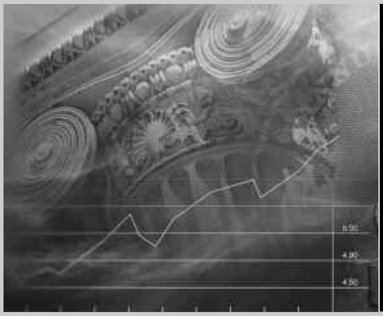
Customer profitability in real-world banking



A LARGE GLOBAL BANK FINDS SIMPLE WAYS TO MAKE CUSTOMERS MORE PROFITABLE

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Introduction

Using business intelligence, a UK-based top 10 global bank translated customer information into simple and practical selling advice for the branch front line. This paper provides key insights into the bank's practical approach to delivering customer profitability and improved performance.

To understand the scale of the bank's customer profitability project, it is important to illustrate the bank's size through its numbers:

- 14.5 million retail customers
- 300,000 high net worth banking customers
- 600,000 local business customers
- 11.3 million chequing accounts
- 11 million savings accounts
- £59.3 billion in mortgage balances
- 2014 branches in the UK
- Between 6 and 12,000 allocated customers per branch
- 41,500 UK-based staff
- Complex set of technical architectures, particularly delivering business intelligence (BI) and management information (MI)

For this major bank, customer profitability is not a new concept. It has been developed and refined over 25 years, and continues as a project today.

Retail banking challenges

In retail banking, finding smart ways to drive customer profits can often seem at odds with that other necessity: offering alternative service access. These days banks have far less direct contact with the customers to which they need to sell. If customers never come into a branch, how can the front line present them with financial solutions, let alone develop a relationship? How can a bank maximize profitable customers while serving less profitable relationships more inexpensively?

Banks tend to have large customer bases, which do not lend themselves to relationship banking on a low-level basis. To prevent customers from shopping elsewhere, front line staff needs to know the appropriate product at the right cost for the customer. And this insight has to be quick, simple, and practical.

This visibility must come from central functions within the bank such as marketing or customer insight. Business intelligence, a technology that lets organizations make sense of their data, can provide this insight. It can help banks translate already available customer data into practical actions for the front line to help them boost sales.

While understanding the lifetime value of a product or the impact of transactional costs is valuable to marketing analysis, it is just a distraction at the counter. Retail staff need to know which customers will jump at low-cost products and delivery channels and which will benefit from more resource-intensive relationship banking services. Because maximizing profitability is about sustaining long-term relationships with customers, inappropriate selling or wasting sales resources on the wrong customers will quickly undermine profits.

Driving customer profitability

Four core areas of an organization must support customer profitability and align to deliver it:

- Strategy and organization
- People
- Data
- Measurement

Few banks can claim excellence in all four areas. Lack of investment or improper organizational structures, business models, or technical architectures can impede banks as they strive for customer profitability. But a bank ignores these barriers at its peril. Holes in its strategy may lead to missed opportunities or, worse, losing customers to more sophisticated competitors. The following sections discuss these four areas in greater detail.

Strategy and organization

Good customer relationships grow from good strategy. But a solid strategy is not always easy to set and, once set, carry out. Banks share many common challenges in developing a solid strategy for customer profitability. To start with, too few banks use customer insight to inform the planning process, a glaring omission given that there are no profits without customers. Another hurdle is the debate between product and channel leadership over who owns both customers and front line staff.

And while great strategy may seem like enough, it cannot be carried out without the organizational structures to support it. Common problems in this realm include:

- Multiple distribution channels delivering inconsistent customer experiences
- Multiple planning and management information functions delivering different targeting approaches across the channels, using different methodologies and technologies
- Multiple legacy technology platforms across and within channels both at core operational system and BI delivery levels.Many banks will have tackled and resolved these problems, but for others they remain an ongoing challenge.

The UK-based global bank being discussed approached these strategic and organizational problems in a number of dynamic ways. It became channel-driven and chose a primary channel that would be responsible for customers and accountable for sales. It segmented customers on the basis of 'propensity-to-buy' models. It set up a variety of approaches to sales targets, the most important of which was an estimated lifetime value of a product, or 'value measure,' which could be used to calculate customer profitability by branch. And it restructured to better serve customers.

Becoming channel-driven

Because of its large customer base, the bank decided to go with a channel-driven approach—as opposed to a product-based or customer-based approach—to becoming more customer focussed.

The organization chose its branch network as its primary channel. Branches would own the customers and staff operating within them. The network of branch business bankers owned its own portfolio of customer relationships and was accountable for driving channel profitability. All other channels, including e-channels such as Internet and telephone banking, contact centres, and network operations centres, would play supporting roles.

Segmenting customers

The global UK bank developed broad segments within the channels. Retail banking segments include premier banking (a relationship banking service for higher net worth retail customers), local business, and the larger overall customer base. Private banking is a smaller (by volume) segment for very high-net-worth customers served outside the core banking channels.

At a central level, the bank segmented by industry, mainly to provide central specialist support and direct mail activity, rather than performance management and targeting.

A shared corporate service called customer insight carries out the more detailed segmentation and analysis. It analyzes customer data to inform product development, direct marketing efforts, and analyze risk.

Most importantly for customer profitability, this group analyzes customers' personal and transactional data to develop 'propensity-to-buy' models. From these models it develops operational action prompts. Front line staff opening customer records on the operational system discovers from these prompts which products to introduce in the discussion with the customer. Prompts may also include pre-approval of lending products or approaching expiration of fixed-term lending and savings products. The information is geared to extending the customer-to-bank relationship and therefore the profitability of that customer to the bank.

The same information also informs content and targeting of centrally coordinated direct mail through electronic channels. Because more groups within the bank made use of these better-targeted sales resources, product sales increased.

Understanding customer behaviour through segmenting let the bank help its sales force deliver a consistent customer experience without burdening it with too much complexity.

Targeting sales

For a sales force to perform, sales targets and their supporting performance information must be clear. As its culture matured, the bank adopted various approaches to the way branches target sales, including:

- Targeting by product volume and/or value—to drive new customer growth, supported by balance retention targets
- Targeting by sales points—the sales force gains more points for selling more profitable products, especially those more difficult to sell
- Targeting by pseudo profit and loss—this approach drives a business culture within retail and integrates measures such as service, complaints, and operational rigor.

With customer insight informing the decisions, the bank adopted different approaches to establishing raw target numbers, economic expectations, product pricing, business cases from strategic projects, and so on. This resulted in allocations being based on one or a combination of factors, including:

- Sales per full-time equivalent staff numbers (FTE)
- Growth on historic performance
- Percentage contribution by branch
- Seasonally adjusted targets

The value measure

In recent years, despite good performance in the retail sector, the bank's competition was either catching up or outstripping it. In response, the bank moved to implement best practices gleaned from its business banking segment. One of these was the value measure, a pseudo customer profitability measure that had been very successful in the business bank arena.

The value measure derives an approximate value for a product over its lifetime by offsetting income (from such factors as balance margins) against operational and transactional cost. This measure let the bank calculate and track the profitability of customers monthly. Through aggregation, it could then gain a heretofore unavailable view of customer profitability by branch, by area, by region, and by country.

The bank set a target for a total branch value increase.

Reporting to drive performance

To support the branch value increase target, the bank implemented Cognos as the standard distribution tool for reporting on value and customer profitability across all retail branches. But it recognized that value reports alone, without the portfolio approach, would not get the job done in a mass market business. It would need a mixture of other reports to drive performance and behaviours.

In addition to value reports, branch managers received the following reports:

- Reports that identify high-value customers to drive contact strategies
- Reports that identify low-performing customers to potentially move them to more cost-effective product and channel offerings
- Decile mover reports to highlight large exceptions and at-risk customers that need nurturing
- Service reports to highlight both branch- and staff-level customer satisfaction with service levels
- Indicative contribution reports to highlight to staff the product volumes and balances being sold, but not against target.

Changing structures and systems

When organizational structure runs counter to strategic goals, restructuring is often the only solution. In its move toward customer profitability, the bank decided to combine retail and business banking under one umbrella, including the management information teams within finance. This left large corporate as a division in its own right.

This organizational change acted as a catalyst to introduce the value measure. However, the existing internally-built performance management information solutions within both business and retail banking were not scalable at reasonable cost to deliver the breadth of reporting needed.

To deliver the critical value-aligned performance measures, the bank built a standard reporting platform, and over the following year migrated all performance reporting across all retail distribution channels to one reporting platform. In parallel, the bank combined the retail and business bank BI teams, reducing the headcount by over 40 percent.

Users gained a single point of entry to their performance management information. The reporting user base grew to some 20,000 people receiving information to drive customer profitability.

Culture and conquest

Using the value measure was initially a culture shock for retail banking. Without its traditional product volume and balance targets, it became a reactive sales force, unclear how to manage value with its mass-market customer base. As sales performance failed to recover from the initial impact of the value measure, the bank re-introduced sales targets based on a pseudo profitability value (staff level only) to complement the value creation approach.

Customer profitability has steadily grown in recent years. It became clear that the combination of value, service, and staff sales measures was working. The bank was able to reward management from branch up to national level on the basis of key performance indicators (KPIs) such as the value measure, staff capability development, employee opinion survey results, operational rigour, and controllable costs.

People

The staff of a financial services organization is its greatest asset. Employees themselves drive customer profitability in the way they serve customers, identify needs, and present solutions to those needs.

Loyalty versus turnover

For many years UK banking had a "career for life" culture with very strong employee loyalty. But with ever-increasing competition and profits under threat, UK banks aggressively attacked their cost bases in recent years. Restructuring, cutting redundancy, maximizing low-cost distribution channels, and off-shoring services and processes have led to increasing turnover and the fading of the "career for life" culture.

With the introduction of better compensation packages and bonus schemes, the U.K. bank was able to stem turnover as well as aggressively recruit externally. This way it could bring new employees with the required skills into the network, instead of the more expensive option of growing the skills of existing employees.

Incentives and rewards

The move away from traditional banking also saw the introduction of half-yearly bonuses for individual sellers. Most retail employees quickly embraced the bonus opportunities of exceeding sales targets, but this was too often achieved at the expense of service and customer-needs based selling. This resulted in declining service and customer satisfaction scores and increasing complaints.

Balancing service with sales is key to the successful growth of any business. To do this, the bank realigned bonus rewards to the individual's contribution across a combination of factors: sales value achieved, the quality of sales (did the customer stay with the product?), and service performance metrics. And on the other side of the equation, there was far less tolerance of underperformance.

In business banking, because the portfolio and relationship banking approach was well established, incentives were easier to set. Sales people received bonuses on the basis of customer value growth across their portfolio.

Data

Without it the right data, employees are merely guessing at what tactics to use at what time to reach an organization's customer profitability goals.

Single customer view

The bank had made a significant investment in a master operational customer database for front line staff.

Staff would use it to perform application and sales processes, leads management, product illustration, quotations, and other useful activities.

The system aimed to create a single customer view, delivering a complete picture of the customer's relationship with the entire group. The front-line user would profile and update this picture as part of the interview process at point of sale. Customer insight and analysis would use it to create prompts and marketing material. It would deliver consistent information for different user needs.

The vision of a single customer view is mostly in place. The stumbling block is to consolidate information from the various third party product systems (for such areas as pensions and insurance products), many a result of corporate acquisitions.

Banks will always find tactical ways around the challenge of unifying information, but at what cost? An integrated customer view is valuable to the entire business, increasing product sales, ensuring consistency and quality of service, and reducing costs. It helps coordinate sales efforts, direct marketing, action prompts, and high-quality service and product propositions. The resulting customer profitability will more than repay the necessary investment.

Standardizing business intelligence

Besides the difficulty of uniting data from so many different systems, the bank was also concerned about maintaining so many systems. If data could be consolidated onto fewer systems or even a single system, costs could be reduced significantly. They could add new capabilities more easily, maintain a common language for key business terms, and reduce training and maintenance costs.

The bank moved to a single standard for business intelligence. Cognos, an IBM company, provided business intelligence to both the front line and central users, as well as for the planning teams and analysts.

Access to Data

Information is a very powerful tool. But information overload, or too much flexibility in its availability, can lead to analysis paralysis for front line users. The front-line branch staff needs to manage issues and maximize sales, not get lost in analysis. The bank made a very conscious decision about what roles should have access to what data and with what level of flexibility.

The front line needed scheduled reporting. Only central teams such as performance planning, analysts, and product teams needed greater analytical and interactive capability. In this way the bank kept the sales force and its management focussed on delivering profitability, not analyzing performance or, worse, searching the data to find excuses for not performing.

Activity-based costing (ABC)

Activity-based costing (ABC), a method of determining very accurate operational and transactional costs based upon the activities associated with a particular banking process, is a great asset in helping drive customer profitability. But while driving customer profitability from ABC is desirable, it is not absolutely essential. Because the bank did not use ABC per se (legacy systems prevented us from capturing the necessary transactional data), it used a pseudo customer profitability value to calculate the true costs of serving customers and customer segments based on assumptions and average costs or revenues.

No organization has perfect data. But banks need to understand if any issues with its data are consistent. If they are, then the bank can set targets, manage performance, and drive customer profitability from this imperfect data. By understanding the starting point, even if it is not an accurate one, the bank can be successful.

Measurement

Necessary versus nice-to-have

It would be easy to deliver a multitude of metrics to a multitude of users. Instead, the bank focussed on the needs of the users and stripped out the chaff. The sales force, for example, received only what was necessary to deliver profit through action prompts. The important thing was not only what the bank measured, but how to turn the insight into actions the sales force could latch onto and deliver.

BI for the people

For continued profit growth off the back of a balanced service and sales culture, clever use of BI and performance management was critical. To achieve this, the bank delivered a range of necessary measures for both the individual sales staff and management teams within the channels:

Individual sales staff received:

- Daily and weekly sales performance information, which included commissions clawback to help focus activity on better quality sales and sustainable customer profitability
- Monthly and summarized year-to-date sales performance
- Monthly service metrics and complaint reporting
- Operational sales standards to ensure compliance with operational and regulatory requirements, such as account opening procedures identifying and verifying the customer.

The management teams received a range of reports, making use of scorecards (traffic lights) and dashboards to ease navigation. These included:

- Aggregated monthly customer value performance
- Top and bottom customer profitability performers
- Decile movement for customers
- Sales value reporting
- Sales standards
- Cost reporting
- Service – customer satisfaction
- Complaint reporting
- Operational rigour
- The ability to drill down to individual seller performance

Greater profitability

Has the global top-10 UK bank delivered perfect profitability? As always, there is still a great deal to do to achieve greater customer profitability. To continue on this trajectory, the bank could:o Better integrate channel, product, finance, risk, and customer insight to ensure the strategy has an overarching approach, eliminating siloes and political agendas

- Invest in better BI tools with improved functionality and presentation
- Derive customer profitability targets in a more sophisticated way, particularly around segmentation and forecasting, not simply adopting the previous year's targets but following the profitable customers
- Establish a single customer view to save time and effort before analysis and reporting can begin
- Gather people metrics to manage staff turnover and improve the customer experience
- Collect better data to understand the real success rates of initiatives

Summary

Banks cannot afford to stand still in the area of customer profitability. Those that do will watch their competitors walk away with existing and potential customers. For this bank, supporting the front line with sales tools based on performance information has been a powerful antidote to customer defection.

Leveraging the available technology to deliver that support can give a financial services organization a distinct advantage. The combination of clear integrated strategies alongside great people, fully exploited data, and the right measures to drive the right behaviours will deliver sustainable customer profitability.

About Cognos, an IBM company

About Cognos, an IBM companyCognos, an IBM company, is the world leader in business intelligence and performance management solutions. It provides world-class enterprise planning and BI software and services to help companies plan, understand and manage financial and operational performance. Cognos was acquired by IBM in February 2008. For more information, visit **www.cognos.com**.

More than 3,500 financial services firms have selected Cognos software to increase customer, product, and channel profitability; manage and reduce risk; address compliance issues; and improve the predictability of financial performance. Among them:

- Nine of the top 10 banks in Europe.
- All the top 10 banks in the U.S.
- Six of the top 10 Asian banks.
- Ten of the top 10 Chinese banks.
- All of the top four Japanese banks.
- All of the top four South African banks.
- All of the world's top 10 investment banks.

For more information

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