The Dawn of a New Financial Services Industry

How will you address the disruptions in the market today and capitalize on the opportunities they present?

A FAST white paper

Introduction

Market challenges such as increasing competition, declining customer loyalty, and growing customer expectations are changing the nature of the financial services industry. A defensive approach is no longer sufficient. Rising to the occasion by appealing to customers' heightened expectations can turn challenge into opportunity for competitive advantage by raising the bar. But it will require a pervasive commitment to understanding your customers and to addressing their needs at the right time and in the right place, delivering superior value.

Increasing competition. Consolidation. Waning customer loyalty. Increasing customer expectations. While these challenges are profound, they are far from being intractable. In fact, successful companies are not only weathering the storm, but they are also turning these challenges into opportunities for competitive advantage. They are adopting profitable product lifecycle strategies, providing superior value to their customers, and increasing their customer relevancy.   They are moving aggressively to address lucrative, rapidly-growing market spaces with pervasive customer-centric strategies to provide enhanced customer value. It is truly the dawn of a new era in the financial services industry and this paper will show you how to claim your stake.

Market Challenges Grow

The Gramm-Leach-Bliley Act and other legislation have opened up markets and increased competition. The result has been increased merger and acquisition activity and industry consolidation, including the acquisition of Fleet Boston by Bank of America. Consolidation has changed the market landscape. Today the 10 largest commercial banks control 49% of all banking assets in the U.S., but as recently as a decade ago this figure was only 29%. Consolidation activity has not been limited to the U.S. M&A activity has also been strong in Europe, where cross-border buying often occurs.

Competition has been a growing part of the market landscape. Online banking has grown in popularity and the resulting decrease in switching friction has made it easier for customers to change banks. Customers have also grown more sophisticated and more aware of their banking options.

Banks are wrestling with the twin problems of declining loyalty and increasing churn as customers shop around more and switch more frequently. Research has found recently that U.S. banks acquire new checking account customers at an average annual rate of 17%, but lose accounts at the rate of 15% a year. Only a few banks actually experienced a net gain of more than 2% annually, with about half losing customers.

Another trend compounding the challenges for the industry is simply customer sophistication with technology. This has steadily grown over the last few years with widespread access to broadband and familiarity with the web. We have all gotten used to free, nearly instantaneous searches that put vast amounts of web content, including news, video, and images, at our fingertips. As the sophistication of consumers has grown, so have their expectations.

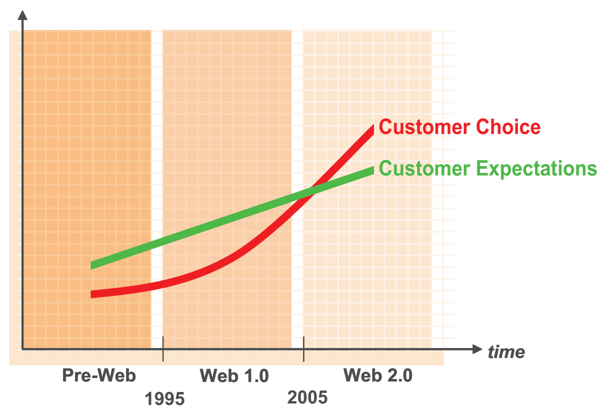

Figure 1: Expansion of Customer Choice and Expectations

Consider the trends shown in Figure 1. Prior to the pre-web world, i.e. 1995 and before, consumers did not have great visibility into the options available to them in the market. This lack of accessible information about alternatives kept customer expectations in the financial services industry relatively muted. However, the Web began to change that. Pervasive, free information online increased the actual number of choices available to customers. Still, in the Web 1.0 period during the Web's first decade, expectations have outpaced the actual number of choices available to customers. Only since the advent of Web 2.0 has the visibility into the number of choices available increased dramatically. Rampant price competition within the financial services industry, coupled with easy access to free information online, has taught customers to look for the best deal being offered. Customers switch firms and stay put only until the next deal comes along. Clearly, the abundance of information has resulted in great awareness of the choices available and has created a better-informed customer whose willingness to pay for commoditized services has eroded significantly.

Furthermore, as consumers have grown more internet-savvy, they have naturally assumed that if they can access information for free online, then large, profitable banks should be able to provide them the same easy, quick access to information. At the very least, consumers expect that the personal data collected about them should lead to a better quality of service and greater personalization. These heightened expectations represent an opportunity to provide differentiated services for which customers are willing to pay premium.

Opportunity Knocks

There are several key strategies to take action and turn these rising market challenges and customer expectations into opportunities:

- **Adopt an Adaptive Product Lifecycle Strategy to Fully Capture the Value of Product Innovation**: Increase the value extracted from product innovations over their lifecycles, from differentiated new offers to commoditized products.
- **Increase Customer Inertia**: Make the customer experience more "sticky" by increasing switching costs. This makes it easy for customers to stay and hard for them to leave.
- **Differentiate by Delivering a Superior Customer Experience**: Enhance service through effective customer intelligence. Innovate to provide value for your customers. Increase personalization and improve targeting. Boost your relevancy to your customers.
- **Find New Profit Pools**: Innovate to take advantage of lucrative opportunities such as the rapidly-growing retirement market.

Adopt an Adaptive Product Lifecycle Strategy to Fully Capture the Value of Product Innovation

One approach banks have used to address the challenges in the marketplace is through product innovation. A lot of money is spent in the financial services industry in this area. Research conducted by Deloitte revealed that the world's top 100 financial services institutions spend a total of $11B annually to develop new products. This would make business sense if the result were products with a competitive edge that justified their investment. However, the truth is that most financial products are easily copied. In fact, among the bankers interviewed, most felt that it was better to be a fast follower rather than an innovator in product development.

The truth is that new products start life as high-margin innovations but quickly get commoditized over time. In order to profit from these assets, a flexible technology is required. This technology needs to sensibly accommodate new products across their entire life cycle.

Scalability is also crucial in an environment where product complexity and proliferation is on the rise. At a $70B global financial services institution, the approach has been to build an Enterprise Data Solutions (EDS) infrastructure based on SOA principles to support the company's information orchestration needs. The number of systems and data sources has quickly grown over time, with EDS currently holding over 34 million records from nine separate systems. The search capability is extended as an XML service using a pub/sub model to applications requesting the data. Using this model to abstract the architecture provides maximal flexibility and performance. Response time has dropped from 10 to 20 seconds to less

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than a second even as total data volumes and query rates have quickly increased with time.

Increase Customer Inertia

An effective way to combat customer defection is to make the experience more "sticky". Make it easy for your customers to stay, harder to leave. One particularly effective way to accomplish this is to increase process benefits, which raise the switching costs for your customers. An example of this in the retail world is the use of technology to assess the prior purchase history or preferences of your customer and suggest other items likely to be highly relevant for them. In the retail financial services arena, encouraging online bill pay is a way to increase customer switching costs, as customers would think twice about the considerable trouble of reestablishing bill payment instructions to various merchants before they switched to another bank.

Reuters, one of the world's leading providers of financial information, has found a way to make their service very sticky for their customers and increase their switching costs. Over 300,000 subscribers to Reuters use their alerting service to get notified whenever a certain trigger is satisfied that matches the profiles they have specified. For example, an alert can be set to trigger when the price of a certain stock falls below a certain point, or when the volatility of a commodity increases beyond a threshold. What is the value of such a service, which can potentially lead to a subscriber reaping millions of dollars because trades are executed at the right time based on information that is provided at the right time? Even more importantly, what is the sense in switching to a competitors' subscription service, even if an alerting service with a similar level of performance were available? It would require time and trouble to set up an alerting profile all over again, and the familiar adage that time is money is very apropos here. Time is money, and often a lot of money, for many of Reuters' customers. With a high-performance alerting service, Reuters has found a way to make their user experience sticky and make it harder for customers to leave.

Differentiate by Delivering a Superior Customer Experience

Delivering superior value is the foundation for building long-term customer loyalty. Strategies which successfully enhance the customer experience require at their core a commitment to customer centricity and the ability to use customer data flexibly and in a timely manner to better understand customers and enhance their interactions with the bank across multiple touch points.

Know your customers.
The first step, not surprisingly, is to understand your customers. How can you better serve your customers if you do not know what their needs, preferences, and perceptions of current experiences are? Successful companies have aligned their business processes around the customer experience by developing a comprehensive "voice of the customer" capability. This capability requires tools that integrate multiple sources of information about customers and provides timely and actionable insight.

Enhance service through effective customer intelligence.
Better use of customer information at the right touch points can dramatically enhance customer service. A diversified financial services company with a large presence in online banking is upgrading their customer call center experience by using search technology. The current process when a customer phones the call center to question a transaction is both time-consuming and inefficient. In the new system, the payee information will be matched against a master directory while the customer is still on the phone, thus increasing the likelihood of immediate problem resolution while simultaneously eliminating a number of labor-intensive intermediate steps. This raises customer satisfaction and reduces the bank's cost to serve.

Innovate to provide value for your customers.
As your customers' sophistication with technology grows, so do their expectations that their bank be able to apply technology in innovative ways to enhance their experience. While technology has increased the number of options available to cus-

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tomers and empowered them to loosen their ties to their financial services providers, it can also be an effective tool to strengthen relationships.

Institutional companies are developing more advanced client trading platforms which provide features such as risk modeling, scenario analysis, and performance management reporting. Companies are also developing enhanced platforms to serve their customers by delivering essential information quickly and effectively. One such company is Reuters whose fast-moving environment demands speed, performance and scalability. Reuters developed the 3000xtra trading platform to deliver these features within a highly resilient architecture. This system holds detailed information on five million derivatives and financial instruments and supports over 300,000 updates per day. Even though Reuters subscribers frequently ask complex queries, some containing more than 200 search terms, Reuters has never found a single query that takes over one second to run, no matter how complex. As Ray Tomkins, search architect at Reuters summarizes, "At Reuters we are driving scalable retrieval of structured information to provide advanced search and navigation facilities for users of our premium desktop products. The core advantages of our solution are that it is reliable, versatile, and guarantees subsecond responses for all queries regardless of complexity."

Increase your relevancy to your customers. Consumers are increasingly strapped for time. "One size fits many" campaigns, such as mass mailings of credit card offers that are not well-targeted, have notoriously low up-take rates. Why? Because consumers are looking for those products and services that have meaning for them. These must align with their values and meet their needs and lifestyle. Consumers are looking for financial service providers who know who they are and provide true "service" to them by providing value. Show your customers that you understand them by providing relevant products at the right time.

To understand your customers, you rely on data on their profile, needs, preferences, and transaction history. This information must be accurate and up-to-date in order to provide a faithful picture of your customer. However, poor data quality affects nearly all companies. In fact, in a recent TDWI survey, 83% of respondents listed data quality as their single largest issue. One industry study has even estimated the total cost to the U.S. economy of data quality problems to be over $600 billion annually.

Recognizing this problem, a large bank is developing a strategy to enhance the quality of their data on customer transactions. They currently spend many millions of dollars annually to understand customer propensity to buy their products and services. With increased levels of data accuracy, they can better target their customers with the products and services that are most relevant to them. This increases both conversion rate and profitability, while simultaneously increasing customer satisfaction and building customer loyalty.

Provide personalized products and services. Customers are seeking products and services that are highly relevant to them and match their needs and values. One key way relevance is achieved is through personalization. To succeed, banks need to provide personalized service across multiple touch points.

Reuters, in providing alerts to over 300,000 subscribers, has allowed these customers to make these alerts highly relevant to them, as they track the stocks and other financial instruments that are of personal interest. In doing so, Reuters has increased both the stickiness of the service they provide as well as enhanced the relevancy of their service with personalization.

Find New Profit Pools

An example of a new profit pool is the retirement market. The retirement asset management market has never been more robust. Responsibility for retirement security has been rapidly shifting away from governments and employers to the individual. According to the University of Pennsylvania's Pension Research Council, as recently as 1992, about 40% of US families had at least one participant enrolled in a defined benefit pension plan. However, in 2001 that figure had dropped to 20%.

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Families covered by defined contribution plans rose by 20% over the same period, from 38% to 58%. Furthermore, in much of the industrialized world, including the U.S., Europe and some countries in Asia, graying populations portend payouts in retirement assets in the trillions of dollars.

Financial services firms are taking advantage of the growing asset management market opportunities as defined contribution plans continue to replace defined benefit plans. Successful companies will figure out how to craft advice and investment alternatives suited to each customer's needs as individual investors.

One large diversified financial institution that has moved aggressively to address this opportunity is ING. New account growth and fund growth have challenged them, like other companies, to provide customer data to plan managers so they can better understand their clients. At ING, this includes six million plan participants within 40,000 retirement plans serviced by the company. These plan managers need timely access to their customers' profiles and to information on their distribution of money across funds in order to better manage these accounts and to provide enhanced customer value and service. For example, they may suggest alternatives to better balance the portfolios of customers whose portfolio profile is too risky or not risky enough for their age or risk tolerance level. This will be an opportunity to enhance customer satisfaction and build customer loyalty while simultaneously increase wallet-share by selling additional products.

A New Dawn

As the Economist in a recent report observed, "The bigger the bank today, the more likely it is to be wildly different from what it was 10 or 20 years ago." With the only constant being change within the rapidly evolving global marketplace, it is likely that this observation will continue to hold true in the future.

Market challenges such as increasing competition, declining customer loyalty, and growing customer expectations are changing the nature of the financial services industry. A defensive approach is no longer sufficient. Rising to the occasion by appealing to customers' heightened expectations can turn challenge into opportunity for competitive advantage by raising the bar. But it will require a pervasive commitment to understanding your customers and to addressing their needs at the right time and in the right place, delivering superior value.

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