

Harnessing the profit-building power of customer segmentation

Financial institutions' customer acquisition strategies are taking a one-two punch as the economic turmoil shrinks both their customer base and marketing budgets. The troubled economy plays no favorites as it spreads job losses, delinquencies, and foreclosures across a formerly robust customer landscape. This changing economic outlook is testing the mettle of many banking industry professionals as they seek to attract and retain profitable customers and disengage with those that do not offer value under their operating model.

Financial institutions are all pursuing those customers who offer the greatest long-term profitability and working to build mutually valuable relationships with these select clients. In fact, today's technology and information-sharing culture makes this once impractical scenario a reality that companies can achieve through the execution of a customer segmentation strategy.

By building long-term relationships with the most valuable customer segments, companies can win over a loyal—and profitable—customer base. Considering that the top reason customers leave one financial institution

for another is because they are enticed by better offers,¹ segmentation not only makes business sense, it can create a competitive advantage. With the pressure to attract and retain customers who offer the greatest value more intense than ever, segmentation is the right strategy for today's marketplace.

The goal of segmentation is to target profitable customers with product and service offerings tailored to their specific needs. Yet it's not only today's profitable customers that organizations should pursue, it's also those who represent the potential to add value in the future, such as younger borrowers who are in the process of building wealth.

Although customer segmentation is not a new concept to financial services companies, it has proven difficult for the industry to translate the theory into an actionable strategy. Some of the challenges include the existence of line of business operating silos, fueled by legacy systems that do not communicate with each other; and marketing departments that develop a segmentation strategy in isolation, without involving stakeholders to understand the needs of the customers or the business.

At a time when the competition for customers is very high, investing in keeping your existing customers, especially those who are, or likely to be most profitable, is an attractive and prudent investment endeavor with potential benefits including:

- Increased profitability;
- Higher return on marketing investments;
- Higher customer retention rates;
- Increased customer wallet share; and
- More predictability of the portfolio and earnings.

Knock down silos to better understand your customer

Many organizations, whether through mergers, consolidations, or simply everyday business operations, service their customers in separate business units, and on different systems. These operational silos prevent companies from understanding which products and services their customers have purchased across the enterprise. Because obtaining a holistic view of the customer is a critical early step in creating customer segments, these barriers must be deconstructed.

¹ PricewaterhouseCoopers, Winning the battle for growth: Building the customer-centric financial institution, 2006.

Most organizations develop a long-term segmentation strategy that they implement over a period of time.

Fortunately, obtaining a top-down customer view does not require a system overhaul. It has been achieved in leading organizations with a universal client identifier—a unique customer identification number assigned to every account that a customer has across the organization.

Gather the right data

At the heart of any successful segmentation strategy is the ability to identify and assemble the right data points—those that provide insight into customers' needs. Yet, we have found that the main criteria often used in segmentation—customers' current and potential assets²—have changed little over the years and, in fact, reveal few insights that companies can use to deliver targeted products and services.

Instead, information such as marital status, birth date, address, geography, number and ages of dependents, credit score, and loan-to-value ratio may be more reliable indicators of customers' needs. The key is to identify the most useful data points, develop processes to confirm their accuracy, and move them into a centralized system where management can leverage them to their full marketing potential.

As with any strategic undertaking, implementing a successful customer segmentation program requires careful planning and strategic decision making. The following steps will help create a segmentation strategy that addresses and overcomes the complexities and roadblocks that exist to achieve profitable returns.

Creating segments – How data tells a story

With demographic data in hand, the work of segment creation begins by grouping together customers with similar characteristics. Because the core driver behind segmentation is the assumption that customers with similar attributes will have comparable purchasing behavior, the creation of segments enables companies to move away from mass-marketing efforts and instead offer targeted products and services to customers in the same segment.

Consider your segments' value

Indeed, when it comes to profitability, not all segments are created equal. To determine the profit potential of each segment, companies must consider the segment's lifetime value, defined as the profit they expect to generate over the entire life of the customer relationship.

When calculating lifetime value, consider the value of not only the expected immediate gain that current loan products will generate, but also the potential value of future business opportunities that could arise from the existing relationship.

Understanding and forecasting each segment's lifetime value enables companies to pinpoint those segments that offer the greatest profit potential and then make strategic decisions about product, service, and retention strategies to best serve the customers within those segments. It also enables management to redirect retention efforts and other expenditures away from the least profitable segments and focus these resources elsewhere.

Offer products and services based on customers' financial life cycles

With its customer base sliced and analyzed, management now knows which client segments offer the most potential value. But to tap into that value, companies must understand what their customers want and when they want it. It's at this stage that the concept of financial life cycles becomes critical to the segmentation process.

² PricewaterhouseCoopers' 2009 Global Wealth Survey identified the critical need for effective segmentation in the current market. Given the degree of skepticism about the quality of relationship manager's advice, 53% of the private clients surveyed said that their primary source of financial advice was now their own independent research and knowledge. Faced with such difficult client perceptions, wealth managers need to significantly raise their standards. They must focus on placing clients at the very heart of their business models. Disciplined segmentation of the client base, accompanied by tiered service offerings, is an ideal way to do so.

As customers move through the various stages of their lives (Figure 1), their financial needs change based not only on their own circumstances, but also on those of the entire household. For example, young, single adults are likely to need new checking accounts, credit cards, and auto loans. When these singles marry, they are more likely to need a mortgage and might also be in the market for a savings vehicle such as a money market account.

What this means for your business

As the distressed economy looms large, banks are battling for wallet share from a dwindling customer base. The race is on to identify, attract, and retain those current and prospective customers who offer the greatest promise of long-term profitability.

Most organizations develop a long-term segmentation strategy that they implement over a period of time. When planning a segmentation strategy, keep in mind the following guidelines:

- Consider the initial set of customer segment insights as the beginning of an ongoing effort to further build out segment knowledge.
- Allow each segment’s long-term value to drive organizational priorities.
- Explore incremental growth opportunities by identifying and targeting emerging segments that are currently not represented in the portfolio.
- Set detailed financial development objectives for each priority customer segment. For example, affluent segments should have specific targets for credit growth and profitability.
- Develop strategies to achieve these financial development objectives that include service differentiation, pricing strategies, and communication approaches.
- Understand customers’ life cycles and stay updated on each segment’s change in life stage and buying habits.

Segmentation is a winning approach with the potential to help companies maximize profits and create a competitive advantage. And in today’s turbulent and competitive marketplace, it’s no longer a nice-to-have, it’s a way forward.

PricewaterhouseCoopers’ has extensive experience helping financial services companies develop and implement customer segmentation solutions that are tailored to their business needs. To learn more about how segmentation can help you achieve your strategic targets, please contact:

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Figure 1: Financial life cycles

