Opportunities for Action in Financial Services

Customization: Making Real Money in a Virtual World

The Boston Consulting Group
Customization: Making Real Money in a Virtual World

Financial institutions enthusiastically rushed to build online retail franchises. Now they are finding that making money on the Internet is far from easy. Firms that invested substantially to develop the online channel have grave doubts about their chances of ever earning decent returns. Their disappointment does not mean that they should rein in their ambitions, however. Rather, it argues for a more methodical approach that will generate revenues by exploiting the Internet’s unique richness and connectivity.

By carefully coordinating their online offerings with other channels, financial institutions can provide highly customized services to preferred customers. For years, financial leaders dreamed about delivering such offerings to valued clients, but individualized solutions almost always seemed distant ideals rather than attainable goals. Today the online channel is changing all that. It provides financial institutions with an improved ability to collect and analyze information on individual customers and, more important, to use this enhanced intelligence to create a tailored offering at relatively low incremental cost. Furthermore, many institutions are now approaching the critical mass of online customers that justifies such investments.

Already, a handful of focused competitors in the credit card industry—including American Express, Capital One, and Providian—are developing promising customized online offerings and integrating them closely with other delivery channels. Established experts at remote marketing and customer management, these companies swiftly incorporate and utilize client information to hone tailored offerings to select
individuals. A few banks and financial firms—including Charles Schwab, Citigroup, and Wells Fargo—are developing similar approaches. Financial institutions that ignore such fast-moving competitors may soon find themselves scrambling to shore up their consumer businesses.

Certainly, many in the industry plan to invest in customization. Studies in the United States, for example, suggest that in the next five years the financial industry will focus on analytical approaches to managing customer relationships, with some estimates suggesting that spending will grow between 13 and 17 percent per year. Much of it will be devoted to developing better solutions for online customization. Clearly, these institutions believe the time is right to use online capabilities to manage customer relationships and finally make real money in a virtual world.

**Falling Short**

Managing customer relationships successfully, of course, involves locating, acquiring, and retaining profitable customers. It also entails reinforcing the power of the brand with a synchronized approach across all of an institution’s contact channels: the staff in branch offices, as well as the company’s Web site, call centers, and marketing campaigns. But that has proved hard to do. Our research has revealed five main reasons for this widespread failure:

**A Lack of Vision and Direction.** The approach that financial institutions take to managing customer relationships online often has no overarching vision and strategy to support and guide it.

**A Focus on Products, Not Customers.** Institutions tend to focus too much on products and not enough
on customers. They often compound the problem by trying to impose a customer perspective on a traditional product-focused organization.

**An Insensitivity to Customer Needs.** Many institutions are unwilling to redesign their offerings to meet customers’ needs and to incorporate new insights into those needs.

**A Dependence on Technology.** Institutions tend to believe that acquiring the right software is the solution to managing customer relationships and that the overall approach to customization should be similar to that for an IT project.

**A Focus on Cost Cutting and Efficiencies.** Many institutions see the online channel as a way to offer cheaper service rather than as a means to provide better service or to sell more products.

Many financial institutions feel challenged by the most basic elements of the online channel. Indeed, a huge gap remains between the channel’s present realities and its tantalizing possibilities. A senior executive at a U.S. mortgage company summed up the frustration of many financial institutions: “No other industry has as much information about a customer as we do and does less with it.”

**The Third Level of Customization**

The frustration runs deep, and with good reason: the online channel already has the power to bring customization to a new level. The first level of managing customer relationships is the traditional approach, which involves simple monitoring and tabulation of existing customer information with little differentiation for various groups. The second level—what we
call the static segmentation model—involves using offline data-mining techniques to deliver a segmented offering based on superior customer information.

The third level, made possible by the online channel, creates the opportunity to use dynamic and contextual segmentation techniques by updating a customer’s personal profile every time a financial institution interacts with the customer. At this level, institutions gain the ability to harness powerful test-and-learn techniques in order to customize their products effectively to a market of one. Clients can also “self-customize” by designing their own offerings. They can, for example, select the risks they want covered by their insurance policies or choose the investment information they want to receive—and how they want to receive it. Financial institutions have provided this level of service to companies for years. Now the Internet allows them to offer such service to individual customers as well.

The credit card industry is currently the most sophisticated practitioner of the third approach. In some countries, leading players such as Capital One and Providian have the ability to present a unique credit-card offering to each customer based on his or her credit risk and history. They can also alert customers to specific services and target promotions to segments based on test-and-learn approaches.

**Developing Customized Offerings**

To reach the third level of customization, financial institutions must address several important issues regarding, for example, the availability of data, the appropriate IT infrastructure, and organizational capabilities and culture. Instead of rushing in and trying to do everything at once, such institutions need to
adopt a phased approach to their customization efforts. They should address strategy issues first, deciding what their business model should be. They should always ensure that significant business value drives their customization projects. Then they should launch pilot programs to find out what works well. Such programs should be kept small and focused, with conservative estimates for potential returns. Finally, financial institutions can start acquiring the technologies they need and implementing their full strategies. In selecting technologies, managers should try to choose flexible tools that can be easily adapted to changing needs.

There are five aspects to this process:

**Insight.** Such an approach begins with a detailed segmentation of a financial institution’s customers on the basis of their needs. This kind of segmentation shows executives what drives profits and suggests how they should customize offerings for valued customers. Given high customer-acquisition costs, segment-specific offerings are critical to differentiating the business and building profitability. For example, NextCard and Capital One already make extensive use of segmentation, using the information they collect to lower customer acquisition costs and improve retention. Developing highly customized offerings also requires achieving a unified view of a customer’s financial holdings. An institution should use the power of its brand and franchise to persuade customers to group all their account information with it.

**Strategy.** Before pursuing a customized client approach online, financial institutions should adopt a strategy appropriate to their level of development. For a start-up, the key challenge will be how to transform visitors into actual clients. For an established online operation, the goal will be how to cross-sell to increase profits and retain customers. If the online
operator is the market leader and competitors are
-catching up, the challenge will be to improve service
to protect market position and pricing.

**Organization.** Online offerings need the support of
employees at branch offices and call centers. Wach-
svia, for example, had difficulty attracting customers
to its online offering until it gave financial incentives
to its branch staff to enlist online customers. The
bank then increased sign-up rates tenfold within a
month. Such an integrated multichannel approach
can be quite powerful but is complex and difficult to
do well. One European bank learned that it had to
follow up its e-mail sales pitches with messages from
its call centers. After the bank made that discovery, its
success rate for bringing in new business doubled.

**Capabilities.** Delivering highly customized offerings
will require many organizations to acquire or develop
etirely new skill sets. Mastery of direct marketing
approaches and techniques is critical to creating com-
pelling, high-quality customized offerings in online
retail financial services. Credit card players have the
advantage because they are experienced practitioners
of the controlled-testing and continuous-learning
techniques that are required to refine customized
offerings and create targeted approaches.

**Infrastructure.** Highly customized offerings also re-
quire a new infrastructure. Thanks to the online
channel, customers can now access and review much
more information than ever before. As a result, finan-
cial institutions need to develop better editorial con-
tent, as well as the operational capability to manage
the content dynamically. Intuit, for example, found
that it had to create a publishing business as it built its
online financial-services company. Customization also
places a significant new burden on an institution’s
transactional capabilities and corresponding IT infrastructure. To attract and retain the primary online relationship with preferred customers, financial institutions need to offer flawless and consistent execution across all their channels. This service often requires more sophisticated software in the technology platform, as well as corresponding new skill sets within the IT organization.

The Experience Is Everything

Ultimately, these assets and capabilities must be deployed and coordinated to create a better buying experience for the customer. Institutions should allow their customers to contact them online, review products carefully, and compare them with competing offerings. There should be links to related products: higher cross-selling rates are a big benefit of online customer-relationship management. If a customer is mulling over new investment options, there should be links to financial planning tools and to life-insurance and disability policies. Most critically, the online offering should always allow customers to complete transactions online. If they cannot close a transaction online, then all the institution’s efforts are for nothing. Realize, too, that in the online world the exit is always just one click away. Any flaw in an offering may drive customers away.

Financial institutions considering a customization approach should also try to answer the following questions: What is our current strategy and position relative to our key competitors when we deal with preferred customers? What are the fundamental drivers of our economics and overall business strategy? Is customer acquisition the leverage point, leading to a focus on targeted marketing, or are the economics of
customer retention and cross-selling more compelling? Finally, which of these drivers can be significantly affected through the creative use of customer information, and which holds the greatest revenue potential after allowing for the costs of delivering more customized products and services?

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The online channel is now attracting enough customers that it makes economic sense to invest in the creation of a suite of personalized offerings that can turn casual customers into profitable long-term relationships. The online newcomers that stormed into the financial world during the past few years have largely failed to develop such relationships. Established financial institutions have an opportunity to leverage their substantial assets and capabilities, learn from others’ mistakes, and create winning customized offerings.

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