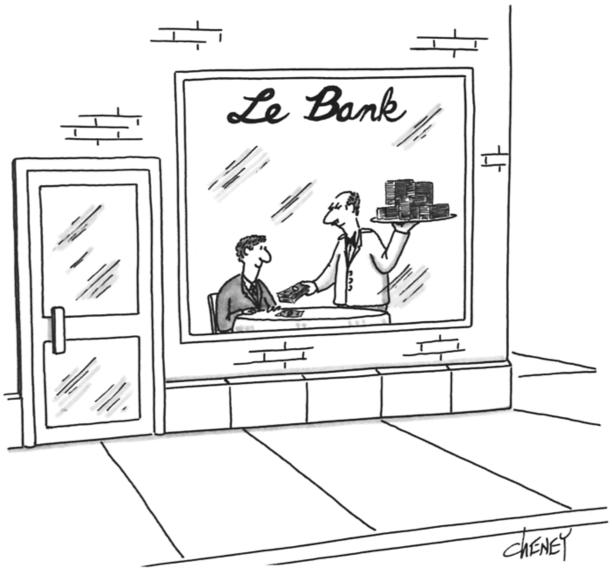

How to win over consumers
and reignite top-line growth

The customer-led bank

by Cornel Wisskirchen, Dirk Vater, Tim Wright, Philippe De Backer and Christine Detrick

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This Bain Brief is based on a global benchmarking survey by Cornel Wisskirchen and Dirk Vater. Input from the United Kingdom, France and North America was provided by Tim Wright, Philippe De Backer and Christine Detrick, respectively. All authors are partners with Bain & Company.

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How to win over consumers and reignite top-line growth

Retail banks have long flourished by following a business approach that would spell trouble in virtually any other competitive industry: paying scant regard to the care and nurturing of their best customers. But that charmed existence is coming to an end. Customer defection rates are up, as are the costs of acquiring and retaining new customers. On average, bank customers are three times less likely to recommend their bank to a friend than they are to recommend any other service provider.

A recent global benchmarking study by Bain & Company reveals that bankers recognize they have a problem. In the study, bankers rated the building of strong customer relationships as one of their most important keys to success. Yet they acknowledged that they were not doing a very good job of rising to that challenge. The study also revealed that the world's best-performing banks garner the highest marks across the entire spectrum of managing the customer relationship—from the design of exciting selling propositions and effective delivery on their promises, to ongoing development of customer-focused strategies that enable them to execute again and again. On average, banks that excel across all those dimensions outgrow their peers, reduce customer turnover and boost their return on equity.

Retail bank executives across the world are awakening to a realization that's obvious to managers in just about any other industry: Long-term growth and profitability hinge on their ability to attract and retain loyal customers. That recognition has been a long time in coming. It's being spurred by a potent combination of increasing competition, regulatory scrutiny and consumers' greater awareness of the range of new options at their disposal.

Banks have worked to improve their performance by using every cost-cutting weapon in their arsenals. They've shifted back-office operations and customer service offshore, streamlined business processes, boosted workforce productivity and squeezed more value out of their information-technology spending. The effort has left banks leaner. But essential as those efficiency gains have been, the relentless struggle to keep pace with competitive pressures has done little to ignite new top-line growth. Among retail banks in Europe, for example, operating expenses dropped 3.1 percentage points between 2001 and 2004, but interest and commission income remained flat. In the US, bank operating expenses, measured as a percentage of consolidated assets, have ratcheted down steadily over the past decade; but net interest income, commissions and fees were no higher at the end of 2004 than they were in the late 1990s.

Indeed, the results of Bain's new global benchmarking survey of 30 major retail banks serving 170 million customers in 15 countries suggest that, without a corresponding focus on the underlying sources of revenue growth, the aggressive cost cutting may be injuring banks' longer-term prospects. Stripped-down services that alienate longstanding customers are increasing defections among the very group that banking leaders now recognize they need to keep loyal to fire up growth.

> Putting customer loyalty at the heart of their growth efforts requires banks to strengthen atrophied capabilities and master new disciplines.

Why they don't love us . . . and why that matters *now*

Legislative and regulatory changes are making the costs of banking services more transparent to consumers and sparking price competition. Meanwhile, direct marketing, as well as websites that allow consumers to compare multiple institutions, are making bank customers more aware of their options and enticing them to move their assets. It all adds up to a seismic shift in how and where consumers choose to do their banking and, for incumbent institutions, a potentially calamitous weakening of customer loyalty.

Putting customer loyalty at the heart of their growth efforts requires banks to strengthen atrophied capabilities and master new disciplines. They must learn to nurture the faithful core of their customer base and hone their skills for spotting and attracting the right new customers. The Bain benchmarking survey reveals how banks can become true customer-focused learning organizations, nimbly adapting to ever-changing consumer tastes and binding their customers to them in a competitive environment.

The increase in customer churn is a problem wherever you look, but particularly in the most lucrative mature markets. For example, the annual rates for defecting current account holders at German banks increased from 4–6% in 2001 to 8–10% just two years later. Although it has leveled off recently, the percentage of switchers among current account holders in the UK tripled between 2000 and 2003. Among retail bank customers in the US, the churn rate hovers at about 15% annually. All signs point to increased customer flight as technology and competition make it ever easier for consumers to switch allegiances.

The cost of losing—and having to replace—a long-tenured customer is staggering. First, consider the years of revenues lost with the departure of an established A-list client. Then factor in the high costs of efforts to sign up new customers, only a small proportion of whom will come close to matching the profitability of the customers who defected. Indeed, some of the new recruits may end up being more of a drag on earnings than net contributors. Banks find themselves having to work harder and spend more just to stay in place.

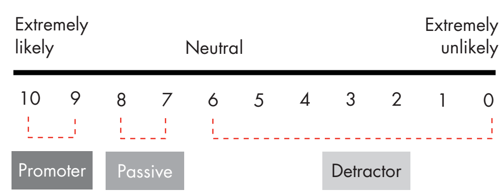
Banks acknowledge that their account holders deserve a better customer experience. In our benchmarking study, the bankers we surveyed overwhelmingly rated managing the customer experience as the most important factor of success, yet they admitted that their efforts to

Is your bank scoring with customers?

In Bain's experience, the best tool for gauging customer advocacy is the Net Promoter™ Score (NPS), a measurement developed by Satmetrix Systems, a software firm that specializes in customer experience management. NPS is derived from customer surveys that ask respondents to rate, on a 0–10 scale, how likely they would be to recommend a company's products or services to a friend. The NPS is calculated as the percentage of respondents whose likelihood of recommending is very high (measured as a score of 9 or 10) minus those who say they are unlikely to recommend (a score of 0–6) or are, at best, passive buyers (indicating a score of 7 or 8). Compared with scores for a cross-section of other industries, US banks earn an average NPS of just 6%—far below those of NPS leaders in the personal computer, property and casualty insurance, and car-rental industries (with scores of 33%, 31%, and 30%, respectively) and superior only to the health insurance industry (with a lowly NPS of minus 19%). US banks are not alone in their customers' low esteem, Bain's analysis reveals. The NPS of German retail banks is just 13%, on average; meanwhile, UK banks rate a dismal minus 6%.

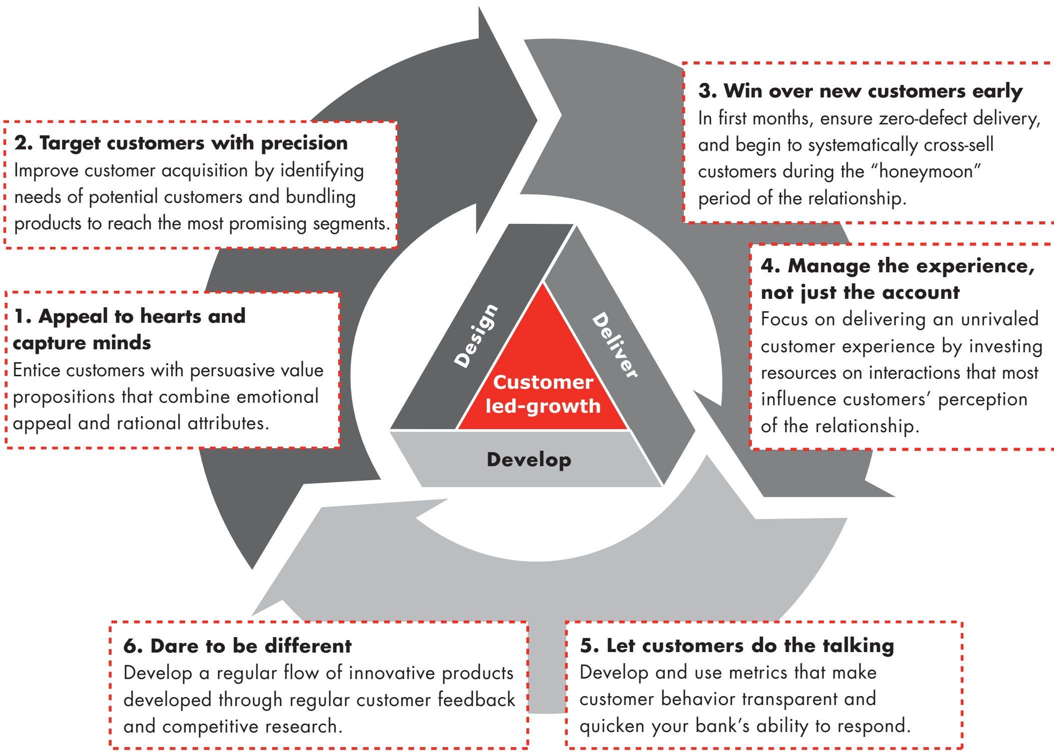
The Net Promoter Score measures customer advocacy

How likely is it that you would recommend this provider to a friend or colleague?



Net Promoter® Score = % promoters — % detractors

Figure 1: The customer-led growth cycle



deliver on that key dimension were falling far short. Customers take an even darker view. In every market we examined, the willingness of customers to recommend their bank to friends or family—as measured by the Net Promoter Score, the best indicator of customer equity—is among the lowest of any industry. In the US, only health insurance providers score lower with their customers than banks. The Net Promoter Score of UK banks is a dismal minus 6%. (See "Is your bank scoring with customers?" at left.)

The rewards for good execution on behalf of customers are high. Compared with their less customer-centric peers, the high performers in our survey experienced better retail customer growth and far lower customer defection rates. The leaders' excess returns on equity (that is, the premiums they earn beyond the rates of return prevalent in their local markets) were 50% higher than for the rest of the survey sample.

What does the elite group do that so many other banks do not? Most banks pay lip service to giving attention to the right customers, but true customer-led banks drive up their numbers by developing customer-management systems that seamlessly permeate all levels of their organizations. (See Figure 1.) They approach three customer elements simultaneously:

- They ***design*** the right propositions for the right customers, a task that involves identifying target segments of the market and crafting propositions and experiences to delight them.
- They ***deliver*** these propositions by focusing the entire company on them, from boardroom to front line, with an early and continuing emphasis on cross-functional collaboration.

- They continually ***develop*** their capabilities to delight customers again and again. That can entail measures such as giving the planning process a new focus, training people in how to create new customer propositions and products, and creating closed feedback loops that establish direct accountability for the ongoing improvement of the customer experience.

Each of these "Three D's" reinforces the others. When wielded together, they can effectively transform a bank into an organization that is continually led by its customers.

Digging deeper, the Bain study found that banks acknowledged six imperatives as crucial to winning over new customers, deepening relationships with existing account holders and reinforcing all customers' perception that they receive superior value:

Appeal to hearts and capture minds.
Although most of the products banks promote are commodities that fail to engage customers' imaginations, customer-led banks design products and services that offer a truly captivating value proposition and generate genuine consumer enthusiasm. They invest their products with attributes that connect with customers on an emotional level, and they carefully align these intangibles with the rational qualities their products offer. Then, they ensure that they can back up those promises with flawless execution that delivers the goods, and provide customers concrete evidence of their reliability. (See Figure 2.)

Figure 2:
Appeal to hearts and capture minds

How banks rate overall importance of factor, compared with how they rate their performance on key elements of factor

Source: Bain Global Benchmarking Survey, 2004-2005.

That ability to deliver products and services that delight hearts and win over minds has been a formula for success at fast-growing Commerce Bank. Based in central New Jersey and operating in six Eastern states and the District of Columbia, Commerce bills itself as "America's Most Convenient Bank." It differentiates itself by providing the customer-centric qualities that the competition conspicuously fails to deliver—easy neighborhood access, early-morning and late-evening hours and virtually no fees, all in a cheerful setting that makes customers feel like welcome visitors. Drawing on his career as a major fast-food franchisee and real estate developer before founding Commerce Bank in 1973, CEO Vernon Hill keeps his 330-strong network of branches open seven days a week. Aiming squarely at one of consumers' pet peeves, high credit-card costs, the bank recently announced the rollout of a new Visa card that will levy no penalties for late payments. The new cards also do away with fees that zap customers for exceeding credit lines and cap interest rates on revolving loans at just 3.99% over prime.

The bank's results demonstrate the rewards that come from combining emotional appeal and rational value. Between 2000 and 2004, Commerce Bank's deposits soared from $7 billion to $28 billion, an annual growth rate of 29% compounded. Commerce Bank's market capitalization has more than doubled since 2000, and its net income has risen 32% since 2001.

Target prospects with precision.
Customer-led banks understand their target customer segments in detail and communicate with laserlike precision. For them, it's not simply a question of attracting the greatest number of customers but landing the right ones.

Identifying the right customers and understanding what motivates them calls for painstaking research. Banks that do this well begin by carefully combing through their existing client base to learn which customers are most valuable to them, how their use of the product evolves over time and what characteristics set them apart early on in the relationship. Smart banks know that the best customer segmentation is only as good as their ability to deploy it. Target segments that cannot be identified or addressed separately only blur their vision. That's why the segmentation techniques they use for acquiring customers often differ from those they use for maximizing product sales to and revenues from customers already in the system. (See Figure 3.)

Customer-led champions tap internal and external databases to develop a fine-grained understanding of their target customers.

They put the resulting insights to use in one-to-one marketing campaigns as well as in designing bundles of products that draw potential clients in and bind them as customers. They deliver their pitches through a structured process involving telemarketing, direct mail and in-branch personal contact.

Grupo Banco Popular, Spain's third-largest banking group, spotted an attractive segment in the nation's fast-growing population of affluent senior citizens. Examining the banking needs and consumption patterns of active retirees in detail, the bank discovered that seniors valued personal security and the convenience of personalized concierge-style services. Banco Popular tapped into those preferences by developing a compelling package it marketed as "Club Senior." Customers who have their monthly pension checks deposited directly into a Club Senior account are eligible for discounts on restaurants, a holiday-travel booking service, discounts on car repairs and access to an information hotline that can answer their questions on a wide range of topics. The club also provides a round-the-clock health hotline, mediation services for help negotiating for housekeeping and repair services, and free legal advice.

The bank more than offsets the cost of all of this mass-produced luxury by binding account holders more tightly to Banco Popular through the credit cards and other Club Senior financial products it promotes. Through an English-language website, Banco Popular also reaches out to well-heeled foreign retirees when they flock to Spain in search of winter warmth. Since the club opened for membership, Banco Popular has become the bank of choice among this demographic group.

Win over new customers early. Banks have learned from hard experience that the likeliest time to lose customers is soon after they first acquire them. They also know that if they fail to cross-sell additional products within the initial 12 to 18 months of the relationship, they may never succeed. In the Bain survey, early engagement of new customers emerged as the most dramatic area of underperformance. (See Figure 4.)

Customer-led banks lay the foundation for a deeper relationship from the outset. Through a carefully crafted after-sale process, they capitalize on the enthusiasm new customers bring to their selection of product and provider by arranging an initial welcoming call in the first week and initiating a month-by-month follow-up program to help customers better understand account features. They monitor this overinvestment in new customers to determine how customers are using the bank's services and systematically track any potential problems that could cause a new customer to defect. When they spot mishaps—successive months of late fees, for instance—they act preemptively to correct the problem and rescue the relationship.

The systematic nurturing of new customer relationships is a discipline that now comes naturally at American Express. Senior managers, troubled by peaks in attrition among new customers, saw a big opportunity to get more value out of the company's investment in new customer acquisition by helping new cardmembers discover the service features that best suit their needs. Analyzing new-customer behavior, they discovered that defections increased sharply in the initial months after customers signed up for a card and, again, around the one-year anniversary. The problem: Customers most likely to close their accounts did not understand the benefits the card offered or had chosen a level of membership that did not deliver the best value. As a result, they never engaged with American Express the way other customers did.

Setting out to become better attuned to the needs of their customers, the American Express team developed several bundles of initiatives to help new cardmembers learn how to take advantage of the card's features and benefits. For example, to cement the deal with some high-potential new cardmembers, American Express representatives engage in telephone conversations to understand their needs, and to explain relevant services, features and membership privileges. In some cases, representatives even help new cardmembers conclude that a different American

Figure 3:
Target prospects with precision

Figure 4: Win over new customers early

Figure 5: Manage the experience, not just the account

Source: Bain Global Benchmarking Survey, 2004-2005.

Figure 6: Dare to be different

Source: Bain Global Benchmarking Survey, 2004-2005.

Express card would deliver better value. Later, tracking the cardmember's initial usage patterns, the company reaches out again by mail or follow-up call to fine-tune services offered and increase the value the cardmember can realize through his or her relationship with American Express.

This new cardmember engagement, education and retention program has yielded a significant improvement in American Express's returns on new-customer-acquisition investments. Persuaded by the success of this approach, customer advocacy in the card division is now one piece of a larger effort to increase Net Promoter Scores and strengthen customer partnerships throughout the company.

Manage the experience, not just the account. Tracking how well they deliver on promises is integral to the leaders' approach to managing the customer relationship. What customers experience day by day in contacts they have with each branch office or call center determines the quality of the ongoing relationship. But Bain surveys reveal that some interactions loom larger in customers' opinions than others. With things like clear account statements, an orderly branch appearance and easy-to-understand product information, customers expect execution to be flawless; but these so-called hygiene factors are generally not the issues that make or break the customer's relationship with the bank. (See Figure 5.)

Other interactions, however, such as how the bank handles the reported theft of the customer's credit card, overdrawing a line of credit or providing timely, personal investment advice can be thought of as critical "touchpoints." Getting these crucial interactions right shapes the customer's perception of the bank and helps build customer loyalty. Customer-led banks assiduously collect data on scores of contacts—from how long customers wait in line to see a teller and the number of branch employees who know them by name, to how quickly problems are addressed and resolved. But the winners excel at executing on the critical touchpoints. They use the feedback to evaluate both management and frontline staff and to strengthen their portfolio of customer-pleasing techniques.

Dare to be different. The banking industry is justly renowned for its lack of innovation. Among German banks, for example, outlays for R&D are a mere 0.7% of all spending, versus some 8% in such industries as automotives and electronics, and new products account for just 14% of all banking and insurance revenues. This dearth reflects the fact that any novelty is easy for competitors to duplicate and usually must pass muster with regulators. (See Figure 6.)

Yet some banks are leading an innovation charge by packaging common banking products or ancillary services in novel ways to appeal to the preferences of discrete customer segments, such as senior citizens, or affinity groups, like fans of a local sports team. Customer-led banks keep their innovation pipelines filled by continually monitoring consumer behavior and tastes and tracking what their competitors are doing. They also apply disciplines from the consumer-packaged-goods industry to systematically generate new-product ideas. Like consumer-goods companies, they pilot-test their best ideas before rolling innovations out widely. And unlike many of their peers, customer-led banks don't simply rely on focus groups to hear what consumers tell them they want from banking products and services; they test their ideas in the marketplace to observe what consumers actually do.

Bold product innovation has allowed British banking group HBOS to move from follower to leader in the UK's retail banking sector. Formed by the 2001 merger of Halifax Bank, a former English building society, and Bank of Scotland, a regional high-street bank, HBOS had strong share in mortgage lending and savings but trailed competitors in core banking products like current accounts, loans and cards. Forced to compete for new customers against dominant rivals Lloyds TSB, HSBC, RBS/NatWest and Barclays Group, HBOS retail banking head Andy Hornby, now the bank's chief operating officer, realized that to break into the top tier, HBOS would have to challenge the "big four" banks' oligopoly directly.

HBOS set out to develop products that would be simple for consumers to understand and sold in ways that made their costs transparent. The bank made its first foray by offering an interest-bearing current account that paid far more on deposits than anything the big four banks offered. Launching the new account with a national advertising blitz that invited competitors' customers to switch, the bank trained frontline customer-service representatives to help new customers shift all of their standing orders and direct debits from their old banks to their new HBOS account. And HBOS reworked its incentive system to reward managers and frontline staff who met ambitious sales and customer-service goals.

Since this initial launch, HBOS has continued to innovate. Sticking to the principles of simplicity and value, the bank has lifted its income-to-cost ratio to a market-leading position. Over the past four years, HBOS has increased its overall share of current accounts from 9% to 14%—an impressive accomplishment in a market that had not seen share change hands in the previous 15 years. Moreover, by using product innovation to create a switchers' market and passing savings from its enlarged base back to customers, HBOS gained an enviable cost advantage that allows it to offer new, low-cost products at prices its competitors cannot match.

Hear what customers have to say. All banks have a mania for data. Measurements of market share, employee turnover, return on assets, billing errors and the like are the lifeblood of daily operational and financial oversight. Increasingly, measures of customer loyalty complement those standard financial benchmarks. But we have found that widely used yardsticks like customer satisfaction scores do not yield insights that promote customer retention, customers' willingness to purchase additional products or upgrade to new ones, or customer referrals. Indeed, most customers who end up defecting had previously responded to such surveys by classifying themselves as "satisfied." (See Figure 7.)

Customer-led retail banks are no exception in their hunger for numbers, but they concentrate on measurements that let them *anticipate* customer behavior. They weave a web of metrics that focus all levels of the organization—from frontline branch personnel to the senior executi suite—on turning customers into advocates Using their key metric systems, customer-le banks track long-standing customers and new acquired ones separately and develop fine grained insights into each segment. That allows management to evaluate its efforts to create distinctive experiences for customers, whether old or new. Customer-focused data ar linked to the bank's financial performanc baked into its planning process and used to motivate staff throughout the organization b tying incentives to tangible improvement in the bank's Net Promoter Scores.

At the core of the banks' data-driven approach to customer-led growth is their finely calibrated understanding of opportunities to cross-sell new products to an established customer or identify loyalists who can give referrals. Insights drawn from the leading indicators also serve as an early warning system, flagging customers at risk of closing their accounts and suggesting countermeasures the bank can take to retain them.

Laying the foundation for customer-led growth

If the qualities that set customer-led banks apart are easy to recognize, their achievement is elusive. Like companies across most industries, banks count on organic growth to help them deliver on revenue and target profits. But our research suggests that most will miss the mark by a wide margin.

Converting customers into loyalists and, even better, making them recruiters of still more customers requires a disciplined, multiyear initiative. The process of becoming a customer-led bank begins with a commitment to eliminate self-defeating behaviors that blind the organization to customers' needs.

Figure 7: Hear what customers have to say

Source: Bain Global Benchmarking Survey, 2004-2005.

For by-the-numbers bank executives, embracing the idea that customer advocacy can produce meaningful growth requires some proof points. The best way to gain the necessary institutional commitment is by launching a compact, well-defined project that phases in the interlocking elements for the approach. Banks should first identify business units that are central to the bank's success and representative enough of all units that initiatives can be scaled up over time. Each initiative should be led by open-minded skeptics who, if convinced of its success, can become champions of customer-led growth.

The pilot effort should establish the project's baseline conditions, beginning with an understanding of the lifetime value of the bank's various customer segments, their price sensitivities and profitability, the amount of and underlying reasons for churn, and the initial Net Promoter Score. The first goal is to understand how the various elements of building customer relationships influence hard measures of financial performance. The follow-on steps are to identify and prioritize opportunities to improve customer advocacy and develop strategies to exploit them. (See "Customer advocacy pays premiums for a European insurer, below.")

The broader challenge is how to ramp up from the initial pilot tests and make winning customer experiences a cultural ethos throughout the organization. With leadership from the top and a rigorous fact-based process for developing selling propositions based on customer needs, successful banks package ideas in integrated programs the entire organization can rally around. They use clear, unambiguous metrics to guide these programs, invest in technology and customer data that support good decision making and tie incentives to the achievement of overall revenue and profitability targets. Finally, successful banks spread stories of success—and of the heroes, from the executive suite to the frontline service reps, who achieve them—throughout the organization to reinforce the customer-focused mission.

With the new culture firmly in place, customer-centeredness is no longer a program but becomes simply the way business is done. All this requires a big effort. But with loyal customers leading the wav. the upsurge in growth is well worth it.

Customer advocacy pays premiums for a European insurer

When InsureCo, a European life, property and casualty insurer with global reach, recently launched its customer advocacy initiative, it began by focusing on 3 of the 10 major interactions it has with customers—quotation services, claims management services and policy renewal. Measuring the Net Promoter Score for each, it then developed a feedback mechanism to track improvements in the customer experience.

InsureCo began capturing customer experiences at the point of contact, established procedures for reporting results throughout the organization and is using the data to help adjust frontline behavior to improve performance. It also modified its internal incentive structure to reward customer-advocacy champions who delivered results. The payoff from the initial effort alone should be handsome. InsureCo management estimates that, as the initiatives are rolled out in sequence, it stands to boost policyholder retention rates and incremental profits over the coming two years.

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