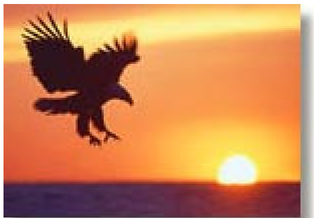

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The Consumer Paradox in Financial Services

Back at university studying consumer market behaviour over 35 years ago, the solutions appeared logical, simple and executable. Whether it was psychological or sociological motivators, consumers purchasing behaviours appeared that they could be moulded or directed in such ways as to achieve their preferences and with that demonstrate satisfaction, the important foundation in building loyalty and repeat purchasing. Since those university days, the competitive landscape has exploded and disintermediation comes from all sides, above and below. At the same time consumers have achieved outstanding level of financial, technological and shopping, yes shopping for value, competencies. Those shopping skills can range from simple price promiscuity or commoditization to sophisticated lifecycle value analyses. In this shopping landscape, brand reputation has been a critical factor for financial institutions, or for that matter all retailers of consumer satisfaction. In Canada we say, "Have you had your Tim Horton's today?"

In the countries/continents where WESI operates, financial institutions regularly, usually annually, research their brand reputation to identify strategic strengths and weaknesses vis-à-vis the competition. Unfortunately the majority of research usually focuses on the traditional financial institutions: banks, credit unions, building societies, trust companies and a couple of the emerging disintermediaries thrown in for a sense of honesty. Generally, that research does not include some critical competitors such as insurance, mutual funds, monaline credit card and brokerage (of many product varieties) companies. Market share in some countries is not generally part of the research since there is no reliable database on which to calculate representative market shares.

The cyclical research generally has two segments – share of wallet estimates and brand reputation elements. We find that the latter are more indicators of future intents, strengths and/or vulnerability for both the financial institution and the consumers themselves. I don't intend to validate the brand elements in different country research studies. Instead, let's concentrate on the real differentiation that shows up in the research studies.

The major banks in the key countries always appear to be in a "pack" of non-differentiation at any real level of significance. Yes, some elements shift small percentage changes year over year and the players don't hold identical rankings with all measurements. Without a doubt in North America, credit unions are consistently differentiated from the banks by wide margins on topical features. In Canada, ING Direct and President's Choice Financial do get some differentiation points over the banks as well.

Specifically, I want to look at two continuous strengths of the credit unions and the consumer paradox therein.

First, community image or involvement where credit unions overall walk away with the gold medal. (In Australia, the Regional Banks could also be included). Before my banking friends yell error, we do admit there are isolated unit examples of success in this area but it is not a consistent, across the board strength. Some banks have community walls in their branches, advertise/recognize their community heroes, sponsor community sports teams, events and organizations, but no longer, as a general policy, require management officers to live in the communities or be active in local organizations where they work which also decreases real participation in community activities. As the famous "Fish" story would say, "they are not there"!

Second, service experiences are also a differentiated domain of the credit unions in North America. If you go into the credit union branches regularly around the globe as we do, you know it isn't isolated to one country. Credit unions practice their membership/ownership philosophy every time you interact with them.

One area of frustration for banks is the call centre channel where they operate 7/24 whereas most credit unions have "telephone service (agents)" 8 a.m. to 6:00 p.m. yet they still receive significantly higher service scores. Comparing "busy times" between the banks' branches and those of the credit unions is like assessing bonfires to matches. Members are recognized, thanked and not rushed; there is a behavioural bond.

The real paradox is why can't the credit unions translate this differentiated advantage into proportionate sales. What I am referring to is simply this – if the credit union has a double differentiated service score over any bank competitor why don't they have double the sales hits per consumer or member?

An example – let's assume a service reputation level of 50% for the credit unions and less than 25% for the banks. If the math were correct, credit unions would sell to 100,000 members what banks sell to 200,000 customers. In fact, the sales values are probably reversed! The question is translating behavioural perceptions into business reality. Holding everything else constant, the catalyst could be the maturity or absence of a proactive sales and service culture. Many have not forged or even strategically prioritized a sales and service transformation and continue member order taking and periodic campaign lifts.

Today's consumers expect proactive solutions recommended to help create, protect or transfer wealth. Also, they look for their financial institution retailers to ask for the sales and related referrals. Hundreds of non-bank intermediaries (look on the Internet and in the Yellow Pages) are doing this every time they touch a consumer, as the banks generally do. Unfortunately, capital bases, liquidity levels and staff knowledge can be real barriers for credit unions' sales growth. There are ways around these as we see "new forms" of credit union charters, cooperatively owned credit union service organizations (CUSO's) and other innovative structures to grow critical mass and financial underpinnings. The sales and service culture must go hand in glove with these other strategic initiatives.

The one strategy we have seen little of is coopetition between banks and credit unions. Since many USA credit unions sold their credit card portfolios to MBNA in the past and it is now owned by Bank of America, this could be coopetition by osmosis – or will that be competition as Bank of America mines the databases?

Sales and service culture dynamics are critical in translating brand value into business value whether you are the largest bank or the smallest intermediary broker. Without the successful transformation, the franchise erosion will slowly or rapidly weaken an institution's growth and hence long term survival.

A Downunder Perspective

Recently, WESI had the opportunity to visit clients and prospects in Australia and generally we continue to see the foundational similarities in the financial services industry in Canada, Ireland and Australia. The political environment within Australia and Canada is still anti-merger and the media continue to attack bank fees and service charges regularly. The difference is in Canada there are pre-notice and annual announcements regulations with the latter, whereas Australia continues on individual bank ad hoc scheduling and rationale.

Emerging competition affects these countries in niche areas or as third party disintermediaries. For example, on average 25% of Canadian mortgage originations are broker based whereas Australia, as a whole, averages over 40% with some states, such as Western Australia, looking at well over 50%. Commissioned sales forces (bank operated) dominate the Canadian landscape but not Australia where franchising is a national success story of sorts. Regulations do constrain country or bush branch closures in Australia and where banks have vacated communities, organizations such as the Bendigo Community Bank concept can be found entering based on credit union principles and 50% community ownership/risk.

In terms of other core channels, we find Canadian branches more customer centric in layout, attractiveness and interaction. Similarly, Canadian call centres are pivotal to integrated distribution strategies and tend to be more sales and, in some case, relationship focused. Continuous improvements are still possible with the majority of Internet financial service experiences in either country.

Where Canada can profile Presidents Choice Financial as a successful in-store/virtual banking model, this channel choice has not succeeded with either of the two major retailers in Australia – Coles and Woolworths.

Commoditization trends appear stronger in Australia with their extensive intermediary networks mentioned above and rate or fee promotions at every turn. Coupled with this margin squeeze characteristic is a tendency for more general marketing strategies versus target initiatives and regional flexibility.

Back to the competitive side, the Australian credit union segment continues its merger trend similar to Canada and the United States. Additionally, more credit union service organizations have appeared on the landscape to build backroom, service economies otherwise not available.

Both Canada and Australia have strong domestic financial pillars and brand profiles but their international standings have slipped somewhat in the past two decades due to political agendas and in some cases, unfortunate international expansion strategies in the United States.

Learning and hence knowledge assets can be built through experience exchanges between countries such as Canada and Australia in the areas of customers, channels, products and yes even the political/regulatory environment. Although successful applications are not always the same, the business begins with sophisticated customers who control multiple choices in all aspects of competitive financial services. When talking about customers, lifecycle marketing applied to the three stages of wealth management – creation, preservation and transfer is not meeting total preferences or needs in either country although Canada shows more progress towards a holistic approach.

Sample Australian Account Fees
(The Weekend Australian Financial Review www.afr.com Feb.4-5, 2006)

1. Day to Day Chequing Accounts
   - ANZ (Access Advantage) $5 monthly charge
   - Bank of Queensland (Reverse Charges Account) $4 monthly charge or $2K fee free balance
2. Credit Cards
   - BankWest (Life Mastercard) 8.99% purchases, 19.99% cash advances, $48 annual fee
   - Heritage Building Society (Visa Classic No Frills) 10.25% purchases & 10.25% cash advances, $0 annual fee
   - NAB (National Low Rate Visa) 10.75% purchases & 16.65% cash advances, $45 annual fee
3. Savings Accounts
   - BankWest (TeleNet Saver) Rate >$2K 6% first 12 months then 5.5%
   - Elders Rural Bank (ERBonline Savings) 5.65%
   - St George Bank (Direct Saver from Dragondirect) 5.4%

Other Australian Headlines of Note

- Bendigo Bank's Community Bank could reach a 20% revenue increase in 3/5 years the bank says. Currently there are 175 Community bank franchised branches.
- New look brand coming from NAB before Commonwealth Games in March
- Bankcard – the oldest credit card (1974) is being phased out due to restricted geographic reach and competition
- Virgin Money, Australia's innovative "Virgin Super" is attracting strong media and consumer attention
- ING Direct's Canadian CEO is now running the Australian operation. The Canadian direct bank has approximately a million customers from all consumer segments.

Canadian Highlights

- CIBC closed the calendar year, after a disastrous fiscal performance, with announcing more layoffs – 950 including senior executives. The Retail Bank loan losses are ballooning unlike their competitors.
- Weakness in CIBC's consumer loan portfolio will continue pass 2006 – Gerry McCaughey CEO
- Scotiabank expands its hold on consumer lending buying $20 billion (U.S.) car loans from GM over the next five years. (Note: Bank of America bought $55 billion in July 2005).
- Mutual Funds Companies see the major Canadian banks as purchasers. Banks currently have 35% of the $570 billion market.
- The Eagle Net previously reported major banks e.g. Bank of American converting phone lines to VOIP, now RBC has announced a Bell deal to convert 8,400 lines.
- Canadian Financial Positions (Various Research)
    - Banks are undifferentiated in consumer perceptions
    - Credit unions always and ING/Presidents Choice Financial are sometimes differentiated from banks
    - Studies fail to adequately assess brokers and other intermediaries as a group impact
    - Credit unions don't seem to capitalize on advantages
- Canadian Management Consulting (Canada) – CAMC
    - Financial services represent 16.7% of all Canadian consulting expenditures (2005)
    - Need to cut costs while driving revenue is pushing process and business model reviews
    - Other key consulting areas: Regulatory Compliance, Corporate Governance, Credit/Operational Risk Management Processes.
- Canadian Financial Institution Stats – The Globe & Mail
    - $24.6 billion paid in fees and service charges by Canadians to banks in the past eight years according to ING Direct.
      (Note: The Canadian banks strategically have shifted to fees as spreads shrink and most analysts agree with this survival switch).
- Scotiabank is headed to being the first Canadian bank to offer retail banking in China (Shanghai).
- RBC Financial Group will refund $7.2 million to 23,000 mortgage customers due to an error in penalty calculations.

U.S. Highlights

- Serving on Chamber of Commerce Boards is promoted for Community Credit Unions by experienced practitioners to market the credit union difference in the USA.
  (*Why not Canada and Australia?* Editorial Note)
- JP Morgan Chase & Co. plans to issue 800,000 contactless payment cards ("Blink") in Texas and Florida
- Inner City Branching – We recognized RBC's Canadian leadership to experiment with inner city branching to present the unbanked with an acceptable value proposition. Late last year, Andrews Federal Credit Union entered Ward 8 of Washington D.C. with what they hope will be a successful branch – good luck to all.
- U.S. Loan Mix – USCU's (Sept. 05) Credit Union Times
  30.5% First Mortgages
  18.8% Used Auto Loans
  17.8% New Auto Loans
  15.2% Other RE Loans
  Other applications are 5% OR LESS
- PNC Financial Services Group (Pittsburgh) and Bank of America (Charlotte) have been given the green light by regulators to develop and own commercial properties.
- U.S. Stats – Credit Union Times

	Assets $B	12 Month Ln. Growth	12 Month Dep. Growth	ROA	Capital/Assets
CU's	692	11.29%*	4.5*	.93%	11.5%
Banks	8,904	9.4%	9.3	1.35%	10.1%
Thrifts	1,796	12.4%	7.7	1.10%	11.0%

* Continues liquidity pressures

- Citigroup leads a consortium as the preferred bidder in China for Guangdong Development Bank.
- Bank of America has closed its acquisition of MBNA to make it Number 1 in cards. (All those affinity card and credit union customer/member lists are now Bank of America's).
- TD Banknorth shareholders approved the acquisition of Hudson United Bancorp. NEXT?

General

- Year End Credit Union Roundup
  Australia:
  - Top service providers but banks are attacking
  - Mergers continue

  Great Britain:
  - Fighting an image problem i.e. service "the poor"
  - Coopetition with banks is unique here

  Canada
  - Top the reputation scores; generally doubling the banks
  - Mergers continue
  - Regulators looking at streamlining regulations

  Ireland:
  - Introduced "one stop" phone/Internet service for all 532 credit unions

  New Zealand:
  - Voice activated ATM's

International

- Scotiabank's branches and offices in Central & South America are impressive:

Anguilla 1	Antigua & Barbuda 2
Bahamas 2	Barbados 8
British Virgin Islands 1	Cayman Islands 3
Dominica 1	Dominican Republic 54
Grenada 3	Haiti 4
Jamaica 44	Netherlands Antilles & Aruba 32
Puerto Rico 18	St. Lucia 4
St. Kitts and Nevis 3	St. Maarten 2
St. Vincent & the Grenadines 1	Trinidad & Tobago 23
Turks & Caicos Islands 2	U.S. Virgin Islands 9

- Scotiabank continues its aggressive acquisition program internationally, buying two banks in Peru and then merging them.

Final Word

Communication Etiquette:

Today we are able to communicate in an unbelievable set of mediums from the original mail to the proliferation of wireless options. It is a virtual communications world with the Internet as its backbone. But there's a problem. In WESI's Customer/Member Care Portfolio work we continue to find "poor communication (response)" manners in financial institutions with customers, prospects and each other internally.

The first glaring problem is the lack of common courtesies in replying promptly to communiqués. Years ago we were taught to turnaround customer letters quickly and now we find e-mails left unanswered for weeks. Remember the habits we demonstrate will influence customer protocols by simple image filtration. There is an automatic response notification on the e-mail system, which can be activated during absences.

The second noticeable issue is the sometimes clinical and curt language practiced by some. Perhaps we see this more internally than going to customers but either way a poor example is sent about the sender to the recipient. Remember, an e-mail is really a replacement of a face-to-face discussion (i.e. we are talking with our fingers) and is an extension of an individual's communication skills. So we should all take the time to be polite with every e-mail and to ensure that good examples are used with customers. E-mail etiquette is probably a good relationship refresher course to have available.