

Branding banks for shareholder value

Planned series of discussion drafts

	Discussion Draft Version	Release Date
Creating shareholder value - an outline	1.0	Mar-10
How customer perceptions develop	2.0	TBA
Branding banks is vital		TBA
Branding banks is hard		TBA
Measuring customer perceptions		
Measuring customer value		TBA
Gaps analysis		TBA
Six Sigma and brand control		TBA
Bank structure and brand control		TBA
Valuing bank brands		TBA

Section 1.0

Creating shareholder value – an outline

Introduction

My purpose, in this series of papers is to define the path from bank branding and customer perception to shareholder value. How does investment in brand and perceptions generate value? In this opening section I set out some of the foundations of what follows.

I shall argue that successful branding is vital to banks but that it is at the extreme end of difficulty on the spectrum of all brands. The normal ways of thinking about corporate brands do not work well for banks. Creating and managing a bank brand is so difficult in fact that the corporate competence in surmounting the challenges is a source of sustainable competitive advantage. This advantage can only be achieved by an understanding of the issues and their implications. There must be a particularly disciplined set of decisions within a well designed policy framework. In some aspects this goes to the heart of and challenges conventional management philosophy.

I am serialising this series of discussion drafts on LinkedIn and welcome any comments. The papers are work in progress towards a book I intend to write one day. I am recording my own journey over many years trying to come to grips with these issues. My approach is founded on practical experience but I have been dutiful in trying to make best use of theory and whatever data I could access.

I developed much of my thinking on this subject working with the Finance & Business Services team of TNS Australia¹. I am grateful for their input and support. However any opinions I express are mine alone. In developing my thoughts I have drawn on the work of others. Attribution is always recorded. Should anyone reading this be concerned that their ideas have been misrepresented or used inappropriately I should be happy to withdraw them.

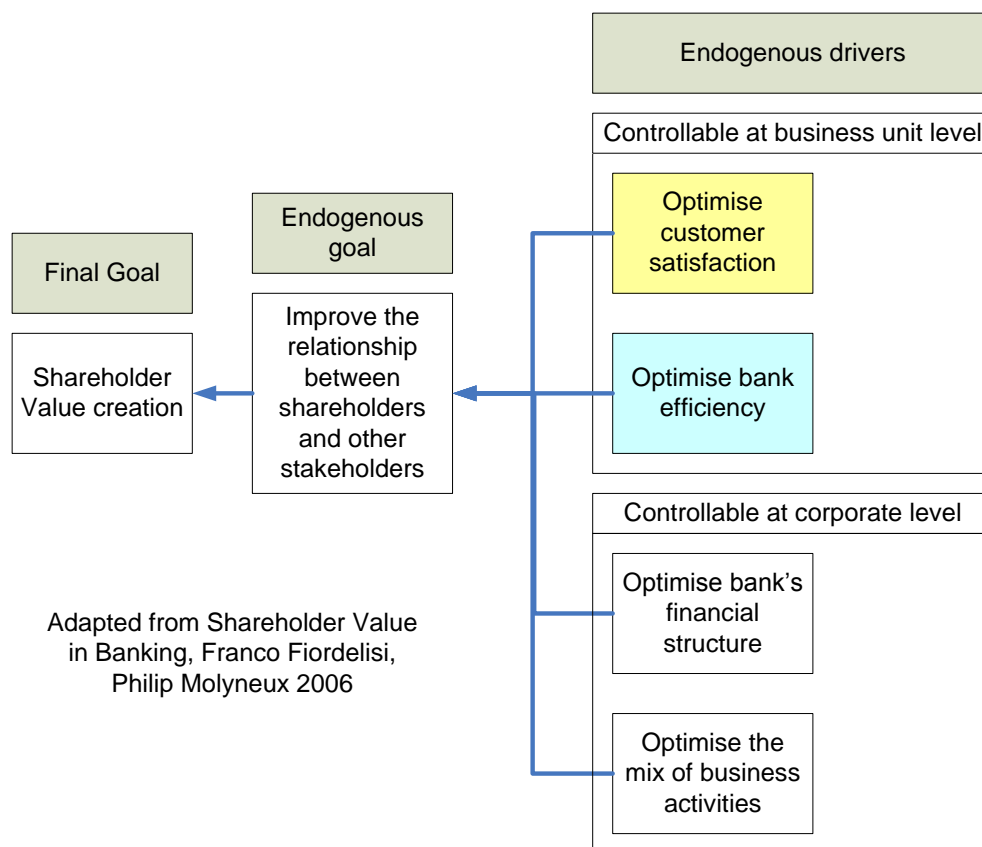
Shareholder value as the goal of the system

I want to establish a framework for thinking about bank brands in the context of the overall goal of a bank's business system. My first task is to try and map this system starting at the highest level. Crucially, in defining a system model in which the roles of brand and customers perceptions could be located I need a precisely defined goal. I take my starting point from Fiordelisi and Molyneux' excellent book – *Shareholder Value in Banking*ⁱⁱ.

My own practical experience, working in enough proximity to half a dozen or so bank CEOs to understand their priorities, is that the thing most likely to keep them awake at night is the share price. (I should say here that I have never actually met one who admitted to being kept awake at night). I was easy, therefore, to convert to shareholder value thinkingⁱⁱⁱ. However, *Shareholder Value in Banking* provided an academically rigorous approach upon which I could build.

I adapted the exhibit below from this book. It shows with great clarity that there are *just four* drivers of shareholder value. My adaptation distinguishes between those primarily controllable at the corporate level and those controllable at the business unit level. I do not mean by this that there is not significant interplay between the corporate and divisional levels. In the management of risk, for example, the development of policy frameworks set at the corporate centre must take into account the implications at the customer interface. The cost of risk is central to pricing. I shall argue later that the stress between these two levels of responsibility is one of the many factors that distinguish branding of banks from that of many other types of organisation.

For my immediate purpose I am concerned only with customer satisfaction^{iv} as a driver of shareholder value and the trade off against bank efficiency that must be decided on by management. I have also inserted the word 'optimise' into the two drivers of value controllable at the business unit level. This recognises the trade-off between cost and improved customer satisfaction that will be an ongoing theme in these papers.

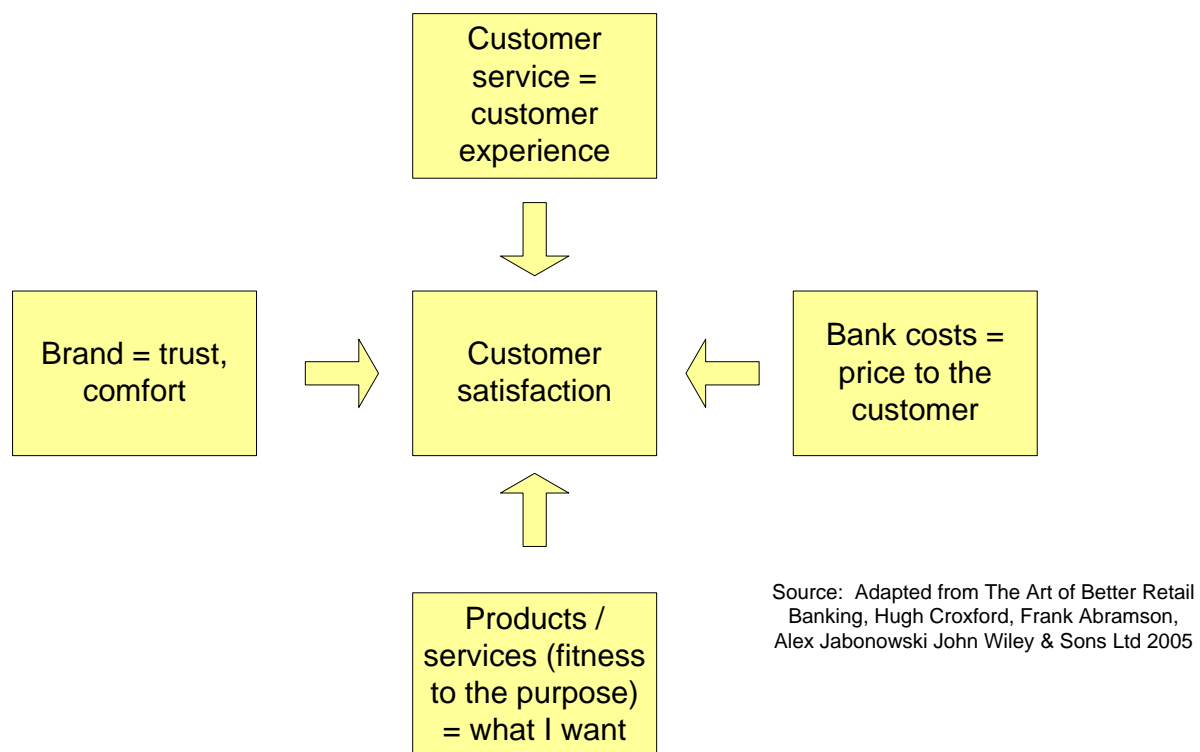


Before digging deeper into customer satisfaction, I want to note one of the conclusions reached by Fiordelisi and Molyneux. The creation of shareholder value necessitates the goals of other stakeholders, principally customers and staff, being met. For example, dissatisfied customers impede progress towards optimal shareholder returns. Indeed this goes beyond apparently competing goals merely being 'met'. It requires their integration. Later I shall outline the implications for branding of multiple stakeholders and show that in this also banking tends to be an extreme case amongst industries.

Finally, it is encouraging for bank marketing people such as me to see customer satisfaction elevated from its usual position of something a bank should do *as well as* make a profit to a key driver of profit in its own right. From now on in these papers I will, accepting Fiordelisi and Molyneux case, take shareholder value as the goal of a bank.

Looking to get a grasp on the concept of customer satisfaction I find helpful a framework from Croxford, Abramson and Jablonowski, in *The Art of Retail Banking*^y. In adapting their framework for my present needs, I have replaced, in the centre box, their words 'sustainable profitability' with 'customer satisfaction'. My reason is that I believe sustainable profitability requires other elements as shown in the Fiordelisi & Molyneux

model. Certainly, I agree that Croxford et al that they have clearly identified the determinants of customer satisfaction. Moreover they have done so in a way that many market research studies fail to. They have distinguished four key elements of satisfaction that each require separate consideration in the way they act, in concert, on the perceptions of the customer. Let me offer an initial comment on each from the perspective of my study.



Products and services are the specification of the features that the customer is intended to get when they sign up for it. All bank products are a mix of computer system design and service delivery. In retail banking they can vary from the highly standardised, such as payment, to the highly customised such as a commercial loan. But for each product / service there is a design of its functionality in the way it is intended to operate.

Subsumed within this concept of product specification is the specification of the way (or ways) in which the product is distributed. This is a large and critical part of product design that I shall return to in a later section.

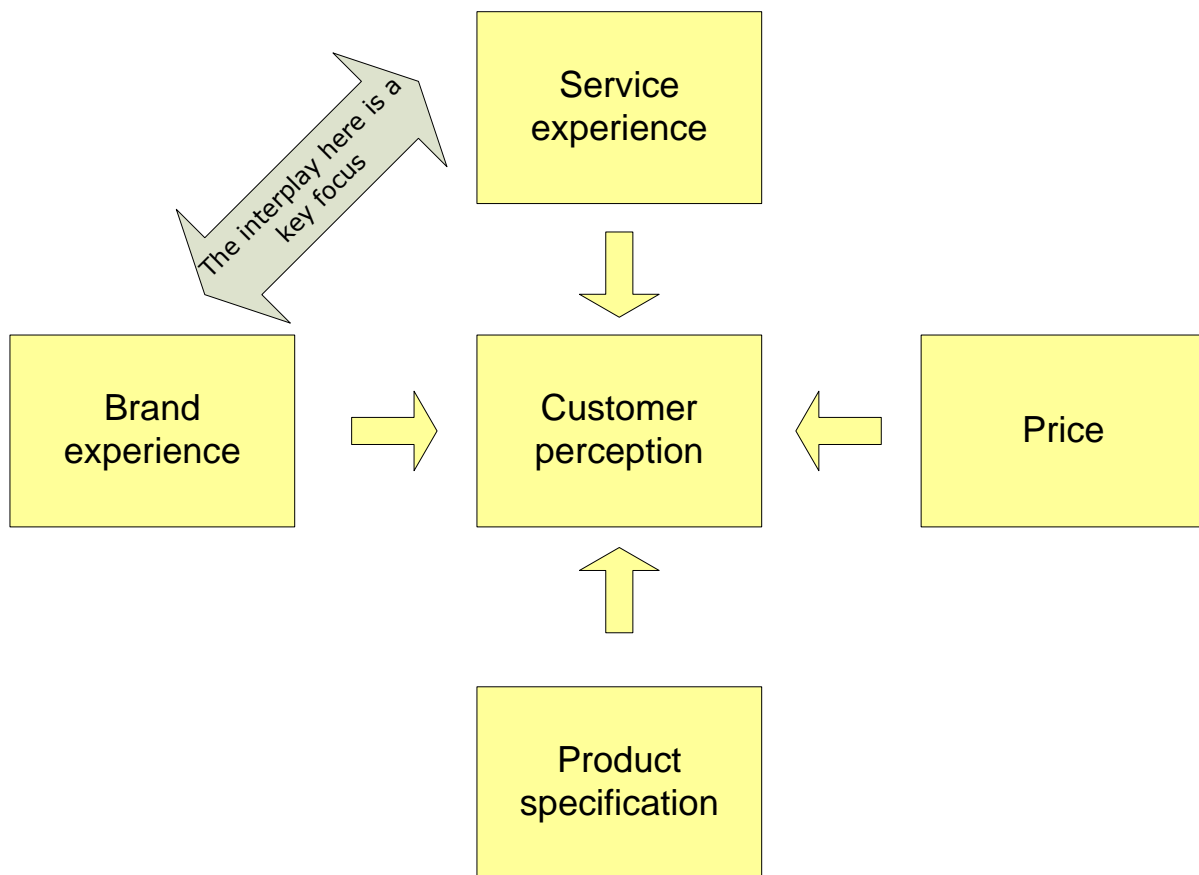
My first observation is that a retail bank's shareholder value stems to a large extent from a set of fairly standard and well understood products. Innovation that creates any sustainable advantage is relatively rare. Examples that come to mind for the Australian market include home equity mortgages in which Citibank believes it gained a two year lead because of difficulty of local banks in adapting their computer systems and cheap point of sale terminals where the Commonwealth Bank gained rapid market share growth that was largely retained after its competitors caught up with the technology. Such examples are fairly rare, however. This is especially so in the context of the total value of a bank. The bulk of that value tends to be in areas where rivalry is fairly stable. In my experience it is more common to confuse customers by overcomplicating product specifications and multiplying niche products rather than making products too simple. A variety of hard to comprehend product offerings of different banks, if anything, reinforces inertia. Product innovation has in fact been most successful for Australian banks when they have acted in concert such as in the introduction of credit cards (Bankcard 1974) or online payments (BPAY 1997).

My qualitative research has consistently shown that people generally expect that if their bank does not offer a product feature that they know to be offered elsewhere in the market their first thought is that their bank will catch up soon enough. This justifies their inertia and they are mostly right. Banks are typically good fast followers. In my own experience, I have never had any significant product specification problem that related to the market rather than internal bank policy.

Turning now to **pricing**, the picture is similar. Banks generally manage to keep their prices in line. The problem, as with product specification, is when they become overly complex. A wide range of retail bank products are easy to compare, both by the banks themselves and their customers. Rates and conditions are regularly published in the business sections of newspapers. A major exception to this is business lending where pricing for risk is opaque to the customer. Even with significant expenditure on market research it is hard for a bank to assess the pricing of competitors in this market. A large sample is required and it is necessary for the researcher to measure the respondent's riskiness in a way that I have never succeeded in. Because competitor pricing is hard to

measure the pricing of each bank tends to be cost based and costs for banks are similar. Part of the reason for this is the apparent absence of economies of scale in banking. Along with nearly all bankers, I know that technical economies of scale must exist. For example the cost of Information and Communications Technology Systems (ICTS) spread over a larger customer base. However this does not appear to yield a cost advantage to, for example, the Commonwealth Bank of Australia compared to its significantly smaller rival ANZ at least not one that manifests in pricing. My assumption has always been that technical economies of scale in banking are off-set to a large degree by less measurable diseconomies of scale, particularly in coordination. The end result of all this is that pricing is rarely a major issue in competition between traditional banks^{vi}. In Australia price competition comes mainly from outside banks. Aussie Home Loans (1992) significantly undercut loan rates in excess of three percentage points. in what had been banks most profitable product. The basis for this was access to funding and an intermediary channel of independent mortgage brokers. These often were retrenched bank managers. ING Direct launched in Australia in 1999 with an on-line / telephone saving account offering a withdrawal at call account at three or so percentage points lower than traditional banks. This forced the banks to follow suit but not before ING had amassed about AUD 15 billion^{vii}.

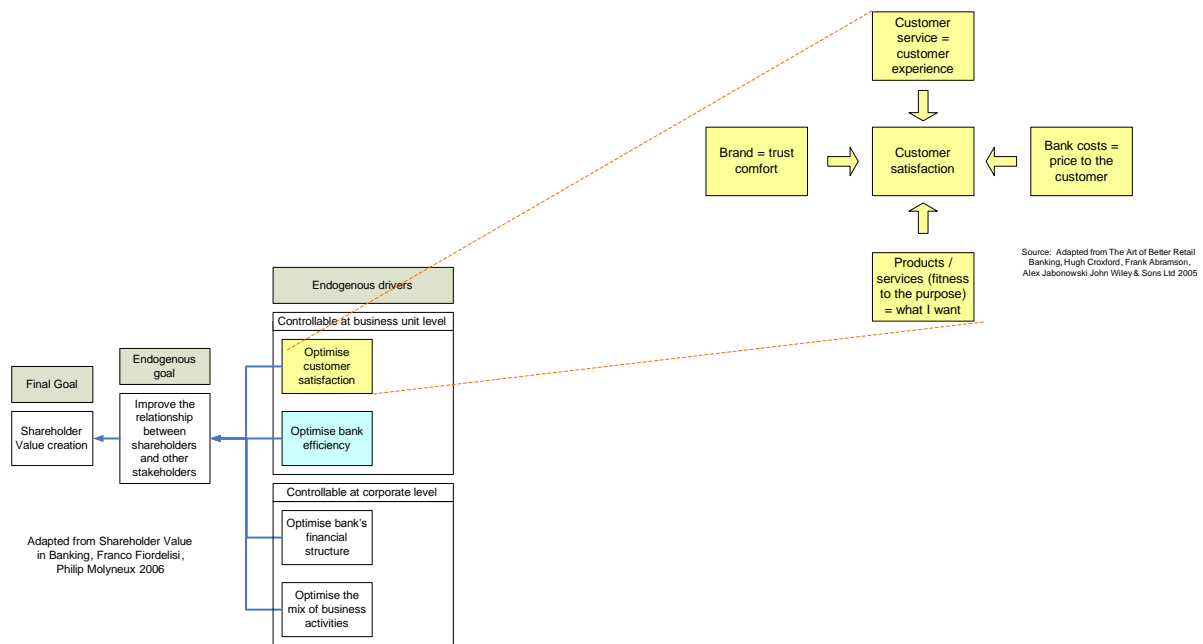
Pricing and product design will feature from time to time in this series of papers but my focus is on **customer's experience** of service and their perception of the **brand** and, importantly the interplay between these. Croxford et al seem to equate brand with trust. In some ways this is true but it begs the question – trust in what exactly? I shall deal with this at more length in a subsequent section.



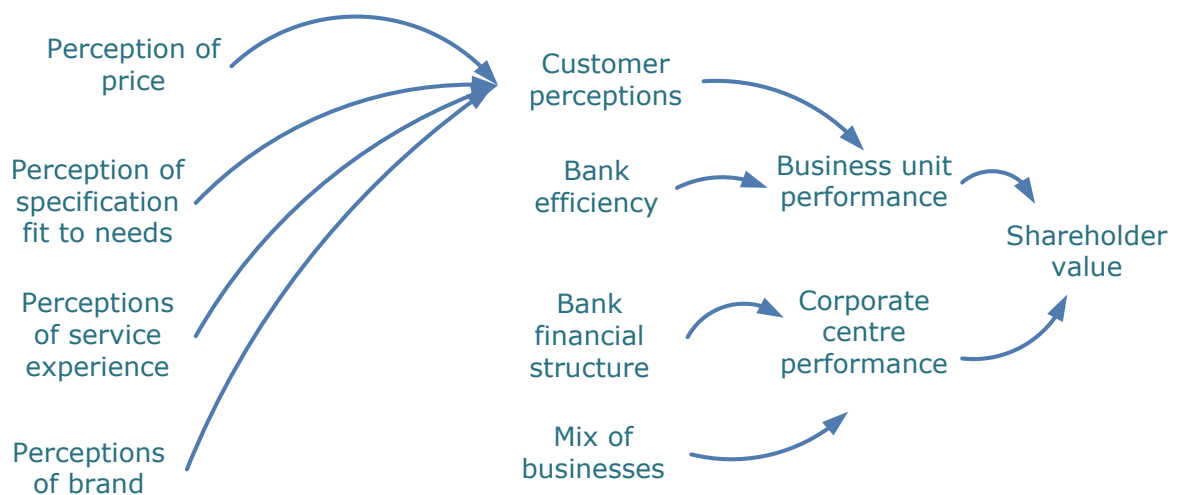
In the next section, *'How customer perceptions develop'*, I shall begin to explore the interplay of brand and service experience. Before I leave this setting of the foundations, however I want to translate the mental models I have adopted into a more rigorous systems dynamics model and also to introduce two other methodologies which will be ongoing features of my intention to make explicit the factors needed to manage bank brands.

Towards a systems dynamic model of bank branding

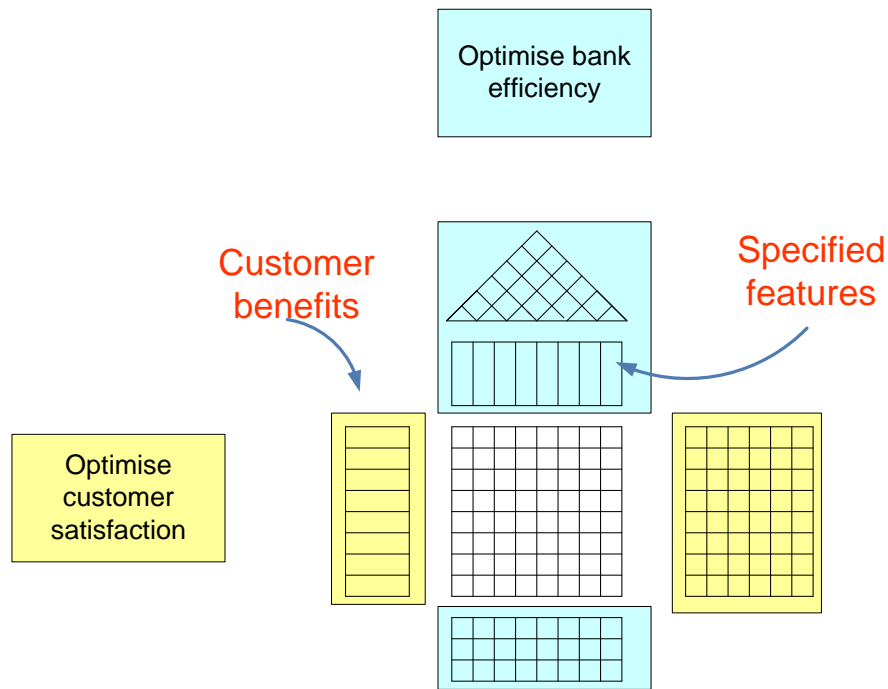
The exhibit below illustrates the relationship between the two mental models I have adopted as the foundations of my study of brand.



I now wish to translate these models into a systems dynamics presentation of the same concepts. This describes a system in which the causal effect of an improvement in a defined entity is related to an improvement in another entity.

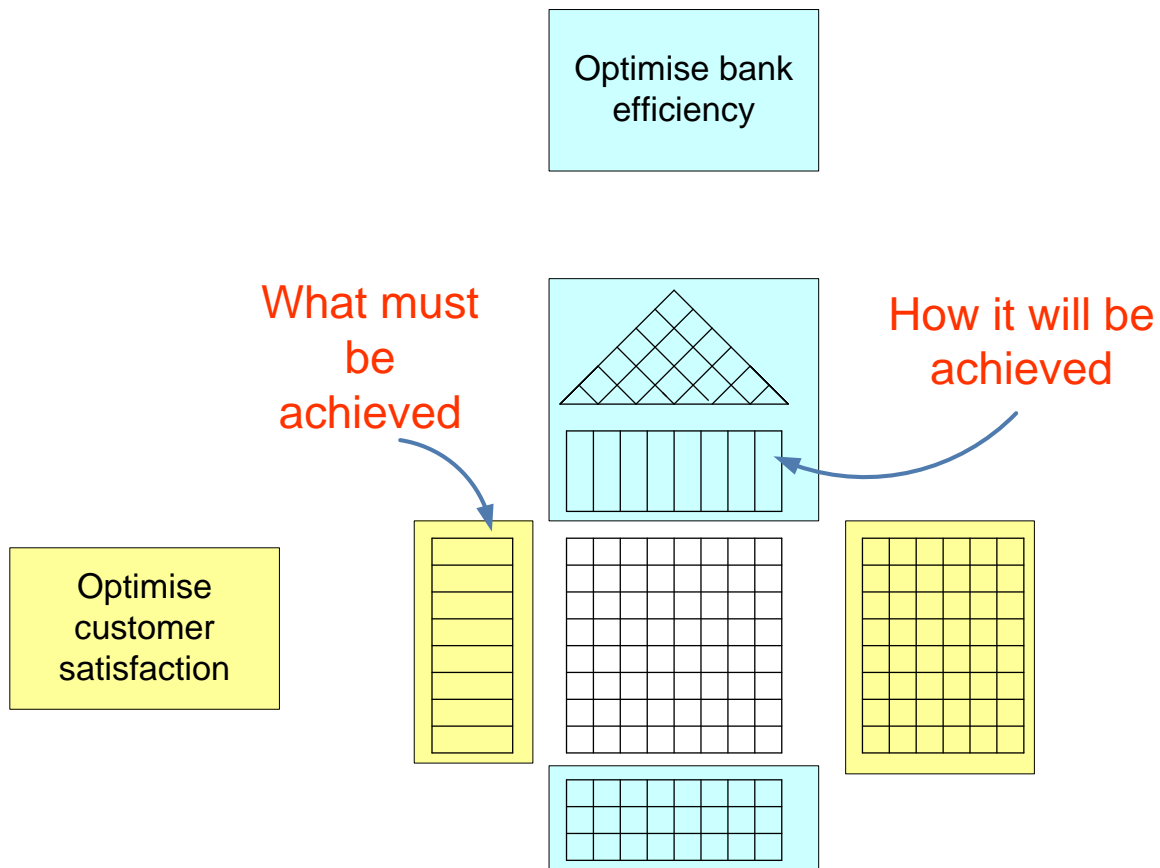


Next I should like to introduce, in this context, Quality Functional Deployment QFD, a methodology used in Quality Management and Six Sigma to relate product benefits to features. It was developed by Dr Yoji Akao as a way to articulate the *Voice of the Customer* (VoC) in product engineering specifications. Assumptions about customer valued benefits are matched to organisationally conceived product features^{viii}.

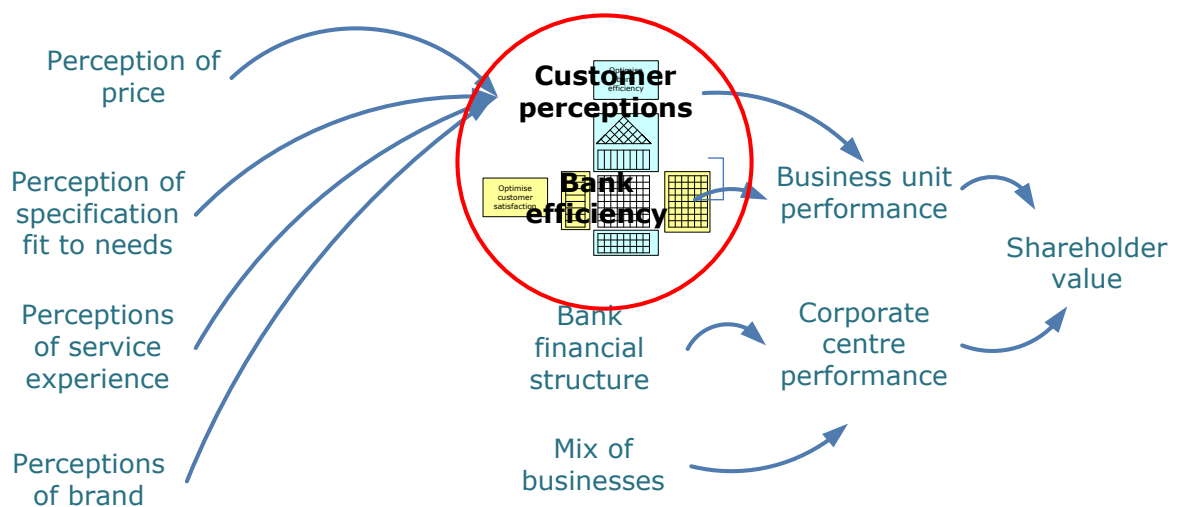


Put simply QFD is a systematic way of relating *what* to *how*. It makes the use of market research explicit in the product design and delivery process. Also it allows people from different management disciplines to play on the same chess board. In this way it makes their assumptions more explicit to each other and better documented. This can be especially important in banking where there is, for example, a large gaps between the world views of marketers such as me and credit policy experts. However, it is difficult to apply in a banking context as I shall discuss in another section.

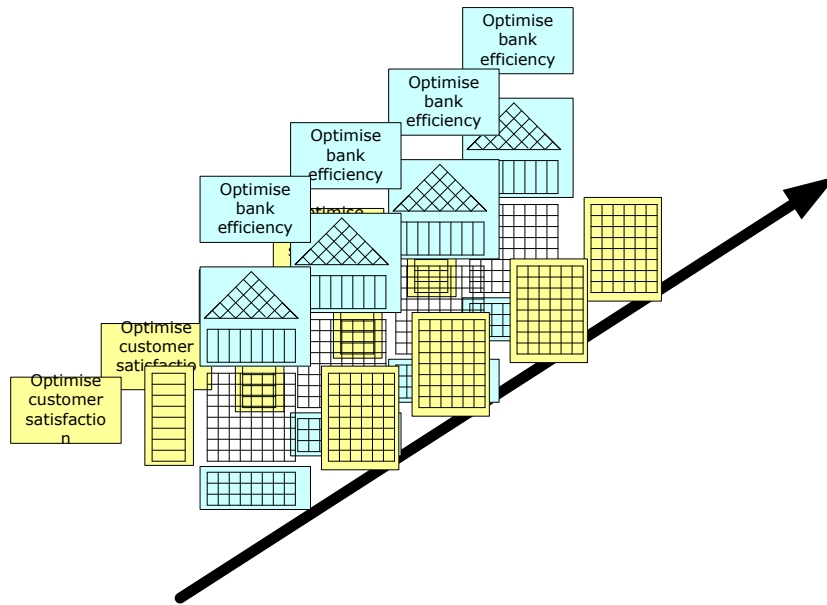
The methodology itself is not complex. Broadly scores are entered in the cells to reflect part pants assumptions as to how well a feature of the product satisfies a customer benefit. Because a benefit may require more than one feature to be designed and because a feature may satisfy more than one benefit, a matrix is needed as shown in the exhibit. The 'roof' of what is sometimes called 'the House of Quality' is to record conflicts and reinforcements that exist within the design itself.



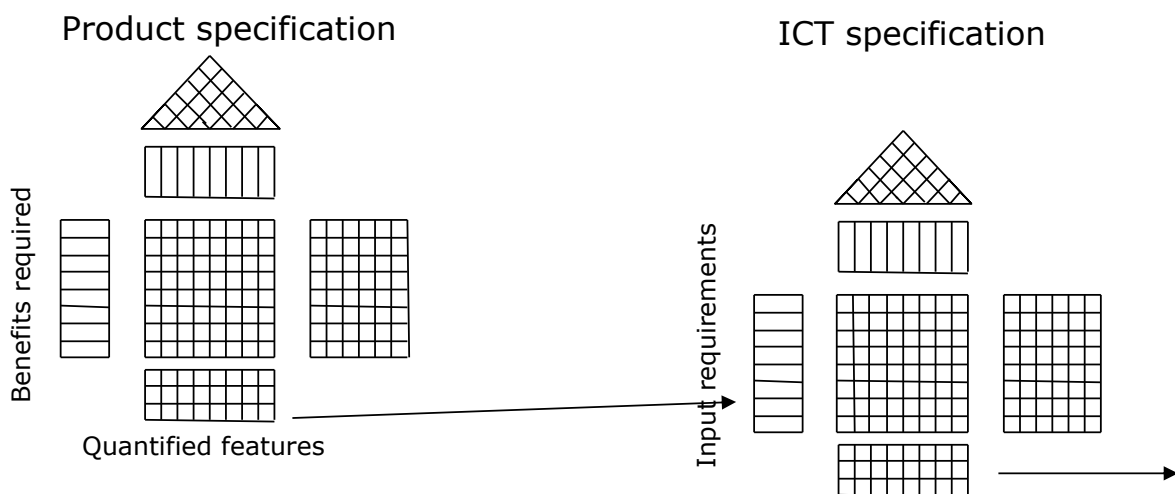
In the illustration below we see how QFD links the competing demands of achieving customer satisfaction with bank efficiency. Reduced cost is clearly at odds with improved service. However, there is a point where the value derived from improved service is optimal in relation to the implied cost. QFD provides a potential construct for arriving at this optimisation.



The application of QFD, even as a concept, is multi-layered. At each level the 'how' response to the 'what' is required becomes in turn the 'what' of the next tier.

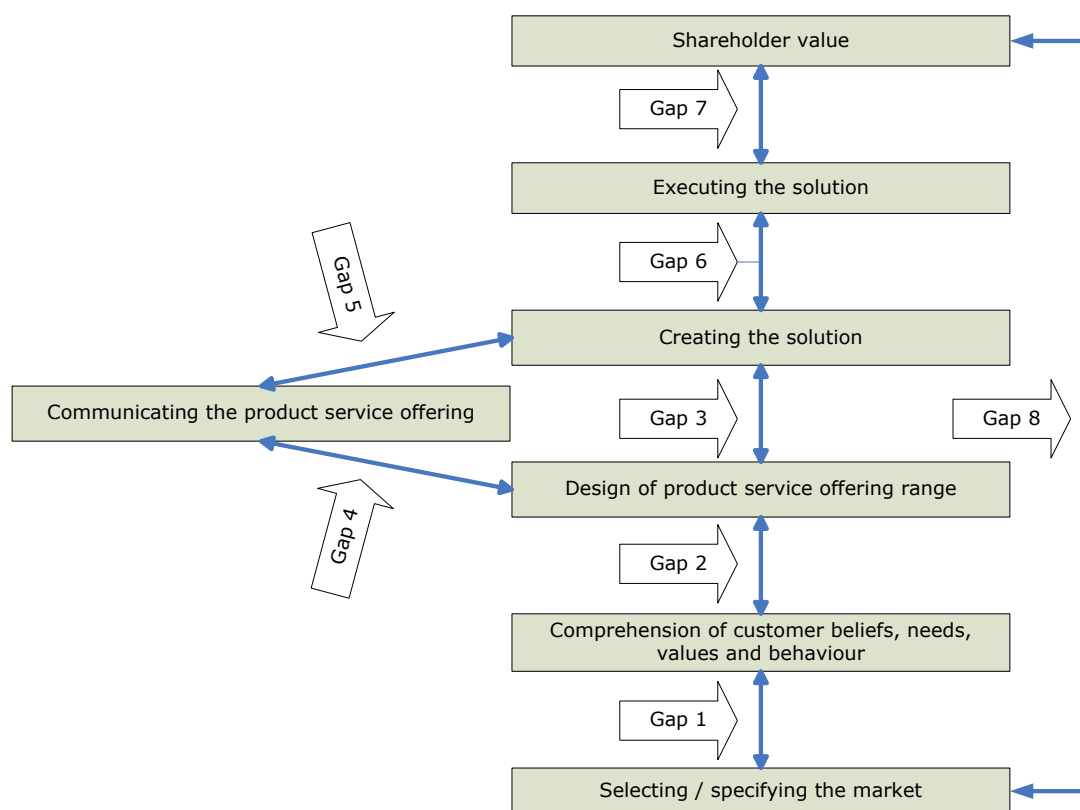


For example, the exhibit below shows how. in the design of a product from the input of the benefits that customers value, the product features become, at the next stage the requirements set for example, ICT systems. In this way the linkages are managed rather than a specification being simply chucked over the wall of one silo into the next.



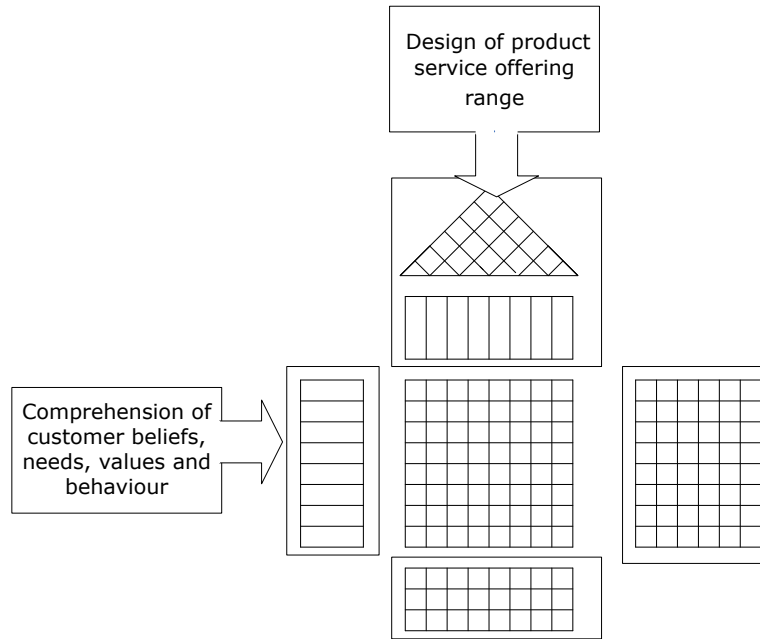
Gaps analysis

A common fault of market research studies in this sector has, in my experience been a failure to isolate the specific point in the development of a solution where the gap between the offering and the requirement fails. Gaps analysis helps in this. The exhibit below is a version that I have developed of this management tool that seems to me helpful in the banking sector.



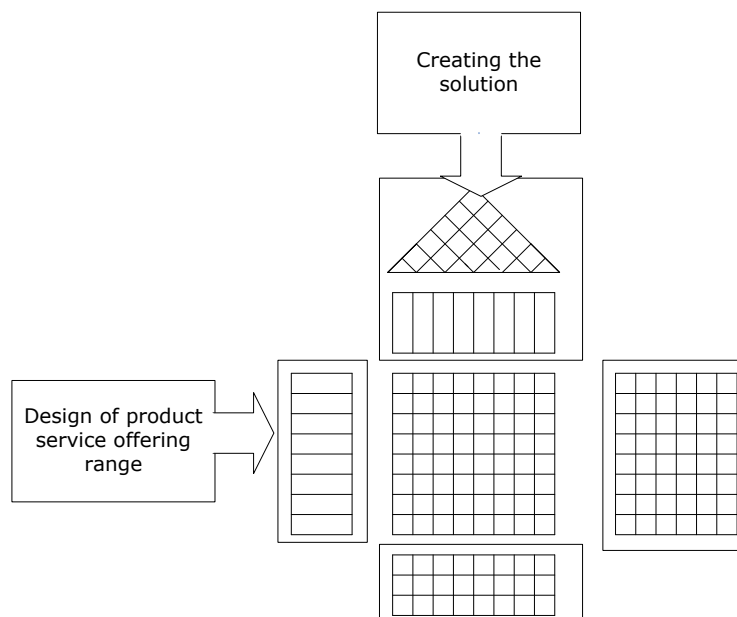
Thinking back to the chain of QFD linkages that I discussed earlier Gaps analysis can impose greater discipline on traversing the path to shareholder value. Thinking of the last linkage I illustrated using the QFD model – that between product marketing and the ICT requirements – Gaps analysis can help clarify the value added chain to which specific organisational entities contribute. On a case by case basis, descriptions of unit goals and objectives tend to be insufficiently precise.

Gap 2 – From comprehension of customer needs to product specification



This is a straightforward QFD application – a simple articulation of the product features that are articulated through organisational understanding of the benefits customers seeks.

Gap 3 – From product specification to solution design



This phase is less obvious than the preceding one. This is an articulation of the way in which the organisation wishes the product as designed to solve customer issues. Essentially it is a conversation between product marketing and distribution.

Conclusion

In this section, I have tried to set out a framework within which I can explore the path from customer perceptions to shareholder value using some of the conceptual tools I shall deploy in subsequent sections. My goal for the system dynamics model I shall design is shareholder value. I shall explore the complex interplay between customer experience and brand. QFD and Gaps analysis will have key roles in understanding cause and effect within the system.

Conceptual frameworks, however, are dangerous. On one hand they provide us with building blocks that we can play with like toys to think about the challenges of branding banks. On the other hand the map is not the territory. Any model is inevitably a simplification of a complex reality. The only way to judge them is by their usefulness for the problem at hand. We must be prepared to modify or jettison them when a better one is at hand. We must not be surprised if there is no one overarching model that spans the gap from customer perceptions to shareholder value.

In the next section I shall turn to how customer perceptions of banking develop.

ⁱ In particular, I should like to thank Gary Lembit, Sharon Taggart, Duncan Rusby, Danny Meisels, James Liu and Tania Kullmann.

ⁱⁱ Shareholder Value in Banking, Franco Fiordelisi and Philip Molyneux, Palgrave MacMillan, 2006, ISBN 13: 978-1-4039-9666-4. One of my 'must reads' – This studies the measurement and achievement of shareholder value in European Banks. Being academically rigorous some of its conclusions are necessarily broad and tentative. The angels are in the detail.

ⁱⁱⁱ My introduction was Alfred Rappaport(1986). Creating shareholder value: The new standard for business performance. New York: Free Press. ISBN 0029257204. I think in an attempt to get top executive attention that Rappaport put too much emphasis on

linking rewards to shareholder value. This perhaps accounted for some adverse media attention when corporations appeared to be run to create executive wealth rather than shareholder value.

^{iv} For the time being I shall stick with the term 'customer satisfaction' as that is the one most commonly used as it is by Fiordelisi and Molyneux and Croxford et al. However, for my purposes it will be necessary to examine this in greater depth.

^v Hugh Croxford, Frank Abramson, Alex Jablonowski, John Wiley & Sons, 2005, ISBN 10: 0-470-01320-6 HB. This is another of my 'must reads'. The approach of the authors is based on detailed practical experience of the industry. This experience is largely confirmed by my own. It makes an excellent companion piece to *Shareholder Value in Banking*.

^{vi} Having said that pricing is often seen as a major issue because of the way banks tend to be structured. I shall pursue the structural impediments to achieving customer satisfaction in a later section.

^{vii} Some of which has been recently lost following adverse publicity for ING in the present financial crisis.

^{viii} I have only two personal experiences of managing QFD exercises in banks. It is certainly true that my learning from this was that it is very difficult in a banking environment. I shall deal with these issues in a subsequent section. For now, I believe that QFD offers the best conceptual tool for managing the interfaces that have to be bridged.