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Customer retention strategy:
Important today, critical tomorrow

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FINANCIAL SERVICES



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Many financial services companies claim that their existing customers are their most valuable assets. But they can often fail to align their operating models to protect these assets. The shake out from the financial crisis is helping to expose the risks of not prioritizing customer retention.

It is well acknowledged that it can cost up to ten times as much to acquire a new customer as to retain an existing one. Not only that, established customers tend to be more profitable. This is as true for financial services as for other consumer sectors. Newly-acquired customers have to be secured at a cost, and the products they buy are often on thinner margins. So it is a deep paradox, in the face of almost every relevant study that shows that many financial services companies appear to pay insufficient attention to customer retention. With the possible exception of cards products, they often take a far from systematic approach to retaining their most valuable and oldest customers.

Why is this? Partly because customer retention is seen as inherently less exciting, or germane, than new customer acquisition. Market analysts tend to place greater store by new business performance. Marketing campaigns often tend to be judged on short-term payback (3 to 6 months). Retention campaigns rarely fit within these time horizons. Sales and distribution personnel tend to find it easier to sell to existing customers due to the relationship with the brand, but their performance metrics tend to focus on new business and market share, they tend not to focus on what they have not lost.

Nevertheless, the value of successful retention can be substantial. As an example, in medium to large wealth management businesses, a one percent reduction in the outflow of assets under management could add several million dollars to annual operating earnings; because money retained tends to be quite 'sticky' the net present value could be five to 10 times the annual benefit. An important aspect of effective brand strategy is the promotion of customer loyalty, and retention and brand value go hand-in-hand.

Until recently, the value destroyed by defecting customers was masked to a substantial degree by the high levels of new customers being acquired. A consequence of the drive for new business growth has been that the detriment from customer leakage, impairing good quality cash flow, was not immediately apparent.

Customers have been enabled and educated to be more mobile, encouraged by regulators keen to create more competitive markets and consumer advocates promoting the benefits of shopping around. When viewed from the customer's perspective advisers have been giving good advice in encouraging them to switch providers. A happy coincidence that in markets where initial commissions still feature strongly they also had the motivation of a direct financial benefit in doing so.

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Today, though, the situation is very different. In investment markets in particular; the number of customers switching between companies has fallen dramatically. The good news is that customer churn has fallen, the bad news is that new customer acquisition and discretionary investment has declined dramatically. Customer retention in some cases may appear to be less of a concern at the moment, however, when the upturn comes, the impact could be profound.

In a number of sectors demand for switching is being held back by a lack of economic confidence. However, when the dam breaks as confidence returns, many customers may well be tempted to switch providers. This could trigger a scramble to sweep up the best customers. Financial services companies with poor customer experience and weak retention programs are likely to be at a major disadvantage. The time to prepare to resist these threats is now.



CEO discussion points:

- Do we truly understand how much value we lose as the result of customer attrition?
- Do we know which products, channels and customer segments lose the greatest value?
- Do we know when customers are most at risk of defection?
- Do we appreciate how much value we could retain in our business if we were to improve our performance?
- Does the way we work help or hinder efforts to improve retention?
- Does anyone in our business have a 'birds' eye view' on the nature, extent and effectiveness of our retention activity?

One of the first priorities is to understand very clearly how, where, when and why value flows out of a business. In our firms' experience, few companies have a clear picture of product, customer and channel profitability and retention performance. At a customer level they need to be able to identify and act upon the most valuable customers who are most likely to defect by targeting triggers to defection and deploying appropriate customer treatment strategies.

There are two broad components to an effective retention strategy: reactive and proactive. In the first case, there are a number of common customer behavior patterns which ought to raise warning flags. A classic example is when a customer asks for a valuation of their investment portfolio. Without an early response, that customer will more often than not move funds to another provider within three to six months. In other cases, customers can be lost simply by default. For example, two or three missed payments into a regular savings or protection plan often triggers automatic cancellation. The first contact the customer receives is a form letter saying the contract has been cancelled. Leaders in retention activity have established rolling campaign programs to counter this accidental leakage involving swift and personalized reaction, emphasizing the benefits of continuity or proposing an alternative range of appropriate products.

Such a disciplined and consistent approach can help limit losses significantly. However, valuable as these approaches are, they are still only treating the symptoms of such customer attrition, rather than addressing the root causes.

Proactive strategies rely on understanding when and why customers may be tempted to defect. Many customer behaviors reflect changes in life-stage which trigger a requirement for advice or a new set of financial needs. These can range from milestone birthdays, through change of job or house move, to significant and sometimes traumatic changes of personal circumstances. These life-stage triggers can sometimes be identified well in advance, so that the customer receives appropriate marketing attention. In the case of a customer approaching the transition to retirement, dialogue may need to begin five years before the ultimate trigger. A good customer retention program should embrace such predictive indicators, singling out those customers at risk and ensuring that effort is concentrated on preventing loss. In other cases there is virtually no advance warning to the product or service provider and the key to customer retention is the ability of the business to identify the customer's situation and respond quickly and appropriately to it. This means identifying changed behaviors in high frequency transactional product

relationships and effective 'customer listening' through call center, web and face-to-face interactions.

Many companies tend to think in terms of their internal processes and business flows; they do not really understand what the experience of doing business looks and feels like from the customer perspective. As a result, they can often fail to recognize the real 'moments of truth' when customers interact with them and are sending implicit or even explicit signals that they are at risk or in the process of defecting. Often, a relatively innocuous event such as poor service from a call center can tip a customer into finally determining to change providers. Once a customer's perception of the company's brand is damaged, defection becomes much more likely. To defend against this, companies should embed preventive activity into all aspects of their operating models.

Identifying early warning indicators is challenging; identifying customers at risk but whose behavior has not yet changed is even harder; creating propositions that are inherently more retentive, or delivering service designed to increase customer longevity, are more challenging still. Success the upturn will depend on recognizing the true financial cost of customer defection, anticipating and planning for a competitive environment in which customers are once again confident, demanding and mobile.

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