EMEA Banking Practice



Driving intelligent growth with Customer Value Maximization

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Following the intense uncertainty ushered in by the recent financial crisis, many bankers are confronting huge future ambiguity about markets, risk, and demand. The questions that will shape the future of banking appear, in many regions of the world, to hinge around macroeconomics and regulation. A large part of the "new normal" to which the banks are returning is the dilemma of how to deliver further growth when demand appears to be stagnant or even declining. Is there any way to fuel revenues and profits despite the aftermath of the downturn? There are certainly better ways – in the retail market segment at least – than focusing on new client acquisition, where economics show that acquisition costs often exceed more than one year's client profitability. To borrow a catchphrase: the answer lies within.

Despite the vagaries of external circumstances, banks still have vast largely untapped potential at their fingertips: their existing customer base. Banks can enhance their revenues while maximizing the value of this base using next-generation one-to-one banking similar to the customer lifecycle management approach now being applied by leading telcos. In-depth analysis of each customer's profile and preferences using state-of-the-art data mining techniques – an approach we have termed Customer Value Maximization (CVM) – can yield very positive results surprisingly fast. Banks have seen with this methodology a shift from fewer than two products per client to over six. Others have been able to increase profitability in their retail branch network by some 20 percent by combining tailormade pricing and cross-selling initiatives. CVM does, however, require a fundamental shift in frontline mindset and capabilities. This article begins by examining the differences between banks' traditional marketing approaches and CVM, then looks at the various stages in the CVM journey, and closes with a new "one-stop shop" solution for ramping up the process swiftly.

The benefits of using CVM

CVM is a proven methodology that goes far beyond basic CRM capabilities, allowing retail banks to identify and capture full potential from their existing customers, with immediate impact on their bottomline (Exhibit 1). A well-devised CVM program will make highly differentiated offers with varying product attributes to customer microsegments, rather than broadcasting the same product-based offering to all customers. Instead of static, backward-oriented segmentation, leading-edge techniques use predictive, self-adjusting models to define the best next offer for each customer. This in-depth analysis based on multiterabyte data can identify future potential by customer – far more valuable than a pure focus on current customer revenues. This data, if skillfully applied, can yield over 100 microtargeted campaigns a year with hit rates of 20 percent and above, compared to the usual handful of broadly targeted campaigns with rates of only 3 to 5 percent.

Banks that are able to capture and sustain CVM potential achieve best-in-class performance, incorporating lifetime value as a key indicator for customer targeting when prioritizing and identifying opportunities across all customer segments and levers. Their targeted campaigns use value-based segmentation and propensity models, and implement highly coherent operating models across channels and functions.

This approach is being applied within banks across widespread geographies. Canadian and Spanish banks are among the most advanced, consistently achieving a step change in the effectiveness of their commercial actions, allowing them to capture initial profit growth of at least 10 to 15 percent.

Banks' profits can be fueled in a downturn by maximizing the value of their customer base

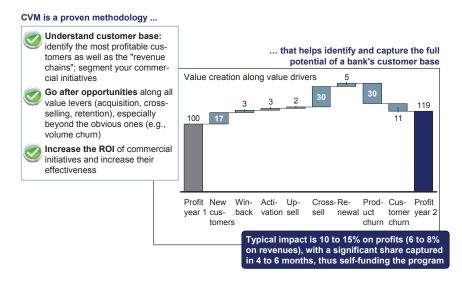


Exhibit 1

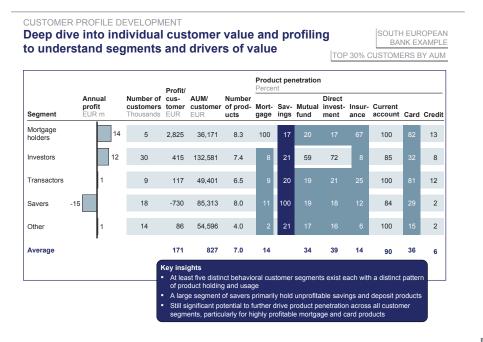
Capital One – reaping the rewards of full-fledged CVM

Capital One is one of the best-practice examples in the industry. Its co-founders call it "an information-based marketing company," not a credit card issuer. The company has been following this philosophy for many years, using individual customer value as a key indicator for its commercial initiatives. It uses customer value in its segmentation process, for example, as well as its behavioral indicators, offering open data access to its front line with a uniform and holistic view of its customer data. Capital One was also one of the first players in the industry to conduct offer prioritization based on expected increase in customer value (across value drivers), using propensity models for cross-selling to maximize the value of customers it had acquired. It also analyzes client purchase patterns and dates to infer its risk and propensity to buy specific products. As a result, it is able to target tailored customer offers (over 3,000 credit card variations) to over 100,000 segments. It also conducts highly flexible test-and-learn campaigns at a rate of more than 65,000 tests a year. These efforts are given top-priority support by the organization via elements such as a unique relational database management system, specific customer acquisition targets for employees at all levels, and an extra bonus to staff who sell higher-yielding products.

CVM in three steps

For effective CVM, it is vital that a bank first understands its customer base: it needs to identify its most profitable customers as well as its "value drains," segmenting its commercial initiatives accordingly. It should pursue defined opportunities along all value levers – acquisition, cross-selling, and retention – with a focus beyond the obvious, as will become clear in the examples below. Finally, it needs to apply rigorous execution. The heightened effectiveness of this microcampaigning and the ensuing commercial initiatives can result in hit rates of over 20 percent, with returns of over 400 percent. Of course, CVM implications are much broader than only personalized commercial offers. Typically, they influence other commercial areas that could include pricing, new product development, dedicated save-desks, or sales force incentives.

Step 1: Develop customer profiles. Creating a multichannel, multidimensional view of the customer by leveraging advanced banking infrastructure and data is the first step in the CVM journey. Lifetime perspective and potential should be incorporated as a key indicator when quantifying customer value. It is also vital to use customer value in the segmentation process, combined with behavioral indicators, and to offer this uniform, holistic customer profile view to the front line. Some banks abandon the initiative at this first stage or struggle to overcome some initial challenges like lack of information, multiple data sources, or different frontline culture. It is extremely important to focus on pragmatic solutions in customer value definition that could be further adjusted along the process (Exhibit 2).



- Step 2: Create and prioritize a heat map. For identifying and prioritizing opportunities banks need to look across all commercial levers (acquisition, customer development, and retention) and across all customer segments. Reality is typically different, however. Our recent interviews with 20 leading European banks revealed that only 15 percent of them were measuring impact of attrition on their results, with attrition including not only lost customers, but also product and volume churn. This prioritization exercise has both strategic and operational implications.
 - The first substep is to generate a heat map with large potential pools by segment/product/commercial lever. This helps banks identify areas of high importance, regardless of the scenario or strategy option, as well as those areas relevant to a specific strategic option. Different segments and levers will be used as a priority depending on the strategic goal the bank wishes to achieve: strategy should be a combination of segment and commercial lever focus (Exhibit 3).

HEAT MAP CREATION Heat map analysis can be used to identify high-level CVM opportunities by macrosegment Heat map model output – scenario 1 EUR millions, annualized Key CVM value drivers									Key valu	
	Acquisition Development			ment	Retention					
Se	gments	New cus- tomers	Win- back	Activa- tion	Up- selling	Cross- selling	Renew-	Product churn	Customer churn	Total
	Mass	30	4	40	36	120	0	25	7	262
Retail	Affluent	110	33	23	27	20	1	101	6	321
	Subtotal	140	37	63	63	140	1	126	13	583
	SOHO/Micro	40	0	21	30	52	0	22	1	166
SMEs	Small	24	0	16	15	23	0	18	0	96
3,	Medium	33	2	23	49	16	3	30	8	164
	Subtotal	97	2	60	94	91	3	70	9	426
	Total	237	39	123	157	231	4	196	22	1,009

Exhibit 3

The second substep is to identify specific commercial opportunities from the heat map by segment and to assess the relative value/importance of all key levers (acquisition, development, retention) across all main segments (retail – mass, affluent; SMEs – micro, small, medium), prioritizing commercial activities for a given year. This will mean defining areas of focus and deprioritizing others. At very advanced banks, annual commercial budgeting is verified bottom up taking into account the additional growth target for each individual client or client segment, and then adding up the results to achieve a figure for the entire network (Exhibit 4).

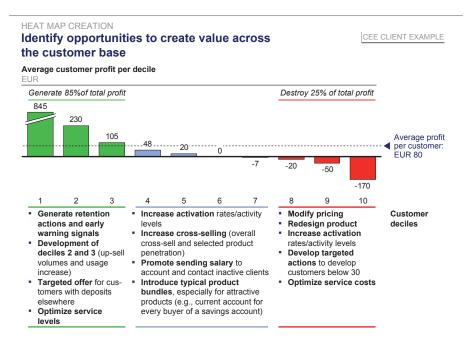


Exhibit 4

Step 3: Execute effectively across the organization. For impact on the bottom line, defining bank priorities needs to be followed by developing specific commercial initiatives and precise execution via the channels. Banks need to effectively manage a bipolar world: with sophisticated analyses in the back office, being translated into simple offers and processes for customer and frontline staff. Hence banks need to work on accurately matching customers to attractive offers and significantly improving campaign response rates by using enhanced customer information from segmentation and advanced modeling techniques. It is often critical to use multilens segmentation (for example, behavioral, needs, attitudinal, economic value, etc.), advanced modeling (for acquisition, development, and retention), both historical and predictive lifetime value, and descriptive statistics. Only then will a bank's specific actions for selected customer segments be sufficiently precise to have impact, whether through best next product to buy, alternative pricing, product rebalancing, or early warning signals of attrition. The results of these analyses need to be then translated into specific offers though sales support tools for the frontline to be able to effectively communicate with customers in this increased complexity environment.

Effective targeting of campaigns using value-based segmentation and propensity to buy/churn models is crucial in the first instance. However, banks then need to execute on campaigns more precisely by testing them before they go out into the field with them, and by using optimal marketing processes to continually improve results. Best-practice banks use multichannel, multivehicle campaign design for this as well as fractional factorial test execution, vehicle testing frameworks, peer group models, and advanced measurement and performance monitoring (Exhibit 5).

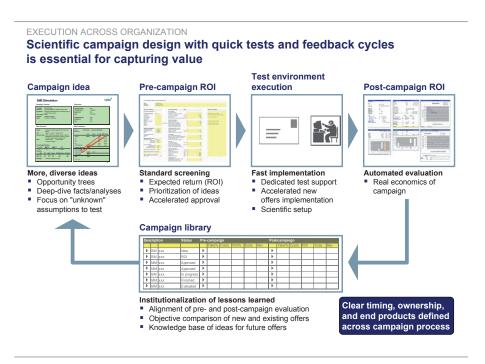


Exhibit 5

McKinsey's Customer Solution Center

Some banks struggle when it comes to developing commercial actions based on analyses of massive amounts of datat or to changing mindset in their distribution channels. Migrating frontline employees from a reactive product-dispatching approach to a highly targeted proactive client-by-client pitch as well as using reactive contact to proactively offer best next product to buy is often a major challenge. Typical hurdles include:

- Data infrastructure issues: Relevant data is often dispersed nonhomogeneously
 across business segments or units in various data sources across the organization,
 and is hard to integrate quickly. Banks frequently struggle with insufficient capacity
 to handle very large data sets to perform analyses on their full customer data.
- Limited analytical and modeling expertise: Banks all too often lack expertise in designing high-power predictive data models at an individual customer level (for cross-selling or assessing churn risk, for example). They also tend to have very few tested hypotheses on key levers to pull by product and customer segment, or none at all.
- Low campaign management capacity and capability: Banks' capability to handle multiple campaigns at the same time is often low, with limited tools typically available, especially in branches (for example, use of a separate Excel list for each product campaign). They also do not optimize channel roles, their utilization of branch potential is low, and they lack automated campaign report mechanisms/ tools to monitor results and quickly adjust/learn.

McKinsey has developed an answer to these obstacles. Its global Customer Solution Center (CSC) combines deep expertise, analytical power, and infrastructure to analyze our clients' customer base and help them prioritize actions to design highly targeted, high-impact campaigns. McKinsey's Customer Solution Center allows banks to accelerate the identification of opportunities to generate faster impact. The facilities available include:

- McKinsey IT infrastructure: Client data is transferred onto a remote McKinsey IT
 platform with 24 TB capacity, offering a fast track to eliminate IT bottlenecks, avoid
 interference with regular operations, and secure, state-of-the-art hardware and
 statistical software applications.
- McKinsey capabilities and tools: Statistical/data mining software, tested, ready-to-use algorithms, best-in-class tools and capabilities, tried and proven methodologies with quantifiable results, industry-specific, proprietary models, and knowledge-leveraging cross-industry approaches (Exhibit 6).

McKINSEY CUSTOMER SOLUTION CENTER

CSC has developed an innovative service model, where on top of analytical skills McKinsey also provides physical infrastructure

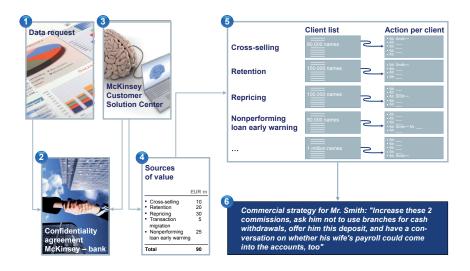


Exhibit 6

These facilities offer a unique opportunity to quickly create an integrated customer view from fragmented data environments, deep-dive into the individual customer value and profile, understand segments and drivers of value, and jointly define bank-specific initiatives.

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Managing a bank's existing customer base to capture higher revenues while also offering greater customer value requires vast analytical precision and reach. Clearly the preferences and needs of each individual customer are different: the difficulty is mining the relevant data time- and cost-efficiently. CVM turns data into value using a lifecycle perspective with highly effective end-to-end customer analytics. Banks lacking the IT architecture or skills have the option of entrusting the entire operation to McKinsey's Customer Solution Center. The advantage is that these capabilities and techniques, once in place, are so granular that they are extremely hard for rivals to replicate. This can give a bank a substantial competitive advantage, translating into boosting its bottom line

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Authors:

Anna Fiorentino
Knowledge Expert
Rome Office
anna_fiorentino@mckinsey.com

Magdalena Proga-Stępień Associate Principal Warsaw Office magdalena_proga-stepien@mckinsey. com

Radek Przybył
Principal
Warsaw Office
radek_przybyl@mckinsey.com

Carlos Trascasa Director Madrid Office carlos_trascasa@mckinsey.com