Beyond Segmentation

How financial institutions in Brazil can reach and retain more customers

Since the mid-1990s, Brazilian financial institutions have been pursuing a customer segmentation strategy, for obvious reasons: By dividing their customer base into distinct sub-groups, banks are able to offer tailored products and pricing. This increases customer loyalty while extracting the maximum profit possible from each segment. But the strategy has not always delivered on its promise. To reap the full benefits of segmentation, banks must go beyond the basics and focus the entire organization on the strategy.

As economies become more mature, their financial institutions become more sophisticated, and Brazil is no exception. Over the past 10 years, the industry has changed dramatically: A stable economy, increased competition from major international banks and, in particular, the end of inflation-derived financial profits have leveled the competitive playing field.

Financial institutions have responded by segmenting their customers into distinct sub-groups and customizing their product offerings and pricing to attract and retain more loyal customers. For the most part, customers are segmented by monthly income. (The exception is private banking where customers are segmented by their liquid assets and how much money is available for investment.)

The problem is that classifying customers into predetermined groups does not necessarily lead to true segmentation. Such segments do not consider the complex networks of relationships and processes that affect each customer's experience *(see figure 1 on the following page)*. Simply offering a tailored product at the point of sale provides an "outside-in" view of the customer, but it does not guarantee that a customer's entire experience with the bank will cater to their distinct needs.

The best banks develop an "inside-out" view of their customers. This view not only focuses the entire organization—people, processes and functions—on the bank's segmentation strategy, but also on the most profitable customer segments.

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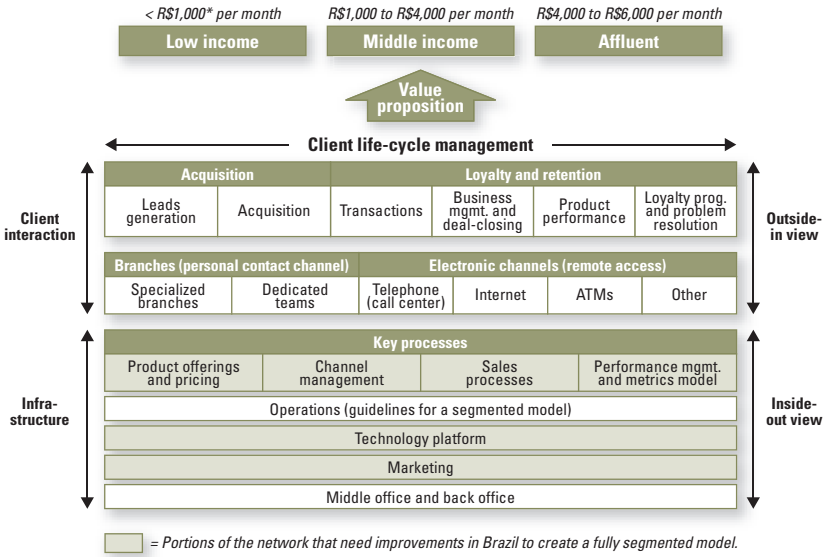
Viewing Customers from the Inside Out

For years, Brazilian banks succeeded in creating a perception among customers that they were receiving exclusive services. They went out of their way to interact with customers by designing processes focused on acquiring new customers, retaining them, and ensuring

FIGURE 1: Complex networks of relationships and processes



Note: Monetary amounts denominated in the Brazilian real. *Source: A.T. Kearney*

their loyalty. They created specialized channels to deliver different services to different types of customers, depending on their needs, and opened up electronic channels so customers could bank via telephone, the Internet and ATMs. Many banks established exclusive branches and areas within branches and even created partnerships with other types of stores to target and serve customers more effectively. Managers did not hesitate to assign sales staff to distinct customer segments and portfolios and monitor their performance. All of these measures were designed to ensure differentiation and serve the specific needs of various customers. And for the most part they succeeded. However, when it came to the processes and infrastructure needed to deliver custom products and services, there were numerous gaps. Indeed, we found that the biggest gaps occurred in four areas, all shown in figure 2.

The following offers a brief look at each process and discusses how each one, when operating effectively, can help banks realize the full financial potential of their segmentation strategies.

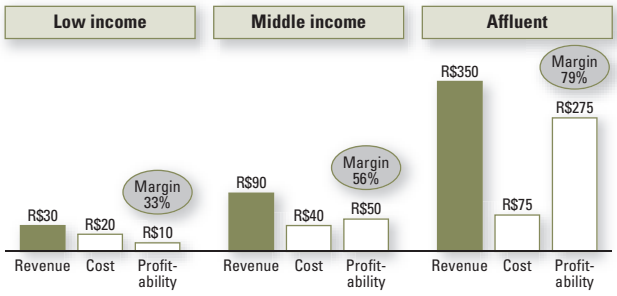
1. Profitable Products and Pricing

Although Brazilian financial institutions have made strides in changing their products and pricing to attract specific customer groups, they have yet to realize the full financial potential of their product offerings. Most banks still customize products to capture different customer segments, rather than to increase profits. For example, certain customer segments have exclusive access to investment funds, interest rates and negotiating terms. But offering these services is simply a form of marketing—to make customers feel valued—rather than a strategy to improve the bank's financial returns. Banks should be using a combination of bundling and pricing strategies to increase profits.

FIGURE 2: Performance gaps in four key processes

Source: A.T. Kearney

FIGURE 3: Profit margins by segment



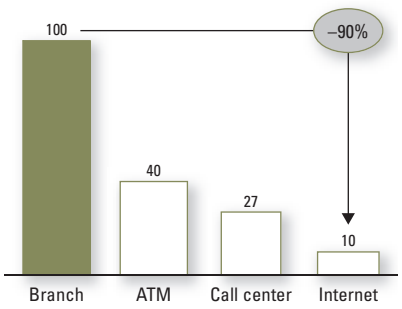
Based on average monthly results per client.
Monetary amounts denominated in the Brazilian real. *Source: A.T. Kearney*

Bundling. A good way to increase profits is to bundle products, which, as we have seen in other markets, is the simplest and most effective way to customize product offerings. However, currently, Brazilian banks only use bundling in its simplest form, to offer a basket of services, such as transfers or checks written for which the customer pays a flat fee. Taking bundling to the next level means creating packages of more sophisticated products for specific customer groups.

A few banks have already begun doing so, relying on medium- and long-term credit as the foundation for a bundled product. From this foundation, they then add more products to address the individual needs of various customer segments. These are called integrated bundles. Some banks are also creating product bundles based on factors such as a customer's age, stage of life, or even a special occasion such as a vacation or Christmas.

Pricing. Banks can also increase profitability through risk-based pricing—charging higher interest rates for riskier transactions. Today, most Brazilian banks only put a price on the service provided to the customer, generally by adjusting fees. When more sophisticated pricing strategies, such as risk-based pricing, are combined with customized product offerings, banks can significantly improve their profit margins.

FIGURE 4: Comparative cost of channels



Note: Considering a cost base = 100. *Source: A.T. Kearney*

2. Cost-Effective Channels

The purpose of channel management is to improve how customers come in contact with a bank or financial institution, while also reducing costs and increasing incremental revenues for each customer segment. To explore the differences of various channels, and the different needs of customers, we analyzed three customer segments. Figure 3 shows the average revenue, costs and profit margins associated with each segment.

For low-income customers, where margins are relatively small, a good channel management strategy can increase profits by lowering costs to compensate for lower revenues. For affluent customers, where the margins are better, banks offer more one-on-one customer service to improve these relationships. However, despite the high margins, the average cost per customer is also lofty (almost three times as high as the low income), so simultaneously reducing cost-to-serve is key. Steering affluent customers to more efficient channels, such as online banking, can reduce transaction costs by as much as 90 percent *(see figure 4)*.

Importantly, a channel management strategy is not designed to eliminate person-to-person contact, as this contact can generate a lot of business. The idea is to reduce the costs of customer contact without losing the commercial focus.

3. Improved Sales Processes

The most successful financial institutions continually analyze their sales processes and the performance of their relationship managers to increase sales effectiveness within each segment. There are three ways to improve sales effectiveness.

Standardize sales processes. Build a bond with the customer, identify his or her needs and valued attributes, make the offer, manage objections, and close the sale. This approach works best when it is customized for each customer sub-segment and, as such, helps salespeople comply with the approach. Creating customer profiles from basic variables, such as age and years of schooling, will not only help identify needs and product consumption patterns (for instance, spenders versus savers) but also allows for constructing predefined offers to meet the needs of key customers.

Increase selling time. Analyzing all activities performed by relationship managers will help determine the value of each activity in generating new business. The focus should be on behind-the-scenes activities, such as internal meetings and automatically generated reports, and on customer-facing activities that do not generate new business, such as transactions and operational services. In our experience, activities that do not generate new business can account for 20 to 25 percent of managers' time. These activities are better handled by lower-level staff or eliminated, freeing up sales managers to focus on meeting customers' needs and generating business. Offering financial incentives or improved compensation will encourage sales managers to give up their less-productive

activities and instead focus on bringing in new business.

Improve training. Best practices in training—including on-the-job instruction for new managers, mentors to advise and monitor career development, and clear and continual communication of individual and branch targets—will go a long way to improving sales performance. Regularly checking the effectiveness of training programs is essential, especially given the increased complexity of the customer segmentation strategy.

4. Integrated Metrics and Incentives

Measuring performance is essential to the success of an inside-out customer segmentation strategy. Measuring consists of defining overall performance goals and then gauging whether or not the goals are being met at all levels of the organization—not just at the customer point-of-contact. All activities within a customer segment are measured, including those in branches and channels. By integrating overall performance goals with managers' responsibilities, and the objectives of each customer segment, banks are better able to manage profits and losses on a per-segment basis.

In addition, incentives will get everyone in the organization focused on the same outcome—especially if they are in line with the organizational culture and modus operandi. For example, a company might offer financial incentives to individuals, or to everyone involved in a customer segment, or some combination of both. It all depends on how the organization is structured, how people work, and the results sought. The idea is to communicate the overall strategy, define how targets will be met, and then use incentives to make sure everyone is focused on meeting the same objectives.

Springboards: Technology and Marketing

A customer segmentation strategy is only as effective as its internal support structure. Technology platforms and marketing are key elements that often act as springboards. Technologies facilitate all activities that surround the customer relationship, not only accelerating operational tasks but also providing information to better manage customer needs. Marketing highlights the advantages and attributes of the strategy, not only to customers but also to everyone within the organization.

Focused on Success

By focusing the entire organization on the goals of customer segmentation, and the most profitable customers, Brazilian banks can differentiate their performance from their rivals, and capitalize on investments already made.

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