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Location, Location, Location: Has Electronic Banking Affected the Importance of Bank Location?

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INTRODUCTION

Banking has traditionally been a brick-and-mortar business that required face-to-face interaction. Customers were required to visit a bank's physical location in order to complete transactions, such as making deposits, withdrawing cash, or applying for loans. This one-on-one interaction between financial institutions and their customers supported the notion of relationship banking.

While relationship banking may still be a valid part of today's business model, evolving electronic banking technologies reduce consumers' dependence on personal interaction. E-banking processes, like direct deposit, automatic withdrawals, and online banking, enable bank customers to obtain services from their financial service providers without entering the bank.

As more bank customers adopt e-banking products and services, one would expect the importance of a bank's location to decline. However, despite increasing use of e-banking technologies, the majority of U.S. households still consider bank location the most important factor in choosing their primary financial institution. In addition, the number of bank branches has increased considerably in recent years. Why is bank location still important to consumers?

This article uses data from the Federal Reserve's *Survey of Consumer Finances* (SCF) to compare consumers' views about bank location in 1995, when e-banking was still relatively new, to data from 2004, when adoption of many e-banking services was more prevalent (see Box 1 for additional information on the SCF). The first section discusses the state of consumer adoption of e-banking products in 1995 and the factors consumers considered important when choosing their bank. The second section shows the growth rates for e-banking since 1995. The third section considers whether consumer choice factors have changed as a result of increased e-banking use and how banks have responded. The final section discusses hypotheses for why location is still important today.

ELECTRONIC BANKING—THE EARLY YEARS

In the early '90s, the banking industry was undergoing considerable change. Banks were consolidating, and the Internet was emerging as a new platform for e-banking innovations. (Electronic banking includes using the Internet to deliver banking services, and using other technologies, such as ATMs and debit cards, to conduct transactions electronically.) Some analysts believed these electronic banking processes would reduce the need for brick and mortar banks. However, in order to supplant brick-and-mortar banking offices, customers would have to use these electronic mechanisms. In this section, we use data from the 1995 SCF to look at the adoption of e-banking

Box 1

The Survey of Consumer Finances

The Survey of Consumer Finances (SCF) is a triennial interview survey of U.S. families sponsored by the Board of Governors of the Federal Reserve System with the cooperation of the U.S. Department of the Treasury. Since 1992, data for the SCF have been collected by NORC, a research organization at the University of Chicago.

The survey collects information on families' total income before taxes for the calendar year preceding the survey. But the bulk of the data covers the status of families as of the time of the interview, including detailed information on their balance sheets and use of financial services as well as on their pensions, labor force participation, and demographic characteristics. In the 2004 survey, 4,522 families were interviewed, and, in the 1995 survey, 4,299 families were interviewed.

This article is based on questions related to consumers' access to and use of electronic banking products and services. The text of the article indicates whether the question on the survey was formed in a way to elicit responses related to the possession of a product versus the use of a product. For example, the survey asked consumers whether anyone in their household had an ATM card. Whereas in relation to debit cards, the survey asked whether anyone in the household used a debit card.

Only those households with transaction accounts with banks, thrifts, or credit unions were included in calculations represented in the charts in this article.

Additional information related to the Survey of Consumer Finances can be obtained at:

www.federalreserve.gov/pubs/loss/loss2/scfindex.html

products and the factors consumers considered when choosing their bank.

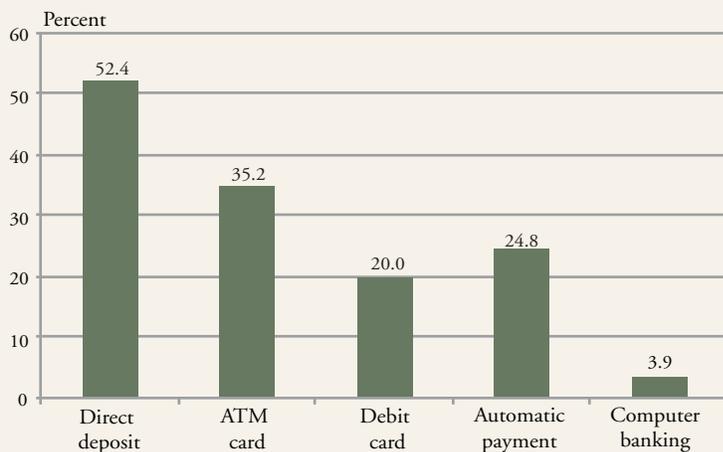
At that time, electronic banking products were not widely used, and many of these products were in their infancy. For example, online banking first appeared beginning in 1995.¹ According to the 1995 survey, only 35 percent of households with bank accounts had an ATM card, and only 20 percent of those with a bank account used a debit card (Chart 1). Online banking was even rarer, with less than 4 percent of households

were more likely to use electronic banking products across the board. For example, 6 percent of households in the top 25th percentile of income used computer banking compared to just 1 percent of those in the lowest income category. With the exception of direct deposit, younger households were the quickest adopters of e-banking products (see Appendix A for detailed charts).

During these early years of e-banking innovations, bank location was a key factor for most households in choosing a bank. The 1995 *SCF* shows that, when opening a checking account, the most important factor for most Americans was a bank's location. Among 31 possible factors, almost one-half of U.S. households said location was most important. Except for the number of services and low fees or minimum balance requirements, all other reasons paled in comparison (Chart 2). Even when taking into account the distance between customers and their banks, location was still the primary driver for choosing a bank.

The importance of bank location is not surprising given the options available to consumers at that time. As noted earlier, most households did not have ATM cards and

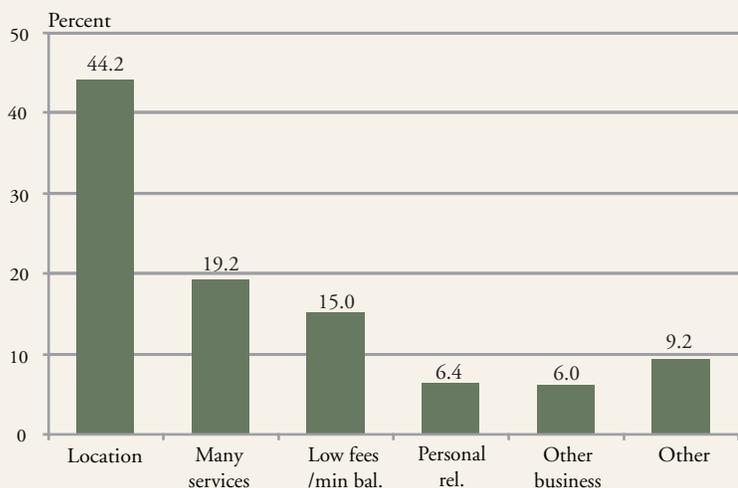
Chart 1
Electronic Banking Product Use, 1995



reporting that they used some type of online banking to do business with any of their financial service providers.² The one bright light among electronic banking product adoption in 1995 was direct deposit of wages. More than 50 percent of U.S. households used direct deposit a decade ago.

The adoption of e-banking products was more prevalent among consumers with certain demographic characteristics. Information from the survey suggests that e-banking product use is positively correlated with household income and educational background and negatively correlated with age. Households with higher incomes and deeper educational backgrounds

Chart 2
Most Important Reason for Choosing Bank, 1995



were not using debit cards—instead preferring to write checks or withdraw cash at the teller line. In addition, online banking was not widely used and not widely available. The following section describes how the adoption of e-banking technologies played out during the next 10 years.

HOW HAS E-BANKING USE CHANGED SINCE 1995?

Compared to e-banking adoption in 1995, the use of e-banking products has become more widespread. And while some e-banking methods appear to be reaching maturity, others are still gaining ground. This section uses information from the 2004 *SCF* to show the change in adoption among all households.

Between 1995 and 2004, the adoption of e-banking products and services increased across the board. This increase was most significant for computer banking and debit card use. During this period, computer banking use increased by more than 800 percent, and debit card use increased by more than 200 percent (Table 1). Meanwhile, automatic payments increased by 107 percent, ATM card usage increased by 88 percent, and direct deposit increased by 45 percent. Penetration of e-banking products also grew during this period. By 2004, more than 50 percent of U.S. households were using four of the five products listed in Table 1.

As product penetration increases, consumer adoption of some e-banking products appears to be reaching maturity. For example, in 2004, more than 76 percent of U.S. households with bank accounts used direct

deposit. Table 1 shows that the growth in adoption of direct deposit was greatest between 1995 and 1998 (25 percent). However, the growth rate declined over the remaining periods.

Direct deposit is even higher among older households. Compared to younger households, older households are more likely to utilize direct deposit, probably for pension and social security payments. According to the 2004 survey, more than 90 percent of households over the age of 65 were using direct deposit (detailed charts are included in Appendix B).

ATM and debit card use followed a similar growth pattern to that of direct deposit between 1995 and 2004. Between 1995 and 1998, the number of U.S. households with an ATM card increased by 55 percent and those using debit cards increased by 85 percent. Both products are now reaching the same level of adoption as direct deposit—66 and 63 percent, respectively.³ These growth patterns may provide clues for the potential market penetration of other e-banking products.

Compared to debit card use, the increase in the number of households using automatic payments was less robust. The survey asked respondents whether they had payments, such as mortgage, insurance, rent, or other payments, automatically deducted from their bank accounts. Thus, the term “automatic payments” does not refer to online bill pay products, but to payments that are established by providing a bank account and routing number to a consumer’s payee.

Among the five e-banking products shown, the fastest growing product during this period was computer banking. As noted earlier, computer banking use skyrocketed by more than 800 percent. However, this

Table 1
Percent of U.S. Households Using Electronic Banking Products, 1995-2004

	1995	1998	% chg 1995-1998	2001	% chg 1998-2001	2004	% chg 2001-2004	% chg 1995-2004
Direct deposit	52.4	65.8	25%	72.4	10%	76.2	5%	45%
ATM card	35.2	54.6	55%	58.2	7%	66.3	14%	88%
Debit card	20.0	36.9	85%	49.8	35%	62.8	26%	214%
Automatic payment	24.8	39.6	60%	43.8	11%	51.2	17%	107%
Computer banking	3.9	6.4	63%	20.3	219%	35.2	74%	805%

increase began from a small base of less than 4 percent. In addition, in 1995 online banking adoption was constrained by consumers' access. Many consumers did not have Internet access in 1995, and many banks did not offer online banking. Access remains a barrier today in some instances. According to March 2006 *Call Report* data, 30 percent of banks still do not offer online banking.

HAS THE INCREASED USE OF E-BANKING AFFECTED THE IMPORTANCE OF BANK LOCATION?

As the number of U.S. households that utilize e-banking services increases, one might expect consumers to place less value on a bank's location. Thus, the importance of location would decrease. In addition, one might expect banks to modify their branch expansion plans in response to this decreased demand for bank branches and as their investment in electronic services increases. How has the importance of location changed in the decade following the 1995 survey? Does distance and length of time since opening an account affect the results? As evidence of bank locations' importance, this section compares consumers' responses to the 1995 and 2004 surveys, as well as bankers' behavior related to bank branch and ATM network growth since 1990.

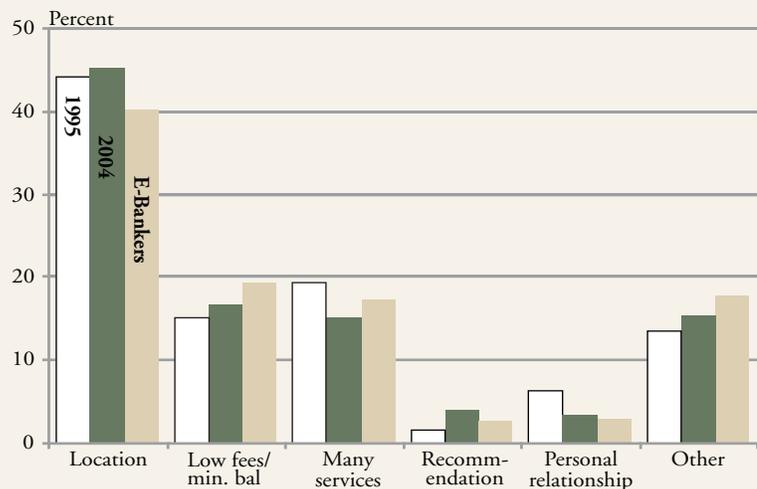
Despite the widespread use of electronic banking products, bank location remained the most important factor consumers considered when choosing their primary financial institution. In fact, a greater percentage of U.S. households picked location as the most important factor in the 2004 survey, approximately 45 percent (Chart 3). Bank location was important to e-banking users as well, referred to here as "e-bankers." These 24 million households used both online banking and automatic payments.

Bank fees and minimum balance requirements and the number of services offered remained important in 2004. Yet, bank location was paramount. Why is the convenience associated with location more important than these other factors? Banking relationships may endure because of the time and effort involved in changing banks, which is compounded with electronic banking services such as direct deposit and automatic payments. Therefore, few consumers may be willing to choose a bank based solely on the basis of paying lower fees or meeting lower minimum balance requirements.

Nonetheless, consumers' attitudes about fees and the number of services changed slightly between the two surveys. Fewer households picked the number of services as a determining factor, while more households said that low fees/minimum balance requirements were most important. This shift of focus is even more dramatic among the e-banker subgroup. E-bankers, who are predominantly younger households, placed greater emphasis on fees and minimum balance requirements, compared to all households, while their emphasis on location is slightly lower—40 percent (Chart 3).⁴

The shift of attention from number of services to the amount of fees and minimum balance requirements could be due to environmental factors, such as

Chart 3
Most Important Reason for Choosing Bank



the national economy and unemployment, which may influence consumer behavior. For example, the 2001 recession could have influenced how households made banking decisions and made bank customers more concerned about the costs they incur to conduct their banking business.

A more likely explanation for this change is the increased availability of information. The Internet has been credited with reducing information asymmetries. Younger households, who are more likely to use the Internet, can compare bank products and fees online.

Just as consumer choices may be influenced by external factors, the importance of bank location may also vary depending on a number of factors. For example, the consumers' distance from bank locations could impact how they think about their choice of bank. Information from the 2004 SCF shows that people living a greater distance from their bank place less emphasis on bank location, probably because they do not have other options, while households that are less than one mile from their bank were most likely to select location as the most important factor (Chart 4). These findings are consistent with the 1995 survey as well. The survey also shows that the majority of U.S. households are less than five miles from their bank (76 percent).

Another factor that may influence consumers' emphasis on bank location is the length of time since they opened a new account. Survey respondents that opened accounts

recently are probably a better gauge for how consumers are thinking about bank location now. The survey indicates that regardless of how recently survey respondents opened a new account, location was still the dominant choice factor. Overall, approximately 45 percent of households said bank location was the most important factor (Chart 5). However, households that established their bank account two to five years prior to the survey placed greater emphasis on bank fees. As noted earlier, these customers may have been affected by the recessionary economic conditions at that time.

Chart 4
Most Important Factor for Choosing Bank by Distance from Bank, 2004

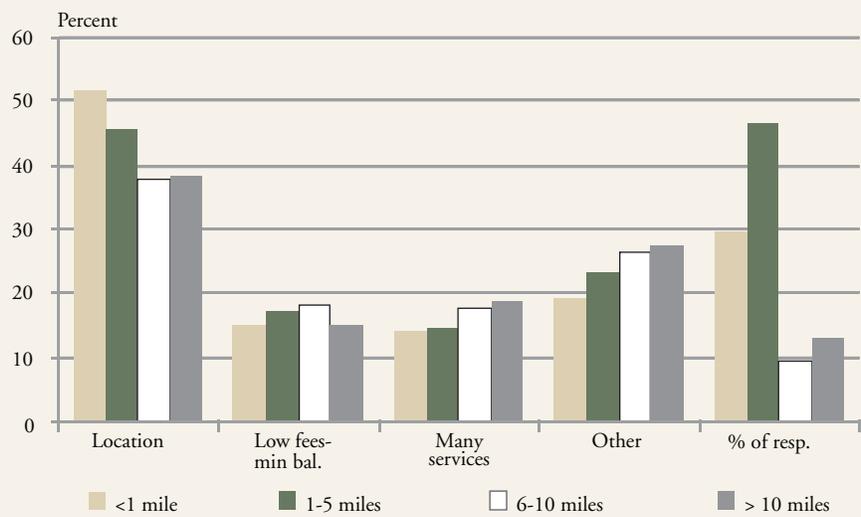
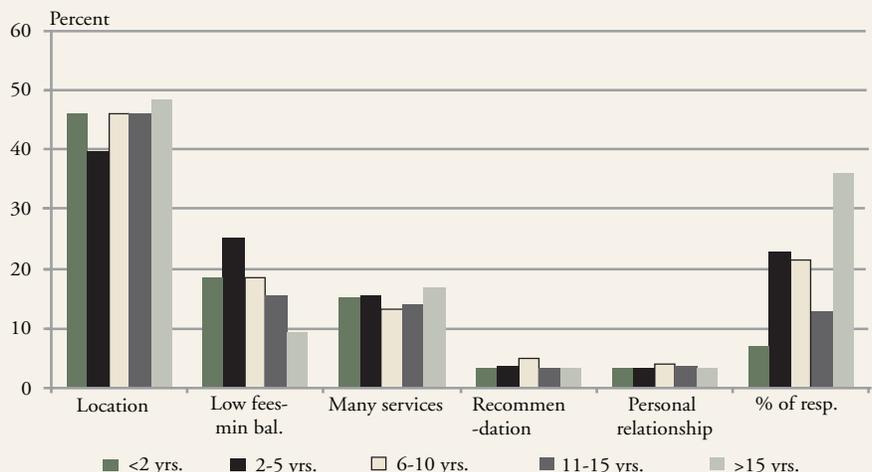


Chart 5
Most Important Factor For Choosing Bank By Length of Time With Current Bank, 2004



Data from the 2004 *SCF* provide evidence to show that bank location is still important to consumers regardless of how recently they opened an account or how far away they live from their bank. Additional developments that support the primacy of bank location include the rapid growth of bank branches and ATM networks. While e-banking product adoption increased significantly between 1995 and 2004, the banking industry continued to build new bank branches. The number of branches also increased despite overall consolidation among banks. FDIC studies show that the number of banks and thrifts has been in decline since the early '80s, while the number of branches has continued to increase (Chart 6). Since the early '90s, the number of new bank branches has increased by 2 percent on average. In 2004 and 2005, new branch growth increased at a faster pace to 2.7 and 3.1 percent, respectively.

The nature of what bank location means to consumers may have changed as a result of innovations in service delivery. For example, instead of expanding their reach by building brick-and-mortar branches, banks can provide convenient access to bank services by deploying ATMs. Chart 6 shows that ATM deployment has mushroomed since 1990, increasing even more rapidly than

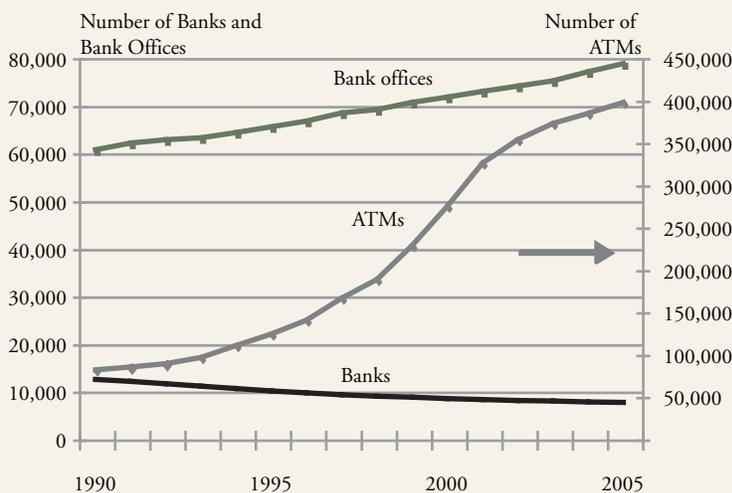
bank branching to almost 400,000 ATMs in 2005. In addition to deploying more ATMs, banks have been opening branches in new retail locations, such as grocery stores. Growth in retail branches has occurred at a faster rate than traditional branches—increasing by 12.3 percent in 2005 compared to 3.1 percent.⁵

The growing number of bank branches and ATMs may be the result of increased demand for convenient access. Banks may also be establishing more branches in order to obtain access to cheaper funding sources, such as consumer deposits. Increased competition for retail and commercial bank customers may also induce banks to expand their footprint, either in response to or before other banks obtain prime locations. In addition, new branches in retail locations can be constructed at a lower cost than traditional brick-and-mortar branches. Finally, banks may be opening new branches in order to take the bank to the customer, instead of requiring the customer to come to the bank. This can be accomplished with a branch near other retail stores, with in-store branches, or by deploying ATMs.

Bank branching not only improves the value proposition for customers, but also pays off for banks. According to studies conducted by the FDIC, banks with more branches have “higher noninterest

income, lower interest and noninterest expenses, and higher returns on equity.”⁶ Some may argue that these findings probably apply to large banks that have extensive branching networks. However, these findings were found to apply to both large banks as well as community banks with less than \$1 billion in total assets. Therefore, even if e-banking innovations reduce customers’ need to visit bank branches, banks may not want to rely on these innovations alone to provide convenient access to an expanding customer base.

Chart 6
Number of Banks, Bank Offices, and ATMs 1990-2005



As bank products and services become commoditized, financial institutions can solidify customer relationships by reducing “customers’ interaction costs.”⁷ In other words, the ubiquity of bank branches, ATMs, and electronic banking products and services reduces the costs customers bear to interact with their financial institutions. The growth of ATMs nationwide certainly increased consumers’ access to financial services.

As a result of bank branch and ATM network growth, even bank customers that do not adopt sophisticated e-banking products, such as online banking, can benefit from more convenient access. As noted from the 1995 data, consumer demographic characteristics show that those who are most likely to use electronic banking products—younger, higher-income households and those with more education—placed less emphasis on bank location compared with older households, lower-income groups, and households with less education. However, consumers with these characteristics may also be more mobile. (Charts related to these demographic groups are included in Appendices A and B).

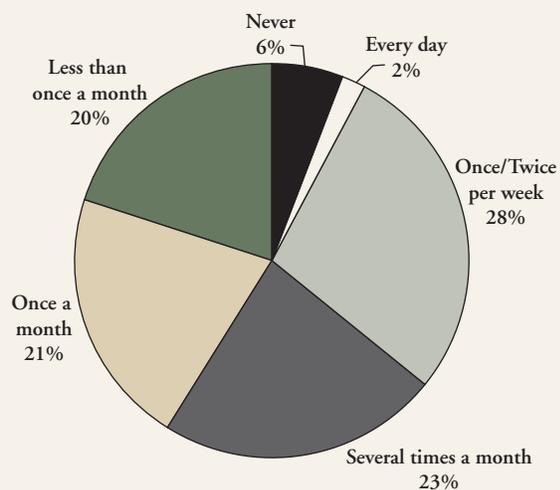
WHY IS BANK LOCATION STILL A SIGNIFICANT FACTOR?

Although the use of electronic banking products has grown significantly, the importance of bank location remains strong. Location remains relevant regardless of how recently an account was opened or the proximity of the bank location. Why is bank location still important? This final section uses anecdotal information from banker interviews and more recent survey data to offer several hypotheses to answer this question.⁸ Several possibilities exist, including whether e-banking products or services are suitable substitutes for bank branches or if electronic processes and physical locations are complementary services that increase convenience.

Notwithstanding widespread use of some e-banking products, these technologies may not be a perfect substitute for personal interaction. Many customers still visit their bank frequently and therefore value convenient bank locations. While many of these customers are conducting financial transactions that could be completed online, the bankers we interviewed were quick to note that even their online banking customers come into the bank on a regular basis. A survey conducted by the Independent Community Bankers of America in 2006 showed that 30 percent of all respondents were inside a bank at least once or twice a week (Chart 7). An additional 44 percent said they visited their bank several times a month or at least once per month.

Electronic banking may also not be a substitute for bank offices because, although many financial transactions can be conducted via online banking, a large percentage of the U.S. population still chooses not to use newer e-banking technologies. Among the bankers we interviewed, online banking use by retail customers varied widely, between 20 and 50 percent, while commercial bank customers seemed more likely to use online banking. A national survey conducted by the Pew Internet & American Life Project in December

Chart 7
Frequency of Bank Visits
(How often are you inside a bank?)



2005 found that only 43 percent of Internet users also used online banking. In addition, as noted earlier, Internet access and the availability of online banking products are necessary elements in order for online banking to serve as a substitute.

Another barrier to substitutability is the depth of consumer adoption. For example, some bank customers use automatic payments and online banking, but very few use online bill pay products. Some of the banks we interviewed did not offer online bill pay and, of those banks that said they offered the service, utilization rates were low. Federal Reserve data indicates that, among online banking customers, most use the service to monitor their accounts (95 percent), while only 56 percent of online banking users also used online banking to pay bills.⁹

Rather than acting as a substitute for services offered by bank branches, e-banking products are likely viewed by consumers as complementary to bank locations. Brick-and-mortar branches, ATMs, branches in retail locations, and e-banking services all increase convenience. Thus, location may not be important in itself; instead, the importance of location may serve as a proxy for convenience. Consumers want the convenience of e-banking products, but they also want the convenience of nearby banks. Therefore, in order to improve the value proposition for customers, banks should consider how they can increase convenience. An excellent example of increased convenience is a Midwestern bank whose bank hours total more than 90 hours per week. The bank's business and retail customers utilize its after-hours lobby until closing time at 10 p.m.

Finally, survey data may not reflect a shift in the importance of bank location because it is too early to see an impact. Data from the 2004 *SCF* suggest that younger consumers are more likely to adopt e-banking technologies. Over time, these consumers' preferences

will have a greater impact on survey results. Most of the bankers we interviewed said they noticed a difference between younger customers, who they say focus on transactions, and their traditional customer base that values relationships. In this context, several bankers predicted that location will decrease in importance in the future.

SUMMARY

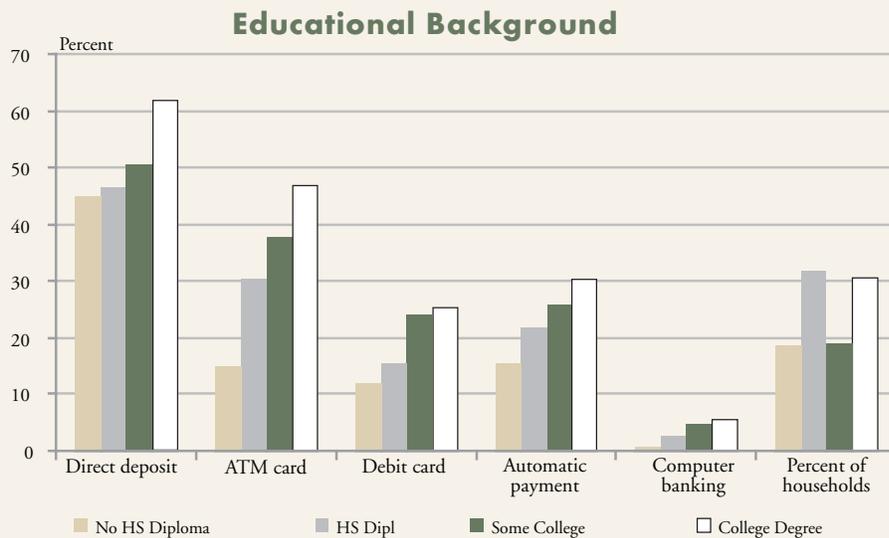
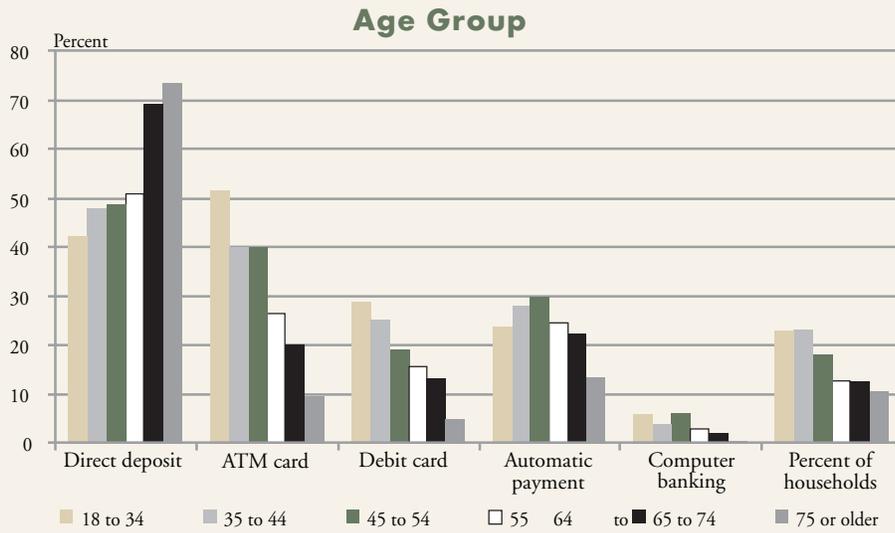
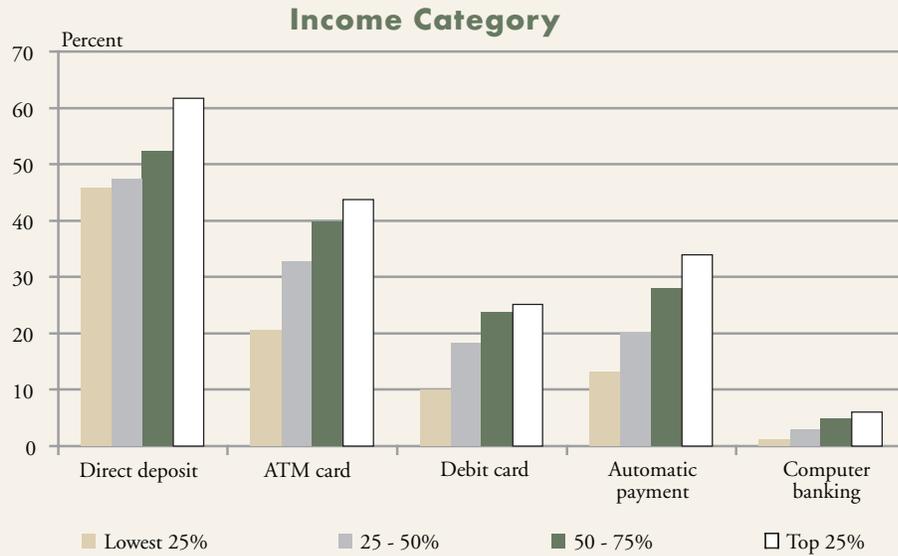
Electronic banking products have transformed the financial services industry. Over the last 10 years, adoption of e-banking products has reached mature levels for some products, while newer e-banking products are still maturing. Now most consumers can obtain access to many financial services without visiting a brick-and-mortar bank. However, despite increasing adoption of e-banking technologies, bank location still remains a very important factor that consumers consider when choosing a bank.

Several reasons may contribute to a bank location's continued importance to consumers. A large percentage of consumers still do not use e-banking technologies or all the features of these services. And many consumers still visit their banks frequently. In addition, not all financial transactions can be completed electronically. Therefore, e-banking is not a perfect substitute for a physical presence in the marketplace. More importantly, bank location is relevant to consumers for the same reason electronic banking is relevant—because bank customers value convenience. Convenience may be the driver that makes bank branch services, in concert with electronic banking services, complementary products.

While the *SCF* does not show a decline in the importance of location, it may be too early to identify the full impact of e-banking technology adoption. Demographic information from the survey and anecdotal information from banker interviews suggest that location may still decrease in importance. Future studies will show if these predictions are correct.

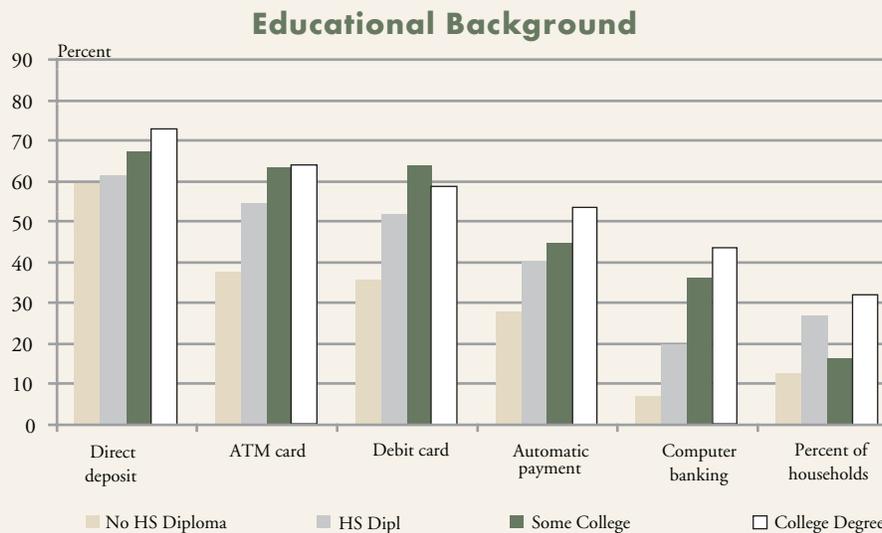
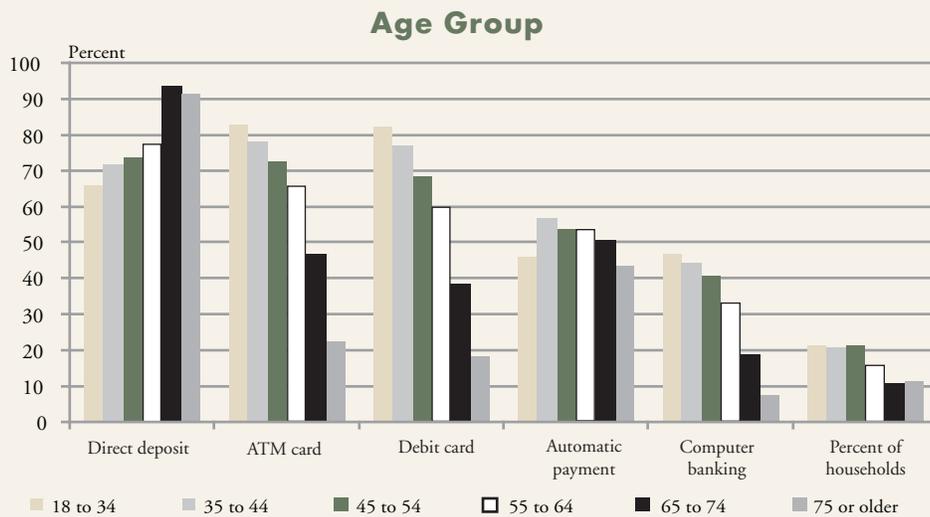
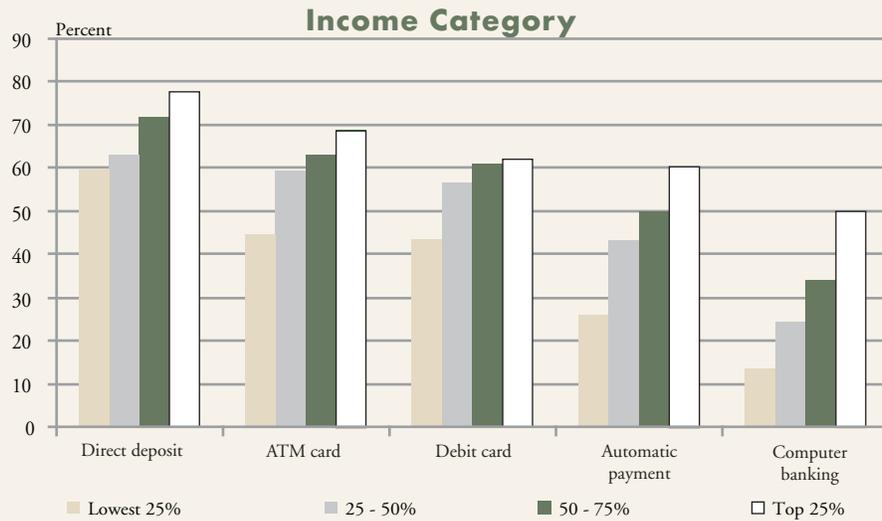
Appendix A

Electronic Banking Product Adoption by Demographic Characteristics 1995



Appendix B

Electronic Banking Product Adoption by Demographic Characteristics 2004



Endnotes

¹In 1995, Wells Fargo became the first bank to offer account access via the Internet, and Security First Network Bank became the first “Internet-only” bank. See Sullivan, Richard, and Zhu Wang, “Internet Banking: An Exploration in Technology Diffusion and Impact,” Federal Reserve Bank of Kansas City Working Paper 05-05.

²This paper uses data from households that have transaction accounts with banks, credit unions, and thrifts. Thus, those without transaction accounts are not included in demographic or other analysis. Ninety-one percent of U.S. households have transaction accounts with banks, thrifts, or credit unions. Families without transaction accounts are disproportionately likely to be low-income, minority, and to have low levels of wealth. See Bucks, Brian K., Arthur B. Kennickell, and Kevin B. Moore, “Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances,” Federal Reserve Board of Governors, *Federal Reserve Bulletin*, 2006.

³Research indicates that education and age are the most important factors related to debit card use. The “Educational Background” chart in Appendix B shows lower debit card use for those with college degrees, although these households are likely older and less likely to use e-banking products.

See “Consumers’ Use of Debit Cards: Patterns, Preferences, and Price Response,” Borzekowski, Ron, Elizabeth K. Kiser, and Shaista Ahmed, Federal Reserve Board of Governors, 2006-16.

⁴Consumers’ increased focus on fees may be the result of banks offering low minimum balance requirements and free checking in order to attract new customers. However, it may also be in response to banks’ increased focus on fee-based income over the last several years.

⁵Seale, Gary, “Branching Continues to Thrive as the U.S. Banking System Consolidates,” FYI: An Update on Emerging Issues in Banking, FDIC, October 20, 2004.

⁶Ibid..

⁷Vandenbosch, Mark, and Niraj Dawar. “Beyond Better Products: Capturing Value in Customer Interactions,” *MIT Sloan Management Review*, Summer 2002, vol. 43, no. 4.

⁸The banker interviews consisted of telephone interviews of the presidents of nine banks ranging in asset size between \$70 million and \$1.5 billion, located in Colorado, Kansas, Missouri, and Nebraska.

⁹The Federal Reserve commissioned electronic banking questions as part of the *Michigan Surveys of Consumers* in June/July 2003. Thirty-two percent of respondents used online banking, 21 percent of all respondents transferred funds online, and 18 percent of all respondents paid bills via an online banking Web site.