paper, and we will report on these in our provisional findings. We welcome views on those areas and any aspects of this paper.

### *Natural or intrinsic barriers: bank branches*

7. Firms entering the market unavoidably incur costs. These might include the cost of putting the production process in place, gaining access to essential facilities or inputs and the acquisition of any necessary intellectual property rights. An important consideration in evaluating the impact of these costs on firms' ability to enter the market is the extent to which they are 'sunk' – ie cannot be recovered upon exit. These costs serve to commit a firm or firms to staying in the market.

8. Economies of scale in combination with sunk investment costs can constitute a barrier when these relate to the cost of entering or expanding in the market. Entry on a large scale will often entail a high risk (that sunk investment costs may not be recovered) because it will generally be successful only if the firm can expand the total market significantly, or substantially replace one or more firms.

9. Providers seeking to enter the retail banking market require access to a distribution channel(s) in order to effectively compete in the provision of personal current accounts (PCAs) and small and medium-sized enterprise (SME) banking services. Branches have traditionally been the principal distribution channel for banks. However, new technology means that many of the functions traditionally provided by branches (eg account opening, basic

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[3] *Barriers to entry and expansion: capital requirements, IT and payment systems*.

transactions, and balance enquiries) can now be done through digital channels (internet and mobile), which raises the question of whether branches remain necessary for a bank to be an effective competitor. We seek to answer this question through this working paper which explores the importance of a branch network for the provision of PCAs and SME banking services.

10. This paper examines the evidence on the following:

*(a)* **Recent trends** – this section describes recent trends in bank branches including the decline in branch numbers and branch reforms.

*(b)* **Importance of branches to customers** – this section examines the role that branches continue to play for personal and SME customers and how consumer behaviours are changing.

*(c)* **Importance of branches to banks** – this section sets out evidence on why existing banks have branches and what functions they deliver.

*(d)* **Branches as a barrier to entry and expansion** – this section examines the cost of a branch network, alternative models for distribution, and the extent to which banks without a branch network are able to pose a competitive constraint in the retail banking market.

### *Additional notes*

11. For the purposes of this paper, 'bank' is used to describe retail banks and building societies (mutuals). The evidence and our analysis is sometimes presented by bank brand and sometimes by banking group. The Royal Bank of Scotland Group (RBSG) comprises the Royal Bank of Scotland (RBS), NatWest and Ulster Bank. Lloyds Banking Group (LBG) comprises Lloyds Bank, Halifax and Bank of Scotland. HSBC Group (HSBCG) comprises HSBC Bank, M&S Bank and First Direct.[4]

12. As part of our market investigation, we commissioned GfK NOP (a market research institute) to undertake a research exercise to help us understand how consumers view and use their personal current accounts.[5] This is referred to as 'GfK consumer research' throughout this paper.

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[4] First Direct does not have any own-branded branches but its customers may use HSBC's branches and Post Office counters to undertake limited transactions.
[5] PCA banking report GfK.

13. To inform our view of the SME banking sector, we have used the Charterhouse Research Business Banking Survey. This is referred to as 'Charterhouse survey data' throughout this paper. We also commissioned Charterhouse to conduct follow-up surveys with start-up SMEs and Research Works Ltd to undertake qualitative research in relation to SMEs.[6]

[6] Research Works SME customer research into the retail banking market.

## Summary

14. This paper sets out the evidence we have gathered on bank branches and the role that they play in retail banking. It examines recent trends in the number of branches and branch usage. While both are in decline, as customers increasingly interact with their bank via mobile and online, branches appear to remain important to some customers.

15. Consumer research undertaken by Charterhouse and GfK found that local branch convenience is the second most important reason for SMEs and the third most important reason for PCA customers in choosing who to bank with. Having a branch network across the country is most important to younger PCA customers and to SMEs.

16. Thus, for banks, branches continue to play an important role in acquiring and retaining customers. 78% of customers open a PCA in a branch and around 84% of start-up SMEs open their first Business Current Account (BCA) in a branch. A high-street presence also promotes brand recognition and loyalty (which is not achieved through offering counter services at the Post Office or competitors' branches).

17. While firms are able to enter the retail banking market without an own-branded branch network (as Atom, Starling and OakNorth intend to do), the key issue is whether banks can achieve sufficient scale to compete effectively in retail banking without a branch network. If this is not the case, the cost of acquiring and maintaining branches may act as a barrier to expansion in the retail banking market.

## Recent trends

### *The decline of bank branches*

18. Branches have traditionally been the principal distribution channel for banks, used by customers for checking account balances, handling cash payments/withdrawals and obtaining advice. The advent of telephone banking in the 1990s, and online and mobile banking more recently[7] (collectively, 'direct channels'), has changed how customers (personal and SME alike) interact with their bank(s), and multi-channel banking has become the new norm.

19. In recent years the number of bank branches in the UK has been in decline. This trend, which is likely to continue for some time as banks implement their branch closure programmes, has been driven by a combination of demand side and supply side factors. For consumers, the ease and convenience of direct banking is driving down demand for branches. For banks, consolidating their branch networks can generate significant cost efficiencies. Under-standing how these drivers interact is important in ascertaining whether branches create a potential barrier to entry and expansion in UK retail banking.

20. In 2013, there were 10,208 bank branches in the UK (see Table 2 below).[8,9] This fell to 9,661 at the end of 2014. The biggest year-on-year change was in Scotland where the most significant branch closures were made by RBS (42), Nationwide Building Society[10] (24) and Clydesdale Bank (17). The UK's branch network has remained relatively concentrated by brand and by geography: Barclays Bank, HSBC, Lloyds Bank, NatWest Bank and Santander UK accounted for 63% of branches in the UK in 2013 and 2014.

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[7] This includes 'digital wallets' that facilitate the storage of payment (and possibly other) credentials and enable users to make payments, either online or via a mobile device.
[8] Based on data from AIB, Barclays, Bank of Scotland (BoS), Bank of Ireland (BoI), Clydesdale, Co-op, Danske, HSBC, Lloyds, M&S Bank, Metro, Nationwide, NatWest, RBS, Santander and TSB. Data provided as at 1 January 2014 (approximated stock 2013) and at 1 January 2015 (approximated stock 2014).
[9] Includes retail branches and co-located business centres. Excludes business centres that only service SME customers.
[10] Nationwide's branch closures were driven by the final integration of Dunfermline Building Society into Nationwide.

**Table 2**: **Total number of branches in the UK***

| | 2013 | 2014 | % YoY change† |
|---|---|---|---|
| England | 8,208 | 7,799 | –5.0 |
| Scotland | 1,123 | 1,037 | –7.7 |
| Wales | 596 | 562 | –5.7 |
| Northern Ireland | 281 | 263 | –6.4 |
| Total | 10,208 | 9,661 | –5.4 |

Source: CMA analysis.
*Based on data from AIB, Barclays, BoS, BoI, Clydesdale, Co-op, Danske, HSBC, Lloyds, M&S Bank, Metro, Nationwide, NatWest, RBS, Santander and TSB. Data provided as at 1 January 2014 (approximated stock 2013) and at 1 January 2015 (approximated stock 2014). Includes retail branches and co-located business centres. Excludes branches (business centres) that only service SME customers.
†Year on Year (YoY) change in the stock of branches between 2013 and 2014.

21. Some banks also have standalone branches or 'business centres' for SME customers that provide services such as a dedicated business banking counter service and relationship/business banking advisors. The total number of business centres in the UK has been more stable than retail branch numbers since 2013 (see Table 3 below).[11]

**Table 3: Total number of business centres in the UK***

| | 2013 | 2014 | % YoY change† |
|---|---|---|---|
| England | 395 | 394 | –0.3 |
| Scotland | 63 | 63 | 0.0 |
| Wales | 22 | 19 | –13.6 |
| Northern Ireland | 20 | 19 | –5.0 |
| Total | 500 | 495 | –1.0 |

Source: CMA analysis.
*Based on data from AIB, Barclays, BoS, BoI, Clydesdale, Co-op, Danske, HSBC, Lloyds, M&S Bank, Metro, Nationwide, NatWest, RBS, Santander and TSB. Data provided as at 1 January 2014 (approximated stock 2013) and at 1 January 2015 (approximated stock 2014). Branches (business centres) that service SME customers only.
†Year on year (YoY) change in stock of business centres between 2013 and 2014.

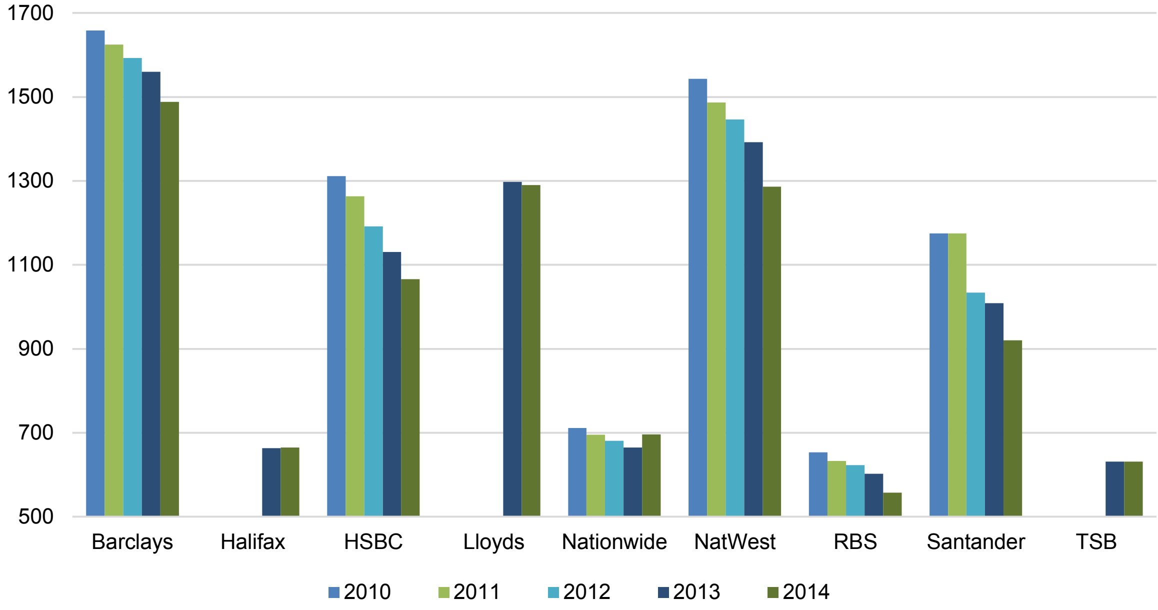
22. In absolute terms, the most significant changes over the period occurred in England where HSBC closed 16 business centres (reducing its stock from 71 to 55) and Santander opened 15 centres (increasing its network from 41 to 56). Santander has plans to continue to expand its business centre network to approximately 70.[12,13] During 2014, HSBC also closed three of its seven business centres in Wales and its only centre in Northern Ireland.

23. Figure 1 and Figure 2 plot the decline in the number of (retail) branches since 2010 for banks with greater than 500 and fewer than 500 branches respectively. With the exception of Halifax, Nationwide and TSB, banks with relatively large branch networks (more than 500 branches) have been closing

[11] In our information request to banks, we asked parties to exclude retail branches which provide basic services such as deposit facilities to SME customers. Some banks have co-located branches and business centres that they cannot separate for data collection purposes. These figures may overestimate the number of business centres.
[12] Santander response to issues statement.
[13] Ana Botin, CEO Santander, interview 31 May 2013.

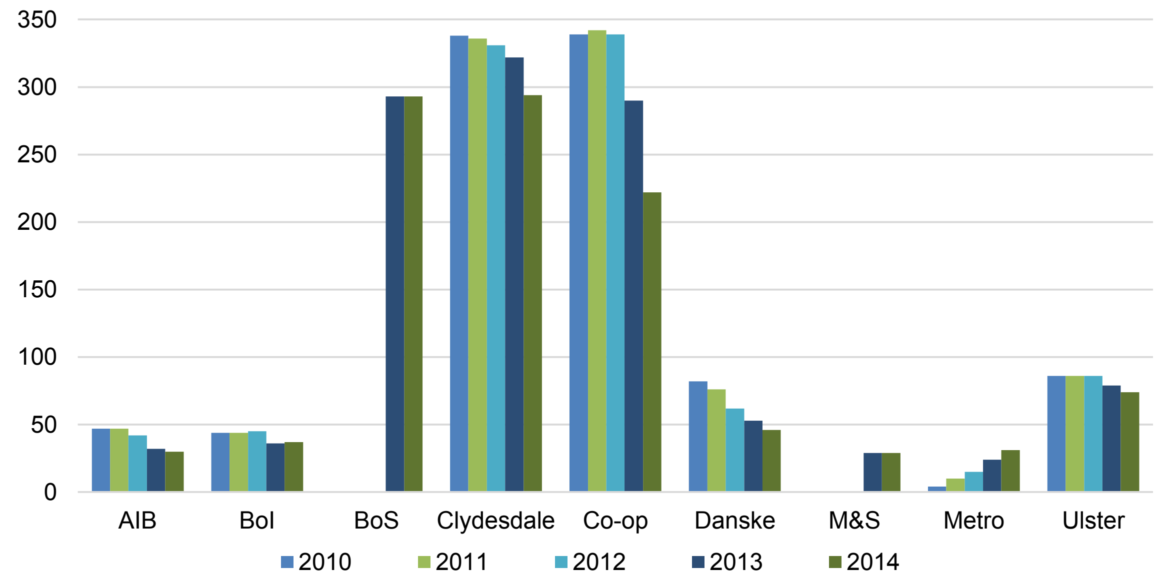
branches in every year since 2010. Nationwide also had a smaller branch network in 2014 compared to 2010. A similar trend of branch closures can be seen for those banks with relatively small branch networks, with the exception of Metro Bank, which has been steadily growing its branch network since entering the retail banking market in 2010.

**Figure 1**: **Number of branches by brand 2010-2014 (banks with more than 500 branches)**




Source: CMA analysis.

**Figure 2**: **Number of branches by brand 2010-2014 (banks with fewer than 500 branches)***




Source: CMA analysis.
*Clydesdale refers to Clydesdale Bank Plc, which includes trading names Clydesdale Bank and Yorkshire Bank.

24. The trend in declining branch numbers is not confined to the UK. A study by Jones Lang LaSalle into the future of retail banking predicts that as many as

50% of existing branches in banks' networks may be 'declared obsolete in their current form in the developed world by 2020'.[14]

25. The extent and rate of branch closures by incumbents may be indicative of banks operating beyond a level that is economically optimal. For the nine banks included in Figure 1, the average branch network size in 2014 remained significant at 961. A report by Deutsche Bank[15] quotes research by CACI[16] which found that 80% of the UK market today can be covered by a bank through around 800 branches. CACI forecasts that 600 branches will 'deliver effective nationwide customer coverage' in five years' time.

*Reforms to existing branches*

26. In addition to an overall branch network consolidation by existing banks, remaining branches are being replaced with smaller, more digitally-focused outlets. A number of aspects of banks' branch optimisation strategies are common across firms and include the following:

(a) **Assisted digital** – a migration to self-service technology (including 'smart ATMs' with enhanced functionality such as cash and cheque paying-in facilities, and mobile technology) and reformed staff interactions with customers. HSBC, for example, is introducing tablets in its branches during 2015 to enable 'simple servicing on meet and greet'. TSB's analysis suggests that increasing self-service facilities in branches can deliver a cost reduction of around [✂]% 'without impacting customer service'. Barclays told us that one of the ways of ensuring that it does not 'leave anyone behind on the digital journey' is the introduction of more than 8,000 'Digital Eagles' (specially trained staff) in all of its branches to provide technology advice to customers and the general public.

(b) **Reduced counter services and teller staff** – according to Barclays, [✂]% of bill payments by its customers are made through online and mobile banking, with less than [✂]% of bill payments made in branch. Barclays also notes the importance of alternative physical channels like the Post Office for cash handling.[17] Meanwhile, HSBC notes that while most visits to its branches remain for cash and cheque deposits, it expects this to decline as cheques usage is decreasing and use of mobile payments and peer-to-peer payments increase.

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[14] Global retail banking. Key trends and implications for retail banking real estate.
[15] UK Retail Banking 2014: Bank to the Future', Deutsche Bank Equity Research, September 2014.
[16] CACI is a location planning consultancy that has worked with a number of banks to assess their 'optimal' branch network size.
[17] Barclays response to issues statement, p10.

(c) **Remote/virtual advice** – replacing static branch-based advisors with a central pool of advisors that engage with customers via video-conferencing. Barclays and Nationwide are examples of banks using this technology to link customers with advisors or relationship managers.

(d) **Alternative branch formats** – temporary ‘pop-up’ branches and smaller branches are being used to fulfil demand where banks may be under-represented (or not present at all). Halifax, for example, has trialled ‘pop-up’ branch operations in Scotland, where branch staff provided customer advice and assistance in shopping centre locations, supported by access to online banking facilities provided in the pop-ups. Barclays has introduced a new distribution format with Asda, called ‘Barclays Essentials’. Barclays currently has eight Barclays Essentials branches, which it says offer its customers ‘convenience and extended opening hours’. RBSG has extended counter services to ‘mobile banking vans’. It told us that this service was used by [✂] SME customers in [✂].

27. Smaller branch networks and reforms to remaining branches are enabling banks to focus investment more narrowly, increase efficiency and cut costs.[18] TSB believes that ‘the branch of the future with its investment in automation will deliver a much more economic branch model’ but it believes that customer-facing staff will remain important for branches to be successful. HSBC notes that the branch network needs to be ‘streamlined towards delivering effective customer conversations’ (rather than continuing to act as transactional hubs).

28. The next section describes the importance of branches to consumers and how their role is changing (which is likely to be a response to, as well as a driver of, some of the trends discussed in this section).

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[18] Although branch reforms are not without cost: RBS noted in its response to our issues statement (p22) that the refurbishment and updating of its branch network carries a ‘significant’ cost. [✂].

## Importance of branches to consumers

29. Customer preferences may be driving a response by banks (existing banks and new entrants) as well as responding to a reduction in the supply of bank branch services. Banking is increasingly becoming a self-serve activity for consumers. Consumers are, according to a report by Deloitte, demanding greater convenience and expect 'seamless integration of remote and in-person channels wherever they may be'.[19]

*Trends in branch usage: PCA customers*

30. Between 2012 and 2014 the total number of branch visits by PCA customers in the UK fell by 15%.[20] Over the same period, the number of log-ins to mobile banking apps rose fourfold, overtaking log-ins to internet banking for the first time in 2014 (as shown in Figure 3 below). While the rate of growth in mobile registrations (by PCA customers) has slowed since 2011 as the stock of adopters has grown,[21] the rate of decline in the importance of branches is expected by some banks to accelerate as it is eroded by technological innovation.[22]

**Figure 3**: **Proportion of usage by PCA customers by channel (branch visits/log-ins/calls)***

[✄]

Source: CMA analysis.
*Branch visits data not available from Danske, Ulster and M&S. Danske and Ulster have been excluded from this chart. M&S has been included where data is available. Clydesdale data on banking log-ins was not available and has been excluded from Figure 3.

31. The reduction in branch footfall varies widely across banking groups. For example, the number of PCA customer visits to Barclays branches fell by more than [✄] between 2012 and 2014 (see Figure 4 below). RBSG and HSBC experienced a reduction in branch visits of [✄]% and [✄]% respectively over the same period.[23] Based on internal analysis, HSBC predicts that branch usage by its customers will fall by [✄] between 2012 and 2018.

[19] Deloitte report, *UK bricks and clicks*.
[20] Calculated excluding Danske, Ulster and M&S, for which data was not available. Data on transactions by channel is not consistent across banks and has not been presented here. Visits/log-ins/calls may not be representative of the number of transactions made by channel.
[21] PCA aggregate data request. Mobile registration rose 148% from 2011-2012, 80% from 2012-2013 and 37% from 2013-2014. Note: data is not available for TSB for mobile banking channel, and for LBG the figures for number of customers registered for mobile/internet banking are calculated by aggregating the individual figures for each LBG brand and therefore will overestimate the total number of customers registered due to double-counting of customers registered with more than one LBG brand.
[22] LBG response to issues statement.
[23] RBSG's reduction in branch visits is calculated using data for the RBS and NatWest brands. Data on branch visits is not available for Ulster.

**Figure 4**: **Number of transactions/visits undertaken by PCA customers by channel (Barclays)**

[✂]

Source: CMA analysis.

32. LBG and Nationwide have experienced more modest reductions in branch visits (of between [✂] and [✂]%) since 2012.[24] For example, [✂].

**Figure 5**: **Proportion of customers using branch in 3 months* (Nationwide Building Society)**

[✂]

Source: Nationwide.
*Used branch counter in 3 months, as a % of active current account holders.
Note: [✂].

*Importance of branches to PCA customers*

33. Despite the recent trends in footfall described above, consumer research undertaken by GfK and independently by parties illustrates that consumers continue to place a high value on branch availability and accessibility.

34. GfK’s consumer research shows that branch convenience (location and opening times) is considered the third most important feature of a PCA for customers (joint with internet banking) after quality of staff and customer service and quality and speed of handling problems. Local branch convenience is considered as essential or very important to more customers (63%) than having a national branch network available (58%).

35. According to Mintel’s 2014 survey, in-branch counter services remain the most important channel for 25% of customers, and 59% say that it is either the most or the second most important banking channel.[25]

36. TSB carried out its own customer research and found that for 69% of customers, having a branch close to where they live is important.[26] TSB believes that bank branches will remain ‘a lynchpin’ of the UK banking system in spite of the ‘digital revolution’ it considers to be underway.[27]

37. Despite the reported importance of bank branches, according to GfK’s consumer research, only 39% of PCA customers visit their branch at least once a month (see Figure 6). This falls to 31% for PCA customers aged between 18 and 44 years. 42% of respondents use a branch less than twice a

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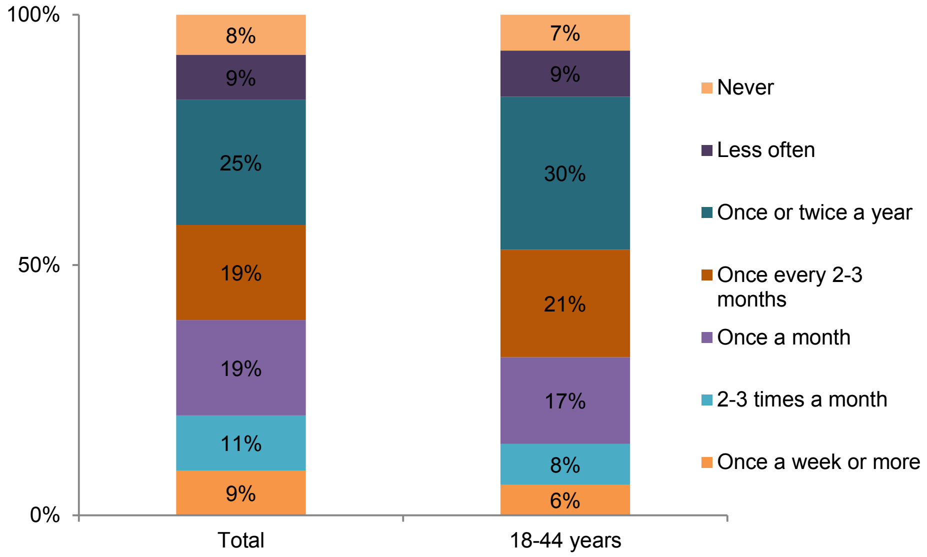
[24] However, LBG told us that the number of branch visits involving person-to-person contact had fallen by approximately 27% since 2012.
[25] Mintel report, Consumers and retail banking 2014. Base: 1,951 internet users aged 16 and over who have a current account.
[26] TSB (June 2014), *Why branches matter in a digital world*. Research carried out by ComRes for TSB, poll of 2010 people (2014).
[27] TSB (June 2014), *Why branches matter in a digital world*.

year (this includes those who said they 'never' use a branch). Consumers may, therefore, place some intrinsic value on a branch presence even where they are not frequent users. In contrast, 66% and 74% of respondents use internet banking and mobile banking respectively and most are frequent users (logging on to their account at least once a week).

**Figure 6: Frequency of branch visits***




Source: GfK survey.
*Respondents asked 'How often, if at all, do you go into a bank branch for anything to do with your main current account?'.
Base: All (Total = 4,549; Low income = 966. Only one channel = 1,239; 18-44 years = 2,090).

38. Barclays notes that customers use internet banking with 'materially greater frequency than visiting a branch and online banking'. For example, the average Barclays mobile banking user logs in [✂] times a month, whereas the average Barclays branch user visits their branch [✂] a month.

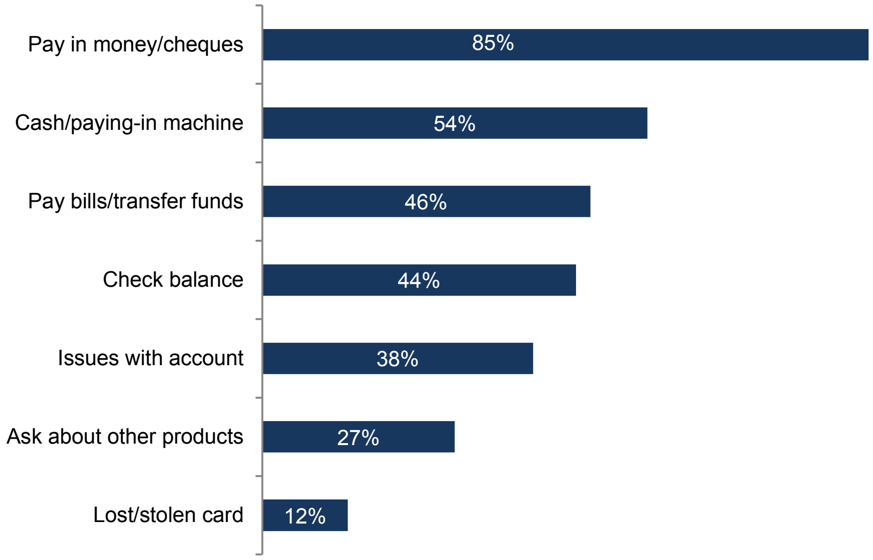
39. RBSG told us that currently, and increasingly, customers make use of multiple channels combining frequent digital access with less frequent in-branch or telephone interactions. It told us that despite reducing its branch network, the number of customer interactions with RBSG has increased in recent years (from [✂] customer interactions with the bank in [✂] to [✂] in [✂]). RBS predicts this will rise to [✂] in [✂] as more people use digital technology to interact with the bank.

40. The most common reasons for visiting a branch cited by respondents to GfK's survey were to pay in money or cheques (either over the counter or by machine) (85%) and to use cash machines or paying-in machines (54%), as depicted in Figure 7. Accenture's report *Winning the race for relevance with banking customers* found that more than twice as many PCA customers

making deposits prefer to do so through an advisor at a counter rather than using a self-service ATM.[28]

41. Further, nearly half (46%) of respondents to GfK's survey that use branches visited their branch to pay bills or transfer funds between accounts. This was more common among those aged 45 years or over (50% versus 41% of 18- to 44-year-olds) and those who did not use internet banking (58% versus 40% of those who do).

**Figure 7: Reasons provided for visiting a bank branch***




Source: GfK survey.
*Respondents asked: Have you used any of the following in the last year when going inside a branch?
Base: All those who have visited a branch in the last year (3,764).

42. Lloyds Bank told us that 'a significant proportion of current branch activity occurs because customers are not yet aware of, or comfortable with, using digital channels'. It notes that branches are 'key enablers of the multi-channel experience as they are used as a point of contact for branch staff to educate customers about digital channels and sign them up to digital banking'. While not accounting for a significant proportion of branch visits at present, Lloyds notes that an increasing proportion of branch visits are for complex conversations across a range of products and its branch strategy reflects this.

43. There is evidence that branch usage differs between PCA customer segments. First, age appears to be a factor in determining branch usage. GfK's consumer research found that, as shown in Figure 6 above, those aged 18 to 44 tend to be less frequent visitors to a bank branch than the average population. However, having a national network of branches was more

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[28] Accenture report (2014), *Winning the race for relevance with banking customers*. Accenture's research consisted of online interviews with 3,604 UK current account customers, conducted in March 2014.

important to younger respondents (68% of 18- to 44-year-olds versus 51% of those over 65) who may be more likely to relocate (eg moving away for university or moving jobs).

44. [✂].

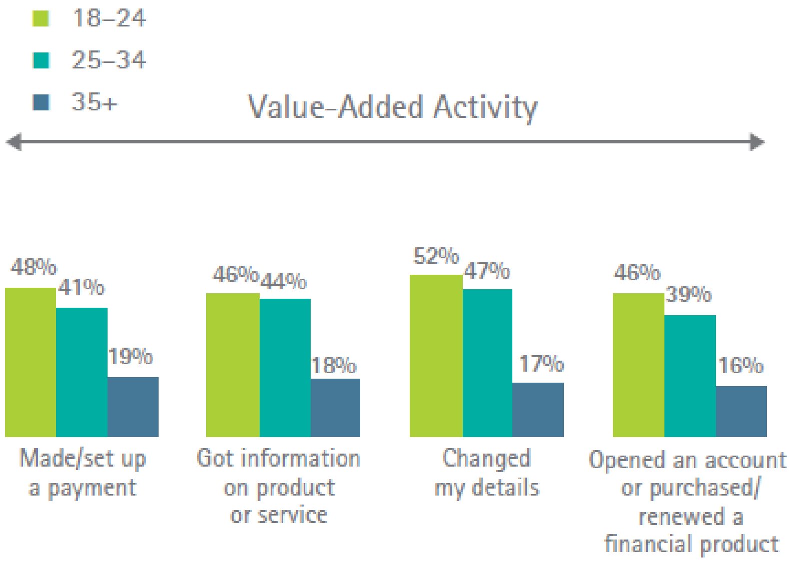
**Figure 8: PCA customer transactions in branch by age for Nationwide (blue) and its peer group (orange) for month to 30 April 2014**

[✂]

Source: Nationwide.
Note: [✂].

45. A report by Accenture found that in addition to those around retirement age, 18- to 24-year-olds were most likely to visit branches, reflecting ‘changing needs over life stages’. According to Accenture’s research, younger customers ‘have a greater bias for physical interaction pointing to their need for face-to-face contact, advice and reassurance as they begin their financial journey’.[29] As Figure 9 depicts, 18 to 34 year-olds are more likely than over 35s to engage in ‘value-added activity’ in branches (defined as non-transactional activity).

**Figure 9: ‘Value added’ activity in branches by age group***




Source: Accenture UK Financial Services Customer Survey 2014. Accenture report (2014), *Winning the race for relevance with banking customers*.
*Responses to the survey question: ‘Which of the following activities did you do during your last visit to your bank’s branch?’. The research consisted of online interviews with 3,604 UK current account customers conducted in March 2014.

46. Second, branch usage is correlated to usage of other channels. Frequent users of telephone banking are, according to GfK’s consumer survey, also more frequent branch users. Further, over half (55%) of high frequency

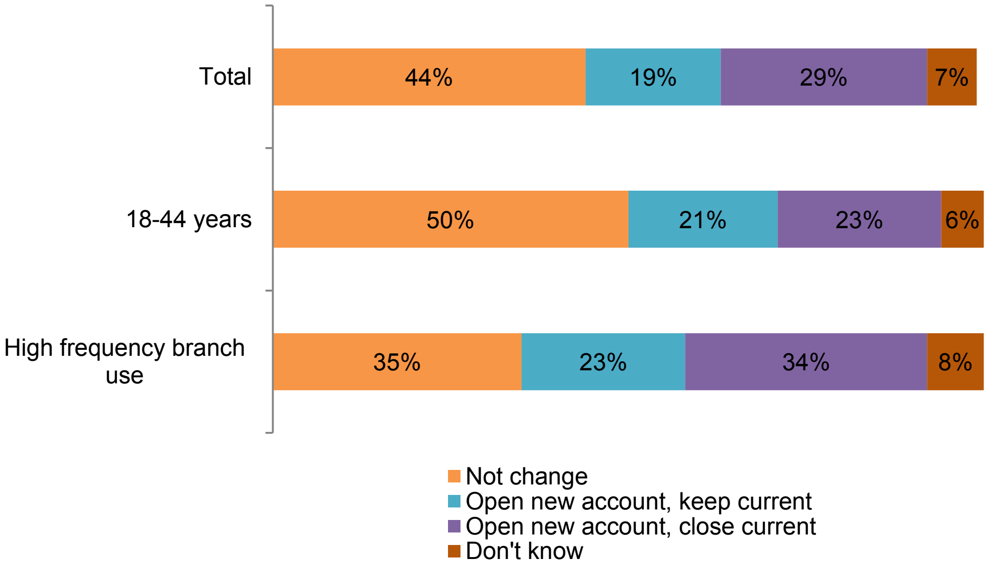
[29] Accenture report (2014), *Winning the race for relevance with banking customers*.

branch users (once a week or more) have never used internet banking. 74% of consumers that do not use internet banking consider having a convenient local branch to be either essential or very important compared with 56% of consumers that do use internet banking.

47. Third, GfK's research found that PCA holders who are on a low income (defined as less than £12,000) tend to visit their bank branch (of their main current account) more frequently compared to the average population. 47% of customers on low incomes visited their bank branch at least once a month compared to 39% on average.

48. The difference in channel preferences by consumer type are reflected in Figure 10 which shows reported customer behaviour in response to the (hypothetical) closure of their main bank branch. On average, 44% of customers would stay with their existing 'main' bank if their most-used branch closed but 29% of customer would open a new account and close their current account. One half of 18- to 44- year-olds would not take any action if their main bank branch closed versus 35% of frequent branch users (those that use a branch at least once a week). This analysis does not take into account the proximity of a customer's alternative branch either with their existing bank or a different bank.

**Figure 10: Reported behaviour if most-used branch closed***†




Source: GfK consumer research.
Note: Base – all those who have visited own bank branch in the last year (3,764). Percentages do not necessarily sum to 100 due to rounding.
*Responses to the survey question 'Thinking about the branch of bank that you use most often, if that branch was closed permanently, would you open an account with a bank with a more convenient branch? If yes would you keep your account [with the bank that closed its branch] open or would you close it?'
†High frequency branch use defined as those customers that visit a branch at least once a week.

49. GfK's qualitative consumer research found that individuals' responses to a branch closure are likely to be determined by the availability of alternative branches in their area and the extent to which they use digital resources. The

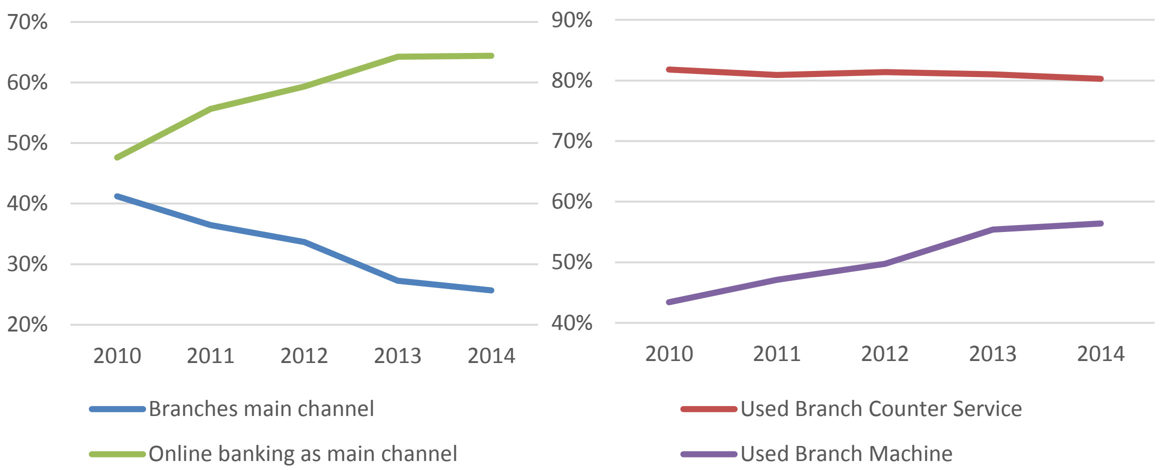
closure of a branch network (ie branches across the country), however, is considered by most to be a 'severely detrimental development'. Younger consumers saw this as a significant challenge to their relationship with the bank, while older consumers saw it as the termination of the relationship.[30]

*Importance of branches to SME customers*

50. According to survey data from Charterhouse, the proportion of SMEs reporting to use branches as their main banking channel has fallen in every year of the past four years, decreasing from 41% of SMEs in 2010 to 26% in 2014. However, over the same period the number of SMEs using branch counter services in the 12 months prior has remained level at around 80%. Meanwhile, the proportion of SME customers using online banking as their main channel rose to 64% in 2014 from 48% in 2010. This is shown in Figure 11 below.

**Figure 11: SME channel usage***

**(a) Branch and online usage 2010-2014†** **(b) Counter service and machine usage 2010-2014‡**




Source: Charterhouse Business Banking Surveys 2010-2014.
*Data from the Charterhouse Business Banking Survey. This is a quarterly survey, collecting approx. 14,000 to 16,000 interviews with SMEs annually.
†In response to the survey question 'What is your most used banking channel?'
‡ In response to the survey question 'Have you or anyone else in your business used Branches/Branch Machine in the past year?'

51. A Charterhouse survey of SME start-ups found that 82% use their local branch to open their BCA.[31] After banks' websites (29%), branch visits or leaflets from branches were the most popular source for start-ups to obtain information on BCAs (22%).

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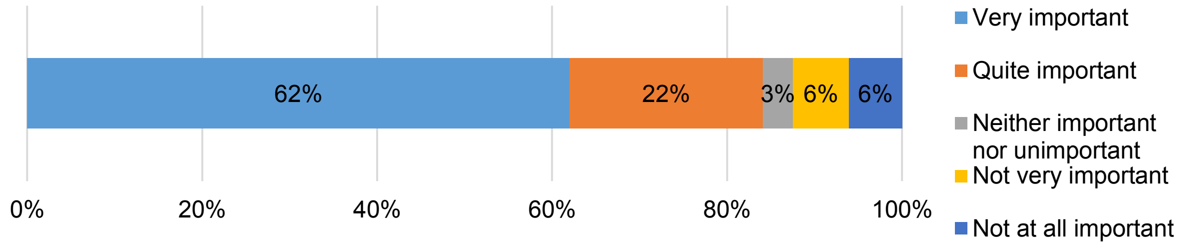
[30] GfK consumer research.
[31] Start-ups defined as businesses which have been operating for two years or less. Survey undertaken by Charterhouse for CMA.

52. According to Charterhouse's survey of start-ups, having a branch in a convenient location or close to their business was the second most important reason for choosing a bank (17%) after access to free banking (19%). Further, 84% of start-ups reported that having a branch is either very important or quite important to their decision of who to bank with (see Figure 12 below).

**Figure 12: Importance of branches to start-up SMEs***




Source: Charterhouse survey of start-up SMEs.
Note: Due to rounding, percentages do not sum to 100.
*In response to survey question 'How important to you choice of bank was having a convenient branch location /or a branch that is close to your business?'.

53. Paying in cash or cheques and taking out cash were the main reasons start-ups provided for requiring access to branches. 84% of respondents to Charterhouse's survey of start-ups quoted this as being the most important reason for having access to a physical branch. The next most important reason was for meeting a relationship manager/bank staff, but this was only true for 19% of respondents. Access to a network of branches across the country was viewed as 'not very important' or 'not at all important' for the majority of start-ups (62%). 29% considered a branch network as very/quite important.

54. Consumer research undertaken by Research Works found that SMEs consider it important to know branch staff, particularly counter staff and the relationship manager.[32] Being known personally implied to the customer that the bank knew their business well and this was given as a reason for staying with their bank.

55. [✂].

56. The services demanded of, and available to, customers in branch is also often dependent on the size of business and the complexity of their needs. For example, RBSG told us that the extent to which a business customer makes use of branch counter services depends primarily on how cash/cheque heavy the business' operations are. In addition to branch services that serve RBSG's

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[32] SME customer research into the retail banking market.

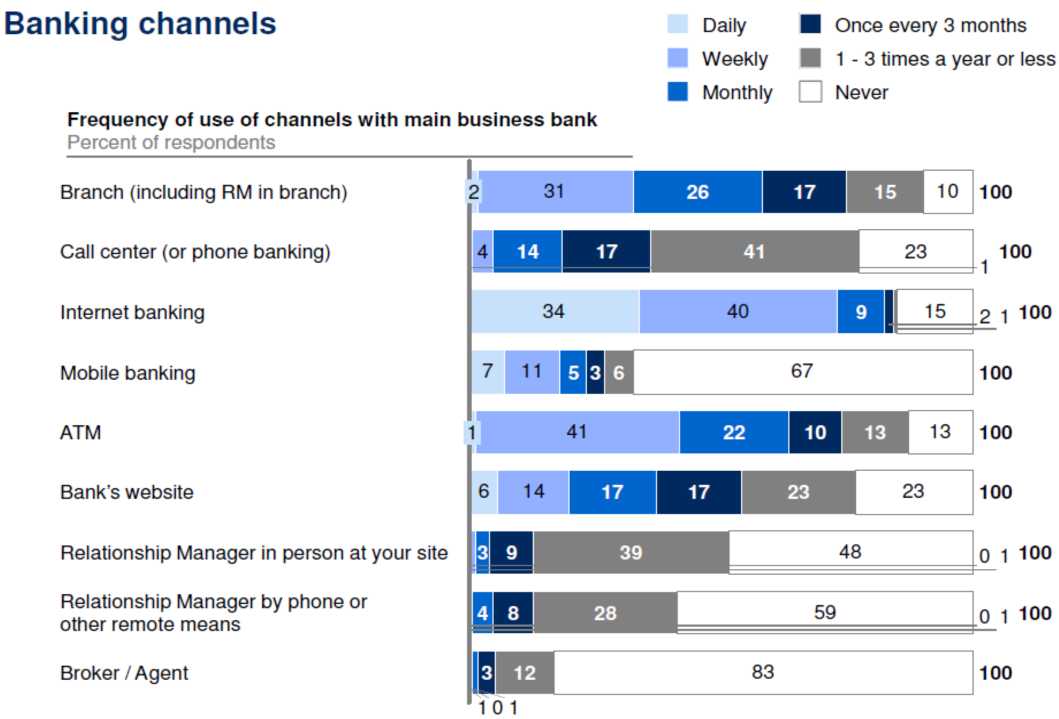
business customers’ simplest needs (day-to-day transmission requirements such as cash/cheque deposits and withdrawals), relationship managers[33] are assigned according to complexity of the relationship, sophistication of customer, size of customer, growth expectations, financial requirements and business needs. Customers with annual turnover of £250,000–£2 million, or who have debt greater than £25,000 are managed by relationship managers (who are typically based in retail branches) on a face-to-face basis. These relationship managers, RBSG told us, interact with their customers to satisfy ‘more complex needs’ including borrowing requirements and introductions of experts in asset and invoice finance. RBSG’s larger SME customers with annual turnover between £2 million and £25 million are managed by relationship managers operating out of separate ‘commercial banking centres’. These do not have counter facilities, and engagement is by appointment only.

57. Similarly to the trends observed in personal retail banking, digital channels are playing an increasingly important role in SME banking. RBSG told us that digital channels account for [✂]% of SME servicing activity and this is expected to grow to [✂]% by [✂]. Further, [✂]% of RBSG’s SME sales are delivered through online or telephone banking services. A separate Charterhouse customer survey undertaken for RBSG shows that [✂]% of its SME customers would value banking services through mobile.

58. A McKinsey survey of SMEs with less than £0.5 million turnover found that one third of customers use a branch at least once a week whilst 74% use internet banking with the same frequency (see Figure 13).

[33] Which would also include business managers, business specialists and the RBS Connect team.

**Figure 13: Banking channel usage by SMEs (less than £0.5 million turnover)**




DC1: How often do you use the following banking channels to interact with your main Bank?

Source: McKinsey small business banking survey: UK, September 2013.

59. Handelsbanken told us that while demand for mobile technology from SMEs has increased, it has done so from a lower base and to a lesser extent than for personal customers. Handelsbanken notes that the demands it is seeing for application ('app') functionality is at present limited to basic balance and transaction information (without the need for payments functionality). It considers that there is 'continued and growing demand from SMEs for branch-based, local relationship banking across the UK' and it will continue to open branches alongside investing in its internet and telephone banking offering for SMEs and developing an SME mobile banking proposition.

## Importance of branches to banks

60. While their importance as transactional centres may be in decline, branches continue to fulfil a number of valuable functions for banks. Namely, branches enable banks to acquire new customers and to retain existing customers. In addition, a high-street presence helps builds brand recognition and thus loyalty.

### *Branches and market positioning*

61. Figure 14 and Figure 16 depict a strong positive correlation between banks' market shares of PCAs and BCAs and the number of branches.[34] Banks that have a large branch network also tend to have a larger share of the PCA and BCA market. Barclays, RBSG, LBG and HSBCG are the four largest banking groups by number of branches and by PCA and BCA market share. Barclays is the exception in that all of its retail branches service its SME customers as well as personal customers, which might explain Barclays' position in Figure 16 and Figure 17.

62. While there is a strong correlation between market shares and branch numbers at the national level (this is more marked for PCAs, see tables 1 to 6 in Appendix B), local effects also exist; analysis undertaken by Deloitte for TSB shows that TSB outperforms in areas where it has a strong branch presence due to a 'network effect'.

63. However, as Figure 15 and Figure 17 illustrate, the relationship between net account openings of PCAs and BCAs and branch numbers is less clear. Santander is a clear outlier in the PCA market (and to a lesser extent in the BCA market)[35] and Metro outperformed several banks with substantial branch networks on net PCA account openings despite having only 30 branches (all of which are located in London and the southeast).

64. While we observe these relationships, it is not possible to draw from them any conclusions with regard to causality. It is not necessarily a direct result of having a large branch network that some banks have a high market share. Those banks with the largest market shares are also those that have been present in the market longest and have therefore been able to build up larger customer bases. Given what we know about customers' behaviour in the PCA market from our work on Theory of Harm 1, there is likely to be a 'first-mover' advantage to these banks. Importantly though, the lack of relationship

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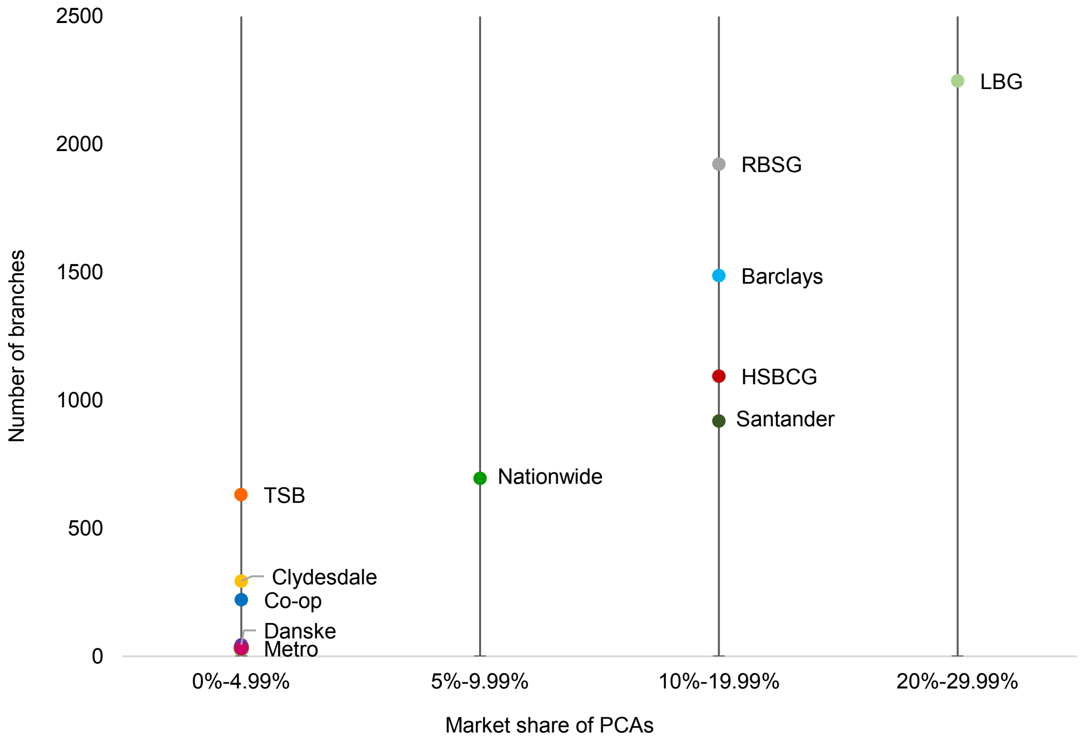
[34] Banks' individual market shares are considered to be confidential. Figures 14 to 16 present market shares in ranges.
[35] This may be due to the success of its '123' current account that launched in 2012.

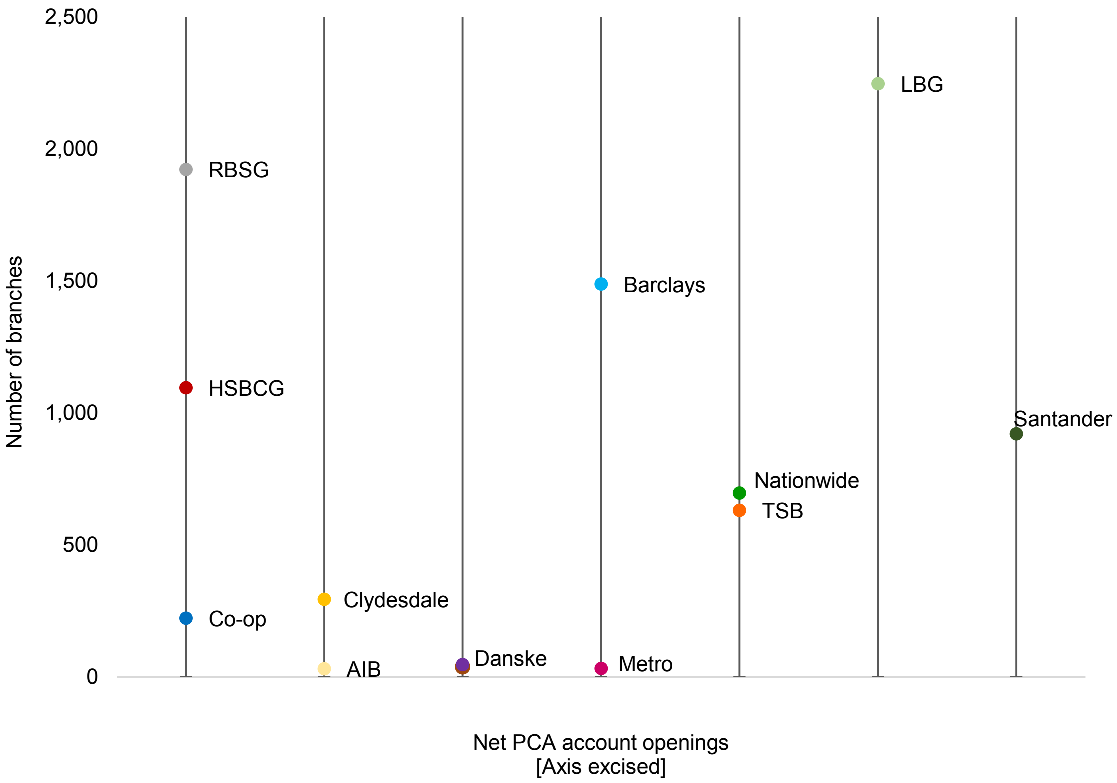
between net account openings and branches suggests that having a small branch network does not necessarily create an insurmountable barrier to customer acquisition (as Metro's experience illustrates).

**Figure 14: Market share of PCAs and branch numbers by banking group 2014***



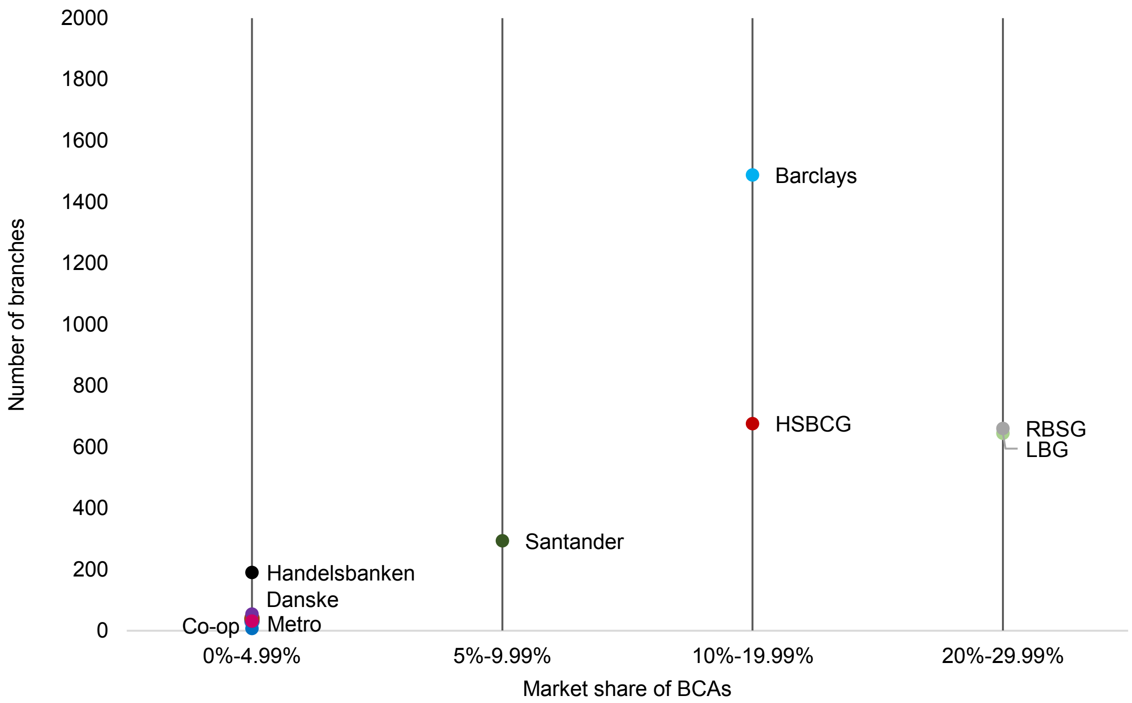

Source: CMA analysis.
*Number of branches excludes dedicated business centres.

**Figure 15: Net PCA account openings and branch numbers by banking group 2014***



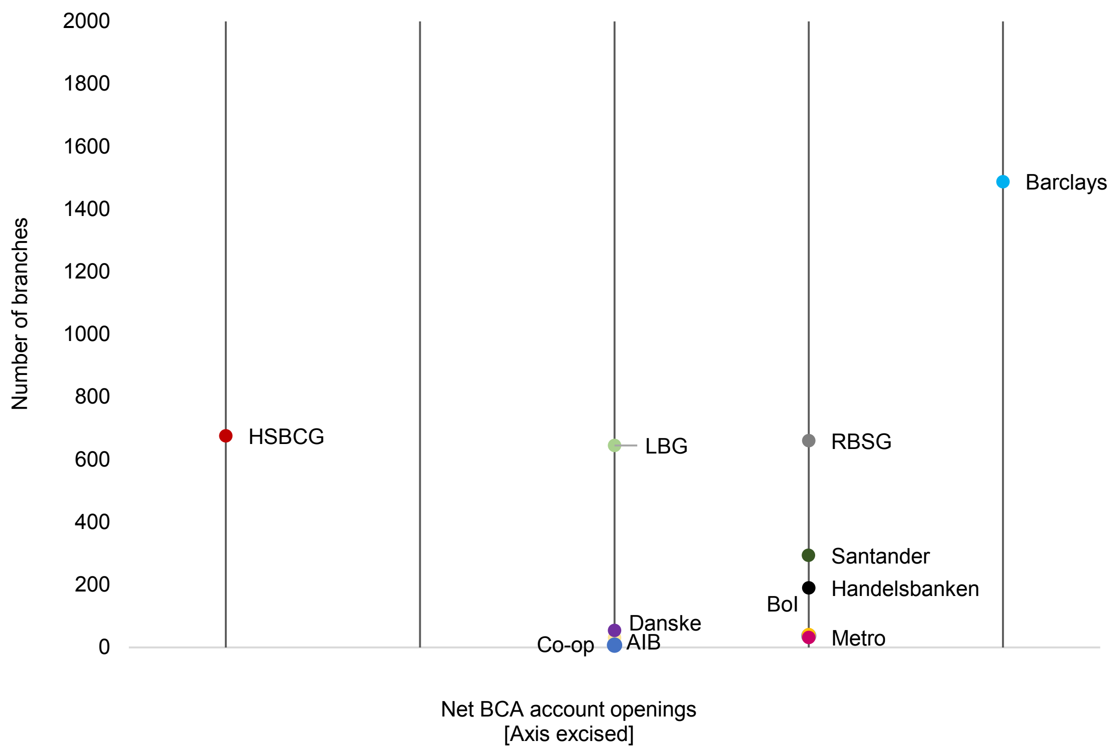

Source: CMA analysis.
*Number of branches excludes dedicated business centres.

**Figure 16: Market share of BCAs and branch numbers by banking group 2014***




Source: CMA analysis.
Note: Barclays considers that all of its branches offer some type of business services.
*Number of branches includes branches that provide business services to SME customers and designated business centres.

**Figure 17: Net BCA account openings and branch numbers by banking group 2014***




Source: CMA analysis.
Note: Barclays considers that all of its branches offer some type of business services.
*Number of branches includes branches that provide business services to SME customers and designated business centres.

### *Customer acquisition*

65. Some banks have told us that branches remain at the centre of their customer acquisition strategy.[36] This is supported by the data presented in Figure 18 and Table 4 below.

66. After day-to-day management of PCAs (which accounts for the majority of total branch visits by consumers),[37] branches of the banks in Figure 18 (with the exception of Nationwide) are most commonly used by personal banking customers to open a PCA.

**Figure 18: Proportion of branch visits to open a PCA, savings account, mortgage, and personal loan in 2014**

[✂]

Source: CMA analysis.
Note: [✂].

[36] Metro, TSB.
[37] 89.4% of all branch visits on average. Average proportion of branch visits for day-to-day account management for Barclays, HSBC, Nationwide, RBS, Santander and TSB. Data on day-to-day account management was unavailable for LBG.

**Table 4: Proportion of successful PCA applications by channel (2014)**

[✂]

Source: CMA analysis.

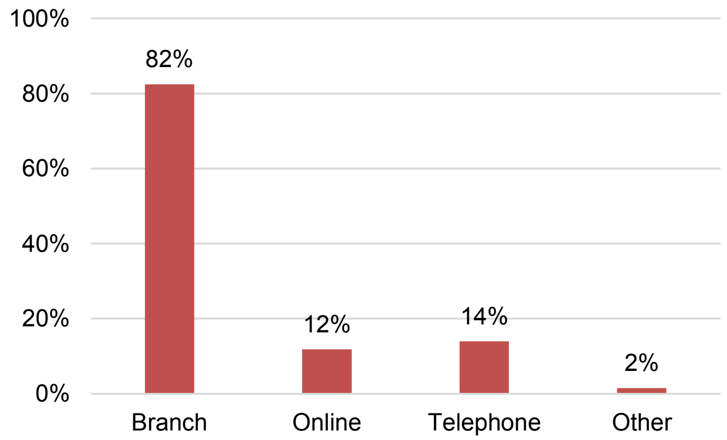
67. For the banks reported in Table 4, on average 78% of PCAs were opened in branch in 2014, down from 81% in 2013 (see Table 1 in Appendix A). Nationwide has the lowest proportion of PCAs opened in branch. After Nationwide, TSB and Halifax are leading in their customer acquisition via online channels.

68. The number of successful online applications is likely to continue to rise as banks invest in technology that enables online account opening (such as RBS's photo ID checker, an electronic document verification initiative). Barclays told us that technological advances in recent years have 'enabled significant enhancements in online account opening'. Currently [✂] of Barclays' customers that start an online application successfully open a current account online; [✂].

69. Clydesdale, which does not currently offer online account opening, told us that the increase in its telephone applications since 2014 can be explained by its switching incentive scheme (customers were offered £150 for switching their current account). It believes this attracted customers without a local Clydesdale branch.

70. Although we do not have comparative data on SME customer acquisition by channel, a survey of start-up SMEs undertaken by Charterhouse shows that on average 82% of start-ups open their BCA in branch (see Figure 19). This suggests that branches are important in the acquisition of SMEs, particularly for new businesses.

**Figure 19: BCA openings by channel, SME start-ups***




Source: Charterhouse survey. Base: 252 SMEs.
*In response to the survey question 'What channels did you use to open your account?'.

71. Further, Santander provided details of the volume of account openings by channel for each of its SME product categories (BCAs, savings and unsecured business loans (UBLs)) in its business banking segment (typically SMEs with a turnover of up to £250,000), as shown in Table 5 below. The predominant sales channel for [✂] and [✂] is [✂]. Online loan applications are available for existing BCA customers only and loan applications cannot be made in retail branches.[38] However, branches remain an important channel for sales of [✂].

**Table 5: Business current account, savings and unsecured loans opened by channel, Santander**

[✂]

Source: Santander.
Note: New business opening for Santander UK's business banking segment during 2014.

72. For Metro Bank, all of its (personal) customer relationships begin in branch (since it does not offer remote account opening),[39] and the majority of its customer acquisition, it believes, has been driven through expanding its branch network. It also acquires new SME customers through its local business managers and local directors in its branches. Metro's branches are designed to be large open spaces in prime retail sites on busy high streets and retail parks to attract customers, and are open early to late seven days a week 'for customer convenience'. It told us that by 'providing a great experience to existing customers and opening new stores, word of mouth drives in new customers'.

73. TSB considers that the majority of its customers prefer to open a new PCA in-branch. Although TSB told us that it has recently seen an increase in its customers' propensity to open PCAs online, and to a lesser but growing extent through mobile channels, it believes that a bank's ability to attract large volumes of PCA customers online is dependent on the presence of a high street branch network. This, TSB notes, raises confidence and brand awareness among prospective customers. Branches therefore remain important to TSB's customer acquisition strategy; TSB's internal documents state that over [✂]% of product sales take place in branches.

74. [✂].

75. Handelsbanken also told us that branches are particularly important for the acquisition of SME customers. HSBC told us that it observed a fall in BCA

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[38] SME customers can apply for a loan by telephone or in a branch that has a dedicated local business manager. See Santander business loans.
[39] Metro offers online account opening for secondary accounts only. Online account opening accounted for [✂]% of successful PCA applications in 2013 and [✂]% in 2014.

openings following a wider business change initiative that included, among other things, a reduction in the number of business specialists available in its branches.

76. Some banks are recognising the need to invest in their online account opening propositions. [✄].

77. Similarly, Lloyds is investing in technology that will enable more customers to be successfully acquired through direct channels. Currently only half of its online applicants can ‘complete their online journey’ to open a PCA. Of those that cannot successfully open an account, only one-fifth visit a branch, which is required to complete the application: the remainder ‘drop out of the process’. LBG believes that by reducing or eliminating the number of customers that are unable to complete their application process online, it will successfully acquire more customers through online channels and reduce further the need for branches.

***Brand recognition***

78. Related to customer acquisition, branches are often viewed by banks as being key to building and maintaining brand awareness and recognition. Branches are increasingly being developed into ‘customer experience centres’ or ‘showrooms’. HSBC, for example, has plans to open high visibility ‘concept stores’, designed primarily to build a strong brand presence in ‘key locations’. [✄].

79. In its response to our issues statement, Santander told us that to create brand awareness in the PCA market as well as ensure it meets its existing customers’ needs for a local branch network, [✄]. Santander has also noted that branchless models (either by banks or financial technology companies offering focused retail banking services) are ‘relatively untested’. With reference to its own Cahoot brand (which launched in June 2000 as the internet-based banking brand of Abbey National plc)[40] and other online-only PCA providers, Santander told us that providers have been unable to make significant ‘inroads’ to the PCA market.

80. Consumer research undertaken by Optimisa for M&S Bank indicates that branches increase confidence in the M&S Bank brand as well as being an important factor in encouraging customers to open a PCA (identified as a ‘pull

[40] See the Cahoot website.

factor'). The research notes that M&S Bank branches make customers feel 'reassured and confident they made the right decision to switch to M&S Bank'.

81. Finally, as stated in our Tesco case study,[41] while Tesco Bank accepts PCA applications (and processes other basic transactions) at only three of its stores, it leverages its large national store network primarily to raise awareness of its PCA among Tesco customers, to whom its products are primarily targeted.

82. Whilst providing a practical alternative to owning a large branch network for basic customer transactions, the apparent advantages of branches in building and maintaining brand awareness and recognition cannot be achieved through arrangements such as inter-bank agency agreements (IBAAs) or through use of the Post Office network.

***Retention***

83. Branches may be used by banks to retain their existing customers. Deloitte's report on the future of branches notes that for 'traditional urban centres' (one of the micro-markets it identified) in particular the challenge for banks is to not only attract new customers through their branches but also to 'build a long-term relationship through high-quality, tailored services'.[42]

84. In April 2014, HSBC undertook a survey of a sample of its business customers to understand their branch preferences. It found that if customers were unable to visit their preferred HSBC branch, retention levels would fall by [✄]% (to [✄]%) for businesses with annual turnover of less than £2 million and by [✄]% (to [✄]%) for businesses with annual turnover of between £2 million and £30 million. This was unaffected by distance to the next closest HSBC branch. When analysing alternatives to branches that maximise customer retention, HSBC found that services at the Post Office and self-service machines outside an HSBC branch are the most preferred alternatives (providing respective uplifts to retention of [✄]% and [✄]%).[43] Retention is also greatest when the cost of alternative services is lower and when distance to travel to branch is lower (less than 5 miles).

[41] See the working papers on the retail banking market investigation case page.
[42] Deloitte report, *UK bricks and clicks*.
[43] This analysis includes corporate customers with annual turnover in excess of £30 million.

## Branches as a barrier to entry and/or expansion

### *Barriers to entry*

85. As our working papers ‘Prospective entrants case study’ and ‘A summary of entry and expansion in retail banking’ outline, a number of firms are currently seeking authorisation to become banks or have recently attained authorisation. These include Atom, Starling, Civilised Bank, OakNorth and Fidor. None of these firms are proposing to enter with own-branded branches.

86. We are aware, however, that at least Atom, Starling and Civilised Bank have firm plans to offer limited branch services through a competitor’s branches. This suggests, as does the evidence presented earlier in this paper, that branches continue to play a role in UK retail banking but that there are (relatively untested) alternatives to having an own-branded branch presence/nationwide network.[44] While some larger banks describe their large branch networks as a ‘costly legacy’,[45] banks recognise the continued need for some form of branch accessibility, particularly for (smaller) cash-handling businesses and some personal customer segments.[46]

87. Nevertheless, it is also likely that as banks develop their digital propositions and leverage new technology to increase efficiency and customer convenience, branch importance will continue to decline at least for some consumer segments. For example, investment in online account opening technology, including remote ID verification, will lead to a decline in the importance of branches for customer acquisition (which remains, at present, significant).

### *Cost of branches*

88. The building and maintaining of a branch network incurs significant fixed costs (at least some of which are irrecoverable)[47] and ongoing costs. TSB’s analysis suggests that it takes around [✂] years to pay back the total investment in a new branch.[48]

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[44] Although many larger banks have agreements in place with the Post Office and other banks for branch services this is in addition to having their own branch networks.
[45] For example, HSBC believes that one advantage of ‘late entry’ to retail banking is entrants’ ability to ‘locate and design branches more in line with customer demand’.
[46] OakNorth told us that the need for a branch presence for cash handling has prevented it from offering a BCA.
[47] The extent to which fixed costs of branches are ‘sunk’ will depend upon a number of factors including whether the real estate served an alternative purpose before becoming a bank branch.
[48] The payback period is the point at which total income from the branch is greater than total expenditure on it.

89. In respect of the ongoing costs associated with branch networks, a report by Deutsche Bank estimates that they account for 30 to 40% of retail bank costs.[49] TSB's analysis notes that [✂]% of its cost base is branch staff and property costs.

90. This affords scale advantages to banks with large customer bases and broad product ranges. For example, Santander told us that a large part of its cost base is fixed costs that support the simultaneous provision of all of its products and services (eg branches and contact centres service numerous customer needs not just PCA services).

91. However, RBS told us that the costs involved in having large branch networks have increased (and the benefits reduced) for incumbents as they are unable to quickly respond to changes in footfall (eg due to long leases). It believes that, far from acting as a barrier to entry, new entrants can use a 'more targeted branch network to sweep up a more profitable customer base in conjunction with a digital distribution strategy'.

92. Atom Bank, which is due to launch later this year as the UK's 'first digital-only bank' having obtained authorisation from the FCA in June 2015, told us that the acquisition of retail branch space and running costs makes branches prohibitively expensive. It told us that 'to open branches when customer use is in decline would only raise [its] costs'. Instead it plans to 'focus [its] investment and growth in the digital space'. Its lack of 'expensive branch real estate' will, Atom believes, be a key factor in enabling it to operate at a cost-to-income ratio below 30% (anticipated from year [✂] of operations).

***Alternative physical distribution channels***

93. Inter-bank agency agreements[50] (IBAAs) and counter services at the Post Office potentially provide an alternative to own-branded branches for banks seeking to enter the UK retail banking market (and have been used to justify branch closures by some incumbent banks). These are, to varying degrees, viewed as a substitute by some customers and banks; to others they only constitute complements to an existing branch presence/network.

94. A total of 16 banks have agreements in place with the Post Office which enable their personal customers to use services over and above withdrawing

[49] UK Retail Banking 2014: Bank to the Future', Deutsche Bank Equity Research, September 2014.
[50] Sometimes also referred to as inter-bank branch agreements (IBBAs).

money and making a balance enquiry.[51] A total of nine banks have such agreements in place for their SME customers.

95. GfK's consumer survey found that the idea of being able to use the Post Office for basic banking transactions was appealing to many respondents because it increased the amount of choice and therefore convenience customers had over where they were able to bank. However, for many the Post Office is not generally considered as secure as a bank, and large queues at Post Office counters were raised as a concern.

96. Handelsbanken, which has a relatively small branch network compared to some of its competitors (198 branches as at 30 July 2015), has agreements in place with HSBC and NatWest to allow its customers to pay in cheques and cash at their counters. It told us that these services were used by almost [✂] of its customers in 2014 (93% of its SME customer base in 2014).[52] However, Handelsbanken told us that it would not consider using shared banking locations to offer SME banking products (ie to fulfil more than basic transactional needs) because it 'competes predominately on delivering first class customer experience through creating face-to-face relationships' through its local branches.

97. RBSG has been in partnership with the Post Office to provide its customers basic counter service since September 2014. RBSG's internal estimates show that approximately [✂] deposit transactions and £[✂] of withdrawals are processed through the Post Office network each month. RBSG believes that the Post Office 'offers a realistic response to [entrants' and customers'] concerns such as cash deposits and account access'. It also told us that 'retail space is available' for new entrants to access should they wish to pursue a branch-based strategy.

98. Barclays, in addition to an agreement with the Post Office, allows personal customers of [✂] 'agency banks' access to its branch services. These banks' customers are able to use Barclays branches to pay money into their accounts and to do encashments (with the approval of credit for each agency bank). Barclays notes that the volumes of customers using such arrangements is 'relatively small': around [✂] (mainly corporate) customers across the [✂] agency banks. Barclays also has a number of IBAAs in place which enable Barclays' customers, typically corporate customers with over

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[51] Of those included within the scope of this investigation. See *Post Office banking services* for complete list of banks that have agreements in place with the Post Office.
[52] [✂].

£25 million in annual turnover; access to branches of other banks 'where Barclays does not have a strong geographical presence.'

99. In contrast, Post Office counter services are commonly and consistently used by Barclays' customers to perform over [✄] transactions each month (mostly in the form of cash withdrawals). [✄]. This differs from what LBG told us about its own customers' use of the Post Office services. LBG's analysis suggests that the most-used Post Offices are nearer to LBG's own branches; around 40% of transactions occur in Post Offices situated within one mile of an LBG branch. LBG believes that this is at least in part a consequence of the largest (and most-used) Post Offices being situated in larger towns and cities where most financial service brands are also present. While LBG has not undertaken any formal research to understand customer motivations for using a Post Office rather than an LBG branch, it believes that it is driven by convenience: because customers may already be using a Post Office for other purposes.

***Alternative banking channels – online and mobile banking***

100. As described under 'Recent Trends', 85% of personal banking customers use internet banking (according to GfK's consumer survey) and 64% of SME customers used online banking as their main channel in 2014 (according to Charterhouse data, see Figure 11).

101. Virgin Money, which launched its 'Essential Current Account' (a Basic Bank Account)[53] in July 2014[54] believes that local branch networks are of declining importance for many retail banking products largely due to the 'growing popularity of alternative distribution and money management channels such as the internet'.[55] Virgin Money notes that it expects this trend to continue as confidence in online banking grows. However, it recognises that whilst the existence of a branch network 'does not present a significant barrier to entry and expansion for most retail banking products', branches are an 'important consideration' for some PCA and SME banking customers. Virgin Money announced in its Annual Report 2014 that it has signed a seven year contract with Monitise[56] to support the development of its digital offering in current accounts.[57]

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[53] The ECA meets the product specifications of a BBA: see HM Treasury and Andrea Leadsom MP (15 December 2014), *Revised basic bank account agreement*.
[54] The launch of Virgin's Essential Current Account was initially limited to Scotland and Northern Ireland, and is to be rolled out in all its stores in 2015.
[55] Virgin Money response to issues statement. Virgin Money has 75 branches nationwide and offers access to basic services at the Post Office.
[56] See the Monitise website.
[57] Virgin Money Group Annual report and accounts 2014.

102. RBSG told us that online usage and online sales for SMEs are steadily increasing, reflecting the 'willingness' of customers to use the internet as a key channel for accessing goods and services and the 'convenience' of alternative channels. RBSG considers that SME customers require a flexible multi-channel model 'which may include branches but which will focus on mobile, telephone and online banking'. This has been reflected in RBSG's strategy which since 2013 has focused its investment on a multi-channel delivery model for SME and personal customers. It also notes that even customers who do value the branch network may place more weight on direct contact with a known relationship manager than the physical presence of a bank on the high street. With 'ever improving' technology, RBSG remarks that such contact does not necessarily need to be provided through a branch network. Thus, although it recognises that the branch network remains 'an important aspect in the SME market for some customers and/or some types of interaction', RBSG 'does not consider it to be a significant strategic entry barrier'.

103. Despite the apparent declining importance of branches to consumers as digital take-up intensifies, branches continue at present to be the primary channel for customer acquisition. This could be a direct result of banks' infrastructure not fully supporting online applications (eg ID verification may require a customer to go into a branch). However, as new technology enables banks to improve their online propositions, enhance the customer experience and success rate of online applications, customer acquisition through alternative channels may rise. For example, RBSG's investment in its electronic document verification initiative has successfully increased customer acquisition via the internet. LBG has also been trialling (since February 2015) technology which will allow new customers to provide their identification documents and likeness to those documents remotely using a camera enabled computer, mobile or tablet.

104. However, HSBC notes in its response to our questionnaire that incumbent banks are often 'at a disadvantage with legacy [IT] systems compared to newer players who can make better use of the latest available technology'. Similarly, [✄].

### *Barriers to expansion*

105. Although a number of new entrants have entered the retail banking market in recent years and several firms are applying for or have recently attained authorisation,[58] it remains unclear whether these banks have the ability to

[58] See our working paper 'A summary of entry and expansion in retail banking'.

exert an effective competitive constraint on larger banks. One factor that might constrain their ability to effectively compete and expand in the market is (access to) branches.

106. Metro, for example, told us that because its ‘business model is centred on branches and servicing local communities’, branch growth is a ‘key constraint’ to the bank’s expansion. Virgin Money, which has 75 branches across the UK, however, told us that it has no plans to expand its branch network in the near future and it does not consider this to be an obstacle to its further expansion.[59] This disparity in views reflects the pursuance of two different business models; while Virgin Money is investing in its digital proposition (see paragraph 101), Metro expects to expand its branch network by 6.5 times (to 200 branches) by 2020.[60]

107. Tesco Bank, whose stores do not, in general, operate like a bank branch, told us that it achieved ‘considerable scale’ in certain products – such as credit cards and personal loans – by pursuing an online and telephone-based strategy.[61] Thus, while developing its PCA proposition, it determined that there was a sizeable customer appetite for a direct proposition such that their growth would not be constrained by not having branches.[62] Unlike new entrants with no branch presence (or existing brand) however, Tesco Bank has the ability to raise consumer awareness about its banking products in-store, which it does so actively.

108. A number of potential entrants that are currently in the application process to acquire authorisation (including Starling and Civilised Bank) are planning to enter with ‘niche’ or ‘limited’ service offerings (in terms of their products and distribution channels) which appeal to particular consumer segments. For example, OakNorth, which obtained its banking license (with restriction) in March 2015, is planning to deliver ‘a set of products with high intrinsic value to specific segments of the market’. It believes that by ‘combining the best-in-class technology, people and strategy [its vision] can be best delivered by a combination of digital and face-to-face distribution channels’ (but not branches). It believes that this will make it more responsive to its customers than requiring them to ‘physically come to [it]’.

109. Similarly, Civilised Bank is planning to target high-end SMEs (with an annual turnover of between £1 million and £25 million), at least initially. Civilised Bank will not offer PCAs initially but it will offer BCAs to its SME customers from

[59] Virgin Money case study.
[60] Metro case study.
[61] Tesco case study.
[62] Tesco case study.

around three months after launch. It recognises the need for branches for cash-handling SMEs and has plans to use a competitor's branch network for this purpose.

110. Lloyds told us that 'it is not clear that scale is in fact beneficial as profits are concentrated in specific customer segments'. Indeed, entrants may be able to expand within their niche offering without the need for a branch presence, but it remains unclear to what extent they might positively 'disrupt' the market through such entry.

111. As described in our Nationwide case study,[63] Nationwide found itself constrained by a lack of capacity in its own branches when considering whether to launch a BCA. The use of branch space potentially 'conflicted with retail requirements' – ie some of Nationwide's branches are currently too small or too busy to accommodate SME service requirements. However, Nationwide expects this to become less of an issue as more transactions are done through mobile and digital channels – making SME banking more attractive to Nationwide.

[63] Nationwide case study.

# Appendix A: Proportion of successful PCA applications by channel

**Table 1: Proportion of successful PCA applications by channel (2013)**

[✂]

Source: CMA analysis.

# Appendix B: Market shares[64]

### Table 1: Market share of main PCA and number of branches – England and Wales*†

| *Banking group* | *Number of branches* | *Market share of main PCA account, range (%)* |
|---|---|---|
| Barclays | 1,456 | 10–19.99 |
| Clydesdale | 167 | 0–4.99 |
| HSBCG | 1075 | 10–19.99 |
| LBG | 1,936 | 20–29.99 |
| Nationwide | 634 | 5–9.99 |
| RBSG | 1,594 | 10–19.99 |
| Santander | 805 | 10–19.99 |
| TSB | 442 | 0–4.99 |

Source: CMA analysis.
*Main current account defined as non-dormant account with at least an average of £500 credit turnover in the previous 12 months (or since the account was opened if less than 12 months).
†Branches that service PCA customers (retail branches and co-located business centres). Excludes branches in the Channel Islands and the Isle of Man.

### Table 2: Market share of main PCA and number of branches – Scotland*†

| *Banking group* | *Number of branches* | *Market share of main PCA range (%)* |
|---|---|---|
| Barclays | 23 | 0–4.99 |
| Clydesdale | 127 | 10–19.99 |
| HSBCG | 14 | 0–4.99 |
| LBG | 296 | 30–39.99 |
| Nationwide | 48 | 0–4.99 |
| RBSG | 255 | 20–29.99 |
| Santander | 84 | 5–9.99 |
| TSB | 189 | 10–19.99 |

Source: CMA analysis.
*Main current account defined as non-dormant account with at least an average of £500 credit turnover in the previous 12 months (or since the account was opened if less than 12 months).
†Branches that service PCA customers (retail branches and co-located business centres). Excludes branches in the Channel Islands and the Isle of Man.

### Table 3: Market share of main PCA and number of branches – Northern Ireland*†

| *Banking group* | *Number of branches* | *Market share of main PCA range (%)* |
|---|---|---|
| AIB | 30 | 10–19.99 |
| Barclays | 9 | 0–4.99 |
| BOI | 37 | 5–9.99 |
| Danske | 46 | 10–19.99 |
| HSBCG | 6 | 0–4.99 |
| LBG | 16 | 5–9.99 |
| Nationwide | 14 | 5–9.99 |
| RBSG | 74 | 20–29.99 |
| Santander | 31 | 10–19.99 |
| TSB | 0 | 0–4.99 |

Source: CMA analysis.
*Main current account defined as non-dormant account with at least an average of £500 credit turnover in the previous 12 months (or since the account was opened if less than 12 months).
†Branches that service PCA customers (retail branches and co-located business centres). Excludes branches in the Channel Islands and the Isle of Man.

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[64] We have been advised that account numbers, from which market shares in the relevant table have been calculated, may not be fully representative of regional market shares. For example, an account can originate from a different nation to that in which the customer is based.

### Table 4: Market share of BCAs and number of branches* – England and Wales

| *Banking group* | *Number of branches* | *Market share of BCAs, range (%)* |
|---|---|---|
| Barclays | 1,456 | 20–29.99 |
| Clydesdale | 30 | 0–4.99 |
| HSBCG | 658 | 20–29.99 |
| LBG | 443 | 20–29.99 |
| RBSG | 556 | 20–29.99 |
| Santander | 258 | 10–19.99 |
| TSB | 0 | 0–4.99 |

Source: CMA analysis.
*Branches that provide business services to SME customers and designated business centres.

### Table 5: Market share of BCAs and number of branches* – Scotland

| *Banking group* | *Number of branches* | *Market share of BCAs, range (%)* |
|---|---|---|
| Barclays | 23 | 0–4.99 |
| Clydesdale | 11 | 10–19.99 |
| HSBCG | 15 | 0–4.99 |
| LBG | 202 | 30–39.99 |
| RBSG | 92 | 30–39.99 |
| Santander | 23 | 5–9.99 |
| TSB | 0 | 5–9.99 |

Source: CMA analysis.
*Branches that provide business services to SME customers and designated business centres.

### Table 6: Market share of BCAs and number of branches* – Northern Ireland

| *Banking group* | *Number of branches* | *Market share of BCAs, range (%)* |
|---|---|---|
| AIB | 30 | 10–19.99 |
| Barclays | 9 | 0–4.99 |
| BOI | 37 | 10–19.99 |
| Clydesdale | 0 | 0–4.99 |
| Danske | 54 | 20–29.99 |
| HSBCG | 3 | 0–4.99 |
| LBG | 0 | 0–4.99 |
| RBSG | 12 | 20–29.99 |
| Santander | 13 | 5–9.99 |

Source: CMA analysis.
*Branches that provide business services to SME customers and designated business centres.