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Innovating Customer Service: Retail Banking's New Frontier

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Innovating Customer Service: Retail Banking's New Frontier

As more U.S. banks reach the federally mandated limit for deposits, theyíll have to find a new way to grow.

Between hidebound marketing ideas, long-standing structural limitations, and complex regulatory requirements, banking by and large lags far behind most other consumer retail industries in developing leading-edge products and services. The industry's rush of consolidation, which in the last decade nearly halved the number of banks in the U.S. to 7,500, has only exacerbated the situation, say financial-services industry experts at Booz Allen Hamilton and the University of Pennsylvania's Wharton School. "In order to make any integration — or at least make the numbers — work properly, you really have to cut a lot of costs," says George Day, a professor of marketing at Wharton, noting that cost-cutting typically translates into a degradation of service.

The consolidation is in turn ratcheting up the competitive ferocity. By federal law, no bank may hold more than 10 percent of the total U.S. deposits, and many of the top 20 banks are closing in on that limit, says Michael McKeon, a New York–based senior vice president with Booz Allen. That means that growth by acquiring new customers will no longer be feasible. Instead, he says, the only way for banks to grow in the domestic market will be to strengthen relationships with their current customers, and to do that banks will have to innovate their offerings.

But innovation is not easy in banking. The industry has to contend with a tangle of regulations acting as "speed bumps" that can slow down product and marketing innovation, says Mr. McKeon. Before introducing new products and sometimes even new marketing programs, banks have to consider such factors as privacy laws, debt security guidelines, and fair lending practices.

Internal structural problems also inhibit marketing and product innovation. Product-focused companies typically have research and development departments, says Goran Hagegard, a principal with Booz Allen in New York. Not so in banks, where IT tends to drive R&D. Furthermore, departments within banking organizations are usually highly segregated from one another; the people who know what kind of technical innovations are needed are often completely isolated from those in a position to deliver the innovations. Cross-departmental teamwork is generally not encouraged, says Mr. Hagegard. "Few and brave are the people who have ever crossed the moat unscathed."

Two other forces — risk aversion and inertia — can tamp down the urge to innovate. Banks must be exceptionally careful not to overcomplicate their offerings, says Alex Kandybin, a Booz Allen vice president based in New York, because product confusion can undermine the confidence the consumer must have in the bank to trust it with their money. And, although many bank consumers might not be happy, they are usually not quite unhappy enough to leave, says Professor Day. "People put up with lousy service because the switching costs are high."

Putting Customers First

When banks do come up with new products, the products often fail because they don't focus enough on the consumer. Eric Clemons, a professor of marketing at Wharton, cites the example of ill-defined smart-card and electronic cash systems, which have yet to take off in the U.S. By contrast, the smart-card system in Hong Kong called "Octopus," which enables users to ride public transportation without having to buy tickets or swipe a turnstile, is a big hit. The lesson, according to Professor Clemons: "If it addresses one real need, no matter how small, we have liftoff."

How can a bank learn to become more customer-focused and innovative? Although regulations aren't going away any time soon, the other barriers to more customer-centered innovation can be whittled away with some concerted effort, say Wharton and Booz Allen experts.

Internal structural changes can improve the chances of success. Break down the wall between sales and customer services, suggests Jerry Wind, a professor of marketing at Wharton. In an unusual move for a banking behemoth, Citibank linked its customer service performance to sales success. "They've created an incredible incentive to address your concern — and then to sell," says Professor Wind. It's not only a brilliant way to improve customer service, he adds, it can also give the bank's marketers greater insight into consumer needs than they ever had before.

Clearer organizational processes can help make it possible for innovations to develop on a regular schedule. Often, notes Mr. Hagegard, banks don't have a clear process for gaining approvals of new product innovations. Without a process, innovations occur more slowly and painfully. RBC Royal Bank has come up with an effective approach. The Canadian bank uses a stage-gate system that helps it determine whether to move forward with an idea, as well as a portfolio review process, which helps it prioritize which projects should move ahead first. RBC's stage-gate group focuses on determining the business case for an idea, while the portfolio review board determines its relative importance in the context of the bank's overall portfolio. One challenge in a two-step process is deciding which approval board takes precedence. At RBC, it's the portfolio group. "This means that the portfolio look is the first step to get funded," says Mr. Hagegard. "However, you would not be guaranteed funding until you also passed the stage-gate process."

Drawing clearer distinctions between those parts of the offering in which line managers are allowed to experiment and those areas they must not touch can also contribute to higher quality innovation. Such controlled, modular architecture can make it easier for experimentation to occur in lower risk areas while keeping core offerings stable, according to Mr. Hagegard.

Finally, banks should look for new insights from the existing customer data. Most financial-services companies either don't mine their data enough or don't do it in a way that allows the information to reach product development, says Professor Wind. One tool that is often used in consumer products but frequently overlooked in financial services is conjoint analysis. Conjoint analysis measures consumer response to different bundles of products, a technique that allows marketers to uncover preferences, better gauge the strength of certain kinds of product features, and understand which customer problems will be most advantageous to solve. Measurement is critical. "Just doing something and praying that it will work and not measuring it is a waste of money and time, because at the end of the year you are no smarter than at the beginning of the year," says Professor Wind.

There are other, more intuitive ways of generating ideas, as well. In a time of dramatic change, Professor Wind says, the key to success is often changing one's mental model of the company's business. Such insights seldom grow out of one's own industry, he notes. "The best rule is, don't look at your own industry." Banking's poster child for such an approach is Commerce Bancorp. Vernon Hill II, the chairman and president, came to banking after achieving success as a Burger King franchisee. By thinking of his bank as a kind of retail store that happens to sell financial services, Mr. Hill has turned his bank, based in Cherry Hill, N.J., into one of the fastest-growing banking companies in the country.

Even product innovations, for example, sometimes need not be financial. Professor Clemons notes that some credit cards marketed to NASCAR fans — featuring a picture of their favorite driver — have performed better than other cards, although the card itself has the same benefits as plainer versions. But the key is that the NASCAR card looks beyond what is thought of as a traditionally desirable market. In the past, such blinders have caused banks to overlook huge pockets of opportunity. Professor Clemons tells the story of two bank consultants who tried to sell the largest banks on their idea to target low-risk yet technically subprime clients for credit cards. Despite the potential market size, no bank was interested in their proposal. Frustrated, the two founded their own company instead — now Capital One, one of the country's largest credit card companies.

To witness the breadth of transformation that can result from seeking innovation beyond stale industry models, one need look no further than the Australian banking sector, which has struggled against a growing wave of foreign competition over the last several years. According to a report in *Retail Banker International*, profits rose 25 percent between 2000 and 2005 at the country's four largest banks — ANZ Bank, Commonwealth Bank of Australia, National Australia Bank, and Westpac Bank — but because of foreign entrants like ING Bank that have used the Internet to draw consumers away from the country's branch-focused lenders, market share in deposits and loans dropped considerably.

As a result, Commonwealth, ANZ, and Westpac have all launched high-interest Internet savings accounts. Commonwealth also introduced a three-year customer service and productivity improvement campaign, called "Which New Bank," in 2003. The program included the introduction of a commission-only sales force, or "mortgage innovators." The sales force also has the option of opening Commonwealth "mortgage innovation centers" to provide customers better access and a more personalized experience. According to *Retail Banker International*, Commonwealth saw an increase in revenue per staff within the first year of the program, and it has become a model for bank regeneration in the region.

"The Australian market is unbelievably competitive," says Vanessa Wallace, a vice president with Booz Allen in Sydney. "Innovation is happening at every point along the system — customer interface, within product classes, as well as the reinvention of branches. There is also hidden innovation in processes, product architecture, and systems. It is a constant innovation game. It would be a mistake to sit still."

Keeping It Simple

At its most basic level, some Booz Allen and Wharton experts suggest, successful bank innovation begins first by learning to look at things from the customer's point of view and then trying to solve a problem. Like many companies, banks on the whole have been better product engineers than marketers, better at "solving financial problems than consumers' problems," says Booz Allen's Mr. Kandybin. In the next few years, Mr. McKeon of Booz Allen believes that "keep-it-simple" offerings are likely to be the industry's big winners, such as annuity-like products that will help baby boomers meet their retirement goals. Nothing complex, he says, just "very simple products that meet their fundamental needs."

"I think that most offerings of the banks are too complex for the average consumer to understand," Mr. Kandybin says. If you look at some consumer products where there is a complexity dimension, he says, such as a washing machine, typically the company will have a sales force to explain the different features. "Banks' products are currently more like washing machines — really hard to sell." But banks have no sales forces to deal with customers. "Nobody sells those products," Mr. Kandybin says. "Nobody really tries to educate consumers."

Even when a product can't be simplified, helping clients deal with the offering's complexity can create greater loyalty. Mr. McKeon cites his experience with Countrywide Financial Corporation. The bank, which holds a mortgage on Mr. McKeon's home, asked every year for a copy of his flood insurance. "Why don't you just get that directly from the insurance company?" Mr. McKeon recalls asking. A traditional bank might have told him that it was impossible, "but Countrywide said 'fine.'" Good for him, but how did the bank profit? "Technically, I didn't pay them for that," says Mr. McKeon. "But it helped develop customer affinity." Countrywide has clearly learned a small lesson with a big payoff: A customer's good will is invaluable. ✚

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