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Introduction

Rather than examining "direct" or "active" distribution channels, best exemplified by tied salesforces, this article concentrates on branch networks and certain other emerging distribution systems which can best be described as "indirect" or "passive", inasmuch as they rely upon the customer to take the initiative in purchasing a financial service or product.

Any basic marketing book will contain a discussion on channels of distribution[1,2]; they are an important means of both efficiently delivering products and communicating effectively with the marketplace. In the basic bank markets, which have been traditionally dominated by the London clearing banks (LCBs) and characterized by the collection of retail deposits, the money transmission mechanism and a range of personal lending services, branch networks have fulfilled both these functions with considerable success. As distribution channels, however, branch networks have certain inherent disadvantages which have become only too apparent with the progressive deregulation of the financial services markets. Alternative distribution channels, particularly those which utilize advanced technology, have partially remedied some of these weaknesses by complementing and supplementing the branch networks.

Figure 1 depicts the mix of distribution channels examined in this article and indicates that they are beginning to emerge not merely as auxiliaries to the branch network but as alternatives. Apart from the obvious threat to the actual size of the branch network, these alternative indirect distribution channels have raised some far-reaching and challenging strategic implications for financial institutions. Friars *et al.*[3] encapsulates these implications in suggesting that financial institutions should select distribution channels that are both market focused and profit based. This suggestion raises a wide range of extremely complicated strategic considerations relating to such issues as the quality and design of financial products, the branding of financial products, the desired corporate image and culture, and so forth.

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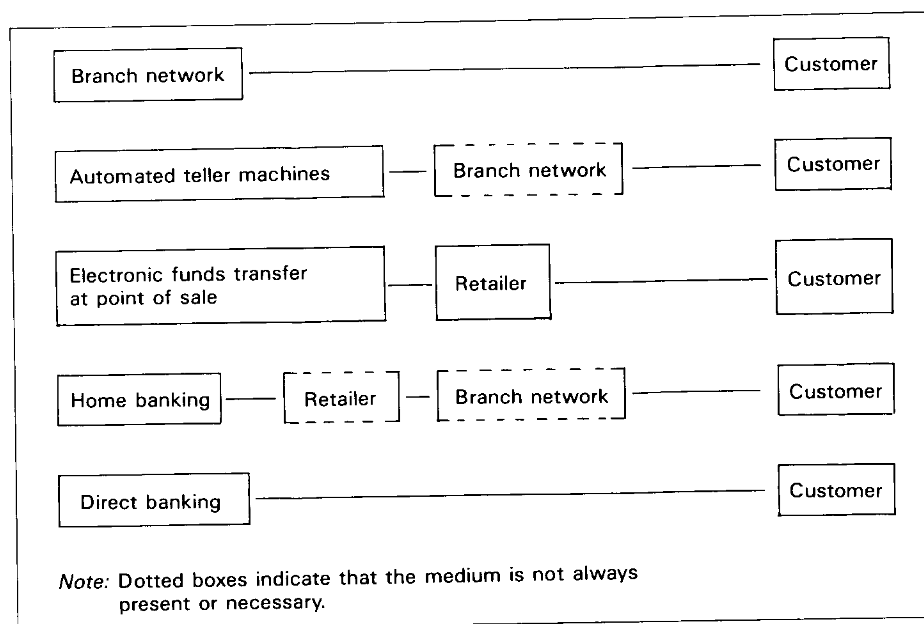

Figure 1.
Mix of Distribution Channels in Retail Banking

Most of these issues are outside the scope of this article but the emphasis on market focus and profit does raise a question that may be crucial to the very survival of some financial institutions, namely, how can a mix of alternative distribution channels be managed in an endeavour to maximize both efficiency and customer satisfaction? Both objectives are essential in successfully pursuing market focused and profit based policies, and both are inextricably linked. In considering the strategic issues in detail, however, the article will indicate that the problem and its solution are not made any easier by this linkage.

Historical Context of the Branch Networks

The pre-eminence of the branch is largely due to the difficulties associated with marketing financial services. Branch networks evolved to attract relatively cheap retail deposits through the convenience of branch locations and branch-based payment systems. Traditionally, they have provided a highly effective, though increasingly costly, mechanism for administering, collecting and delivering cash. They have also, simultaneously, facilitated the provision of an extensive range of associated lending and ancillary services.

Branch banking has also been typified by a high density of potential customers and the generation of substantial amounts of revenue. The former was very much a function of location, whereas the latter was a direct result of high gross margins facilitated by the cartelized oligopoly operated by the LCBs until 1971. The cartel effectively precluded price competition but other forms of competition, particularly "functional" competition aimed primarily at increasing (maintaining) market share by increasing customer satisfaction, were prolific. The most obvious example of this competition was the continued expansion of the LCBs' branch networks in the late 1950s and 1960s.

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After 1971, various changes in the financial services markets, collectively referred to as "deregulation", have systematically changed the nature of competition in the markets. Not only have the traditional constraints on price competition been removed but the demarcation lines that previously existed between the various financial institutions have been considerably eroded. As a consequence, different types of financial and non-financial institution which traditionally never competed (at least not directly) are now actively competing directly against each other in an increasingly universal financial market. In future the net effect may well be to reduce gross margins on most traditional retail bank products and thereby increase the pressure to develop and introduce new products and alternative distribution systems.

These non-branch competitors and the increased cost constraints now experienced by branch-oriented institutions are primarily responsible for the emergence of "product"- rather than "relationship"-oriented marketing strategies. This change in marketing philosophy, which is clearly expounded by Kimball[4], poses a potential threat to the branch infrastructure because, at the extreme, a product strategy emphasizes the sale of financial products through non-branch distribution channels. This is in stark contrast to the relationship strategy, traditionally associated with the LCBs and building societies, which typically utilize the branch network to attract customers and develop personal relationships as a basis for selling financial services.

The importance of this relationship between customer and branch has been crucial, as verified by its being referred to by Green[5] as no less than "fundamental to the very process of banking". This importance, however, is only tenable provided that the conditions which determined the branch networks' historical position continue to apply. The most important of these conditions are that the market continues to respond to it, and that it will remain the basis for existing and emerging patterns of competitive behaviour. However, the branch networks' important position, even in the basic bank markets, is becoming increasingly less certain due to a combination of interrelated factors which are radically changing customer and competitor behaviour in the financial market.

The Important Issues

Kimball and Gregor[6] suggest that the key to successful management of the delivery mix is to control product-delivery costs and maximize the potential for generating revenue. Costs will include product and systems development, advertising, support activities, delivery costs and overheads. Apart from the prudential aspect of controlling costs *per se*, an important aspect of managing the delivery mix is to reduce total average* costs by changing the composition of fixed and variable costs. This necessitates increasing the fixed cost element in delivery systems in an attempt to increase profitability via economies of scale and the generation of extra business. Revenue, on the other hand, will be

* Total average cost $= \dfrac{\text{Total variable cost} + \text{Total fixed cost}}{\text{Quantity}}$

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determined by the numbers of potential customers, market share, products purchased per customer and the gross margin per product. This suggests that successful management of the delivery mix will necessitate an increase both in the number and variety of distribution channels in an endeavour to increase sales volume, and reduce total average cost.

The optimum mix of distribution channels is another important issue confronting management in financial institutions. The eventual choice will influence both the product range and its impact within the marketplace. Chandler *et al.*[7] claim that the most successful distribution strategies are tailored to enhance levels of customer service and, therefore, customer satisfaction.

At the extreme this would suggest providing the customers with as many distribution channels as possible in an attempt to satisfy all their wants. In reality, however, such an objective must be qualified by considerations of cost. The quantity and the mix of distribution channels affect the basic cost structure of any organization and therefore determines ultimate price competitiveness and overall profitability. Without seriously questioning the importance of customer satisfaction in the delivery-mix equation the optimum mix can only be arrived at by taking into account average costs and the potential for increased revenue generation. Particularly important in this respect is the typically large amount of front-end investment in new technology and the commonly recognized customer reluctance to pay for extra satisfaction.

In deciding on the mix of distribution channels, financial institutions are effectively determining their overall ability to operate successfully in the financial markets. The choice is based on the following considerations:

- maintaining a strong market position through attracting and retaining a large, profitable customer base;
- introducing new distribution channels to counteract the cost-benefit characteristics of the branch network;
- building a distribution channel mix that can respond flexibly to changes in competition and the marketplace;
- exploiting fully the benefits inherent in the existing infrastructure.

In making this decision, the clearing banks in particular face the most difficult problem because their dominant position in the marketplace is still based primarily upon the branch network. Howcroft and Lavis[8], suggested that any change in their strategic distribution system would, therefore, appear to necessitate a gradualistic approach in an endeavour to reduce the impact on the branch structure and the attendant investment in staff and systems. However, the past few years have subsequently witnessed the majority of clearing banks making rapid and substantial changes to their branch infrastructure and organization.

Another important issue which faces all financial institutions instigating change of this kind is the desirability of maintaining customer loyalty during the transitional period. To some extent, this will depend on the ability of new entrants to gain access to the markets via new distribution channels. Competitive

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pressures have already increased as a direct consequence of the wider range of distribution channels currently available and because of the customers' apparent propensity to be influenced by price considerations when buying "one-off" financial products.

In addition to competition, technology has become an important arbiter of strategic direction. Not only is it changing the economics of the marketplace but it is also providing both an opportunity and a challenge to incorporate technology characteristics into product designs. Electronic cash dispensers and company cash management services already utilize technology to this effect. Technology-driven distribution channels can be utilized to focus products and target customers by ensuring that products are sufficiently differentiated from competitors. The superiority and uniqueness of such products will possibly increase customer loyalty by making them less inclined to change banks because of the inconvenience and cost involved in changing delivery systems.

Bank corporate strategies are, therefore, increasingly being determined by a wide range of considerations relating to technology and competition. In direct contrast to the pre-1971 cartelized oligopoly, the LCBs and financial institutions generally are consequently becoming less capable of determining their future policies solely by reference to predominantly internal considerations and are becoming increasingly responsive to the market. In the process, financial institutions which rely extensively on expensive branch networks are beginning to regard their branches as one of a range of possible delivery systems, rather than as the central aspects of their business.

The delivery mix must, however, be internally managed in order to fulfil certain essential prerequisites of survival. These prerequisites include the need to:

- occupy the market;
- acquire new customers; and
- service existing and emerging customers.

The emerging channels of distribution, particularly those which are technology driven, such as Automatic Teller Machines (ATMs), Electronic Funds Transfer at Point of Sale (EFTPOS) and home banking, have a tendency to emphasize the third requirement inasmuch as they are primarily aimed at providing a range of basic services. The important considerations of market occupation through tangible presence and acquiring new customers through physical location are functions which have been traditionally fulfilled by the branch network.

The fact that branches are prevalent in the basic bank market and are not readily reduced without incurring loss, combines with the above considerations to suggest that they will almost certainly continue to be an important element in the future distribution mix. Branch-oriented financial institutions are, in fact, already attempting to combine the advantages of the branch with those of electronic distribution channels. Implicit in this mix, however, is a definite and deliberate change in the organization of the branch network and its basic function. This change reflects both the need to maintain a cost-effective business and the need to ensure that the branch networks complement, rather than merely replicate, the new and emerging alternative distribution channels.

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Arbiters of Change

Competition: Bowersox[9] suggested two reasons to explain why channelling had received insufficient coverage in the literature. The first concerned the lack of applied analytical tools to deal with the problem and the second, and most important, related to the absence of adequate motivation, i.e. competition. Certainly this diagnosis once applied to the financial system, but the past 20 years of systematic deregulation have changed not only the level of competition but also the patterns of competitive behaviour. The Financial Services Act, combined with the government's progressive privatization of pensions and the emergence of the mortgage as the crucial lifetime financial transaction will compound these changes and as Ginarlis[10] suggests may well place further question marks against the future effectiveness of the branch network in these new and emerging financial markets.

The basic problem is that branch networks, typical of clearing banks, building societies and estate agents are essentially "passive", i.e. the emphasis is on the customer to make the effort and visit the office. By contrast the "active" sales medium is the tied salesforce typical of industrial life offices, unit linked offices and major retail brokers, which involves company representatives visiting customers at their convenience, i.e. usually at home and typically outside normal banking hours. Belton[11], basing his views on empirical evidence in Canada, claims that although branch networks may be eminently suitable for relatively simple packaged insurance products, e.g. endowment mortgages or house contents policies, they are certainly less suitable for the more complex life or pension products which require more detailed information and individual tailoring. Clearly, the same observations and conclusions are equally applicable to branches in the evolving British financial services industry.

The Securities and Investments Board's (SIB) polarization regulations have further complicated the situation by insisting on the designation of retail salesmen either as company representatives (agents) or as independent intermediaries (principals) but as Table I indicates the response has not been uniform. A minority of institutions have independent intermediary status and, therefore, offer a full brokerage service. The majority of clearing banks and building societies, however, have become company representatives and, therefore, will endeavour to sell only the insurance products of the companies they represent. In the case of Barclays, Lloyds, Midland and TSB, these are associated companies or subsidiaries of the banks in question. This dichotomy in the market is potentially confusing to the average customer and the bias towards company representatives effectively reduces the outlets for independent insurance companies which desire to remain independent but which do not have their own salesforce. This places a serious question mark against whether the best interests of the customer are being met under these circumstances.

Electronic technology: In distribution terms there are essentially two types of technology — that which complements a branch's function, e.g. front office terminals, cheque truncation, and that which provides an alternative means of distribution, e.g. ATMs, EFTPOS, plastic cards, home banking. New technology, to date, has generally supported branch networks by facilitating

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Bank/building society	Status	Company represented
Bank		
Barclays	CR	Barclays Life
Lloyds	CR	Black Horse Life
Midland	CR	Midland Life
National Westminster	II	—
Bank of Scotland	CR	Standard Life
Royal Bank of Scotland	II	—
TSB	CR	TSB Life
Yorkshire	II	—
Abbey National	CR	Friends Provident
Building society		
Halifax	CR	Standard Life
Nationwide Anglia	II	—
Alliance & Leicester	CR	Scottish Amicable
Woolwich	CR	Sun Alliance
National & Provincial	CR	National & Provincial Life
Britannia	CR	Britannia Life
Bradford & Bingley	II	—
Cheltenham & Gloucester	CR	Legal & General

Notes:
CR: Company representative
II: Independent intermediary

Table I. Polarization: Designation of Branches

greater volumes of transaction business. The functional efficiency of branches has, therefore, been markedly improved but the general availability of this technology has meant that no significant competitive advantage has emerged.

As an alternative distribution channel, however, new and emerging technology is changing the pattern of competitive behaviour. By reducing reliance on the branch network, the single most important barrier to entry into the basic bank markets has been significantly reduced. This has enabled credit card organizations, particularly the non-bank American Express and highly centralized financial service groups to access the market. Insurance groups, data processing companies and retailers, similarly, now have the potential to offer a comprehensive range of financial products throughout the UK. Moreover, substantial capitalization combined with technology has introduced another competitive threat in the form of large Japanese and American banks with the potential to provide personal and corporate financial services throughout Europe.

The combined net effect of new technology and increased competition has fragmented the marketplace and eroded the traditional homogeneity of the various financial institutions. As distribution channels based on technology

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have the capability to offer specific bundles of services, the traditional interdependence between savings, payment systems and lending products has also started to break down. Nicholas[12] makes the observation that this has increased the emphasis on market segmentation and introduced the potential and opportunity to design products which increasingly incorporate reliance on specific technological distribution channels.

The Development of Delivery Systems in the UK

Branch networks: The development of large branch networks in the UK is largely a consequence of evolutionary and unplanned growth. The clearing bank mergers in 1968, for instance, saw the formation of a group of four major banks whose networks had grown under the influence of "functional" competition, inasmuch as it restricted price competition but provided a rate of return sufficient to encourage physical expansion. The mergers, however, created overlarge networks which, combined with increased competition, eventually led to a slow contraction in their size as shown by Table II.

The factors responsible for this contraction derive basically from two sources: the first is that customers are increasingly seeking both greater control and greater convenience in the conduct of their financial affairs. Greater affluence and sophistication have also resulted in enhanced financial awareness with a resultant decline in the "endowment" element in bank profits. Essentially, bank customers are seeking higher returns from their savings and are, therefore, less

Table II.
Branch Networks in the UK

	1983	1989
Girobank	22,301	21,030
National Westminster	3,226	2,997
Barclays	2,912	2,645
Lloyds	2,276	2,184
Midland	2,345	2,042
TSB	1,604	1,538
Royal Bank of Scotland	894	842
Bank of Scotland	559	527
Clydesdale	381	356
Yorkshire	215	251
Co-operative	75	109
Standard Chartered	—	14
Total banks	36,788	34,535
Total building societies[a]	6,643	6,962

[a] The number of building societies had declined from 206 in 1983 to 126 by 1989. To aid comparison the figures for building society networks include Abbey National.
Source: *Abstract of Banking Statistics*

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inclined to leave their idle funds in non-interest-earning current accounts. Instead they are increasingly maintaining merely transaction balances with the clearing banks, thereby reducing the ability of the banks to attract cheap money. The second factor relating to a contraction in branch networks was observable in the 1970s and, as Hammond[13] commented, derived from the vulnerability of branches to excessive costs. The situation has been exacerbated by the traditional low levels of cost recovery on payment systems and by the emergence of alternative cost-effective technology-driven distribution systems.

Building society branch networks have been cited as examples to illustrate the deficiencies of clearing bank branches, particularly in terms of style and operating efficiency. The expansion of the societies' networks, shown in Table II has, undoubtedly, undermined the clearing banks' competitive advantage of convenience and has had the almost incidental effect of providing direct price competition. Nevertheless, despite the similarities, not least those afforded by the building societies' pre-1983 cartel, there are fundamental differences in the traditional business conducted by building societies and clearing banks. In essence the traditional building society function has been more simple and limited in range, compared with the traditional business of the clearing banks. These differences reduce, to some extent, the validity of a direct comparison between bank and building society branches. As Barnes's[14] empirical study implies, when the full implications of the Building Societies Act (1986) and the Financial Services Act (1986) are realized, building societies too will almost certainly incur problems not entirely dissimilar to those experienced by the clearing banks, particularly those relating to the functional and cost efficiency of branches, compared to new and emerging distribution channels.

Table III indicates the extent to which insurance companies and building societies have diversified into estate agency business and in the process taken over and reduced the number of independent estate agents operating in the

	Estate agency	Parent	Mid-1986 outlets	Mid-1989 outlets
(1)	Royal Life Estates	Royal Insurance	256	817
(2)	Prudential Property Services	Prudential Corporation	92	800
(3)	Halifax Property Services	Halifax	N/A	643
(4)	GA Property Services	General Accident	80	612
(5)	Black Horse Agencies	Abbey Life (Lloyds)	350	563
(6)	Hambro Countrywide	Hambros	350	563
(7)	Nationwide Anglia Estate Agencies	Nationwide Anglia	N/A	480
(8)	Cornerstone Estate Agencies	Abbey National	N/A	434
(9)	TSB Property Services	TSB	N/A	181
(10)	Hamptons	Abaco Investments	N/A	160

Source: *Chartered Surveyor Weekly* and *Euromonitor Research*

Table III. Ownership and Size of the Top Ten Estate Agencies

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market. In this respect, the net effect on the market is not entirely dissimilar to the SIB's polarization regulations on independent insurance companies. The short-term costs associated with this strategy have, however, been very high: Halifax Building Society, for instance, wrote £99 million off its reserves in 1988 and most of this amount related to goodwill from the acquisition of estate agents the previous year. Moreover, the subsequent collapse of the housing market resulted in the majority of chains shown in Table III realizing a loss for 1989.

With approximately 80 per cent of new mortgage business currently being conducted on an endowment basis, rather than a traditional capital repayment basis, the structural changes in the estate agency market are, to a large extent, attributable to the critical link between housing transactions and brokerage income. This suggests that despite the above mentioned "costs", the housing point of sale will, in the absence of any obvious alternatives, remain the focal point for selling insurance products.

The advantages associated with a comprehensive branch network must, therefore, not be underestimated. In general, branches still constitute a substantial barrier to competitive entry and remain a most effective distribution channel in the basic bank markets. Information technology has facilitated their importance by making them more cost-effective. Automation of a significant amount of processing, administration and routine customer service has reduced the branches' overall manpower requirement for traditional bank clerks while simultaneously increasing their output capacity. Faust[15] argues that technology has also reduced the administrative pressures on branches and provided the opportunity to regard them increasingly as marketing or retailing centres, with the potential to project corporate image.

A significant amount of investment has already taken place at certain preselected branches in an endeavour to reflect this change in image. Branches have been selected, using social and demographic information, both to justify the cash investment and to match it more accurately with the potential of the branch. The criteria for selection typically include detailed analysis of the population and workforce around the branch and the specific appeal of any branch, including the amount of floorspace and shopping trends in the surrounding area.

The general atmosphere within these branches has been substantially changed by simply facilitating closer physical contact between staff and customers. Bandit screens are less in evidence and a more welcoming image is projected through open planning, branch décor and the general attitude of staff. Improvements in customer service too, have been attempted by the adoption of a "zoning" policy by some clearing banks. This strategy involves designating the floorspace of certain key branches for specific banking transactions. For example, for customers requiring a quick service, typically associated with money transmission, balance enquiries, statements, etc., a high-tech, self-service area, typically near to the entrance of the branch, is allocated. "Off the shelf" products such as account openings, simple loans and credit card applications are provided in a completely separate area of the branch, incorporating an essentially open plan, face-to-face environment. Finally, for more complex products, such as personal financial services and mortgages, a slower, more personal

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approach is used, using a private part of the branch set well back from the entrance.

This policy of zoning is also conducive to "hub-and-spoke" branching whereby a core branch offers a full service (possibly zoned) with satellite branches offering a more limited, sometimes highly automated service. The logistics of the system vary between different banks but it is typically structured around a "key branch" which may have responsibility for between four and 15 satellite branches. An area office will typically co-ordinate and control the activities of the key branches within its jurisdiction and have overall responsibility for marketing and the generation of corporate business and other predesignated key accounts within the area. As Caron[16] explains, the satellite branches, themselves, concentrate on personal banking services or banking for small businesses and are usually designated general, support, counter or agency branch status depending on their primary function. In some instances the processing of cheques is only undertaken by the key branch or some centralized processing department. A decade ago, however, Doyle *et al.*[17] raised doubts, which still persist, about the desirability of this latter policy because, although it may have cost advantages and this is by no means certain, it has long been recognized that some form of in-branch processing may be necessary to maintain the traditional banker-customer relationship at branch level. Other problems associated with centralizing the processing function include: identifying and obtaining planning permission for the optimum location of the centre, the daily physical transport of vouchers from branches to the centre, possessing and maintaining state-of-the-art technology necessary to process high volumes of paper, the handling of daily queries relating to returned and stopped cheques, and so forth.

Apart from centralization of the processing function, hub-and-spoke branching also has the propensity to reduce costs by focusing specialized management in key branches, thereby avoiding the duplication of expensive management skills so abundantly obvious in the traditional branch network system. Satellite branches operated by staff on lower salaries can then be utilized to provide basic banking services and to sell financial products. Hub-and-spoke banking is also highly conducive to focus strategies and is easily reconciled with the desire to maintain some form of physical high street presence in an endeavour to sell financial products and project corporate image. Indeed, the combination of such considerations may well lead to an eventual increase in the number of branches operated by the clearing banks. However, Meidan[18] emphasizes that satellite branches, with their limited and specialized services, need to be located with particular care to maximize both revenue and customer satisfaction. Branches specializing in the needs of small business customers have already emerged on the peripheries of towns and cities. Brantley[19] cites the examples of cash shops offering essentially encashment facilities, which have similarly been opened within supermarkets and shopping precincts.

Zoning and hub-and-spoke branching have also introduced the opportunity for banks to pursue simultaneously both product and relationship strategies through their branch networks, thereby dispelling the view that the two strategies

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are either mutually exclusive or that product strategies cannot be effected through branches. For instance, in hub-and-spoke branching, relationships are of paramount importance in many satellite branches which are typically used to attract new customers and provide basic bank services. Opportunities which are identified or present themselves for selling financial products can then be referred to the product managers located in key branches.

The zoning of key branches themselves is similarly a recognition of the advantages of both relationship and product strategies, depending on the type of product being sold. Apart from the day-to-day account transactions which can be automated to some extent, other basic transactions such as account opening and general enquiries need a personal approach which necessitates creating a relationship between banker and customer. Favourable corporate image and culture can then be projected both to attract new customers and to strengthen relationships with existing customers. Ideally, successful relationship banking will result in customers being more inclined to purchase more sophisticated products from their primary bank than elsewhere. Opportunities to sell sophisticated financial products can also be more readily identified from the relationships, at which point customers can be referred to the specialist or product manager located in a separate zone but within the same branch.

In essence the LCBs, in particular, are currently endeavouring to improve their overall branch delivery system by adopting the following strategies clearly observable in the marketplace:

- Attempting to provide a service when the customer requires it, by extending branch opening times to incorporate evenings and Saturdays.
- Reducing the amount of processing done at the branches by centralizing back-office work at more cost-effective locations.
- Changing training priorities for staff, with a greater emphasis being placed on selling.
- Investing in certain key branch locations to upgrade the premises and project a corporate identity compatible with retailing financial services in the 1990s.
- Researching products more vigorously and targeting them towards specific customer segments.
- Increasing investment in self-service equipment, particularly ATMs, for money transmission and enquiry services.
- Adopting a more segmented approach between the personal and business markets in an attempt to enhance the quality of service to both.

This approach is absolutely necessary because of the substantial inherent disadvantages associated with the branch network. Branches still remain expensive and, as distribution channels, they can justifiably be referred to as "passive" and "static": passive inasmuch as the customer needs to be "induced" (the traditional inducement being the payments mechanism) into them and static inasmuch as they are relatively inflexible and difficult to adapt

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to changing market conditions. In fact, this partly explains why the history of the basic bank markets has been gradual and evolutionary rather than precipitous and revolutionary. The traditional branch network is also not best suited for distributing the full range of financial services, particularly the more complicated life products which require a more personalized approach. Non-branch competition in the form of "active" sales representatives combined with technology-driven distribution channels may well prove to be a severe test of branch banking in future.

Technology: The need to make branches more cost- and functionally efficient has resulted in the wide-scale introduction of automatic teller machines (ATMs) (see Table IV). This development has not only mitigated the decline in branch numbers but also made what Choraphas[20] hails as "the" strategy in retail banking, namely 24-hour branch banking, a reality. In addition to cash dispensing services, ATMs provide balance enquiries statements, chequebook request services and in some instances, deposit collection facilities. Marketing messages can also be transmitted onto the ATM screens.

Multifunctional ATMs, however, are not necessarily conducive to providing the most cost-effective and efficient service. Not only are they more likely to malfunction, compared to more basic machines, but their ability to settle

	1983 No.	1989 No.
National Westminster	1,304	2,517
Lloyds	1,535	2,103
TSB	445	2,192
Barclays	683	1,972
Midland	703	1,773
Royal Bank of Scotland	469	622
Bank of Scotland	203	314
Clydesdale	194	295
Yorkshire	92	212
Girobank	–	182
Co-operative	–	71
Total banks	5,628	12,253
Link*	–	853
Matrix	–	375
Halifax Building Society (Independent)	–	1,244
Link and Matrix	–	2,128
Total building societies	112	4,600

* Includes Abbey National

Source: *Banking World*, November 1989

Table IV. Installed Cash Dispensers and ATMs

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combinations of banking transactions can lead to lengthy queues and consequently to customer delays. Significantly, the market has witnessed an emphasis by some banks (notably Midland Bank) towards single-transaction machines in an attempt to service customer needs quickly and efficiently. Typically, clusters of single- (or limited-) transaction automated machines, each offering a different service, are beginning to appear in banking halls, the objective being to maintain the range of services offered by multifunctional ATMs, without the associated delay.

Although an important consideration behind the introduction of ATMs was the desire to change the mix of costs another subsequent consideration has emerged which is concerned with the revenue-generating capabilities of ATMs. An important aspect of this development is the question: Are ATMs distribution systems or financial products? In reality they have qualities and attributes which are indicative of both but this mutuality has important implications for pricing strategy. Currently ATM pricing strategy reflects both these considerations. Access to account information, for instance, is not charged, reflecting the delivery function of ATMs but account transactions, etc., are typically charged in accordance with the bank's pricing tariff, reflecting the product function of ATMs. The future resolution of this question or indeed any changes in the bank's own views on the primary function of ATMs will, therefore, have a marked effect on pricing strategy.

The move towards ATM sharing agreements has largely been caused by the desire to reduce both variable and fixed costs, and to spread the risks associated with the new technology. The various reciprocity arrangements and the company groupings typical of Matrix and Link have been based largely on technological compatibility rather than any other consideration but it does, nevertheless, raise the possibility of future power groupings based on different criteria. This possibility constitutes another reason why financial institutions should attempt to establish distinctive market positions and so endeavour to safeguard corporate identity and market share. The inextricable linkage between co-operation and competition will, at least in the medium term, serve to safeguard the future of branch networks because unlike co-operative ventures, the branches will inalienably define and identify the individual bank and, therefore, project corporate image.

EFTPOS is essentially a payment system which may also be described as a distribution channel. The joint development of an EFTPOS network, however, has the potential to create a barrier to the entry of other groups and thereby maintain the market position of individual institutions in the same way as the payment systems oligopoly did. Accordingly, a report commissioned by the Bankers' Clearing House, under the chairmanship of Child[21], to review the organization, membership and control of the entire British clearing system made specific recommendations regarding the implementation and control of EFTPOS.

As a consequence attempts were made to establish a national EFTPOS system involving the LCBs and some of the larger building societies. A company, EFTPOS UK Ltd, was formed to implement the project but after three years

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and an estimated £60 million expenditure, the initiative was terminated and the inaugural service ended in April 1990. Apart from the technical difficulties in devising a national system, its failure was primarily due to delays caused by attempting to incorporate central clearing into the system and by adopting the principle of open membership to any "qualified" financial institution. These delays effectively encouraged and gave ample opportunity for the banks to develop and install their own less ambitious but, nevertheless, successful EFTPOS systems independently of the national system.

The introduction of EFTPOS is a major initiative in using technology to control the growth in overheads. Paradoxically, although it is an adjunct to branch banking and dependent upon an established customer franchise, it weakens both the role of the branch and the banker-customer relationship. EFTPOS, therefore, may be perceived as an important technological step away from the branch banking concept and may, despite the setback of EFTPOS UK Ltd, ultimately undermine the traditional branch network.

In the process, however, EFTPOS may actually strengthen the need to have highly visible "retail" outlets whose primary function is to sell financial services rather than provide traditional payment services. This would compensate for the possible breakdown in the personal relationship between the banks and their customers when operating a full EFTPOS service but would also raise the most difficult problem of how to attract customers into branches which do not have money-transmission facilities.

The advantages of EFTPOS to retailers and customers are not absolutely clear and, despite the frequently vaunted view concerning its potential to curtail rising costs, the advantages to banking institutions remain similarly debatable. Its introduction would almost certainly disrupt the existing pattern of conducting business, at not inconsiderable cost both to financial institutions and to retailers. It would not overtly build and foster customer franchises and would possibly undermine the existence of branded credit cards and the economic and functional validity of the traditional branch network. In this respect, EFTPOS encapsulates the major strategic dilemmas posed by new technology in the traditional bank markets.

Home banking has even more far-reaching implications as a new distribution channel because it relies even less than ATMs and EFTPOS on an established customer franchise and marketing base. It is also not dependent on co-operative schemes with other financial institutions, although it would require the intermediation of a communications company to provide the interactive communication networks. The technology is now readily available in the form of videotext systems based on either telephone lines using packet switching techniques, or cable television systems utilizing their ability to carry several hundred channels simultaneously. Much would depend on the demand for these technologies by the general public in determining the future success of home banking. The success of financial institutions in developing software packages capable of delivering an appropriate product mix, with a high degree of interactivity between customer and institution, would also be critical in determining future long-term success.

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For established banks and building societies the objectives behind the introduction of home banking on a national scale would be, if it ever occurred, essentially twofold:

- as a strategy to defend market position against non-traditional competitors who may seize the opportunity provided by relatively low entry costs to access the basic bank markets; and
- as another opportunity to introduce a more explicit pricing strategy based on fee income in an attempt to mitigate the increasingly volatile endowment element in their business income.

Other Distribution Channels

The existence of highly efficient postal and telephone services in the United Kingdom has enabled highly centralized operations, such as money market funds and cash management accounts, to attract substantial volumes of business despite having no captive customer base or retail branch network. This has enabled non-branch financial institutions with completely different cost structures to compete against institutions with branch networks, by underpricing them and offering relatively high levels of service and convenience. Although the threat is marginal, it is nevertheless sufficient to disrupt the economics of branch banking based on competition between industry groups with similar cost structures.

Maher's[22] empirical research in the United Kingdom shows that financial institutions are beginning to utilize direct marketing techniques to communicate with targeted markets. In the United Kingdom financial institutions with extensive branch networks are similarly beginning to exploit direct mail and telephone selling techniques.

Three banks currently offer direct banking of which First Direct, a subsidiary of Midland Bank, is the most visible. Despite the inherent dangers in this distribution channel, the most obvious being the front-end investment in installing automatic call distribution (ACD) telephone systems without any assurance of acceptability by customers, it does nevertheless potentially offer a method of reducing marginal costs by increasing the customer base and generating increased revenue. The ultimate success of direct banking, however, will be determined by customer acceptance which is very much a function of customer awareness and customer confidence in the systems. The extent to which it improves on existing distribution channels and satisfies the needs of a sufficiently large proportion of the customer base will be another important determinant of success. A high degree of success, however, will undoubtedly induce and precipitate a breakdown in contact between customers and branches.

Conclusion

Distribution chanelling represents a central issue in the future development of the financial services industry. Already the effects of electronic technology, deregulation, increased competition and heightened customer awareness have had a significant impact on the delivery of financial products and services.

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In the basic bank markets, branch networks have already been modified by number, organization and function but they will probably remain an important distribution channel in these markets. They will, nevertheless, be increasingly complemented and supplemented by new and emerging distribution systems.

In the long term, the effects of these changes will, it is hoped, produce financial institutions that are far more efficient and competitive but, in the process, some of the fundamental aspects of their business may change. Home banking, for instance, has the potential to provide a substantial threat to the branch networks in the basic bank markets and introduce a fundamental change in the traditional banker-customer relationship. The traditional "tied" salesforce of life companies constitutes a similar threat in the emerging private investment markets especially with the more complicated financial products which ideally need a more personalized service.

The conflict between relationship and product-oriented strategies is already having an impact on the behaviour of customers and consequently on the organizational structure of branch networks. The traditional preference of customers to purchase financial products on a relationship basis has certainly diminished and customers have shown a greater willingness to purchase single products from financial institutions other than their primary bankers. Significantly, these financial institutions are essentially product oriented with commensurately small (or non-existent) branch networks. This does not automatically signal the demise of branch banking but it does partly explain why clearing banks, in particular, have introduced radical changes to their branch networks in the form of hub-and-spoke branching, zoning, centralization of the processing function, an emphasis on selling, etc.

In the final analysis, these and other considerations alluded to in the article will most certainly bring into focus the future role of branch networks and question their traditional dominant position. Their importance in determining both organizational structure and competitive behaviour, even in the basic bank markets, may well therefore be reduced. The branch network will, however, probably continue to be an important distribution channel which, together with new and emerging distribution channels, will need to be managed in an endeavour to optimize performance. Indeed, the actual management of the distribution mix will undoubtedly be of increasing importance in determining future competitiveness in the financial services market.

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