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Mapping Customer Segments for Personal Financial Services

Tina S. Harrison

Reports the results of a qualitative study of financial services consumer behaviour.

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Introduction

The financial services industry has undergone dramatic changes in the last decade altering both the structure of the industry and the way in which it operates. Deregulation in the 1980s with the introduction of the Building Societies Act (Brooks, 1989) has enabled building societies to operate more freely. They are now able to compete directly with the banks for the same customers. Consequently, the traditional domains of the banks and the building societies are now being eroded. The sector which is now emerging is one of financial services.

As a result of the relaxation of legal restrictions, this sector has experienced product proliferation. The number and range of products on offer has increased greatly as financial institutions have aggressively attacked all segments of the market. Marketing has begun to increase in importance, although the urgency to adopt marketing concepts and strategies has not been apparent since market opportunities have been favourable.

The 1990s, however, have brought about a very different picture. Financial institutions are now facing rising costs, reduced consumer spending, market saturation, increased competition and the recession. Profit margins are being squeezed and financial institutions are being forced to rethink their marketing strategies in an attempt to maintain a competitive edge. In contrast to the expansion and diversification of the 1980s, financial institutions are now experiencing rationalization and streamlining of their businesses (Kitching, 1982). It has soon become apparent that financial institutions can no longer be all things to all customers. The importance of identifying profitable customer groups is increasing and market segmentation strategies, which recognize the importance of concentrating on the needs of homogeneous groups within a larger heterogenous market, are receiving greater attention.

Financial Service Segmentation

Much work has been conducted into the segmentation of retail financial services customer markets (see Speed and Smith, 1991 for a review of the literature). However, too much has been either too simplistic, too descriptive or merely replicative of similar research conducted by financial institutions themselves.

Segmentation methodologies fall into two areas. The first of these deals with a priori approaches to segmentation whereby a basis for segmentation is chosen, such as product ownership or usage, and results from the survey provide estimates of segment size and the characteristics in terms of demographics, socio-economics, etc. (Wind, 1978).

The majority of segmentation research in financial services has tended to be a priori in nature. The characteristics chosen have been largely demographic and in uni-dimensional form which has concentrated on only one variable at a time. In particular, variables such as stage in the family life cycle and social class have been utilized (see for example Baker and Fletcher, 1987; Mathews and Slocum, 1969; Meidan, 1984; Stanley, *et al.*, 1985). The stage in the family life cycle is an important consideration since it has been noted that individuals do have different financial needs and objectives as they progress through life. However, there are problems associated with such an approach to segmentation. A priori methods investigate only the characteristics of the selected segment; they do not attempt to measure the profitability or the size of the segment against the remainder of the market. Moreover, there is not necessarily a link between the segments selected and buyer behaviour. Thus, it is possible to describe differences between behaviour of customer segments on the basis of external characteristics, but these external characteristics are not necessarily the determinants of behaviour. It is the determinants of behaviour which are of importance.

The second approach, which has gained much less attention because of the need to employ sophisticated computer equipment, is that of *post hoc* segmentation. This method involves dividing a heterogeneous market into segments based on their homogeneous responses to a survey (Gwin and Lindgren, 1982). A very comprehensive review of the studies involving these techniques has been provided by Speed and Smith (1991). The majority of research in this area has tended to rely on cluster-based models which group individuals according to their homogeneous responses based on the inter-correlations between items. These models generate difficulty in accessibility to markets as there is often a weak link between the results produced by clustering and the characteristics of individuals in terms of demographics and socio-economics. A discriminant approach is more desirable, which discriminates between variables and highlights the relative importance a number of independent variables have on the dependent variable. The clustering approach, on the other hand, is unable to demonstrate this as it does not distinguish between dependent and independent variables, and since all variables in a cluster-based model are in effect dummy dependent variables.

Understanding the Consumer

It is apparent from reviewing the literature that segmentation studies in personal financial services have not been adequate. While past research in this area has provided detailed descriptions of customer groups in terms of their attitudes and financial behaviour, it has been unable to provide the essential information financial institutions are seeking: who are likely to be the profitable customers and how can they be located?

In order to provide the answers to these questions segmentation studies must be more holistic. The answer lies in gaining a greater understanding of the financial services customer and his/her behaviour. The traditional segmentation variables of age, stage in the family life cycle and social class have provided little insight into financial services customer behaviour. Furthermore, evidence suggests that these are now less than optimal bases in view of recent societal trends such as the changing structure of the family as a result of increased divorce rates, and the increasing number of individuals who choose not to marry (Cornish and Denny, 1989; Derrick and Lehfeld, 1980; Leach, 1987; Wagner and Hanna, 1983).

Research studies must focus on the financial services customer and the perceptions, attitudes and motivations he/she has towards financial services. Psychographic segmentation attempts to address these issues since it hinges entirely on the way the customer thinks (Wills, 1985). Psychographics look at “the inner person rather than the outward expression of the person” (Beane and Ennis, 1987, p. 22). However, according to Ziff (1971), the definition of psychographics remains a controversial one and is perhaps a main contributory factor to much of the confusion that surrounds it. To some researchers psychographics refer to basic personality characteristics, whereas other definitions include attitudes, values and beliefs. In addition to this the general concept seems to be foreign to the traditional running of many financial institutions and is perhaps one of the reasons why psychographically-based research has not yet reached its full potential in segmenting the market for personal financial services.

Such an approach to market segmentation, which focuses on the customer and his/her mind set, is potentially very complex. In order to take full advantage of the factors which could affect take-up and usage of financial services it is necessary to develop a multi-dimensional model. This allows for a greater number of variables to be included in the study from which determinants of financial services behaviour can be identified and markets segmented.

In addition to this it is important to analyse the market segments in terms of the implications for potential profitability. Since adequate means of identifying profitable customers quantitatively are not available, a qualitative assessment of potential profitability is being used which provides an indication of the relative degree of income likely to be generated as a result of the customer’s behaviour in the use of financial services. By nature financial services are not one-off purchases but involve a series of two-way transactions over an extended time period (McKechnie, 1992). It is this post-purchase period and the behaviour of the customer therein that is of importance in assessing potential profitability.

Research Problem

The research outlined in this article is the initial stage of the development of a multi-dimensional model for segmentation in the personal financial services sector. The work presented here is based on a preliminary qualitative study which attempts to highlight variables for segmentation in the personal financial services sector which may prove to have deterministic power for financial services behaviour. A detailed quantitative study is currently under way to investigate the relative sensitivity of the variables chosen in identifying potentially profitable customer segments for financial services.

Methodology

Sampling Procedure

Individuals were interviewed in detail about a wide range of financial services and products. The individuals were selected from the Register of Electors for a particular ward in the Manchester area which is known to contain a relatively heterogeneous population, thus accounting for a variety of different individual characteristics. Letters were mailed to 33 households selected at random from the register and follow-up telephone calls were made to arrange interviews. Forty-five per cent of the individuals from the households contacted agreed to an interview, thus giving a sample size of 15. Although this is a relatively small number, it was considered to be sufficient for an exploratory study of this kind. Interviews were conducted in the respondents' homes and lasted between one-and-a-half to two hours.

Test Variables

The variables chosen in the study were selected on the basis of the limitations presented earlier in segmentation studies in the personal financial services sector. In an attempt to achieve a greater understanding of the financial services customer and how he/she uses financial services, several aspects of consumer buyer behaviour have been developed as segmentation variables. The following variables, in particular, have been considered to be of prime importance.

- Individuals' own perceived knowledge and understanding of financial services.
- Perceived confidence and ability in dealing with financial matters.
- Expressed level of interest (involvement) in financial services.

The variables were measured on the basis of the individuals' own self-assessment of how they perceive their own levels of knowledge, confidence and interest to be. Thus, the measurement tool was a subjective rating, although the majority of respondents found it useful to rate themselves also on a scale of 1 to 10.

In addition to the cognitive variables mentioned above it was also necessary to have some account of financial services usage for each respondent in order that the relationship between financial services consumption and knowledge, confidence and interest could be examined.

Financial services customers rarely have just one product, but rather are customers of a range of products or a "package". Thus, the relationship between the customer and the financial institution can become very complex as there are numerous points of contact. Therefore, rather than analyse the results in terms of discrete product holdership it was decided to adopt a technique to categorize individuals in terms of their financial consumption. A study by Kamakura *et al.* (1991) found that financial services consumption and service acquisition appears to occur in a hierarchical order from higher-liquidity, lower-risk products to those requiring greater resources and with lower liquidity. This enables both financial services and users to be positioned along a "latent" difficulty/ability dimension which assumes that the more "difficult" financial products require higher levels of investment "ability" or maturity. Thus, according to this concept, the ability (in financial terms) to become involved with any of the basic foundation products (i.e. current accounts, savings/deposit accounts, loans and mortgages) is necessary before the more "complex" products, involving longer-term commitment, resources and risk are looked into.

This hierarchical movement between financial services is referred to as "financial maturity", which hypothesizes that individuals move from lower-order to higher-order financial products and ownership of higher-order products presupposes ownership of lower-order products (or at least the ability to own them).

Running concurrently to this is the notion of financial objectives and the financial life cycle. Financial objectives or financial needs also form a hierarchy that evolves over time. Thus, individuals and households have a financial life cycle reflective of the needs and objectives which are of importance at particular stages in the family life cycle. For example, consider two groups of financial services (credit and loans, and savings and investments) which individuals and households acquire. Savings products can be viewed as a means of financing future consumption based on current earnings, whereas credit and loans products are viewed as methods of financing current consumption based on future earnings. Both take-up and ownership of these products have been hypothesized to depend on financial needs or objectives and ability to acquire (Katona, 1960). For example, such objectives could be to save (borrow) for the sake of emergencies, maintaining liquidity, making major purchases, children's education, retirement, growth in capital value or generating future income (Kamakura *et* *al*., 1991). Certain needs/objectives assume that others have already been or are capable of being met.

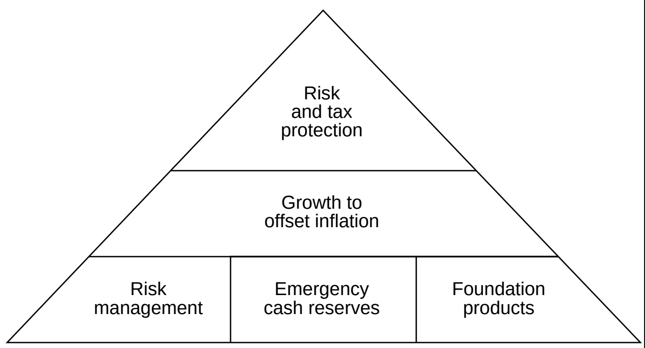
Figure 1 illustrates the hierarchy of financial needs/ objectives. The diagram shows the movement of financial services customers from the base of the pyramid to the tip. There is a general observation that individuals move from the less risky assets to the more risky ones.

The hierarchy of financial objectives is very similar to the hierarchy of needs proposed by Maslow (1970) which states that the lower, basic needs pertaining to human survival must be met before the higher needs, which are not directly related to human survival but relate to life enhancement and quality of life. In terms of financial services consumption the question of resource allocation is of importance. It is, therefore, expected that basic objectives such as liquidity, cash reserves and insurance are satisfied before allocating funds for higher-order products. However, similar to Maslow's hierarchy of needs, the extent and rapidity of the upward movement varies from individual to individual as a result of a number of factors.

Analysis of the Data

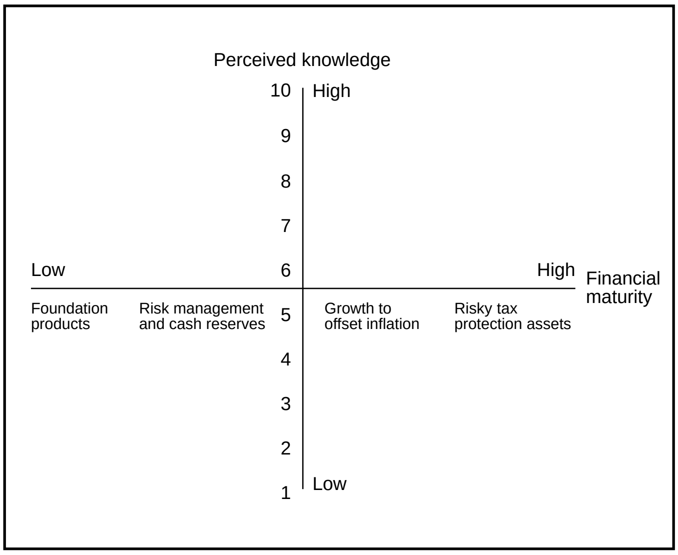
The analysis consists of mapping the 15 respondents in the sample on a two-dimensional map (see Figure 2) constructed from the variables mentioned above. The vertical axis, labelled perceived knowledge, takes account of the individual's own subjective assessment of how much they feel they know about financial services. It also takes account of how confident the individual feels about his/her level of knowledge. Respondents were also asked to verify their verbal account of how knowledgeable they feel by placing themselves on a scale of 1 to 10, where 1 is not at all knowledgeable and 10 is extremely knowledgeable. Thus the map illustrates high and low perceived knowledge where low = 1-5 and high = 6-10.

Figure 1. *Hierarchy of Financial Needs*



Source: Adapted from Kamakura *et al*. (1991)

Figure 2. *Two-dimensional Segmentation Map*



The horizontal axis measures the "degree of financial maturity" as defined by Kamakura *et al.* (1991). Based on the previous discussion of hierarchical financial objectives and the complexity of the financial product the following scale of financial maturity is being used:

Financial Maturity Scale

(1) *Foundation products*:
- Cheque account (and related services).
- Savings/deposit account.
- Credit card.
- Mortgage.
- Loans.

(2) *Risk management and cash reserves*:
- Life assurance.
- Endowments.
- Pension plan.
- Time deposits/TESSAs.

(3) *Growth to offset inflation*:
- Stocks and shares.
- Unit trusts.
- Personal Equity Plans.

(4) *Risky, tax protection assets*: Government bonds.

(Adapted from Kamakura *et al.*, 1991.)

Financial maturity is also measured as low and high, where low financial maturity is defined by individuals having current usage of any of the foundation products and risk management and cash reserves. High financial maturity is exhibited by those individuals who are involved in more risky, tax-protection assets and whose objectives are growth to offset inflation.

Findings

The findings (illustrated in Figure 3) highlight four financial services customer segments based on their level of knowledge and understanding of financial services and on their degree of financial maturity. The segments are labelled "financially confused", "apathetic minimalists", "cautious investors" and "capital accumulators" which reflect the characteristics of the individuals in each of the segments. Each segment is characterized by particular attitudes towards financial services, perceptions of financial services, financial services behaviour and also degree of future orientation. There are also differences in financial objectives and motivation and the implications each segment has for potential profitability. A brief description of each segments characteristics follows.

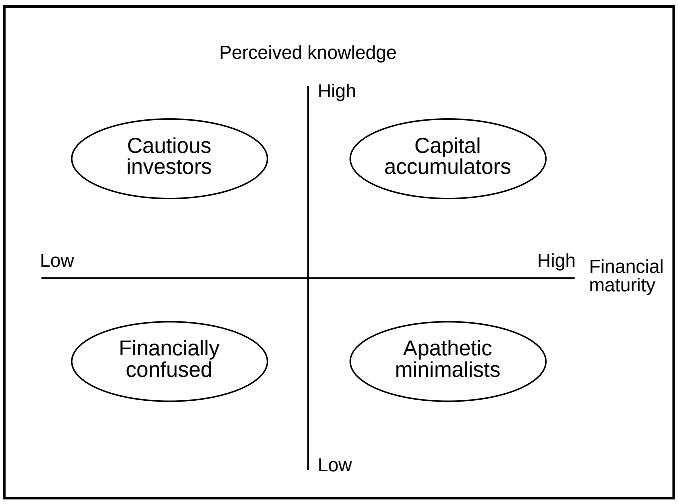
Financially Confused

This group is characterized by a low level of perceived knowledge and a low level of financial maturity. Thus, individuals in this segment have a nominal involvement with financial services. The majority of products used by this group tend to be foundation products such as cheque accounts, savings, loans and mortgages. Individuals do not claim to be very knowledgeable about financial services, least of all about the one(s) that they themselves have and use.

A common feeling of this segment is one of apathy towards financial services. The level of interest is very low, which may be a prime factor driving perceived knowledge since although respondents claim to know very little, at the same time they feel they do not need to know very much because they believe that they are unlikely to ever have a need for many financial products.

The four respondents which fell into this segment seemed to divide themselves evenly into two sub-segments based on their differences in the types of foundation products used and their attitudes towards them. Obviously, these sub-segments are very small and cannot be taken as conclusive evidence of financial services customer behaviour. Nevertheless, they do provide an insight into the possibilities that there are for further segmentation within broadly defined segments.

Figure 3. *Financial Services Consumer Segmentation*



The first sub-segment (financially confused savers) is characterized by a very limited use of foundation products with no use of credit and loan facilities and only a small amount of savings. Attitudes towards borrowing and loans are definitely unfavourable. However, whenever such financial services have been used it has been with caution and reservation. A possible reason for such negative attitudes could be a result of a strong fear of debt and worry of not having enough money. This has resulted in a small amount of savings with the short-term objective of "emergency cover". Individuals in this group are also extremely cautious and wary of shares and other financial products perceived by them as being too "risky".

The second sub-segment (financially confused borrowers) exhibits a much wider use of foundation products, particularly loans and credit facilities. Not surprisingly, these individuals express no strong negative attitudes towards borrowing and the use of loans and have no reservations about the use of credit/borrowed money. However, the future orientation of these individuals is also rather short term due to an apathetic view of savings and investments and short-term objectives of borrowing money.

Apathetic Minimalists

This segment is characterized by a fairly low level of perceived knowledge of financial services, although a quite high level of financial maturity is exhibited. Thus, despite the lack of knowledge individuals feel they have, they do own fairly complex and high involvement financial services such as stocks and shares and unit trusts and PEPs.

Similarly to the financially confused segment, the five respondents who fell into this segment of the map could be divided into two groups characterized by saving-dominant responses (two individuals) and credit-dominant responses (three individuals); the former exhibiting very limited use of foundation products, with particular emphasis on savings, and the latter showing a much wider use of foundation products, in particular loans and credit services. A prime reason for this could be due to the stage in the family life cycle into which respondents in each of these two subsegments fall. The saver-dominant sub-segment is comprised of individuals in either the bachelor or empty nester stage of the life cycle (Wells and Gubar, 1966). Hence, they are unlikely to have dependents and financial commitments in terms of family and mortgages. Thus, these groups are less likely to exhibit a need for loans and credit facilities.

The credit-dominant sub-group is comprised of individuals largely in the full nest stage of the life cycle (Wells and Gubar, 1966). Thus, by definition these individuals will have families and dependents to support and mortgages to pay. They are, therefore, more likely to have a need for borrowing since expenditures at this stage of the life cycle are very high relative to income, and opportunities for saving are much fewer.

Despite the differences in the use of foundation products exhibited by the two subsegments, there do not appear to be any strong negative attitudes towards loans and the use of credit. However, the saver-dominant sub-segment does seem to have a definite fear of getting into debt which has possibly led to extreme caution in the use of loans. Furthermore, these respondents feel that loans should only be used in an emergency, which would suggest a reactive approach to borrowing.

Individuals utilize loans to achieve their aims in life

The credit dominant sub-group does not appear to suffer from this fear of debt. The behaviour of this segment is also different with regard to the usage of credit and is also slightly more extravagant. This segment exhibits a rather proactive approach to borrowing and individuals will utilize loans and credit to achieve their aims in life.

As well as the feeling that knowledge of financial services is very low, this segment also appears to have a very low level of interest in financial matters. In fact, it seems that individuals in this segment do not attach very much importance to financial services at all which could be a primary factor affecting motivation.

Individuals also reported low levels of confidence in their knowledge of financial services as well as in their ability to deal with financial services. There was a general feeling that advice would need to be sought on particular services. As a result of this they appear to be willing to entrust third parties with their decisions and delegate the responsibility to someone else – a financial institution. This would also explain the fairly high degree of financial maturity exhibited by this group as take-up of the complex products held by respondents was instigated by financial advisors.

A further explanation for the high degree of financial maturity could be found in the type of products owned by these individuals. In terms of the shares reported, the majority were from the recent government privatization issues. A report conducted by Financial Research Services (1988) indicates that there has been an influx of new investors to the stocks and shares market via the various privatization issues which has made share buying more accessible to a wider range of individuals and has heralded a shift from the traditional up-market profile of this type of investor. Thus, it may be argued that this somewhat “simplified” method of share buying requires less financial sophistication than other forms of share buying and is essentially an “easier” method of buying shares.

Cautious Investors

The three respondents in this segment perceive themselves to have very good knowledge of financial services and yet they exhibit only a moderate degree of financial maturity concentrating mainly on savings and investment items but ignoring those which they perceive as being too risky.

In terms of the use of foundation products there is wide usage by this group, including loans. They are not afraid of loans and have no fear of debt, neither do they have any strong attitudes towards loans and the use of them. However, if this segment were to borrow money, they would look for what they consider to be the “cheapest” alternative. This would usually involve using interest-free credit from a retailer, borrowing from an insurance policy or using a charge card. Usage of credit cards does not fall into this group of perceived cheaper alternatives. Consequently there appears to be a dislike for credit card usage from this segment. The problem is not with the credit card itself, as the convenience offered by the credit card is seen favourably. However, cost in terms of interest is considered to be too high to use on a regular basis. Thus, credit cards used by this segment experience only selective use.

In terms of the higher involvement, more complex financial products held by this segment, the emphasis is on “safer” savings items, particularly in the form of insurance or private pensions. The cautious nature of these individuals seems to cause them to avoid such investments as PEPs, shares and unit trusts with a definite aversion for speculation and the risk attached to it.

The knowledge and financial sophistication of this group appears to be influenced by occupations in professional/ business capacities. This too may be a reason for the high level of interest individuals in this segment exhibit towards financial services and related matters.

A further observation of this group is their future orientation. In contrast to the financially confused, who take a rather short-term view of their futures and have mainly short-term objectives of saving for emergencies, this group have much longer-term financial objectives. Thus, they are not worried or opposed to tying their money up in an investment, just as long as it is perceived by them to have very little risk attached to it. Respondents are particularly aware of the importance of making provisions for their futures; thus they re-evaluate their financial situations periodically.

Capital Accumulators

This segment is characterized by a very high level of perceived knowledge and understanding of financial services as well as a high degree of financial maturity. Thus, the three individuals in this segment have complex, high-involvement financial products such as unit trusts and PEPs about which they feel very knowledgeable and confident.

In many respects the respondents in this segment are very similar to those in the cautious investors segment with one major exception, the capital accumulators are not averse to speculation and are, in fact, favourable towards the products perceived by the other segments to be high risk.

In general, this segment exhibits very selective use of the foundation products with a distinct lack of credit/loan usage. Again, this could be due to the age of respondents and the stage in the family life cycle, as this segment is comprised largely of respondents who are either in or near retirement age, have finished paying their mortgage and have no dependents.

While there did not appear to be any strong attitudes towards loans and the use of credit it was not viewed as very favourable. The prime reason seemed to be not fear of getting into debt but, similarly to the cautious investors, the expense incurred through interest payments. Consequently, in cases where credit was used, “cheaper” alternatives would be sought such as interest-free credit from a retailer, in the case of major purchases, or the use of credit cards, to take full advantage of deferred payment, and credit card balances would always be paid in full so that no interest cost is incurred.

Similarly to the cautious investors this segment also has a strong future orientation which seems to be reflected in the type of products used. The value of interest on savings and investments and income generation through financial investments is of greater importance than easy access to funds.

Analysis has suggested four customer segments

As with the cautious investors, the high levels of perceived knowledge of financial services and, indeed, the high level of interest in financial matters could also possibly be as a result of occupations in financial and business-related fields.

Conclusions and Implication

The analysis has suggested four customer segments for financial services on the basis of customers’ own perceived knowledge, confidence and interest in financial services and the relative degree of financial maturity, defined by the type and complexity of financial services currently in use by the respondents. Each of the four segments is distinct in terms of the financial objectives exhibited, motivations for financial services usage and attitudes and behaviour towards financial services. Both the financially confused and the apathetic minimalists take a rather short-term view of their futures. The financially confused segment is primarily concerned with saving for emergencies but otherwise has negligible use of financial services. The apathetic minimalists have slightly higher perceived knowledge of financial services and much higher financial maturity. However, the degree of financial maturity appears to be the result of successful selling on the part of financial institutions. This segment is very trusting and willing to take the advice of financial advisors. Hence, an easy sales target.

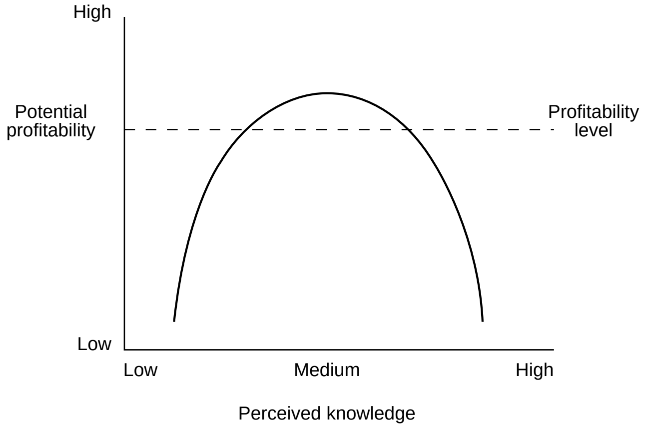
The capital accumulators have a similar degree of financial maturity to the apathetic minimalists. The difference between the two is that the former have made a conscious effort to become involved in the higher-risk products and are in fact motivated by the perceived benefits offered by these products. The apathetic minimalists would otherwise not have bought such high involvement financial products if it had not been for the advice given.

The cautious investors are very much like the capital accumulators in that they are very future orientated and their financial objectives are very long term. The difference is that the former prefer to avoid high-risk products and opt for "safer" investment type products, although both segments are in favour of tying money up and high returns are more important than easy access.

At this stage it is not possible to draw conclusions as to whether customer's own perceived knowledge, confidence and interest in financial services are determinants of financial services behaviour or indeed potential profitability. However, it does appear that segments defined according to these variables do exhibit distinct attitudes, motivations, financial objectives and behaviour. It also seems that, based on the behaviour exhibited by the segments, there are opportunities for differing levels of potential profitability from each of the segments. Figure 4 hypothesizes the relative level of potential profitability from segments with low, medium and high perceived knowledge based on their behaviour towards financial services.

Figure 4 indicates that the segments with extremely low and extremely high perceived knowledge offer the lowest levels of potential profitability. The explanation for this is that those with extremely low levels of perceived knowledge also seem to have very low levels of interest in financial services and do not seem to attach a great amount of value to financial services. As a result of this it appears that overall behaviour towards financial services is low and product usage is limited to a selective number of foundation products, mostly a savings account, a mortgage and a current account. The customers with a very high degree of perceived knowledge of financial services would also seem to possess a high level of financial sophistication. These individuals, therefore, know which products are best suited to their needs. They are also likely to approach an independent source which

Figure 4. *Conceptual Segment Profitability*



may not necessarily allow for fee generation for financial institutions.

The customers who fall into the category of moderate level of perceived knowledge and confidence in dealing with financial matters seem to offer the greatest opportunities from the financial institution's viewpoint in terms of potential profitability. The point at which this becomes crucial is unclear; so too are the reasons for this. However, it is suspected that individuals in this category may fall victim of lack of information or misinformation. Certainly, the results of this study have shown that certain respondents are easier sales targets than others which may provide opportunities for profit potential.

Certain respondents are easier sales targets than others

It must be stressed that this is only preliminary work and further quantitative work is being conducted to further test the discriminatory power of the variables explained here. However, from the results of the qualitative work it would appear that individual perceived knowledge, confidence and interest in financial services could possibly form determinants of financial services behaviour and potential profitability. If this is the case they could prove to be valuable bases in segmenting the market for personal financial services.

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