Divide and Prosper: Targeting Key Customer Segments to Drive Bank Profits

In today’s slow-growth era, a seven-step framework can help banks identify and sell to their highest value customer segments.

Executive Summary

North American retail banks face multiple challenges, including a low interest rate environment, rising regulatory costs and customers spurning traditional branches. In response, they are moving to reinvent their operating models, better understand their customers and grow their share of wallet within their most profitable segments.

Rather than accept vague classifications such as “mass affluent,” leading banks are organizing around the specific needs of their most profitable customer segments. This white paper describes why it is essential to organize around customer segments rather than geographies or product silos to grow share of wallet, boost customer retention and improve lead generation, while increasing branch and call center productivity. We end with our proven seven-step framework for banks to identify and sell to their most profitable client segments.

Business as Usual = High-Risk Strategy

North American retail banks are facing a prolonged period of low interest rates and higher compliance costs, both of which make it harder to earn a reasonable rate of return on invested capital. These financial institutions also need to rethink their retail strategies as younger customers shun branches in favor of online banking or even abandon conventional banks for nontraditional players, such as PayPal, Google Wallet and Amazon Payments.

Amid these changes, banks are shifting from a focus on customer acquisition to capturing a greater share of wallet from their most profitable customers. There is room for growth here; a March 2012 report from BAI Research found that financial institutions typically capture only 46% of a customer’s total deposit balances. The percentage of total balance captured is even lower for other types of accounts, at just 10% for total loan balances and 2% for total investment balances. The rest represents an untapped market that is available for primary financial institutions that can understand customer needs and can convince existing customers to consolidate more of their banking and investment activities with them.

Moving from strategic intent to operationally capturing a greater share of wallet requires thoughtful tactics that enable cross- and up-selling. Identifying and seizing these opportunities requires a deeper understanding of customer needs, wants and expectations. It is no surprise that many retail banks are embarking on efforts to segment clients and customize service...
levels using analytics and data-driven decisions. Another BAI Research study\(^2\) shows segmentation is the top investment area for marketing and product development at banks with more than $2.5 billion in assets. For banks with under $2.5 billion in assets, investments in relationship packaging and pricing strategies are followed closely by segmentation (which helps drive the effectiveness of their strategies).

Segmentation per se is nothing new. But historical and broad definitions such as “mass affluent” and “affluent” vary across banks and are not precise enough to generate higher revenue and profits in today’s challenging market. To succeed, banks must understand the underlying emotive needs and desires of specific client segments and use those insights to restructure around their most profitable customer segments.

For some banks, the segmentation exercise may uncover the classic “80% of profits from 20% of customers” truism that is commonly found among our clients and further affirmed by industry research. Some banks may choose to focus not on customers who are the most profitable today but on those they expect will grow more profitable as the relationship matures. But whichever segments they identify as most valuable, banks that fully understand and serve specific segments are most likely to prosper amid continuing competitive pressure and technological change.

Some of the most important evidence supporting the effectiveness of this strategy comes from customers themselves. A survey conducted by BAI Research found that consumers are eager for their banks to approach them with cross-sell opportunities that help them better manage their financial affairs.\(^3\) Developing and targeting such offers, however, requires a more in-depth understanding of the high-value customer segments than what most banks have today. Many banks lack the internal systems, processes, data and insights to identify and proactively serve their highest-value segments.

**Five High-Value Segments**

In partnership with BAI and in our work with clients, we have identified five distinct customer segments that can help banks tailor their product and service offerings (see Figure 1). Each segment offers different revenue potential, investment objectives, comfort with technology, levels of satisfaction with their current financial institution and service preferences. Banks can combine an in-depth understanding of each segment with their business objectives to refine cross-sell efforts that maximize their share of wallet and long-term profitability. Deeper understanding of each segment will also help banks adjust their IT and staff investments to maximize profit potential.

- **“Marginalized Middles:”** This is the largest banking segment and consists of individuals who are younger than the average customer and have the second highest revenue per household. Compared with other segments, these individuals are the least satisfied with their primary financial institution, most confused about bank fees and most likely to pay someone else to handle their finances. The size of this group, and its tendency to visit branches less than other segments, may make it impractical to provide these customers with personalized service. For Marginalized Middles, consider a greater focus on self-service channels and easy-to-understand marketing messages as cost-effective ways to increase customer satisfaction and solidify the relationship.

- **“Satisfied Traditionalists:”** This segment accounts for almost 20% of customers and represents the oldest customers with the second-highest total deposit revenue potential per household and the highest investment balance. The profitability of this group is limited by its low receptivity to product offerings and to online, mobile and debit services. Building a product base focused on the needs of these individuals, such as products and services that manage cash flow with low risk, could drive a greater share of their wallet and revenue.

- **“Sophisticated Opportunists:”** Members of this group are of average age, with the highest income of any other group. While these individuals represent only 7% of the market, they are high-potential and very knowledgeable customers who are the most receptive to consolidating with one institution and the most open to new investment products with high upside and relatively high risk. Clarity around fees, as well as product features and benefits, are important to them. Product packaging, such as rewards for consolidating accounts, is
also important. Also consider online financial planning and investment management tools that allow this group to manage its finances.

• “Disengaged Skeptics:” This group represents a rich opportunity, as its members (about 20% of all customers) are very dissatisfied with customer service at their primary institution. They trust banks only for basic payment services, and with the bulk of their investments in other institutions – such as brokerage companies and investment firms – they must be convinced to rely on banks rather than investment firms to manage their financial affairs. To capture a greater share of wallet, banks must offer comprehensive and trustworthy investment solutions, enhanced customer service and less-risky investments as this segment (the second-oldest) nears retirement.

• “Struggling Techies:” This group also represents about 20% of the market and has the youngest members with the lowest income. While this is currently a low-deposit, low-revenue group, these individuals have the highest share of wallet at their primary institution and are very receptive to tempting offers. The mobile and social media initiatives they crave allow low-cost support that fits their current revenue potential, while forging a relationship that can pay off as they grow into a more profitable segment.

Segmentation in Practice
Identifying and targeting key customer segments is already delivering benefits for banks. For example:

• As the economy remains a concern for most consumers, their need for guidance and services from financial institutions is likely to grow. That help doesn’t always have to come from a high-cost, in-person channel such as an advisor in a branch. Low-cost alternatives, already being provided by discount brokerage firms, include online investment screening tools and call center support. Segmentation helps identify which channels are most appropriate for each segment.

• Market research showed one major bank that it was losing market share with wealthy residents in specific geographic areas. A study revealed that this segment was more interested in preserving capital than being exposed to market risk. In response, the bank offered deposit products with increased interest rates, supporting the rollout with marketing efforts.

• Identifying customer segments for specific delivery channels (such as mobile) can uncover potential opportunities. A Cognizant mobile banking analysis,4 for example, found that “Ardent Affluents” use advanced features

Capitalizing on Opportunities for Share of Wallet Growth
Satisfied Traditionalists have the greatest amount of money to invest, but they keep just 2% of their total investment dollars at their primary institution. Meanwhile, Sophisticated Opportunists have a lower investment total but a higher percent of investment dollars maintained at their primary financial institution.
such as mobile photo bill pay; are open to receiving expert guidance on personal finance and investments; and are interested in services such as spending pattern analysis and loyalty rewards/points. "Liberal Users," by contrast, are not heavy mobile users but "will respond best to services related to money management," according to the analysis.

Best Practices

Based on our work with clients, we have developed a seven-step customer segmentation framework. It takes into account customer criteria such as channel preference, risk tolerance, sensitivity to rates, and fees and product mix to help banks tailor offerings for each segment.

This framework also takes into account profitability criteria such as the breadth of products each segment is likely to purchase, the length of their relationship with the bank and estimated lifetime value.

1. Define your strategic objectives and assess your internal capabilities. Consider your goals in customer retention, new product introductions, planned entry into new markets and the changing role of your branches. This is also the time to identify internal capabilities (staff, process, technology and culture changes) to achieve these goals, assess how well you understand these capabilities and determine the optimal mix of building, buying or "renting" capabilities to fill gaps. This step must involve retail bank executives and other business leaders, and it usually involves workshops and consensus-building meetings. Among the outputs that help the bank are SWOT (strengths, weaknesses, opportunities and threats) analysis and IT gap assessments.

2. Define target markets and customer segments. This is the core work of understanding likely profitability characteristics and baseline assumptions for each target market and customer segment. It includes understanding which specific factors are important to each segment, such as their risk tolerance, channel preference, rate or fee sensitivity, and their expectations for customer service. Among the tools used in this analysis are client surveys and internal profitability and cost models.

3. Target desired niche/sub-groups. Which groups have attributes the bank is seeking, such as receptivity to new offers, likelihood to consolidate with one institution or high household...
incomes? Ideally, the results of this targeting are a redesign of the bank service model to better serve more profitable segments.

4. **Develop test and control cell offers.** Based on modeling and profitability analysis of these sub-groups, test to see which products and services generate superior response rates and receptivity and how each segment compares with a control group. A typical test cell might include 700-1,000 customers. The duration of the offers depends on the scope of the change being tested, with longer tests conducted for more expensive strategies such as redesigning physical branches. Cell offers are often conducted first in one geography and then rolled out to others if successful.

5. **Refine programs and measure results.** Continually improve your ability to quickly capture test results and decide which pilot programs to move into production and which to shelve. Metrics include net new customers or additional deposits/loans that current customers bring from other financial services providers. This should be a continual process as the bank rolls out new offers, measures their success and tweaks offerings as market conditions, customer needs and technology change.

6. **Roll out proven programs, offers or solutions to a broader audience.** Prioritize and accelerate the deployment of products and services that resonate with a target segment, accounting for budget and service capacity constraints.

7. **Document and communicate key learnings.** This is the ongoing process of understanding what worked well and what could work better with adjustments. Also consider the customer service lessons that were learned, how they can be applied to other parts of the bank and how the bank can best evolve its capabilities to address changing customer preferences.

**Looking Forward**

Tomorrow's banking leaders will be those that most effectively understand the underlying needs and desires of their most profitable client segments and focus their organizational talent and capabilities on creating unique products and services. Segmentation is not a one-time event but an ongoing process of understanding changes in demographics, technologies and customer needs. These insights can help banks continually fine-tune their products, services, marketing efforts and channels to maximize their return on investment by focusing on their most profitable segments.

**Footnotes**


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