



Loyalty and Retention: How and why to implement a best-practice retention strategy in the Financial Services sector

Research White Paper

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Introduction

The problem

Companies whose strategies and processes are geared to customer acquisition without consideration for profitable retention often find themselves on a treadmill of price discounting, and destroy further value through unstructured and poorly evaluated attempts to slow customer attrition.

Purpose

The purpose of this Research White Paper is to:

- Explain the commercial importance of effective retention activity in the FS sector
- Identify the ways in which retention efforts typically fail
- Highlight best retention practice in analytical methodology, product development, acquisition strategies and customer contact strategy

Approach

The approach has involved:

- Collation of detailed information about loyalty and retention approaches encountered within financial services organisations, based on a combination of original research and extensive client work across numerous countries
- Identification of relevant concepts and methodologies
- Identification of key success criteria
- Utilisation of anonymous case studies
- Presentation of actionable insights, offering financial services companies the opportunity to see how the recommendations would apply specifically to an organisation like their own

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The commercial importance of retention

Organisations are often too preoccupied with the chase for new customers and market share to realise the effect of attrition...

It has been recognised within financial services for some years that the retention of customers is an important contributor to commercial performance. However, many organisations struggle to move away from their historic focus on the unfocused acquisition of new customers. There are three broad reasons for this. First, the culture of many FS organisations is geared towards acquisition: salesforce reward structures and training programmes emphasise the importance of selling and cross-selling; and operational processing is built to cater primarily for volumes of new business arriving and capacity planning around acquisition campaigns.

Misguided chase for market share

Secondly, financial analysts have historically valued organisations in accordance with their performance in terms of market share, on the assumption that market share of new business is a strong indication of organisational strength. Although this correlation has proven to be deeply flawed, and indeed the chase for market share is in many cases now directly responsible for an erosion of margin and profit, within corporate hierarchies the targeting of customer acquisition continues to be a dominant strategic goal.

Thirdly, the ability and appetite to measure the commercial effect of customer attrition has in many instances been lacking. At a basic level, this means that many organisations do not track the bottom-line effect of attrition, and focus simply on the tracking of volumes of lost business. Utilising the wrong metrics will therefore cause organisations to be satisfied that their overall balances are growing, while unaware that the profitability of their business is systematically falling. Indeed, the commercial impact of many acquisition-focused activities is often dwarfed by the impact of profitable business simultaneously being lost.

The links between retention and acquisition strategy

One of the truisms of retention work is that “retention begins with acquisition”, and this is unquestionably true – but in a way that is not typically recognised. Retention

work should indeed begin at the point of acquisition, but is badly compromised by the way in which customers have been attracted to the organisation, and the governing strategy that has caused such customers to be attracted in such a manner.

Retention is a factor of many things: acquisition channel, price, customer handling and others. But the single factor that outweighs all others is the strategy that brought customers to the organisation in the first place. In many cases there is a recognition that newly-acquired business is less profitable than existing business, but the organisation will continue to believe that this can be compensated for by the increased business volumes that best-buy pricing attracts, and the future business that these new customers will bring.

The fallacy of 'compensating profit'

In this regard low-margin acquisition strategies are therefore justified on the grounds that the newly-acquired customers will stay longer than competitors' customers, that they will cross-purchase other, more profitable products, and that the margin on the product that brought them to the organisation can itself be increased over time. In practice, unless the organisation happens to be exceptionally good at those practices that lock in retention behaviour, these expected elements of 'compensating profit' never arrive.

Organisations pursuing aggressive acquisition-based strategies, or simply pursuing strategies that expect new customers to behave as profitably as previous customers did, tend to reduce the overall profitability of their customer base over time. This process of value destruction can be extremely rapid, particularly if the organisation pursues significant infrastructural investment in an attempt to handle increased volumes, or if it attempts a primarily price-led play to improve the retention of existing customers or protection of market share.

The problems here are twofold. First, a lack of strategic planning that makes proper predictions of the future impact of current actions. Secondly, a lack of robust financial measurement that converts customer and organisational activity into adequate evaluation. It is therefore essential that the following questions are asked at an early stage in the planning process, and continue to be monitored at regular intervals subsequently:

Critical evaluation questions

- What is the fully-loaded cost of our acquisition strategy, including infrastructural spend to accommodate the expected business volumes?
- What is the current value of the customer base?
- What is the expected value of the customer base in 12 months' time, based on anticipated product holdings, margins and attrition?

The process of asking these questions will highlight the link between acquisition