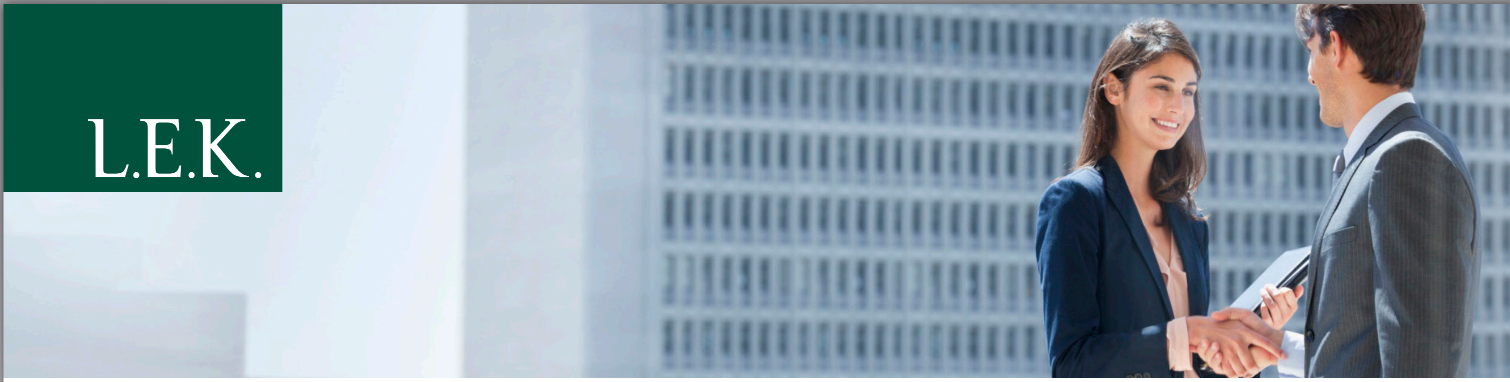


EXECUTIVE INSIGHTS VOLUME XVI, ISSUE 37

It's Not You, It's Me: Why Customer Relationships Should be the UK Retail Banking Battlefield

Huge sums have been expended by regulators in an effort to improve competitiveness and stimulate more customer-focused behavior in the U.K. retail banking sector. Some 15 regulatory reviews have been conducted in as many years, addressing technical questions about the behavior of the various parties and, in particular, improving transparency and ease of account switching. The fact remains, however, that there is a crisis of public confidence in the U.K. retail banking industry. Given the seeming inability of the investigations to reverse this impression, observers may be forgiven for concluding that they're looking in the wrong place for answers.

Throughout the regulatory investigations, the rhetoric of the regulator has shown increasing frustration, while the banks have become increasingly adept at defending their positions. This has been brought sharply into focus by the Competition and Markets Authority's announcement on 6 November, 2014, confirming that it will proceed with market reviews in personal current accounts and SME banking. These reviews could, predicts the *Financial Times,* "radically alter the shape of the sector ahead of May's general election." Pent-up political pressure and public frustration close to an election means that this is more plausible now than it has been in the last 15 years.

Retail banks could accept that they will continue to be the pariah of the commercial sector, repeatedly investigated, frequently under threat of break-up and regularly at the bottom of customer confidence league tables. Or they could adopt new strategies to reboot their customer relationships and get the regulator off their back.

Regulatory Regime Change, Political Pressure and Competitive Threat: the Time is Now

The run-up to the May 2015 general election presents a unique opportunity for fresh thinking, thanks in part to a recent change in oversight. The Competition and Markets Authority (CMA) started life on April 1, 2014, replacing the Office of Fair Trading and the Competition Commission. The same day, the Financial Services Authority (FSA) shut down, making way for the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

Both the FCA and the CMA are more focused on consumer interests than their predecessors and their goals dovetail neatly with the interests of banks which, after a public battering over executive pay and the 2008 financial crisis, need to connect more positively with their customers. Add to this the political pressure to 'solve' the banking 'problem,' the c.20 organizations who have applied for U.K. banking licenses and the emergence of disruptive technology-led and other innovative players increasingly encroaching on banks' home turf, and these issues could hardly feel more pressing.

It's Not You, It's Me: Why Customer Relationships Should be the UK Retail Banking Battlefield was written by **Ashish Khanna** and **Peter Ward**, partners, and **Diogo Silva**, a principal, in L.E.K. Consulting's London office. For more information please contact financialservices@lek.com.

Regulatory Investigations: Ground-Hog Day

Since the turn of the new millennium, banks and regulators have been locked in a costly cycle of competition and customer service investigations. Yet despite millions spent on these reviews, the discussions remain stiff and restrictive, with a widespread perception that not much has changed.

British banks have been subject to 15 competition investigations in as many years, launched by a clutch of regulatory bodies, from the House of Commons Treasury Committee to the Office of Fair Trading. These reviews have brought more legalistic tinkering than bold rethinking of how British banks can best serve their customers. The regulatory investigation cycle has also had a corrosive effect on the focus of consumer research and understanding. Blue-sky thinking is difficult when your data on the customer, constrained by the need to respond to the regulatory challenge, is culled from telephone banking surveys that ask customers to answer technical questions about such issues as branch hours, switching procedures and overdraft notices.

Customer Disengagement: It's Not You, It's Me

Recent initiatives on current account switching and pricing transparency have tried to improve customer rights and create a more dynamic and competitive environment. But the average banking customer greeted these changes with marked apathy. In 2014, for example, only around three percent of customers will switch their account – hardly the transformation the regulator was hoping for.

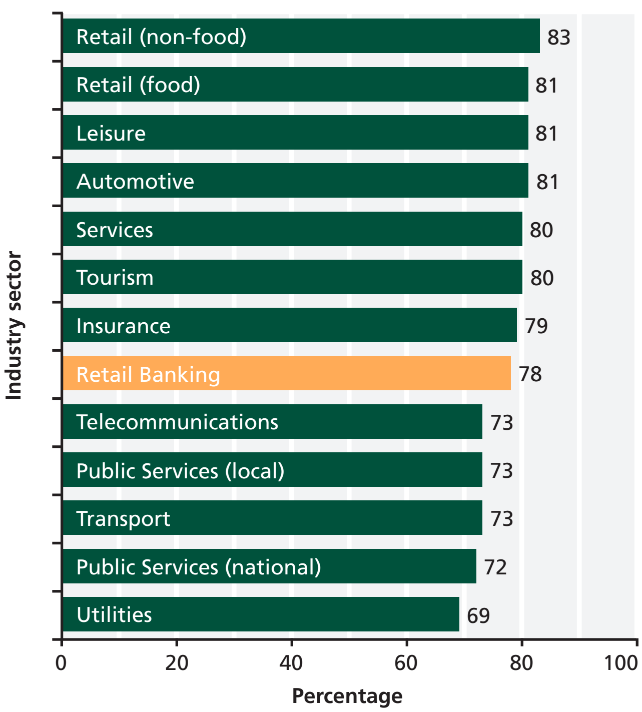
Not only does the launch of multiple competition reviews sap banks' resources, they also perpetuate the popular image of banks as ruthless predators rather than service providers. It's hard to build a strong relationship with customers while three-inch headlines blare that your industry's being investigated – again.

Meanwhile, despite banks' best efforts, customers feel that their interests are less and less at the heart of banks' concerns. Research conducted by L.E.K. shows that, between 2007 and 2012, consumers surveyed felt that financial institutions grew increasingly less like 'service providers', becoming markedly more 'salesman-like' and that banks were too 'pushy' with assertive sales tactics that didn't take into account the consumer's situation or mindset. In addition, the FSA's "Retail Conduct Risk Outlook 2012" stated that banks were "less attuned in terms of responsiveness, consumer-focus and service standards compared to the non-financial service retail industry."

Not that customers were complaining about their banking services; quite the opposite. In surveys, customers say they are broadly satisfied with their banking experience; customer satisfaction with the retail banking industry ranks just above the U.K. average and substantially ahead of sectors like Utilities and Public Services (See Figure 1).

Figure 1

UK Customer Satisfaction with Banks vs. Other Sectors



Customer satisfaction with retail banking, as measured by the UK Customer Satisfaction Index, is above the UK average of 77.

Source: UKCSI, Jan 2014

This apparent satisfaction, or rather lack of dissatisfaction, should not be taken as an endorsement of banks' relationships with their customers. The public's trust in banks as British institutions has plummeted over the last generation, with public opinion polls charting a sharp drop in respect for the banking industry since 2008's financial crisis (See Figure 2).

This disengagement and erosion of trust has been exacerbated by a diminishing need for customers to visit branches and engage with bank staff directly as the use of online banking has increased.

Customer Centricity: It's Good to Talk, Better to Listen

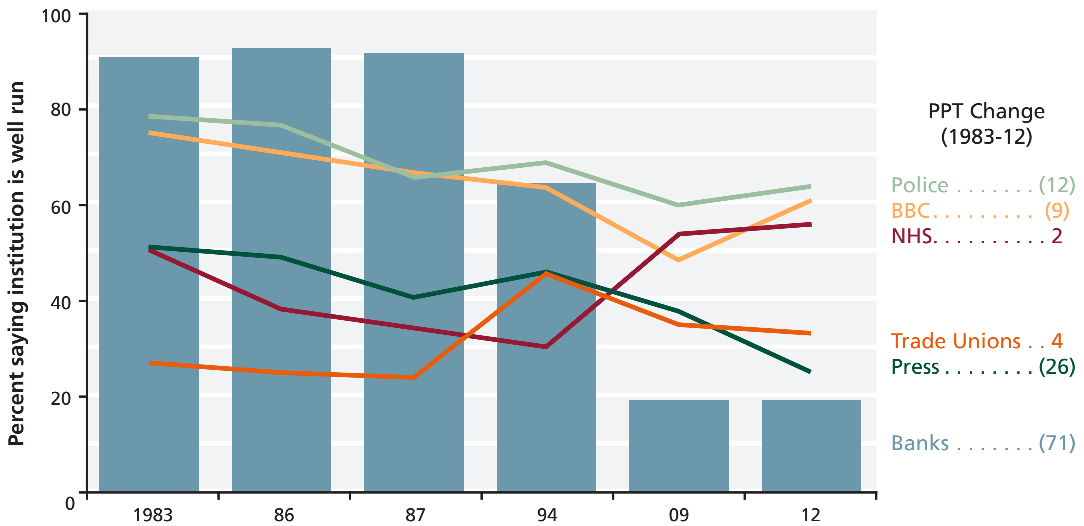
To add depth and meaning to the conversation with their customers, banks should base their product development and relationship management on watching and listening to understand customer needs. It's not that banks haven't been trying – focus groups and surveys work beautifully for a conversation driven by products that are pre-existing or works-in-progress – for instance testing a bank's latest app – but they don't always spark ideas for new ones. Technology can provide the answer, giving access to large volumes of customer data, gathered over an extended period, that could facilitate a deep understanding of long term customer behavior. The new era of hyper-connectivity could enable banks to re-establish an old-school branch manager-type familiarity, just by very different means.

While bank strategies are driven by products, a customer's own decisions are driven by needs: when a man walks into a bank to talk about a loan to buy a car, he ultimately needs (or wants) that Audi, not a motor loan. It is one mindset to ask what yesterday's transaction data says about John Smith's ATM needs, and quite another to ask the sorts of questions that create a portrait of his needs both today and over the next five or ten years, with a depth that will build trust by showing a better understanding of his major life events. Steve Jobs' suggestion: "Get closer than ever to your customers. So close that you tell them what they need well before they realize it themselves" is now not just a pipe dream for banks, which have much more information about their customers' lives than Apple does.

To create that intensity, bankers need to start thinking like pioneers in the tech, media and consumer goods sectors. For example, Motorola, Microsoft and Disney have hired trained anthropologists

Figure 2

UK Consumer Attitudes Towards Major Institutions



Note: Data on consumer attitudes to banks is available only for the years shown in the chart.
Source: British Social Attitudes Survey

to help identify the next major trend, while Intel has a team of ethnographers who scour the earth to study consumer lifestyles. Procter & Gamble, worried it was losing market share in nappies, followed 12 mothers as their children grew. The mothers had an online platform where they could post, chat and swap information. Where earlier surveys had had trouble retaining the interest of participants, the nappy study didn't and by the end of three months, P&G had 600 pages of customer feedback.

The focus of retail banks' customer research needs to shift in this direction, away from transactions and incremental change to pre-conceived ideas, and towards whole customer understanding. Banks clearly have greater regulatory constraints and a very different product set to consumer and tech companies, but a significant opportunity for innovation in customer service awaits.

Corporate Structures and Reporting: Put Your Mouth Where Your Money Is

What if banks were to start framing their business around customers, rather than products? Is it too much to imagine that, instead of appointing someone as Head of Retail Mortgages, a bank could, in time, have a role of "Head of Men in Their 40s with Children?" It would be much easier to persuade regulators and customers of genuine customer focus if corporate reporting and bankers' livelihoods were linked directly to customer segments.

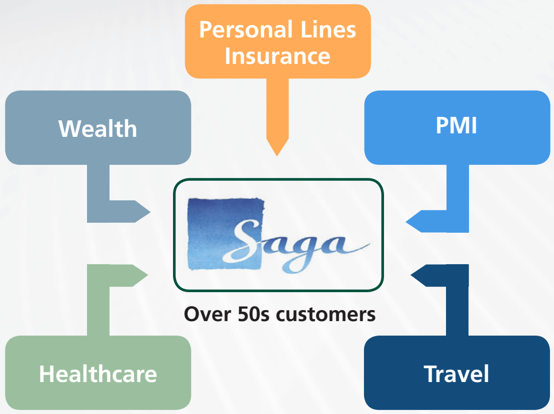
There are serious challenges, of course. Banks' IT systems are based around products, as, by and large, are their P&Ls. Some allow for 'shadow' segmental P&Ls and segment owners, but product is still king. As a result of these technical challenges, banks don't model 'whole customer' relationships on the customer's lifetime or demographic across all products – current good practice is to work with segmental single product models. Change may need to be incremental to ensure that the benefits outweigh the costs, and will likely involve API-style innovation through partnerships rather than wholesale systems replacement taken on by the bank alone.

Failure to address structural changes perpetuates the sense that banks focus on selling products rather than serving customers: banks are often forced to deal with customers on one product at a time rather than looking at their full product set; and regulators see incentive structures set up to reward success in product sales, rather than customer service.

Lessons are available from industries such as insurance, roadside assistance and consumer goods, which market to customers by anticipating and meeting their needs.

Saga Group: a Best Practice Example of Retail Financial Services Customer-Centricity

One company in retail financial services which has deftly leveraged this shift from a product-based approach to a customer-focused one is the Saga Group. Its understanding of over-50s customers, built up initially from a narrow holiday and travel proposition, allowed it to think more broadly than competitiors about its over-50s customer group. This allowed the Group to invest in developing proprietary customer data and to branch out into a raft of services, from insurance and health to legal support. According to L.E.K.'s analysis, all of these services are performing significantly more profitably than their peers across all product segments.



It's a Win-Win-Win Situation

Banks urgently need to respond to current threats by changing the nature of the debate with both regulators and customers, building a more explicit focus on customer-centricity, through three areas:

- **Regulatory relations**, shifting the focus of debate from products, technical arguments and metrics to customer needs;
- **Customer relationships**, taking an explicitly customer-centric approach, especially in consumer research and product development, and, at least as importantly, being seen to do so; and
- **Internal reporting and organizational structure**, moving towards a focus on customer segments rather than products.

By making the regulatory discussions more customer-centric, banks can break the dreary cycle of burdensome regulatory investigations. By doing the same with customer relationships, looking to the consumer goods and tech sectors for inspiration, banks can work with customers to reimagine what banking means to the average Briton, on the customers' terms, and to correct their frequently inaccurate and damaging views of banks and the banking system.

Only this can stop the sapping effects of customer apathy, get customers actively engaged with their banks again and, in the longer term, help head-off threats from competitors and burnish their reputations along the way. Banking can get back to what it's always really been about – trust and relationships with customers.

Tackling these issues head-on will undoubtedly be extremely challenging, but if the banks don't start now, in the face of the public's loss of trust, urgent threats from new outside competitors, and from regulators and politicians calling for a break-up of the biggest institutions, then when?

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