Private & Confidential

A Customer Research White Paper

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Customer Preferences Uncovered

Research or not to research! That is the question! Many organisations spend thousands, even hundreds of thousands of dollars, plus significant person hours on research annually and others invest nothing. Perhaps the latter group has allocated their scarce resources and nothing is available. Or by chance, do officers believe that their experience and intuition are good barometers of the market as well as customers' beliefs and preferences? We'll come back to this environment shortly.

The Studies

First, those that spend scarce resources on research must believe in the necessity, tradition or role of research in their business models.

What is done with the information and/or recommendations?
Was there an action plan for the project before it was started?
How did we capture or recapture the value in the past?
When do we know it is time to investigate market variables?
Where do you look for the answers?
Is all research external or is there a mix of customers and staff opinions?

Lots of questions to think about in trying to uncover market mysteries. For example, many institutions will do staff and customer satisfaction research annually to gauge trends because they know slippage can impact profitability. Are the results incorporated into performance management considerations? Do we actually establish proactive improvement strategies or do we only present the research results? Our conclusion is that those who don't have a commitment to follow up actions are wasting their … money! Research for the sake of research is an illusion of value.

Second, some practitioners only participate in syndicated research so they can compare themselves to the participating group composite. If you show better than the average, you're generally happy … lower, then you worry about who is "abnormally" raising the average. Did you find out before signing the contract if the group was the same, year over year? Or, did the samples change as well as the question set? So what faith can you place in the results for comparative decision making purposes? Syndicated research appears to be like being a member of a team and not really getting to know the other players. You wonder how the result or score was reached.

Thirdly, are the findings purely the statistical conclusions of researchers without the insight of experienced practitioners of strategy and tactics within the industry. We have seen researchers utilise rather standardised templates to drive results. In other words everyone almost gets the same answers where their universes differ significantly as do segments within a population. On the other hand, perhaps we move too far away from statistical reliability and validity and we activate surveys that are predetermined "beauty contests" or simply subjective consensus.

Channel Choices

Let's agree that proper research is valuable if the pre and post management of the project is action oriented and objective plus there is a real cost/value relationship. But don't forget this is not a one time thermometer and prognosis. Marketing is an art not a science. So we want to continually apply professional research standards to gain continuous advantage in business. So where do you start and how much is enough? One truism to remember is that everyone at some point contracts for research but many take little or no action based on the results. So let's make an assumption here. If we know where our customer or member preferences are for alternate delivery channel used now and in the future (say three years out) couldn't we make improved channel investment decisions amongst the choices, such as

Branches	- full service - community - specialty (seniors, professionals, students, etc.) - satellite - In-store - sales only - automated depots
Self Service Appliances	- ATMs (branded & generic) - kiosks - wireless devices - PC's – desk/laptops (Internet access) - telephones (call centres) - mail/courier - armoured car - shared/syndicated units - cable TV
Agents	- mobile (captive) bankers - captive rural reps - multi service stores (insurance, financial planning etc.) - syndicated agents - "open" agencies (mortgage, brokers, lending centers, etc.) - seasonal agents

Alliances	- business partnerships
	    - reciprocal
	    - non-reciprocal
	- corporate employee groups
	- financial or non-financial
	- event specific
	- group based
	- sourcing specific

Naturally, you can probably add variations to the list or demonstrate how certain products or preferences use a multiplicity of complimentary and supplementary choices. What is suggested here is the fact that customers have a menu of choices that THEY CONTROL, at any point in time. Customers and segment mixes can also differ from one financial institution to another; not just in different parts of a country but even across the corner from each other. The combinations and permutations are extensive and while customers have preferences unique to them, no one in the industry has bottomless resources to satisfy every need. Somehow we have to take the guesswork out of decision-making models and minimise the differences of internal management opinions. Every channel is expensive to build and maintain. Therefore, predictable assistance is warranted and valuable in a dynamic, competitive marketplace.

Customer Decision Variables

Within a universe or customer population we have generally found in a half dozen different countries that delivery or channel preferences are impacted primarily by five variables – age, income, gender, education and geography or location. For example, a thirty five year old professional, university educated, male in Toronto, may not have the identical channel preferences to a similar individual in Vancouver. On the other hand, we have found women in management ranks between 35 and 55 years, have a greater tendency whether in Sydney or Perth to jump from the branch to the Internet for financial product purchases. Historical treatment in the industry coupled with time available for conducting financial transactions may have been key influences in the behavior. These are a couple examples of what could be important decision-making inputs for distribution, sales and service and of course marketing responsibilities. Why have these multiple trends occurred?

Customer in Control

In the past two decades with the rapid evolution of multiple customer delivery channels, financial service institutions have tried to predict existing and potential user preferences to optimise investments and hopefully catchments. To this day, even the largest, more sophisticated enterprises are still experimenting and using guesstimates to determine channel investments. Concurrently, consumers have become more financially and technologically literate while commoditising financial products. They have expanded their information, influencers, options and motivators while doubling or tripling the number of service suppliers they deal with regularly or for specific lifecycle products. The dynamics are not always synchronised between the customers and the suppliers. Each time disconnects occur, an opportunity is opened for another competitor to erode existing relationships.

The Consumer Decision Sets

The consumer or small business owner has <u>two transaction sets</u> with financial services. First, there are service transactions, the daily necessities such as making deposits, cashing cheques, initiating payments, exchanging currency, obtaining account information and other convenience options. Generally, channel accessibility, cost, quality of service and accuracy are important considerations with these activities.

Second, periodic purchases arise out of private decisions to acquire new or additional assets or to support life or business cycle needs, which may be planned or are emergencies. The menu can include opening an account, acquiring a loan or mortgage, investing short or long-term funds, arranging insurances, writing a Last Will and Testament, obtaining business start up capital and so forth. Generally people want access to a knowledgeable person who can assist them in the final product screening and acquisition phase. Many may access supporting Internet information prior to meeting with one or more financial services persons but they still want this spontaneous dialogue for the final selection and execution. Unlike service transactions which are regular, high volume, low cost activities, purchases incur high costs for periodic needs with major cost variances among channel choices for the financial service supplier.

Dollars & Sense

For service transactions if the cost for an over the counter account transfer is one dollar, the same activity through a call centre agent is maybe fifty cents, through an ATM twenty cents, the call centre IVR ten cents, and the Internet option less than a cent. These variances support the rationale for many service transaction migration pushes by banks. On the other side purchases are considerably more expensive amongst products and channels for the suppliers. Opening an account and doing the background checks could be $125, setting up a car loan $350 and taking out a mortgage $850 all in a branch environment. Initiating that car loan through a call centre could be $150 and the Internet a portion of that. Additionally, selling a mortgage, car loan, line of credit and credit card, combined through a relationship “financing package” would be approximately $1,000 whereas selling the products individually would add up to $1,900. As we can see with the high volume service transactions and the product purchases, knowing customers current channel uses and preferences in the medium term will improve productivity and target marketing.

If the institution does not know its transaction and selling costs many organisations, such as ours, offer proxies for internal guidance until proper or real costs are isolated. A representative number of financial institutions do claim transaction costing data is available but very few have a handle on their sales costs by channel. The proxies or benchmarks available are industry averages or composites from those who have this information available and they tend to be the larger more efficient suppliers. Good costing data is critical for the management of the bottom line and building real decision models is less expensive than people perceive. If you are building a new channel, such as a call centre, the business case needs the costing parameters for both service and sales transactions. In the latter case, not only are the specific sales costs lower than say the face to face in a branch, good call centre agents can sell two to three times the volume in a comparative timeframe due to access logistics. So knowing costs and capacities of channels becomes essential knowledge in building a competitive customer delivery mix and marketing the efficient options synchronised with consumer preferences,

Applied Preference Research

Preferences of customers direct their channel choices together, of course, with access to the deliver options if available or where available. These preferences are dynamic and as stated earlier are moulded by age, income, gender, education and location at a point in time. One cannot guess or use intuition to determine these preferences. In fact, our research has continually shown that where customers, line staff and head office management are surveyed concurrently, there is a significant set of gaps between customers' actual preferences and management perceptions of what they are. Line staff are closer to the customers choices. So there are major decision risks built in to models solely dependent on "management experience".

The first time in my career that I invested in customer channel preference research was as if someone turned on a new light in my mind. The preference research undertaken was innovative and comprehensive back in the early '90s. There were 3,200, ninety minute, in home interviews that uncovered current preferences and future intentions given various motivators and influencers across Canada. The wealth of knowledge created by this exercise was exceptional in building consensus for strategic delivery decisions and coding the customer database to assist sales and service staff in migrating customers to their preferred choices. The extensive nature of this initial study is not economical for smaller institutions or larger ones with very limited research budgets. Consequently when starting our customer centric consulting business, one of the critical building blocks was a streamlined customer preference research study that could be administered through interviews by telephone or face-to-face lasting thirty to forty five minutes. The objective was the same – learn customer groups' channel preferences today and three years out given various catalysts and influences. The interpretive work was performed by experienced financial service distribution professionals, and the findings were presented in easy to apply decision models and strategic recommendations. Traditionally, in broad channel progression assumptions, practitioners believed that customers migrated in a natural series of steps from the branch, to ATMs, then the call centre followed by the Internet and mobile bankers. Suddenly, the preference research uncovered groups that had unique progression patterns skipping some channels entirely, channels that the institution would have invested heavily in if the standard assumptions had been applied. Incentives or motivators were also interesting when viewing different groups. For example, the frequency with which the 35-45 year olds with a young family and a mortgage versus the 55-70 year olds use information sources such as the Internet is significant. The role of the Internet as an information/educational channel is undisputed but staging into actual transactions is quite different. Referrals by family or friends to access certain channels is also of major strategic importance perhaps instead of spending large sums in advertising and promotion campaigns to motivate migration actions. Some natural conclusions emerge in almost all studies in all countries. The free chequing account has become one of those standards with most segments.

The Bottom Line Benefit

What do these Customer Preference Research studies cost? In our experience, a good average including the field administration by telephone interviews would be in the neighbourhood of $75K to $100K for 2000 surveys. Smaller sample sizes would be less.

Perhaps a 1,000 survey population would be $60K to $75K. From this you have current preferences of various segments; their migration intentions for sales and services; the influences that could accelerate the progressions and an insight into what would increase the various value propositions. One quickly sees the value of this research when you consider the installation of one full service ATM at $100K, building a full service branch at $3.5M or constructing a call centre at a higher amount. Wrong decisions in building the delivery channels are very costly and these decisions are not easily amended once implemented.

All of us as financial service professionals need to direct our business from a customer-in perspective. We must know our customers' needs and preferences for the variety of business options available. Having strategic knowledge of these preferences to guide delivery channel development and management could be the key to survival and success – ours and our customers.

Following the Trends

With some performance management systems linked to research, annual studies are a necessity such as with the value-profit chain to determine new benchmarks and trends for remuneration and budgeting purposes. Customer Channel Preference Research does not have to be done annually but could be if there are significant strategic decisions to be made. For instance, you are building a call centre (7/24) and you need to determine the take-up rates by segments for sales and service activities or you have decided to enter a new geographic market and must determine the right channel mix to optimise investment returns. One important trend to remember in expanding channel availability is the transaction multiplier effect. As you offer more access alternatives to the branch, service transactions will migrate but it isn't a one to one relationship and customers do not automatically vacate previous channels used. There is a transaction extension characteristic where customers continue to use previous and new channel options. More importantly, as they move to more convenient access, say from the branch to ATMs, and then to a call centre, the number and type of service transactions expand generating additional revenue and touch point contact opportunities. For example, a person may have withdrawn cash at the branch twice a month but now uses the ATM three times and the branch once.

Once the financial institution knows channel preference intentions, they can target their resources to synchronise with customers' preferences and therefore accelerate adoption and the expected trends. Without this knowledge, an institution could be trying to push or pull customers in a direction they don't prefer and hence will resist wasting time and money. This is very important with sales where competitive success today needs every advantage with the proliferation of suppliers in the marketplace. Knowing the preferred purchase channel, influencers and motivators can mean the difference between a quick sales versus a non-response. Working with customers' current and future preferences makes dollars and sense.

Profitability–Preference Pairing (PPP)

Once you have good costing information and channel preference research results you can move to the next level of decision-making logic – the profitability-preference pairing model. Here, one applies segment, channel and product preferences data to sales and service costs in a matrix model to determine both ends of the spectrum i.e. high preference correlation and low delivery costs versus low preferences and high costs plus the combinations in between. If you have high correlation with a segment's preferences and your costs are low, this is an opportunity to emphasise the sales and service option for the customer and your advantage. On the other hand if your correlation is low and delivery expensive this can be a candidate for abandonment. In between you could have high preferences and high costs, which can lead to a priority to decrease costs, or if that is not feasible, perhaps outsourcing or co-sourcing the delivery. PPP is a sophisticated decision model that requires reliable information on preferences and costs. Proxies do not work in the pairing exercise.

Customer Value Profit Chain

Customer channel preference research, properly interpreted and applied, is one of the most valuable research expenditures for a financial services supplier. The results reinforce a customer-in point of view and decision models. Most importantly, the findings help professionalise some of the most costly ongoing capital decisions in a financial institution – minimising guesswork and optimising returns.

Value is created for the customer and profits for the supplier when the customer's expectations are met or exceeded which reinforces and builds loyalty. Understanding expectations, preferences or needs assists in decreasing relationship and operating risks. Although we have referenced on more than one occasion in this paper, the sizeable risks connected to erroneous channel decisions don't forget the customer vulnerabilities that you face. Customers do not always tell you about their dissatisfactions – but they tell others. When Peoples Express Airlines failed in the USA, management was puzzled because only 1% of their customers complained. Additionally, competitor proliferation is diluting customers' attention to historical suppliers of products, service and channels. They don't announce their intentions to you publicly but make no mistake even the most loyal customers consider competitive offerings. Each day, market forces try to erode customer relationships. That erosion becomes lost revenue and income as well as loyalty. Mistakes are costly!

Research Action

When any research is commissioned it should not be for the sake of research but for specific action needs, which you know up front and which will be executed once the survey information is available.

The customer or member franchise is the foundation of financial service business success. Therefore, is it not appropriate to allocate some resources toward customer research especially where risks are high – either in relationship erosion or delivery capital? There is always a finite budget for research and the tradeoff process can get into sensitive subjectivities or "silos". Start from the customer – what do you want to know? What is the impact of decisions – positive and negative? How frequently do we listen to customers? There is no business without a strong and vibrant franchise. Knowing the customer is a prerequisite for success.

The preference research covered in this paper is probably the first and most important building block in your distribution business – delivering what the customer wants, when, where and how, to optimise their satisfaction and your success – a win-win situation.