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THE NETWORK PLANNING TOOLKIT –

FINANCIAL DYNAMICS

By

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Within our distribution business, our channel balance sheets and income statements must meet or exceed customer delivery expectations with equally competitive productivity and profitability. Every channel and the total mix in financial terms cannot be less than the best or over time, the franchise will be eroded. In this white paper, I am again going to elaborate on some of the diagnostic financial work, which needs to be present in your planning toolkit.

A) Consumer Preferences

For six years, in a half dozen countries, we have provided an economical and effective research tool to predict consumer delivery preferences for financial services amongst multiple channel choices. In some cases, executives automatically perceive the value of knowing what channels their customers want to use today and in the future plus they want to know if management and staff beliefs synchronize with customers. Then there are many decision makers who debate the need for such information because they believe that they have a great understanding or “feel” for what their customers want. Interestingly, many of these same organizations state that they are customer centric and are attempting to develop customer sensitive experiences to improve sales and service satisfaction.

Distribution decisions are costly in financial terms, application of scarce resources, competitive dynamics, real vs. perceived customer needs and so forth. For example, a regular stand-alone branch facility could cost three and a half million dollars in capital and then attract an annual operating budget of at least a million dollars. On the other hand, a fifty seat call centre (7/24) could attract a million dollars for capital and three and a half million for operating costs. Would you build a branch or a call centre? Not enough information yet, right! Similarly, when installing self serve transaction equipment such as ATM’s, management has a range of choices – a counter top offline, or dial up, cash dispenser at five thousand dollars (U.S.) or a web enabled, full function machine on line at sixty thousand dollars. Again, we need to more information to enable a proper decision. We would also do similar scenarios using captive sales forces versus commissioned, syndicated resources. In all cases, we need to know, for one thing, what are consumer preferences and where are they expected to trend? If they are predicted to increase use of telephone and Internet services then perhaps we should look long and hard at a branch build decision. A few conspicuous competitors will use the branch as the market penetration channel in areas where they currently have no representation and they “know” that current suppliers in the vicinity do not engender good customer experiences.

In the vast majority of channel decision models consumer preferences should be the starting point. The cost to uncover the real delivery drivers can be pennies per customer whereas the risks of not understanding preferences can be significant from financial, market share and reputation costs.

B) The Churn Costs

What is the annual churn? All financial institutions have one from the largest to the smallest. Generally stated the churn is the amount of balance and fee business (revenue) you must replace to stay at the same levels, year over year. Some of the reasons for a churn are natural processes whereas others are actual business losses or self inflicted costs. Studies have been done by many experienced diagnosticians and the summary results are clear – on average institutions spend 25% of their annual expenses on their business churn. So there are good reasons to know the under-riding causes and to address the potential solutions.

Let's start with the more common causes to the more difficult to solve.

1. ***Paydowns***: repayment schedules on debt products e.g. loans and mortgages automatically and predictably draw down business balances which need to be replaced by add-ons, re-writes or new sales. Each one of these actions attracts different sales and setup costs so that must be considered in tactical decisions. For example, the total origination cost of a mortgage can be as high as $1,000 to $1,500 whereas the loans add-on under a master mortgage agreement could be as low as $100.

2. ***Renewals***: both investments and financings have set terms of expiration or times for renewal. Obviously, if the institution is not proactive to retain the business in a dynamic, competitive market, customers will normally be shopping more than if there was planned relationship intervention. The Internet shopping resources, constant media promotions and aggressive, commissioned based sales officers can influence customer renewal decisions. Team retention strategies involving multiple channel personnel equipped with the best pricing and feature options, proactively courting the customers, can reduce market vulnerability.

3. ***Self Inflicted Product Replacements:*** Marketers doing their customer centric research constantly find unsatisfied product features which require design adjustments to maintain satisfaction levels. These should be simple add-ons but sometimes due to technology restraints a completely new foundation product is a necessity. In the design and development thereof, forward thinking people also build in an account conversion program to automatically switch the old product to the new. Sometimes, the plan is a manual customer interface conversion action on each account, which costs more than just opening a new account for an existing customer since you also must close the old account. At the end of the day, the balances should be the same but the conversion costs eat into new sales and service time.

4. ***Switches**:* In some markets, competitors switching programs are an erosion wave that drastically hits renewals mentioned above. Institutions must be aware of "public registration records" where competitors can mine for relationship renewal information and start an "attract process" six to three months ahead of time. Although this primarily applies to mortgages any chattels registered are public and some make the registry office a daily market research stop. Instead of waiting for switch signals, remember to have a proactive set of tactics during the first 90 to 120 days after opening the customer file.

5. ***Competitive Actions:*** All competitors whether full service or niche players have their sites set on your customers through sales target lists or product innovations. The market is overcrowded with traditional competitors, Internet attackers, brokers for everything, everywhere and emerging or new entrants to your marketplace. This competitive force will, regardless of your best efforts, take some of your business and add to the churn.

This is not an all-inclusive list of churn creators but it should give you a sense of the implicit costs and the need to know how customer preferences affect the churn and hence the distribution or customer delivery business. Yes, there are counter strategies for churn actions and these can be effective in reducing costs, customer abandonment and competitive vulnerability.

C) Sales & Service Costs

With every product we have at least two operating costs after design, development, testing, training and implementation. We refer to these as the sales cost and the transaction or serving costs. Both of these in turn are affected by the delivery channel in which the action and activities happen – a branch, call centre, ATM, Internet, commissioned sales/service force etc.

If we look at sales costs for specific products we find significant variances e.g. take an average loan application, interview, scoring, setup/documentation and draw down (this excludes any consideration for the marketing and promotion costs which we assume are shared over all channels through which the loan can be sold). The sale of a loan involves both variable costs and an allocation of recovery for fixed costs. Perhaps the fully absorbed sales cost is $400 to $500 through the branch. With the call centre setup this could drop to $150 to $200 and the Internet choice a$50 to $85. Wow! Cost differentials can be major and if consumers prefer the virtual access of the latter two and these channels are not available at the customers' initiation, there is an opportunity lost cost as well.

Whether we are addressing sales or service costs, we need to know roughly if our competitors share similar cost elements and sizes thereof or if they have advantages in the market place. If certain costs of yours are competitively high and the sales and/or servicing related to highly preferred products, you need to address cost management surrounding these items. Some answers can be related to process reengineering where we have found 25% to 40% savings. Alternatively there are co-sourcing and outsourcing options which can go as far as reducing costs by 75% using international resources.

Clearly, an institution's distribution business is influenced in major ways by sales and service cost differentials as well as the intangible customer satisfaction values. Assuming one is or can be the best in all these cost elements can be dangerous. In fact, not having reliable sales and service costing programs can signal a management gap affecting eventual survival.

D) Branch Proximity & Profitability Analysis

Branches and their locations need to be analyzed periodically due to changes in customer patterns, traffic flows, new local competitors, commercial or residential development plans, bylaw changes, physical state of the facility, etc. Mathematical models can assist in this process but complete reliance on same would be misguided. Two of the obvious core elements are proximity and profitability.

Proximity refers to distance/access relationships with other branches of your company as well as closeness of competitive units from full service to brokers. With traffic flows laid out on a local map with average volumes (available from municipalities in sizeable locations) one can undertake mathematical exercises to determine how many competitors are potential intercepts within a kilometer, five kilometers, or other set distances. Besides visualizing the maximum potential flow and probability for your unit you can do likewise with competitors' branches. Analyzing changes can be the initial signal to consider relocating, consolidating or even enlarging or closing a facility.

Profitability, of course, is an imperative for any unit and the financial parameters should include all business supported by the branch (servicing other branch customers, as well as business customers accounted for elsewhere) in costs, revenue and value. Various approaches exist to calculate contribution i.e. variable cost coverage, fully absorbed costs (fixed and variable) including head office allocations and potential costs three to five years out. Similarly, on the revenue side some only consider direct accounting income, direct and indirect or a total group contributions model. In performing the financials, a customer centric approach is always warranted and beneficial. Over time, customers relocate and retain all or some business with their "home branch". Others start new relationships, hopefully with your institution in another location. If plans are going to assess alternative location purposes, it is important to know what relationships are in danger or expendable from a particular location. Today this may be less of a concern to some with their multi-channel options if customer feedback confirms such and "gut feel" doesn't direct the strategy.

E) The Cost of Human Resources & Knowledge Management

I have learned more and more recently from an expert in knowledge management the related people costs amongst the channels of distribution. Retirements, turnover and policy changes have and are continuing to erode our greatest business asset – people's knowledge. Most corporations do not have an inventory of this asset on a balance sheet, so accounting is somewhat ambiguous even though we see the costs.

For example, one company that I am close to changed their policy mix for front line branch staff a few years ago to the point that contract or part time resources dominated customer moments of truth daily. These people receive basic transaction training at the beginning of their job and thereafter, unless they are paid they do not normally attend ongoing knowledge building sessions. One officer rightly speculates that there has been erosion in staff morale, customer satisfaction, and the churn has been accelerated. Transaction times appear to have lengthened as well as the perception of wait times and line-ups. In fact, customers can feel less recognized and less appreciated, which can create an opportunity cost through the lost business "trickle".

Another example is in the call centre business where the majority of agents turnover annually. I used to say thirty thousand dollars was the start up knowledge training investment for agents but at this high level of turnover the erosion in teamwork, productivity etc. adds to the annual operating budget. If you are training people to take higher paying, identical jobs, elsewhere, then knowledge management perhaps should be on the radar screen.

Finally, the case of a bank which offered "early retirement" packages to anyone over fifty five in hopes of making room for new university recruits for between 8% to 10% of the workforce. You know the response! Most employees over 55 accepted packages if they were eligible, leaving the bank with a major knowledge vacuum and early retirement expense double that which was anticipated.

These are only a few of the examples in knowledge management costs which are occurring today, although the true cost is escaping many post mortems. In financial services, retailing knowledge acquisition, building, nurturing and management can change the competitive position of a delivery channel quickly. Sales and service requires stability in relationships and continuous mutual learning with customers. Trends in the opposite direction represent costs that need to be quantified and repositioned. Showing a lonely expense line for training and development is only the tip of the iceberg.

F) Other Delivery Costs Solutions

Distribution dynamics can hide other significant costs if they are not managed from a customer perspective – end to end. I want to highlight three of these briefly.

Problem Resolution: Complaints, concerns etc. occur everywhere in a multi contact financial service organization. Generally, each officer who handles one of these issues reinvents the resolution each time, everywhere in the organization. Preventative tactics are not in place nor are centralized resolution/remedial processes. The solution set is a customer care portfolio designed to listen and learn from customers as well as continuously remove recurring themes and the related costs.

Resource Scheduling: Within delivery channels, we normally think of peaks and valleys in sales and service workflows. A call centre operating 7/24 obviously needs a variable plan of agents on the job. Similarly, branches require a scheduling process, which ensures that staffing mirrors customer visitation patterns based on scientific projections. Work scheduling can be managed locally or centrally using expert software to save costs but not jeopardize service or sales.

Cash Management: Cash in the operating system is a cost whether it is in a teller's drawer, the vault, ATM or an armoured car. The tracking, predicting and managing of cash on hand through a software program and management principles leads to decrease channel costs of a recurring nature.

Other costs affecting delivery such as heat, power and communications have all attracted focused expert auditors to save double-digit costs. If we can deliver to our customers for less cost, greater speed and accuracy and hence more satisfaction, we build loyalty and repeat revenue as expenses decrease – an equation for success.

Summary

The management of the financial dynamics in your distribution business has many facets, all commencing with the customer and ending at the bottom line. Your network planning toolkit needs strong financial knowledge and analytics if channels are to be competitive customer centric delivery assets. Since delivery variables change constantly, the toolkit is used for continuous diagnostics and improvements. Everything that goes into making a channel successful in sales and service should produce net positive results, which continuously grows with repetitive applications.