

»» Branch closures: German banks are shifting up a gear amid Herculean challenge of digitisation

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Germany's banks are accelerating branch closures. They shut down 2,200 branches in the past two years, stepping up the pace of downsizing their branch networks once again.

Since the year 2000, one in four branches were closed – 10,200 locations across Germany. Closures in cities and rural regions were at roughly the same levels lately. If the pace continues, only half of Germany's bank branch network will remain by the year 2035.

However, a look outside Germany's borders shows that this cannot be called an excessive cutback. Many neighbouring states have thinned out their bank branch network much more – others are about to. Compared with other European countries, Germany's branch density is mid-range.

A key driver – now and in the future – is digitisation, which has firmly taken hold in the banking market. New competitors, new technologies and changes in customer demands are shaping the transformation of the competitive environment. Along with this Herculean challenge, efficiency improvements and demographic effects are pivotal.

Although they are thinning out their branch network, access to bank finance must remain open for SMEs, which are often locally based. Small and medium-sized enterprises in particular rely on the expertise and experience of their local financing partners, particularly for consultation-intensive financing situations such as internationalisation, innovation and digitisation projects, or business succession. Branches should be ready for this.

The profound transformation that has been under way in Germany's banking landscape for some time now has begun to leave increasingly deeper marks. German banks are trimming down their branch network. An end is not yet in sight – especially considering the cutbacks being planned by large credit institutions.

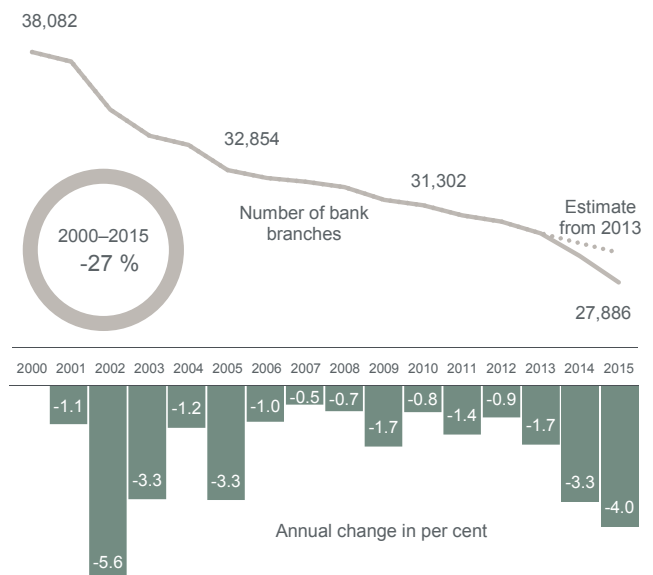
KfW Research has been observing this transformation process together with the University of Siegen for some years now.¹ The most recent efforts to expand and update the analysis period (from initially 2003 to 2013 to a timeframe

that now encompasses the years 2000–2015) illustrate one thing very clearly: the downsizing of the branch network since the turn of the millennium has been much stronger than estimated.

Downsizing has been even more intense than assumed

Since the year 2000, around 2 % of all bank branches in Germany, or around 680 branches, have been closed on average each year. Previous estimates were around 1.3 %, or 430 branches per year. Germany's banking landscape 'lost' almost 10,200 branch locations between the year 2000 and 2015. That was a 27 % drop (Figure 1). In other words, one in four bank branches that existed at the start of the millennium are now gone.

Figure 1: Pace of branch closures has picked up lately



Note: The analysis period was recently expanded by the years 2000–2002 as well as 2014 and 2015. Previously, statements could only be made on the period 2003–2013.

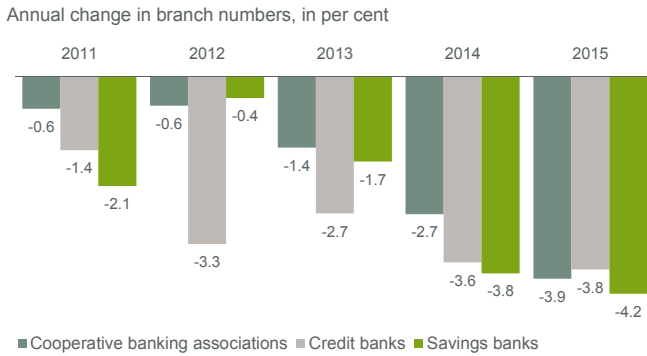
Source: Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), calculations by KfW Research

Banks are stepping up pace of closures

The thinning of branch networks picked up pace once again significantly in 2014 and 2015. In these two years alone, around 2,200 branches were closed across Germany, representing annual declines of 3 to 4 %.

Around 27,900 branches still remain in this country – of 38,000 that existed in 2000. For 2015, the initial estimate was for a corridor between 29,800 (assuming a slight drop in ‘downsizing rates’) and 28,300 branches (assuming a strong shrinkage). Closures affect the various types of institutions in equal measure (Figure 2).

Figure 2: Closures across all types of institutions



Source: Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), calculations by KfW Research

Few regions in Germany without closures

The branch network is being trimmed back in almost all regions of Germany. Branch closures can be seen in 94 % of districts and cities. Seven regions exhibit an unchanged, dense branch network (such as the cities of Hamburg, Cottbus or Emden). Contrary to the general trend, 17 regions in Germany have experienced growth in the local banking market between 2000 and 2015, headed by the city of Frankfurt (Oder), with +59%, and the district of Fürth, with +56%.

Overall, rural regions are slightly more affected by the thinning than the cities (-27% since 2000 / cities: -23% since 2000). The district of Osterode am Harz, for example, has reported a decline from 78 to 32 branches (-59%). The trend is not bypassing cities either, as shown by the example of Bayreuth, which has reported a decline of 52%. While cities were affected slightly more by closures than rural districts up to the year 2007, the trend has continued largely at the same pace since then. A German city currently has an average of 60 branches (of formerly 79) while a district has an average of 73 locations (down from 101).

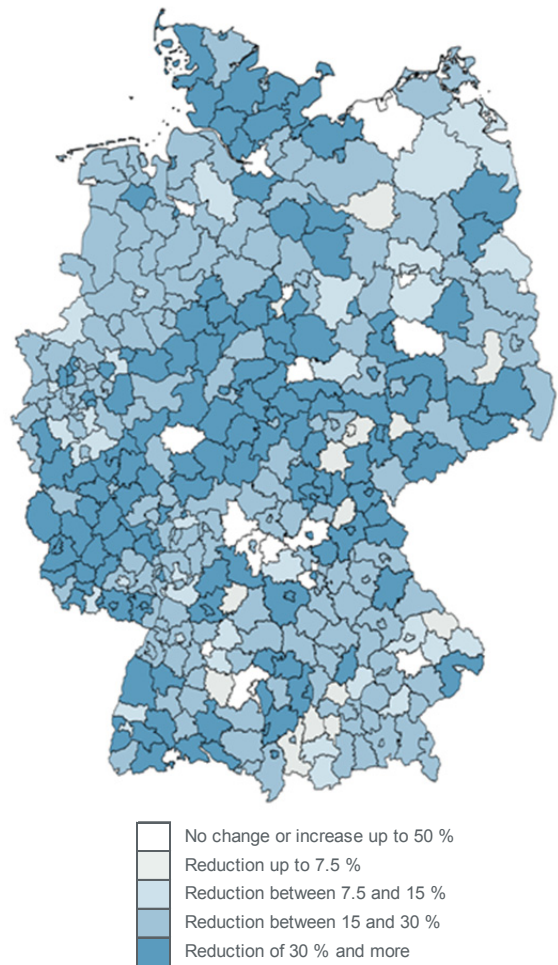
Overcapacity is being cut (almost) everywhere in Europe – Germany is in good company

Germany’s banks are not alone with their branch closures. Many national banking markets have recently undergone structural change. At the top of the list is the Netherlands, where 66% of bank branches were closed between 2000 and 2015, followed by Denmark (-53%) and Belgium (-48%).

A group comparable to Germany includes Finland (-32%), the UK (-24%) and Spain (-21%). So there can be no talk of a drastic reduction in this country.

Figure 3: Branch density is falling (almost) nationwide

Relative change in number of bank branches from 2000 to 2015 in percent; districts and cities with district status



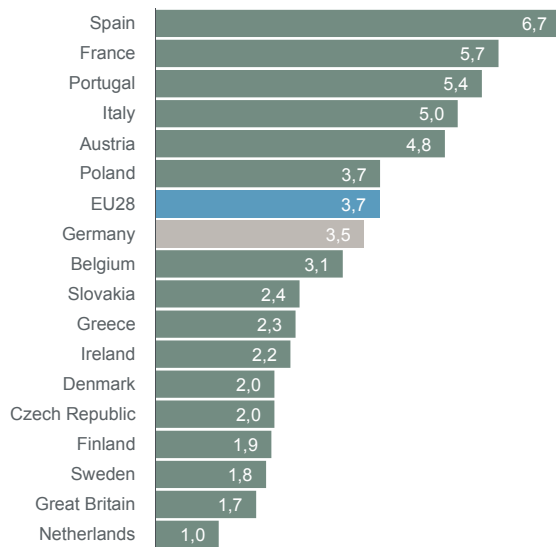
Source: Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), calculations by KfW Research

Measured by number of inhabitants, Germany’s branch density is roughly mid-range (Figure 4), slightly under the EU28 average.

The overall picture, however, also shows that not all banking markets are shrinking. In France and Portugal, in particular, branch networks have grown significantly since the turn of the millennium, by nearly 50% each. France currently has some 10,000 more branches than Germany – but around 14 million fewer inhabitants. Italy and Spain, two countries with much fewer inhabitants, have roughly the same number of branches as Germany. That puts these countries far ahead of Germany in branch density.

Figure 4: Branch density in Germany is mid-range

Bank branches per 10,000 inhabitants (branch density); selected countries of EU28



Sources: European Central Bank, Statistical Data Warehouse, Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), calculations by KfW Research.

Germany in 2035: at best, only half of all branches will remain open

The surprising acceleration in the rate of branch closures requires an update to the trend in branch numbers (Figure 5)¹. Assuming the closure rate remains unchanged, more than half the branches that still existed in 2000 will be closed by the year 2035 (-52 %, or a loss of 19,600 locations).

Under the assumption of a ‘slight recovery’ in the rate of closures, by the year 2035 there would be around 34 % fewer branches. In a scenario of ‘accelerated shrinkage’, on the other hand, around 60 % of branches would be closed by 2035 compared with the turn of the millennium (23,000 fewer locations).

Digitisation: a Herculean task

Apart from the reduction of overcapacities (such as duplicate structures created by mergers or in regions with a strong population decline) and considerations on strengthening profitability or improving efficiency through continuous professionalisation and standardisation, digitisation is a major driver of the trend described here.

The ongoing transformation of business processes through modern, innovative digital technologies (internet, blockchain, data analytics, robo-advice, self-learning algorithms etc.) and continuing network integration has arrived in the banking industry. Increasingly broader and faster internet access will also keep technological change in the banking sector on a high level for the foreseeable future.

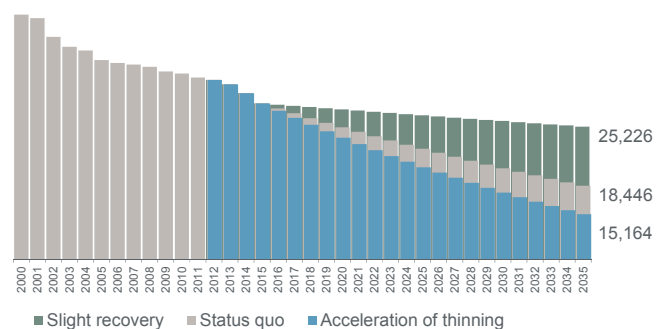
Changed customer demands will require adjustments to sales processes – away from the branch network towards online offerings – and drive the consolidation process. The Deutsche Bundesbank explicitly welcomes this process.² Customers’ media-use and communication behaviour has changed. Permanent availability, fast delivery times, real-time advice, individual offers, user-friendliness and mobile capability are only some aspects they are increasingly demanding. But that is not all: Customers can compare prices and offers of diverse sellers quickly and without great effort (lowering their transaction costs). This is true particularly of more standardised products and services requiring less knowledge and consultation.³

Technology-driven players unrelated to the industry such as Google, Apple and others, and digital start-ups offering financial services (FinTechs) are also making competition more difficult for banks and leaving a lasting imprint. The services currently being offered by new players in the financial sector still tend to focus more on single products and services that can be provided even without a full banking licence. However, some of them already have a banking or at least an e-money licence (e.g. Google and Facebook), enabling them to expand their offering to financial services.⁴

The changed competitive constellation is putting more pressure on traditional financial institutions and could even intensify current consolidation movements. The effect these players are having, however, is still limited – for now.

Banks are facing the challenge of having to adopt digitisation strategies of their own in order to survive in the changing competitive environment. A holistic approach involving all business areas appears to be the most promising way of doing this – but a Herculean task for many institutions.

Figure 5: Estimated development of branch numbers up to 2035

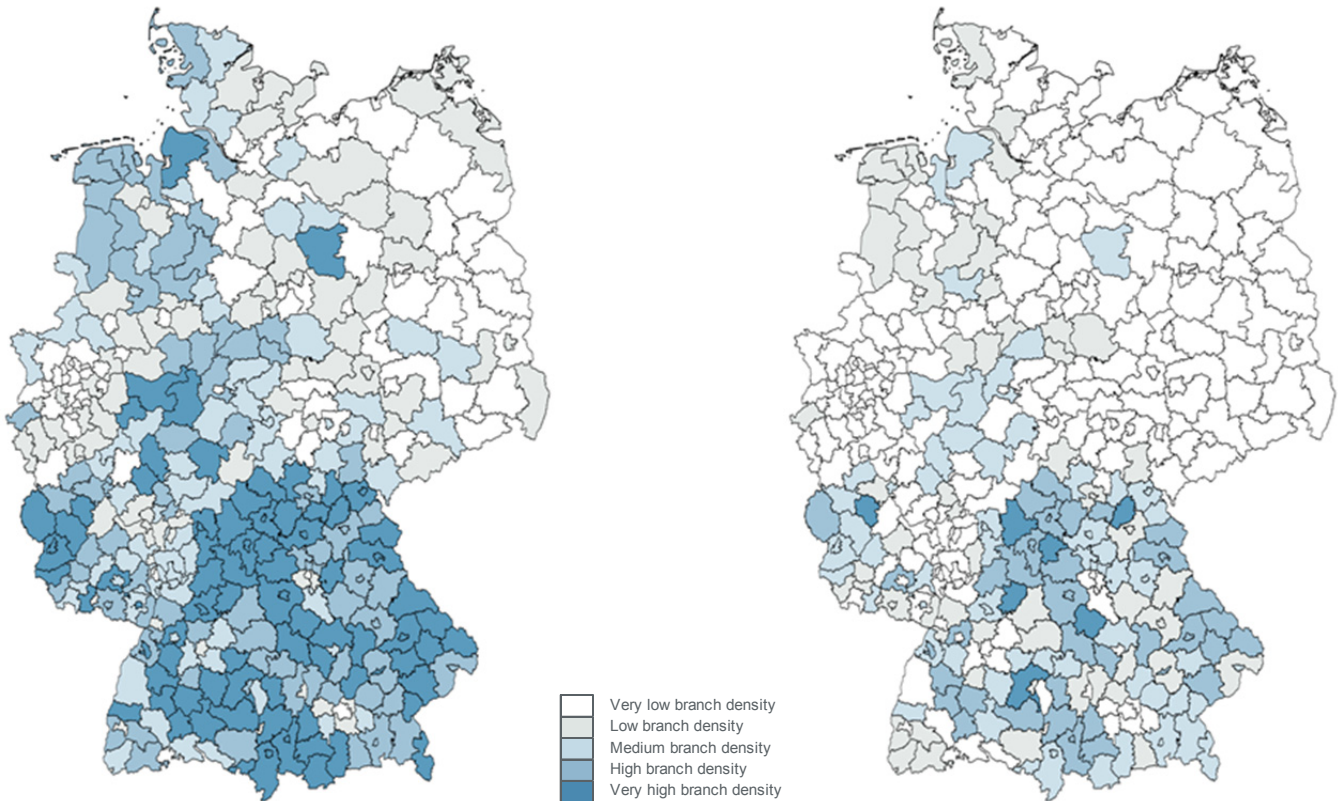


Note: Linear continuation of the number of bank branches. ‘Status quo’ with an annual decline of 2%. ‘Slight recovery’ with an annual decline of 0.5%. ‘Accelerated thinning’ with an annual decline of 3%.

Source: Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), calculations by KfW Research

Figure 6: Branch density in 2015 (left) and 2035 (right)

Bank branches per 10,000 inhabitants (branch density) of 402 districts and cities



Note: The illustration for the year 2035 is based on the 'status quo' scenario. It assumes that the expansion of the branch network will continue at the same rate observed on average across the years 2000 to 2015. Values below 2.6 denote very low branch density, a range of 2.6 to 3.2 stands for low branch density, 3.2 to 4.0 represents medium branch density, 4.0 to 5.1 means high branch density, and 5.1 and above signifies very high branch density. For comparison: Germany arrives at an overall value of 3.5.

Source: Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), calculations by KfW Research.

Reduction in branch density limits accessibility slightly

Taking into account current population forecasts, branch density in Germany could drop from an average 4.1 branches per 10,000 inhabitants to 2.4 by the year 2035 if the branch closure trend observed since 2000 were to continue ('status quo' scenario). In other words: while a branch served around 2,900 inhabitants in 2015, it would have to attend to 4,200 inhabitants in the year 2035. This calculation already takes into account the shrinking population.

The thinning out of regional banking markets has consequences. Physical accessibility will decline for retail and business customers. Earlier analyses conducted by KfW Research have shown that a reduction in branch density by one unit increases the average distance to the next bank branch by five kilometres.⁵ As these are mean values, average accessibility in rural areas is likely to decrease much more significantly.

Proximity is important for the supply of credit

The quality and quantity of financial services depends in part on the geographic distance between the branch and businesses, particularly in lending. Greater proximity between lenders and borrowers is usually associated with an improved flow of information. This is particularly the case for

'soft' information. This type of information is not found in an enterprise's business figures but can play a crucial role in the final lending decision. Examples include the business owner's management qualities, reliability or life situation, the enterprise's long-term strategic goals, existing succession considerations, or the degree to which the business avoids or embraces risk. These aspects regularly go into the assessment of lending risk. A higher degree of information uncertainty can result in higher risk premiums or the denial of loan applications. Physical proximity enabling regular and, ideally, long-term contacts between lenders and borrowers can mitigate these negative consequences.⁶

Structural change requires adjustment

But the branches are also changing. They have to because many transactions can now be conducted digitally. Banks' online offerings are being sought after much stronger than previously, even by business customers. A diminished branch presence is therefore also an expression of a structural adjustment they are making to steadily evolving social conditions. So long as banks continue to offer the services that are important to SMEs even as their branch numbers decline, the consequences of the change process in Germany's banking landscape should remain manageable. ■

Database on bank branches

The data underlying the study on bank branches were taken from the Bisnode publication 'Hoppenstedt Banken-Ortslexikon' (Hoppenstedt regional listing of local banks), with 30 June as the reference date of each year. This data source includes geographic information (addresses) of the head offices and all branches of the banks surveyed. The resulting possibility for geocoding – which data from the Deutsche Bundesbank do not allow – makes the database used here a unique tool.

In accordance with the scientific question it addressed, the study covered only regular bank branches (with employees and full-time opening hours). It did not include service centres, payment agencies, mobile banks or similar facilities. The distinction of the various bank types into 'savings banks', 'cooperative banks' and 'credit banks' followed the classification system of the Deutsche Bundesbank. The study did not include data on the branches of Postbank as they were not available from Postbank even on request.

¹ Studies published on this topic thus far: Bernhardt, K. and M. Schwartz (2014), The network of Germany's bank branches is dwindling, Focus on Economics No. 49, KfW Research and Bernhardt, K. and M. Schwartz (2015), 25 Jahre freier Bankenmarkt in Ostdeutschland – Deutlicher Rückbau seit Wiedervereinigung (25 years of free banking market in eastern Germany – significant reduction since unification – our title translation, in German), Focus on Economics No. 99, KfW Research.

² https://www.bundesbank.de/Redaktion/DE/Pressemitteilungen/BBK/2016/2016_04_13_bankstellenbericht.html

³ Dapp, T. F. (2015), Fintech reloaded – Die Bank als digitales Ökosystem. Mit bewährten Walled Garden-Strategien in die Zukunft (*FinTech reloaded – the bank as a digital ecosystem. Into the future with proven walled garden strategies* – our title translation, in German), Deutsche Bank Research, Frankfurt am Main.

⁴ See Dapp, T. F. (2015).

⁵ Bernhardt, K. and M. Schwartz (2014), The network of Germany's bank branches is dwindling, Focus on Economics No. 49, KfW Research.

⁶ Academic studies that explore a resulting link between physical distance and lending include Degryse, H. and S. Ongena (2005): Distance, lending relationships, and competition, *The Journal of Finance* 60 (1), p. 231–266; Alessandrini, P., Presbitero, A. F. and A. Zazzaro (2009): Banks, distances and firms' financing constraints, *Review of Finance* 13, p. 261–307 and Agarwal, S. and R. Hauswald (2010): Distance and private information in lending, *Review of Financial Studies* 23 (7), p. 2757–2788.