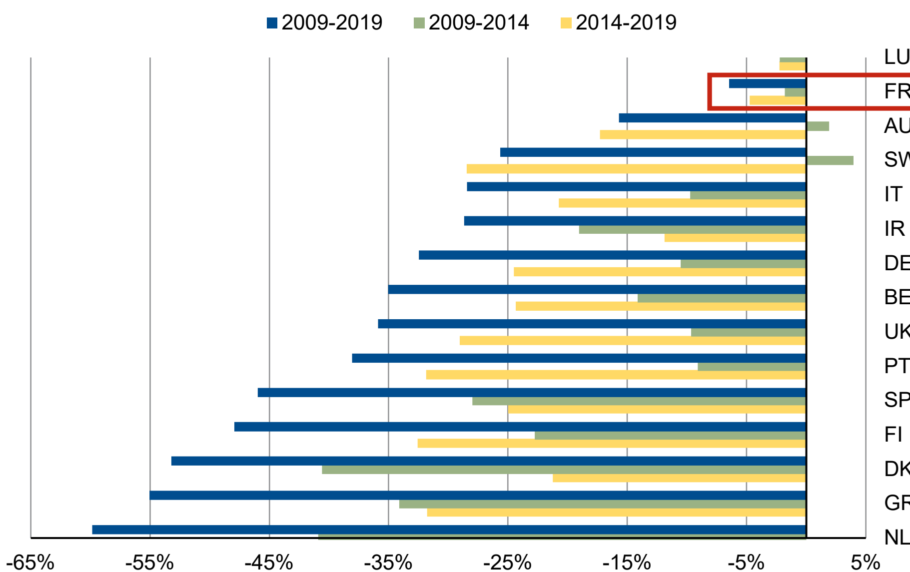
French banks: adjusting large physical networks; the flip side of digital transition

French banks are latecomers when it comes to cutting branch networks. However, for clients, the pandemic is forcing even the most reticent users of digital channels to follow this accelerating digitisation trend. Société Générale's plan to merge its dual domestic networks is a pioneering if long-awaited endeavour, and a case study for other French banks.

The latest European Banking Authority risk assessment for the European banking system highlights the drastic transformation of physical networks in the last decade. While physical branch networks declined by more than 40% in some countries over the past 20 years, branch numbers fell by little more than 5% in France (Figure 1).

The latest Banque de France risk assessment for the French financial system also highlights the need for French financial institutions to step up changes to business models, while seeing digital transformation as a new source of risk. Indeed, next to asset quality, we believe that digitisation will drive banks' creditworthiness in the coming years.

Figure 1: Variation in the number of branches (selected European countries)



Source: EBA risk assessment for the European banking system, figure 79.

Analysts

Nicolas Hardy
n.hardy@scoperatings.com

Team Leader

Dierk Brandenburg
d.brandenburg@scoperatings.com

Media

Keith Mullin
k.mullin@scopegroup.com

Related Research

2021 European Banking Outlook
December 2020

When cash is no longer king: from mobile payments to central bank digital currencies
December 2020

Scope Ratings GmbH

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

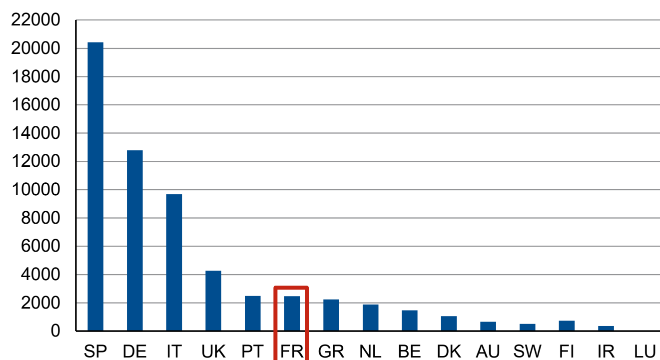
info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

French banks display low efficiency and large networks

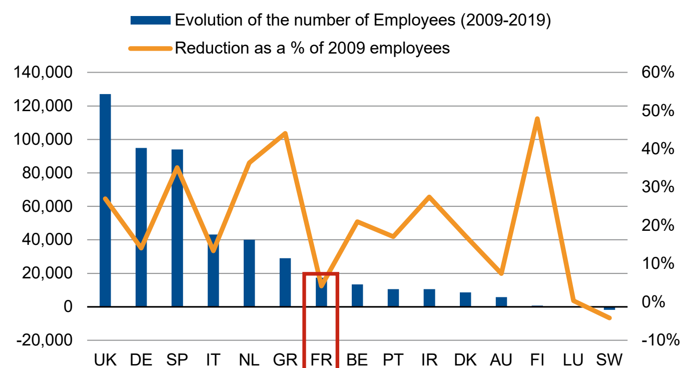
Spanish banks have closed more than 20,000 branches and UK banks cut more than 120,000 staff, but French banks have only made moderate adjustments over the past 20 years, cutting branches by little more than 2,000 and staff by less than 20,000 (Figures 2 and 3). Even notoriously fragmented markets like Germany and Italy achieved stronger retrenchment of branches and personnel compared to the much more consolidated French market.

Figure 2: Number of branch closure (2009-2019)



Source: ECB, Scope Ratings.

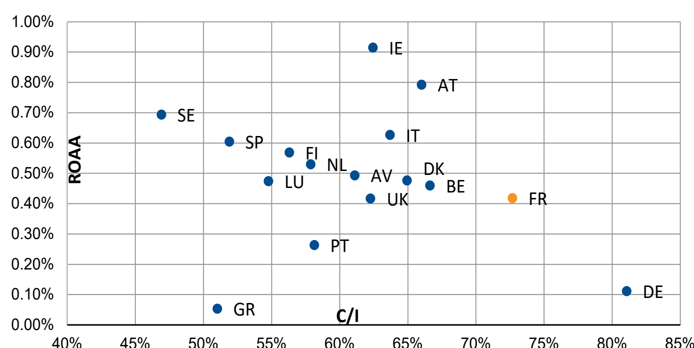
Figure 3: Reduction of the average number of employees (2009-2019)



Source: ECB, Scope Ratings.

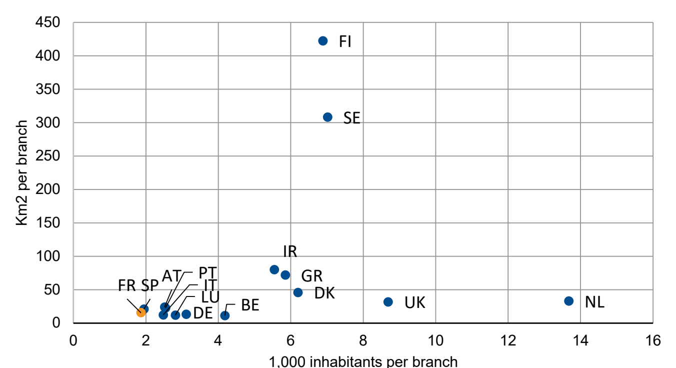
French banks have been trailing European peers in terms of cost efficiency and lagging other markets with the exception of the larger German banks (Figure 4). While not all of this is due to costly branch networks, France nevertheless has one of the lowest number of inhabitants per bank in Europe (Figure 6).

Figure 4: Cost to-income (x axis) and return on average assets (y axis) (quarterly average over 2017-2019)



AV: average. Source: EBA Risk Dashboard, Scope Ratings.

Figure 5: Inhabitants per branch (x axis) and km2 per branch (y axis)



Population and land area at end 2018. Branch data at end 2019. Source: OECD, World Bank, ECB, Scope Ratings.

There is no magic number to define optimal network sizes

Defining optimal branch density is complex because parameters such as customer preferences, product mix, balance between urban and rural areas or age structure are fluid and differ by country. Properly identifying and allocating costs and revenues to distribution channels is another challenge. This is particularly relevant for universal or bancassurance business models. Where to draw the line in, for instance, retail banking and insurance activities?

With the accelerating digital transition, maintaining an extensive branch network is less desirable. But the cost of cutting large branch networks represent a deterrent to M&A.

HSBC's retail network in France is available for sale, for example, but finding a buyer is taking time. A small number of large banks already dominates the French market, so consolidation will need take the form of internal optimisation rather than mergers. Next to cost cutting, optimisation of the existing infrastructure also requires investment in product capabilities. We can see a broadening of the branch offering beyond banking products towards a store model that sells insurance products, mobile phones or home protection systems, for instance.

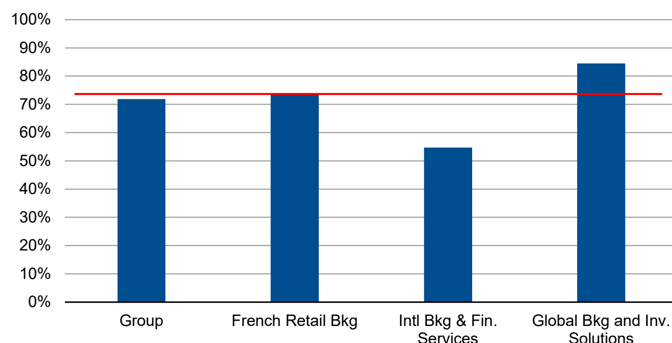
SG a case study for the other large French retail banks

'60% of CdN network is within one km of an SG branch'

SG's plans to merge the domestic networks of Société Générale (about 1,800 branches) and its regionally anchored brand Crédit du Nord (about 800 branches) came as no surprise. Société Générale had already cut 20% of SG branches and 15% of CdN branches since 2015 and the rationalisation of central and support functions, including IT, has already to some extent been achieved.

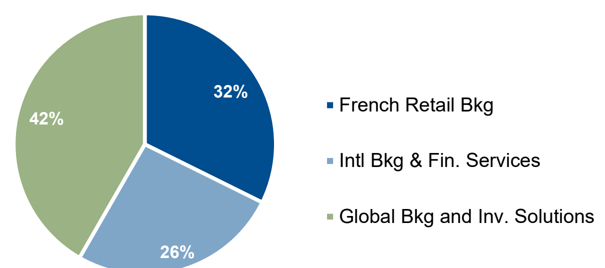
Some sixty per cent of the CdN network is within one kilometre of an SG branch. The cost of the French retail operations accounts for more than one-third of the total cost base and its cost-income ratio is above 70%. SG is now targeting a reduction in capacity from the existing 2,100 units to 1,500 by 2025, a reduction of nearly 30%. The project is part of a broader overhaul that will see SG adopt a more open architecture, including partnerships for product offerings; and promoting its digital-only bank to attain a client base of 4.5 million by 2025 (it was 2.5 million as of October 2020). Addressing the cost-return profile of CIB activities is another priority.

Figure 6: SG's reported cost to income ratios by business lines (end 2019 figures).



Source: Société Générale, Scope Ratings.

Figure 7: SG's reported cost base by business lines



Source: Société Générale, Scope Ratings.

SG's initiative, if successful, will set a precedent

If successful, the project could set a precedent for a broader shift from multi-brand approaches created out of mergers towards unified franchises that have sufficient reach and digital brands as well. Other French banks maintain large and dual domestic networks combined after past mergers or acquisitions but referring to network size as a sign of commercial strength is rapidly losing momentum, except for niche strategies.

Figure 8: maintaining of dual domestic networks is the norm in France

Crédit Agricole	8,400 branches o.w. 5,929 in France including LCL, 1,925 branches in France
BPCE	About 7,440 branches (end 2018 estimates) Banques Populaires: more than 3,300 branches in France Caisses d'Epargne: 3,777 branches in France
Crédit Mutuel	5,535 branches o. w. 4,999 branches in France including CIC, 1,874 branches in France
Société Générale	5,007 branches o. w. 2,598 branches as part of French retail banking including Crédit du Nord: 805 branches in France
BNPP Paribas	Above 5,600 o. w. more than 1,800 branches in France
La Banque Postale	Via the network of 7,740 post offices

Data at end 2019. Source: banks' reporting, Scope Ratings.

Other banks may see SG's initiative as an interesting case study if it demonstrates that a large geographical overlap between highly complementary networks (with only 1% of shared clients) can be significantly reduced while maintaining a similar territorial footprint.

We could see a convergence of network sizes in the range of 1,600-1,800 branches for national networks mainly established in urban areas. A convergence towards 2,200 branches for other players, to cover more remote areas, would mean about 5,000 branch closures in total, a seventh of current capacity. But even then, such consolidation would only bring France on par with countries with the densest networks (shown in figure 5).

Other domestic players may find it difficult to replicate SG's strategy, however. It demands shrinking physical networks while preserving locally established franchises, dealing with customer satisfaction, workforce engagement and brand reputation at-large. For co-operative banks, for which local retail branches lie at the heart of their local entrenchment and are even a key component of their governance structures, this is a Gordian knot.

Network adjustment, digital transition and the P&L: no short-term miracle

Adjusting the cost base has a cost

Transforming distribution channels to improve efficiency requires first an investment phase. Turning digital will weigh on banks' financial performance for years.

SG estimates project costs will be EUR 700m-EUR 800m (including 70% in 2021) but will generate a net cost reduction of more than EUR 350m in 2024 and about EUR 450m in 2025 (compared to 2019 levels). During this period, we do not expect a rapid ramp-up of revenues from SG's digital arm, mainly because of the costs of client acquisition. SG expects Boursorama Banque to break even and then achieve net profit of EUR 100m by 2023 and EUR 200m by 2024.

Network adjustments and growing demand for ESG reporting: the perfect match

Time has come to substantiate ESG reporting

Cutbacks in branch presence and digitisation affect client groups to different degrees. They could ultimately decrease financial inclusion among population groups that are already under-banked or have limited ability to adjust, e.g. older people or very small businesses. Managing workforce adjustments, from layoff measures to skills training, is also important for reputation and business continuity.

We would therefore expect that large-scale network optimisation will have to be assessed through an ESG lens as well. ESG frameworks are still in the making but provide the right toolkit to capture the complexity of network adjustment projects and their long-term implications for value creation.

Figure 9 highlights some of these dimensions, which are also relevant parameters for analysis of creditworthiness.

Branch consolidation is also happening at a time where the pressure on banks to substantiate ESG reporting is growing. The EU non-financial reporting directive (NFRD) already imposes disclosure requirements on large companies, including banks. The framework is relatively loose at the moment, but initiatives to revisit this approach are already taking place; for instance, the European Commission's 2020 public consultation on this issue. The EBA is also mandated to develop a technical standard on disclosure requirements (Pillar 3), including ESG risks which should be effective by June 2022.

Figure 9: network adjustments: how the ESG grid can inform credit analysis

Environment	Contribution to achieve environmental targets or meet stakeholders' expectations (carbon footprint, natural resources management).
Social	Customers acquisition, retention and satisfaction. Brand strategy. Interaction with local communities. Employees acceptance and engagement. Efficiency of collective bargaining frameworks. Talent retention and key man risk. Turnover rate. Diversity and inclusion policies.
Governance	Quality and accountability of management: ability to foresee and adapt to industry change, ability to manage substitution of products & services or impact of reorganisation. Degree of transparency and disclosures.

Source: Scope Ratings.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan

Regus Porta Venezia
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

111 Buckingham Palace Road
UK-London SW1W 0SR

info@scoperatings.com
www.scoperatings.com

Disclaimer

© 2021 Scope SE & Co. KGaA and all its subsidiaries including Scope Ratings GmbH, Scope Ratings UK Limited, Scope Analysis GmbH, Scope Investor Services GmbH, and Scope ESG Analysis GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope's ratings, rating reports, rating opinions and related research and credit opinions originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data. Scope's ratings, rating reports, rating opinions, or related research and credit opinions are provided 'as is' without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct, indirect, incidental or other damages, expenses of any kind, or losses arising from any use of Scope's ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party as, opinions on relative credit risk and not a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope's credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings GmbH at Lennéstraße 5 D-10785 Berlin.