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TOXICSERVICING

A REPORT BY FUJITSU AUSTRALIA AND NEW ZEALAND
AUGUST 2007

TOXIC SERVICING: ERODING PROFITABILITY IN THE FINANCIAL SERVICES SECTOR

THE CUSTOMER CHALLENGE

Financial services companies must defend increasingly threatened profitability and market share as competition in the industry continues to heat up. Margins are facing further compression, new products are hitting the market and third-party non-bank channels are exerting a bold and growing influence. This competitive environment is fuelling a fierce battle for customers.

With increased pressure on profitability, banks have focused on customer acquisition to grow market share. However, while more customers may contribute to increased revenue, it is important that businesses choose their targets carefully; not all customers are created equal. One purpose of this paper is to demonstrate that winning customers at any cost is expensive and potentially damaging.

Across the sector, branches are being re-modelled into customer-friendly retail outlets with a greater sales focus. Customers now have a wide range of self-service options for managing their accounts, portfolios and policies. The focus is on creating a more compelling customer experience – or ‘wowing’ the customer. At the same time, customers have more information, more choice and feel empowered to change service providers, with third-party channels doing their best to tempt them away from the incumbents.

However, the cost of attracting new customers in Australia has jumped by more than two-thirds over the past five years, now totalling between \$500 and \$800 per customer acquisition. The cost of cross-selling to the existing customer base is far more attractive at less than \$100 per customer. But with customer churn at an all time high, businesses can be robbed of this chance to grow revenue. Therefore, retaining customers, particularly the most profitable customers, is critical.

POISONING PROFITABILITY

While some financial services companies are focusing on attracting and retaining as many customers as possible, the benefits of this approach are questionable. Our research shows that while customers welcome a great buying experience, they would trade this in for great service. Yet, despite this, the sales promise is rarely delivered. We call this ‘toxic servicing’ and it is poisoning the profits of financial services organisations.

Toxic servicing is the most pressing issue for financial services businesses in Australia and New Zealand. Customers are significantly frustrated by what they see as woeful standards of customer service. Fujitsu’s research points to this issue as the most critical element of increasing profitability today. The toxicity isn’t limited to a handful of operators – it is prevalent sector-wide and those businesses that tackle the issue most effectively will realise a strong competitive advantage.

ABOUT THE RESEARCH

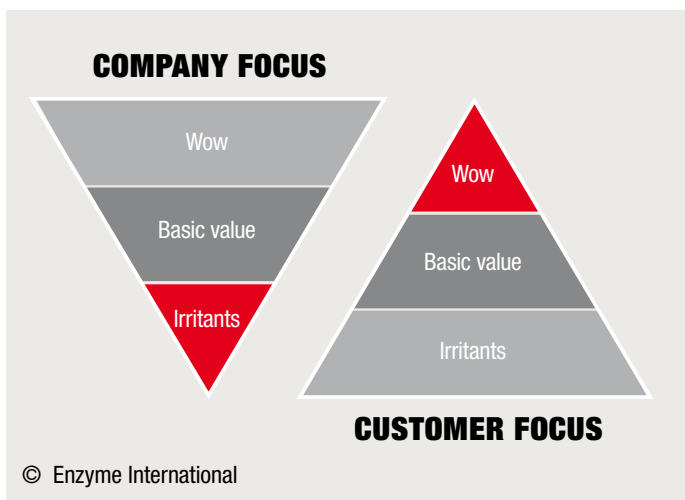
The data has been drawn from extensive consumer banking surveys, which included an omnibus survey of 26,000 personal banking customers across Australia and follow-up focus groups. In addition, data from previous Fujitsu financial services industry surveys is incorporated, as well as research from financial services client engagements conducted by Fujitsu and our partner Enzyme International.

PAIN BEATS PLEASURE

Around 30 per cent of the money financial services providers spend on keeping customers happy is wasted. Many organisations focus their spending on initiatives to create a fantastic customer experience – what we call the ‘wow’ factor. However, customers are much more concerned with the things that cause them the most irritation or frustration. Providers give some attention to elements of basic value to the customer, but virtually none focus on those issues that are the major sources of customer irritation. This translates into wasted resources and missed opportunities to retain customers, which negatively impacts the bottom line.

Through the eyes of customers, financial services organisations have the wrong priorities. For customers, the primary focus should be on their sources of frustration, not on the ‘wow factor’, as described before. The pain of poor service far outweighs the pleasure derived from customer acquisition or retention activities. Banks that recognise this are more likely to focus their attention on addressing the real issues for their customers. This translates into a reduction in customer churn and a positive flow through to profitability.

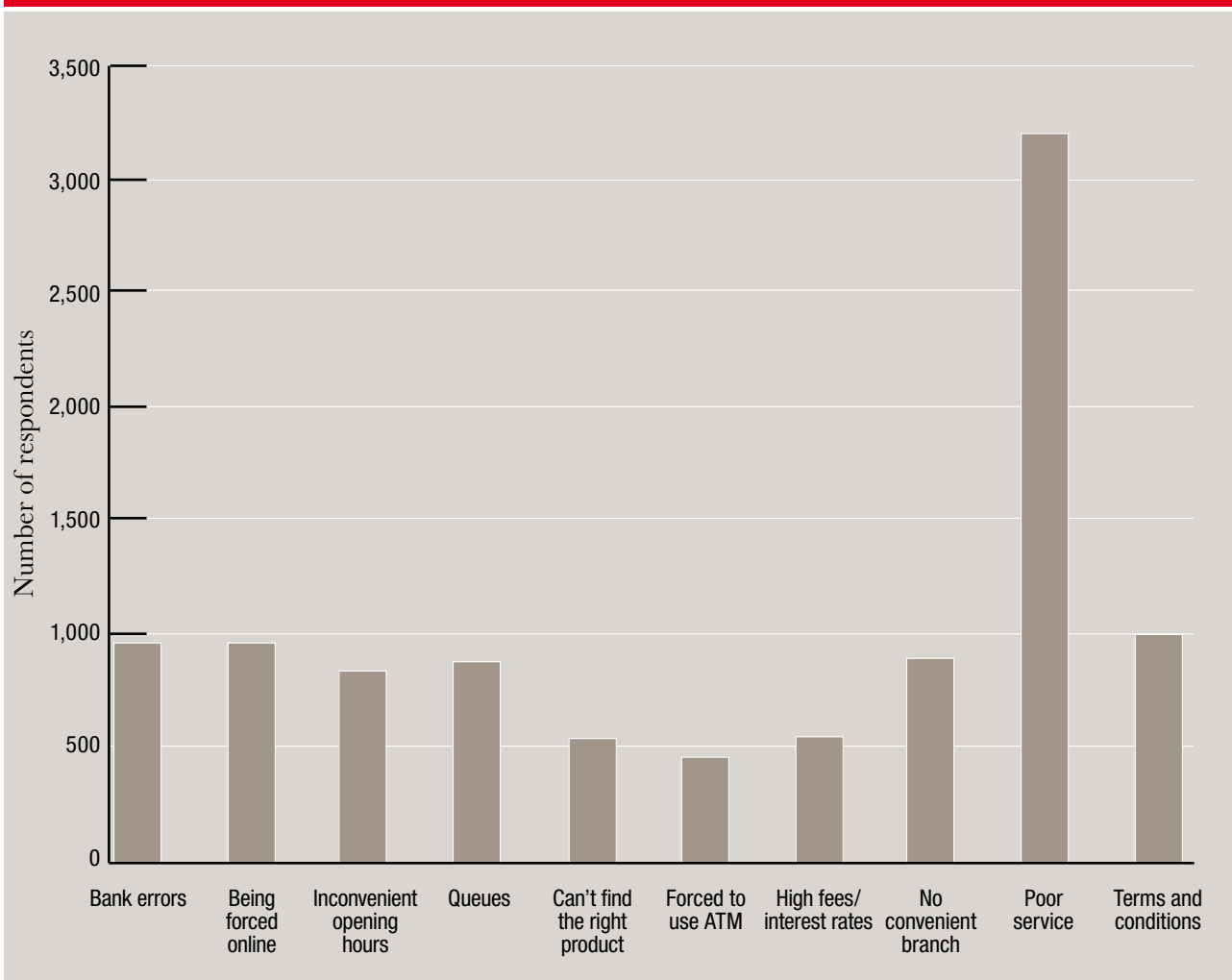
FIGURE 1 - DIFFERENCES IN ORDER OF PRIORITIES



TOXIC SERVICING - CORROSIVE TO YOUR CUSTOMER BASE

Contrary to what many financial services businesses assume, price is not the primary driver of customer churn. Our research shows that, in reality, poor service is the number one toxic issue driving customer churn in the financial services industry (Figure 2).

FIGURE 2 - BIGGEST FRUSTRATIONS

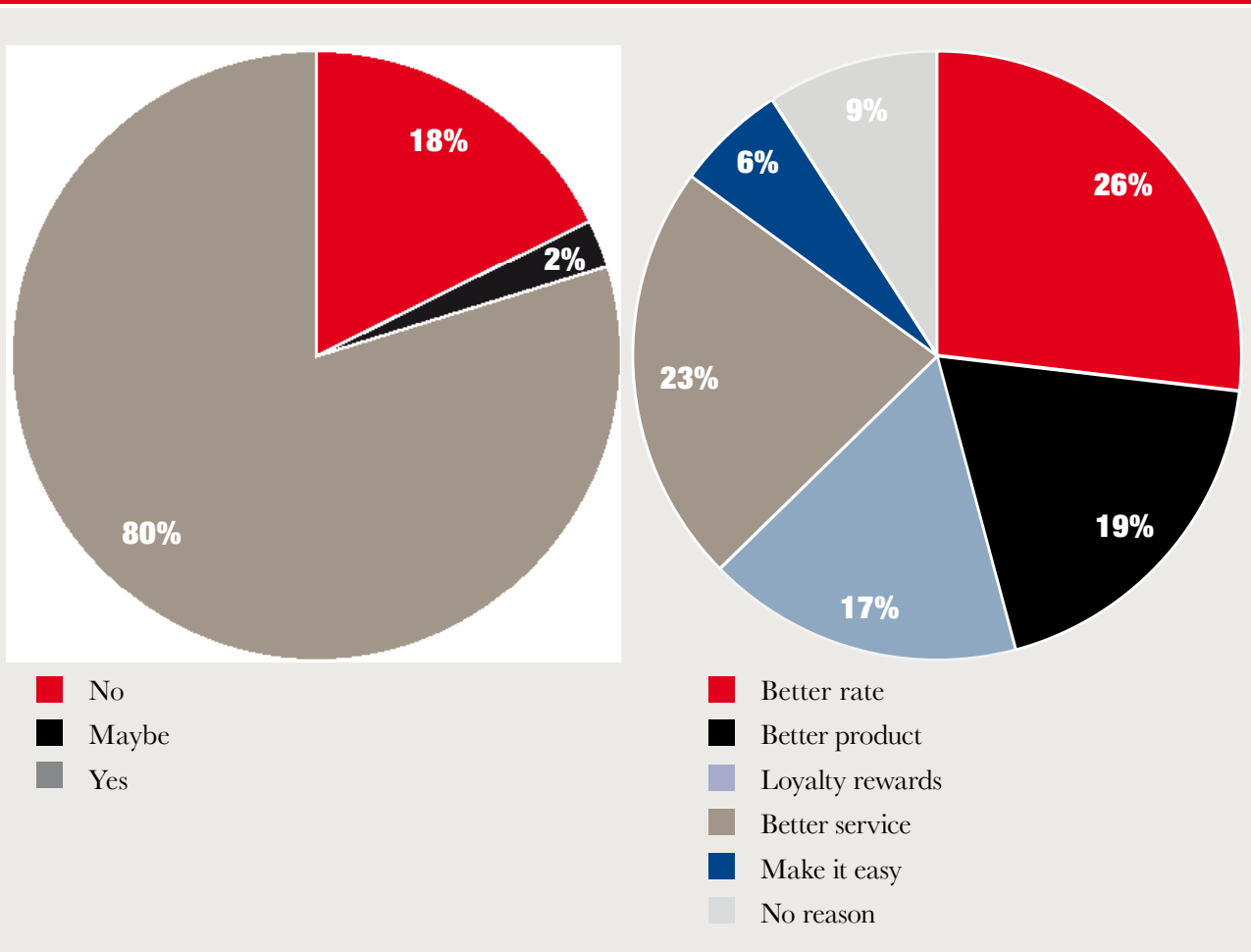


Our experience with financial services customers reinforce the message that price is the primary driver of churn. In the case of one retail bank, the primary catalyst for customer churn was having loan requests and product applications knocked back, despite being an existing customer. For an insurer, the primary driver of customer churn was a perceived lack of care, which customers saw when the insurer failed to

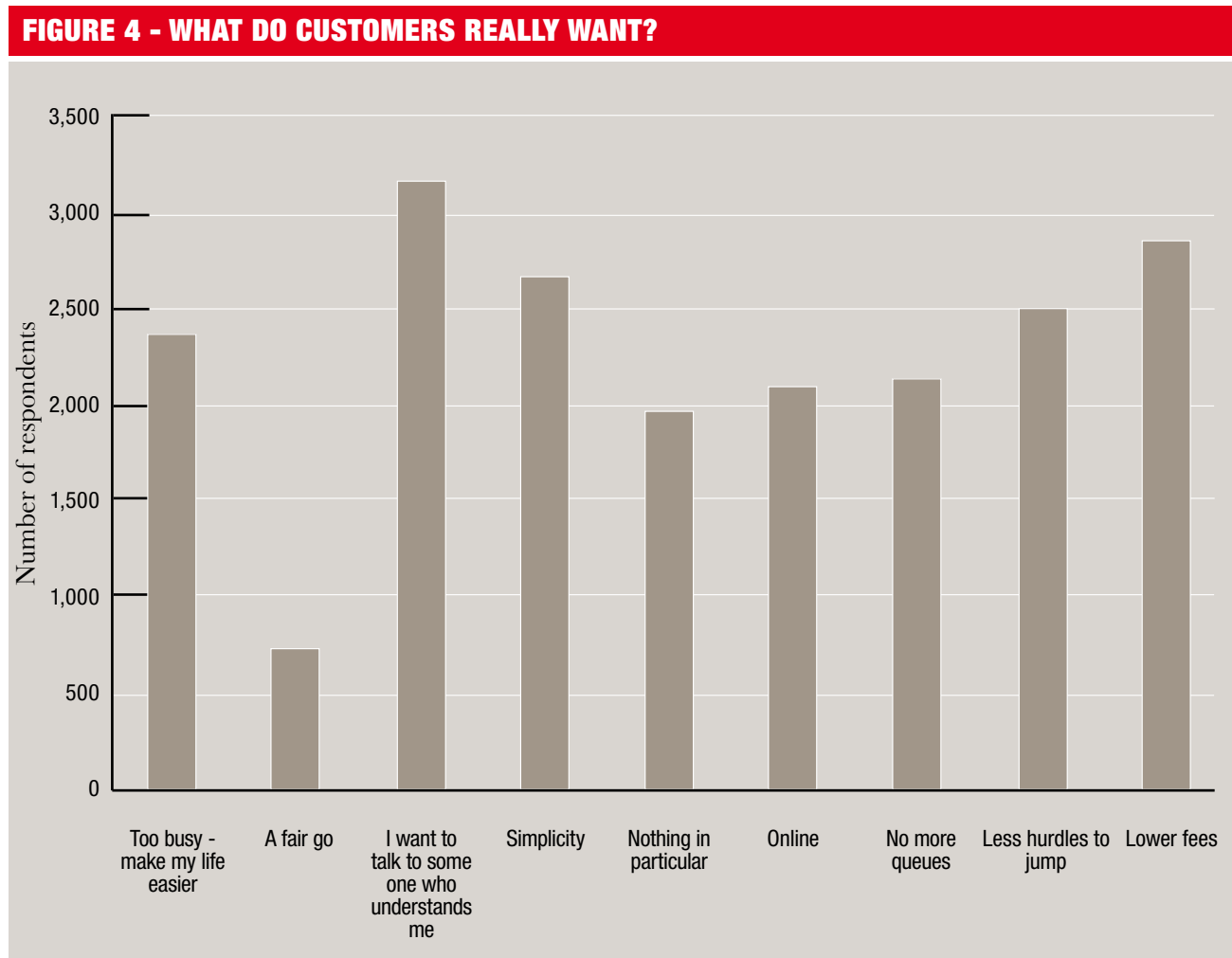
explain the reasons for annual increases in premiums for existing customers.

Importantly, our research also highlighted that toxic servicing has created a high degree of instability among customers, with the majority (80 per cent) saying they were ready to switch providers (Figure 3).

FIGURE 3 - WOULD YOU CONSIDER SWITCHING?



Toxic servicing threatens to eat away at the most valuable of customer segments, including high value and, until recently, long-term customers. Our research shows toxic servicing is relevant to all age groups, not just 'Gen Y' customers who tend to be seen as more demanding. Importantly, customers value the human interaction with skilled staff, and are also seeking ways to make their own lives easier. There is a significant opportunity to address these simple needs by effectively addressing toxic servicing issues.



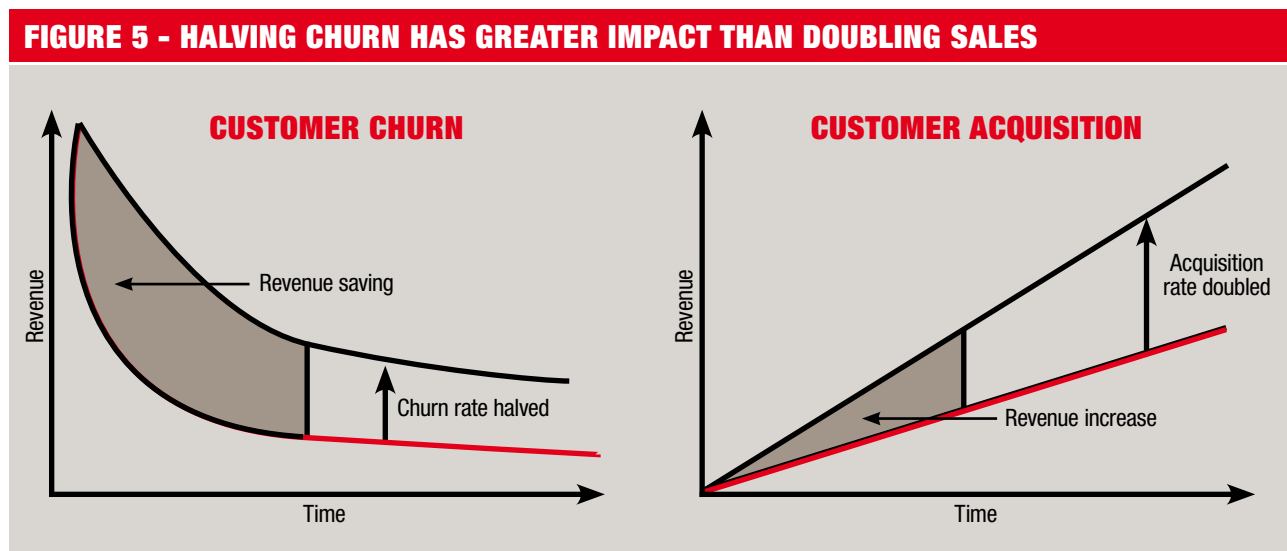
CUSTOMER CHURN EQUALS PROFIT CORROSION

The instinctive response to downward pressure on profits is to attempt to increase revenue by driving sales and new customer acquisition. However, there is another far more powerful lever for stimulating profitability – reducing customer churn. Most organisations do not realise customer churn has a far greater impact on revenue and profitability than new customer acquisition.

Acquiring new customers is an expensive and inefficient process, costing in the order of \$500 to \$800 per customer. Organisations need to retain each customer for a period of time before there is any return on this investment. Customers who churn early, before the break-even point, represent a financial loss for the business.

The relationship between an organisation's customer acquisition rate and revenue is inefficiently linear – spending twice as much on sales and marketing will not double the number of new customers you attract. On the other hand, the relationship between an organisation's customer churn rate and revenue is exponential, owing to the typical value of a customer over time.

Reducing the rate of customer churn for a financial services provider (Figure 5) will therefore have a far greater impact on revenue and profitability than a similar increase in the customer acquisition rate.



CORROSION RUNS DEEP

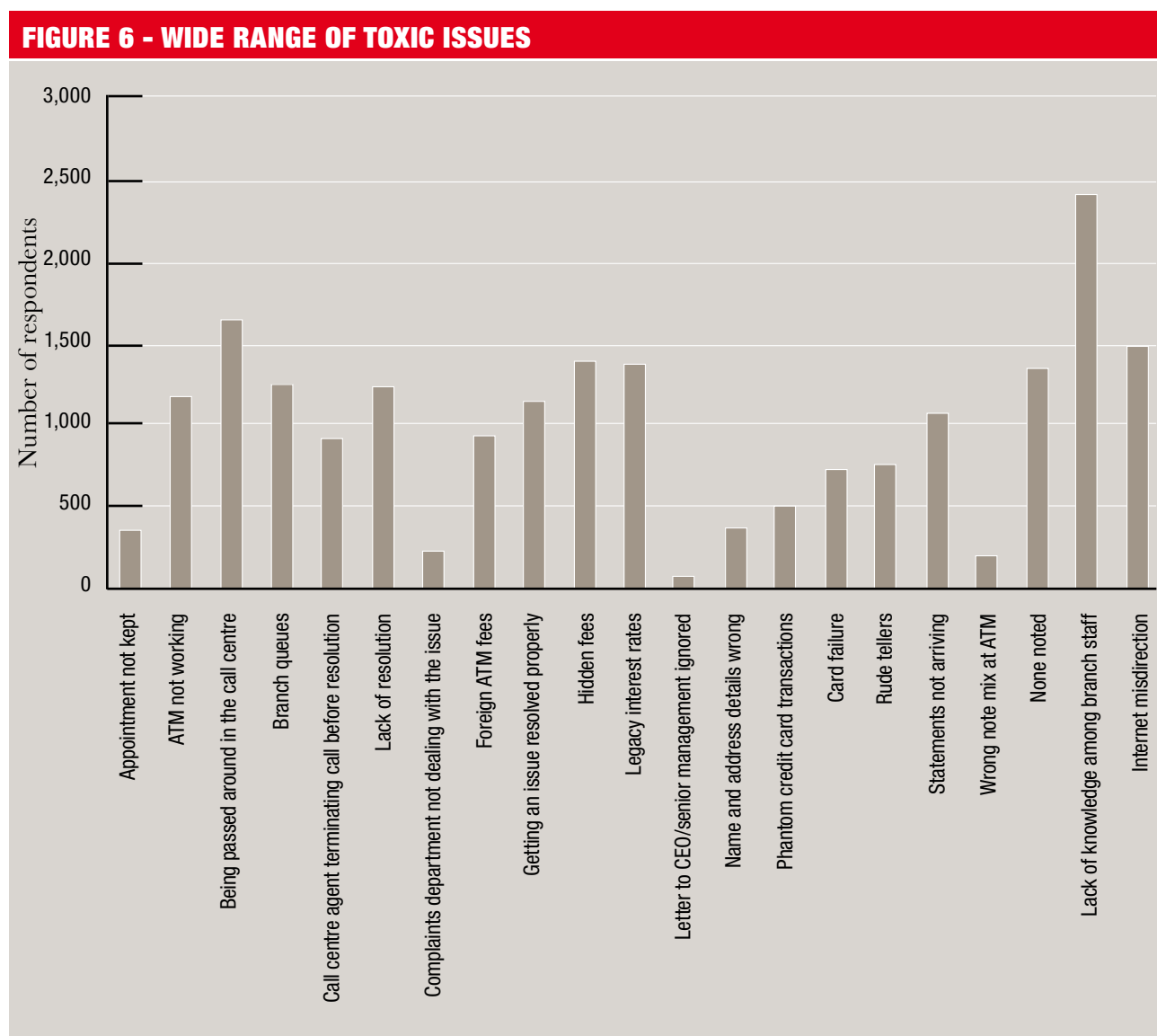
Customer churn is endemic in the financial services industry. On average, churn rates for the industry are in the region of two per cent per month, or 25 per cent per annum. The impact on profitability has been borne out repeatedly during our research and work with customers in the financial services industry:

- For a major home loan provider with a mortgage book of over \$10 billion, two per cent customer churn per month equated to a profit loss of over \$70 million each year.
- For a major insurer with over 800,000 home insurance customers, two per cent churn per month was the equivalent of over \$250 million lost revenue each year.
- For a major retail bank, every one per cent decrease in customer churn added over \$10 million to the bottom line.

The link, then, is clear: toxic servicing exerts a powerful effect on increasing customer churn, thereby driving down revenue and profitability. By the same token, the potential exists to dramatically increase revenue and profitability by putting a stop to toxic servicing. The key issue for financial services businesses is how to identify and prevent toxic servicing occurring in the first place.

QUANTIFYING THE UNQUANTIFIABLE

Toxic servicing is a complex problem. It is not simply about poor customer service; customers find a wide range of issues toxic (Figure 6). There are multiple and interdependent driving forces behind these issues, including process inefficiencies, counterproductive business policies, inadequately trained staff, poor technology and organisational culture issues.



Furthermore, toxic servicing issues will vary by customer segment and by the type of financial services provided. The challenge facing organisations is how to determine which toxic servicing issues apply to their business and how to adjust the complex driving forces internally to eliminate them.

The most effective route to minimising toxic servicing and customer churn comprises three main stages:

- Discovery – finding out what customers value and what frustrates them most.
- Modelling – simulating the dynamics of the customer relationship and balancing and optimising the competing initiatives and business drivers within the organisation.
- Implementation – enacting a business transformation program to achieve the desired goals.

For financial services organisations the discovery stage typically involves research surveys and focus groups to gather customer feedback. However, this approach is more measurement than research and contains a number of pitfalls which can impact its effectiveness:

- Using pre-defined questions constrains the scope of the answers.
- The feedback contains no information on how to solve the issues.
- The environment and style in which the questions are asked can influence the responses.
- Typically, surveys are outsourced to a third party, which means the business and those in the business who need to use it do not have real ownership of the data.

Discovery must, therefore, be conducted without presumptions and combine objectivity with a non-threatening, rigorous approach to obtaining full and honest customer feedback. Techniques such as asking customers to weigh up one value against another have been found to be very effective in the discovery process. Additionally, senior managers from the organisation must be completely involved in the discovery process to ensure the results obtained are owned and understood by the staff who will subsequently apply them to decision making.

The second stage to combating toxic servicing and customer churn is to model the relationships between the underlying causal factors for the problems highlighted in the discovery stage. From this, the net benefit to the organisation's performance can be gauged. This requires creating dynamic organisational models that can simulate customer behaviours and company performance in real time across a range of scenarios. Techniques such as Business Kinetics Modelling, customer segmentation and profit modelling can be used at this stage.

The final and possibly the hardest stage is to implement the recommendations resulting from stage two. Typically this requires a program of organisational change encompassing people, process and technology. At this point, best intentions can give way to harsh reality and resistance to change. This transition is critical, however, otherwise the projected revenues modelled will fail to materialise and toxic servicing and customer churn will continue to impact profitability.

THE END GAME – PROFITABILITY

Toxic servicing is a critical issue for financial services institutions in Australia and New Zealand and has a very real impact on profitability. However, organisations that successfully manage toxic servicing stand to reap a considerable reward in the form of dramatically increased customer retention, revenue and profitability in a highly competitive market.

To be successful, organisations need to shift their existing mindset and approach to customer satisfaction. With the very real potential to increase business profitability, combating toxic servicing is a compelling priority for every financial services business.

ABOUT FUJITSU AUSTRALIA AND NEW ZEALAND

Fujitsu is a full service provider of business, information technology and communications solutions. Throughout Australia and New Zealand we partner with our customers to consult, design, build, operate and support business solutions. From strategic consulting to application and infrastructure solutions and services, Fujitsu has earned a reputation as the single supplier of choice for leading corporate and government organisations.



ABOUT ENZYME INTERNATIONAL

Enzyme International is a specialist consulting firm with a unique service offering that helps companies understand the behavioural and operational factors that enable them to attract and retain customers, both internal and external to the organisation.

Fujitsu and Enzyme International have created a powerful joint service offering that provides a true business transformation capability for tackling toxic servicing issues from discovery through to implementation.

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A07_0029_00