THE IMPACT OF THE *Customer*

BY PAT ALLEN

STRATEGIST B. JOSEPH PINE II SAYS MEANINGFUL CUSTOMER INTERACTIONS HELP FIGHT COMMODITIZATION. CAN RETAIL BANKS THAT FOCUS ON "EXPERIENCE" SUCCEED IN DRIVING GROWTH?

B. Joseph Pine II

| SYNOPSIS | Customer experience commands attention as a means of fighting commoditization and winning business. In order for retail banks to differentiate their offerings, says Strategic Horizons LLP's B. Joseph Pine II, the recent focus on efficiency and cost control must be shifted. One challenge, he says, will be for banks to value — as opposed to limit — time spent with customers.

"Eventually," wrote B. Joseph Pine II and James H. Gilmore eight years ago, "the most significant question managers can ask themselves is: 'What specific experience will my company offer?' That experience will come to define their businesses."

Fast forward from that seminal article in the July/August 1998 issue of the *Harvard Business Review*. Pine and

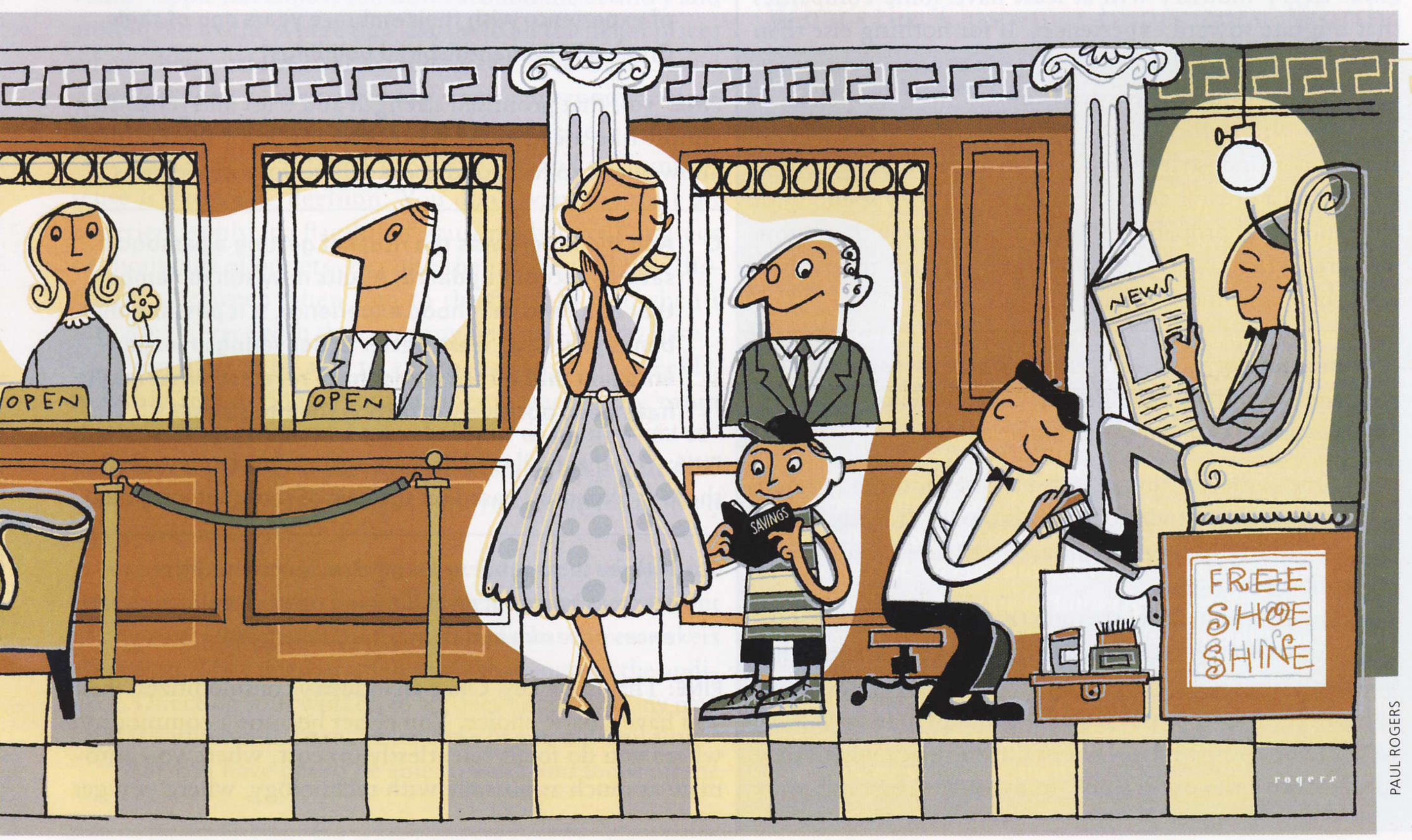
Experience

Gilmore's 1999 book *The Experience Economy: Work is Theatre & Every Business a Stage* and their subsequent speaking and consulting through Aurora, Ohio-based Strategic Horizons LLP have advanced the idea that "experience" is a fourth type of economic offering.

After the extracting of commodities, the making of goods and the delivery of services, there is the staging of experiences, they say. "The best way to market any product is with an experience so engaging that potential customers can't help but pay attention — and pay up as a result by buying that product," the authors have argued, persuading a varied client roster that includes Whirlpool, LEGO and Microsoft.

While branch network expansion and expense control have been dominating retail banking plans over the last eight years, Pine and Gilmore's consideration of the customer experience this year intersects with heightened attention from the banking industry as it increasingly confronts the risk of commoditization.

"What customers experience at their banks, similar to how they perceive their retail outings, is critical to deepening their loyalty and the amount of business they conduct," according to the premise of research underway by BAI. BAI Research is partnering with Pine and Gilmore on a comprehensive project that will include both a survey of management practices at U.S. retail banks and consumer



PAUL ROGERS

What's an Experience?

The ING Direct Café in New York is a favorite example cited by strategist B. Joseph Pine II. ING Direct has no physical branches but uses its cafés in New York, Philadelphia, Los Angeles and Wilmington, Del., to, Pine says, "entice people to walk in so financially savvy and surprisingly friendly baristas can engage them in conversation and explain their deposit and loan products."

Visitors pay for their coffee — which means that the cafés are money-makers in their own right. But more important, the interactions yield tens of millions of dollars of new account business for ING.

Experiences provided by Umpqua Holdings, the Geek Squad and Luxor Resort & Casino will be part of a BAI Research general session, to include Pine, at BAI's Retail Delivery Conference & Expo Nov. 14–16 in Las Vegas.

research. The aim: "To provide insight and inspiration to help banks think — and act — differently so they can deliver differentiated value to customers."

The results of the research will be available exclusively in the November/December issue of *Banking Strategies*. Prior to the completion of research, Pine explained the relevance of customer experience to banking.

Q | Is it your feeling that every industry is eventually going to migrate toward experiences?

PINE: Every industry will at least have some companies that migrate toward experiences. If for nothing else than to generate demand for their core offerings, even if they don't fully get into the experiences.

You will definitely see industries going at different paces. Those industries that have a greater number of touchpoints and a greater amount of time that they spend with customers will probably migrate more quickly than those that are farther away and don't have as much interaction with their customers.

Q | One focus of your work with BAI is to assess banks' "current state of readiness to enter the Experience Economy." Can you elaborate on that?

PINE: One of the key things that relates to how ready banks become is their attitude toward customers. It seems to me that no industry has commoditized itself more readily than the banking industry.

Banks have had the attitude that spending time with customers costs them money, rather than realizing that spending time with customers gives them a tremendous opportunity. So, they pushed people out of branches to use ATMs. They pushed them out of the one place where they could control the experience, to use voice response units and to use the Internet instead, all because they wanted to lower the cost.

That encouraged customers to treat banks as a commodity, to buy solely on price, because they weren't getting any great level of service, and they certainly weren't getting an experience.

Q | In your book, you describe Las Vegas as the experience capital of the world and offer as one example the ancient Roman environment created by Caesar's Palace. In fact, haven't banks implied a certain kind of experience with their embrace years ago of their Greek and Roman-inspired buildings?

PINE: Yes, that promised strength and trust and reliability, almost like a cathedral where the inside of the building allowed you to feel good about where your money was.

Q | And then there was the ritual of getting a passbook savings account updated. Adults now still remember that as a fond childhood experience. Is it possible that banks years ago were better at delivering an experience and that recent tactics have reversed what might have been positively affecting their business?

PINE: Yes, that really did happen, again as banks viewed all of those as expenses, based on the cost of those interactions.

Q | If there is no other industry that is commoditized as much as banking, does banking need to deliver experiences now more so than other industries?

PINE: That is the key. Once an industry commoditizes, then you have a basic choice. You either become a commodity, where you do focus relentlessly on cost, where you automate as much as possible with technology, where you get rid of as many people as possible, where you reduce the amount of time that interactions take. All of that is what's important when you are a basic commodity.

Or, you go the opposite direction and say, "How can I find a way to differentiate myself?" Because that is the basic choice.

Is the focus on cost or on differentiating? What an experience does is allow you to differentiate yourself, allow you to create something distinctive that consumers want to have, they want to partake in and they realize that this is where they want to spend their time.

Q | Obviously, banks have hundreds and thousands of outlets. Is it possible to deliver experiences across all of the outlets or do you just identify some flagships?

PINE: We have a whole model for thinking about that. It is a strategic decision, but some companies create flagships or a one-of-a-kind venue generally associated with their headquarters or where their heritage is. Others want to create multiple venues, and others want to create an experience every time they interact with consumers.

Volkswagen has Autostadt, a theme park outside of its original factory in Wolfsburg, Germany, as a flagship venue. Apple has almost 150 stores around the country and around the world, where they can go to all the major places where their customers are congregated. The Geek Squad wants to create a distinctive experience every single time they interact with consumers or with businesses.

There are all different ways to do it, and what makes sense is a strategic decision. You don't want to create an experience only at a flagship if you already have hundreds or thousands of outlets. Because then there will be a disconnect between when I go to the flagship and when I actually interact with the company on a day-to-day basis.

You have to be able to enhance those daily, weekly, monthly interactions. Now, it doesn't necessarily mean that you need to spend a huge amount of money and redesign everything. When you do design and put in new places, then you want to make sure you are making them an experience.

One of the key principles of the Experience Economy is that work is theatre. That whenever workers are in front of customers, the gist of the experience is that those workers are acting. They need to act in a way that engages the audience. Directing your workers to act does not require any new capital equipment. That can be done in any old building.

But you have got to be able to work and focus on the interaction of individual customers, and what you do with them, and how you stage that experience in front of them.

One of the great things about experiences is that there is a lot of open space here, where companies can design different experiences and do it in different ways. So, it's not a matter of copying what other people are doing, but rather coming up with your own unique way of creating an engaging experience.

Q | What have naysayers said about your work?

PINE: What naysayers have said is that we are emphasizing entertaining customers. I say no, we are very clear — we devote an entire chapter to this in the book — entertainment is just one way of engaging customers. You can have an entertaining experience, you can also have an educational experience, which I think is very important in financial services. How should I use my money? What things do I need to know?

You can also have an escapist experience, where you go some place and do some activity. And you can have an esthetic experience, where you can create an environment where people want to hang out. That is another opportu-

What's the 'Customer Experience' Worth?

In fact, Needham, Mass.-based TowerGroup has quantified the gains that await financial institutions "achieving Customer Experience (CE) leadership." Using the customer experience to lower customer attrition can make a dramatic difference in overall market share and growth, wrote senior analyst Rodney Nelsestuen in June. He estimates that cutting customer churn in half can net a 6.8% growth rate compared to 5.2% net for competitors. "This 30% difference in growth rate represents more than $360 billion in assets across insurance, banking and brokerage," he says.

Here's how Nelsestuen suggests individual financial institutions compute their own revenue benefits of customer experience (the value of an extended customer relationship): "Using initial annual revenue less acquisition and year-one servicing cost, add the present value result of multiplying the improved retention rate by future revenues. Then multiply that same retention rate by the potential growth due to viral marketing, up-selling and cross-selling."

"Taken together, these results will demonstrate both the short- and long-term value of providing a superior customer experience," says Nelsestuen.

nity that many banks already are taking advantage of, where they can create places that customers want to be, like Starbucks delivers an esthetic experience.

Others say well, that's just a fad, look what's happening in theme restaurants. For example, Planet Hollywood has gone belly up, Fashion Model Café didn't make it, All Star Café didn't make it and Hard Rock limps along and so forth. And yet, that is all true, because many of those didn't figure out how to do it well. In fact, you can point to a lot of failures of companies that tried experiences.

Any time you have a significant and economic change, most companies—not just many—most companies will fail.

Q | As you anticipate introducing this to the banking industry, where would you expect resistance to come from? What will be a tough sell to bankers?

PINE: A couple of things. One, they will say, this is going to cost us too much money. They are going to say consumers don't value it, this is not what they want from a bank. If that's so, that's because the banks have taught them not to value it. But, too many banks are already succeeding for them to get away with that excuse.

They are also going to say that they are not retailers per se, rather, they have all these other things to do like handling money and so forth and that is their core business.

Q | And you would counter with...

PINE: There is a reason they call it retail banking. They are, in fact, retailers. Banks are companies that have to create places in which customers interact, and customers only want to interact in places that either provide them the greatest possible convenience at the lowest possible cost, which they are going to treat as a commodity. Or, they are going to want to interact with places where they value the time that they spend with companies and want to spend more time with them. Banks have a fundamental choice as to which way they go.

Q | Banks have had what they believed to be sound rationales for their recent customer service strategies.

PINE: Correct and obviously the goal now is not to be inefficient. The goal is to do everything, all of that core banking stuff—and I use the word "stuff" in particular, because it is a term that you apply to commodities. Have all that core banking stuff and be efficient. Don't make any mistakes in people's accounts. Always count the money correctly and quickly, and all that sort of stuff. But realize also that every person who walks through there is unique. Every person who walks through there is an opportunity to be able to say, what more can we provide to this person that is of value? What customers value today is experiences.

Q | Is there an element of un-learning or bad habit-changing that you think needs to take place in banking?

PINE: Well, I keep coming back to the same thing, because I think it is the fundamental issue with banking. The thing that they have to un-learn is that spending time with customers is a bad thing, not a good thing.

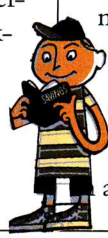
And the goal is not to push customers out. We do not want to measure people on how many customers they get through in a day or in an hour in a call center. What you want to measure is the quality of the interaction with each individual one, because measurements are the other key factor that has to change, in addition to the attitude and the mindset. How do we measure people in order to ensure that we are going in the right direction? In particular, what catalytic mechanism do we need to put in place to make sure change is happening in the direction that we want?

Q | Do the customers need to develop a whole different view, too?

PINE: Right and that is not going to change easily, because they have been taught for so long about what to expect. So, one of the things to do is to actually go beyond expectations. Expectations are the basis of customer satisfaction, one of the key things that we measure. Customer satisfaction is, in fact, defined as the difference between what a customer expects and what that customer perceives he gets.

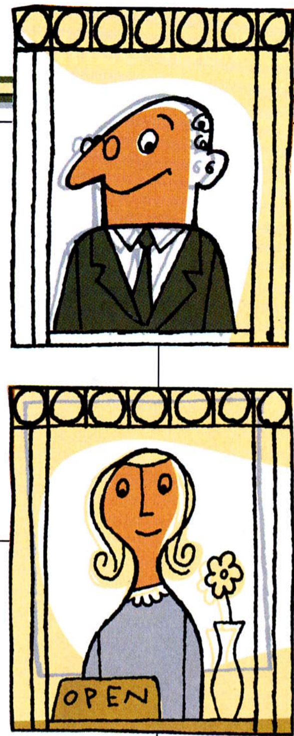
But if our expectations have been set by our past interactions with the company and, therefore, we have had low expectations of the bank, it is easy to say that we now have high customer satisfaction. So what? That is because we have taught customers to expect so little from us.

Instead, what we need to measure is customer sacrifice, which is a gap between what a customer really truly wants and needs, and what they have to settle for today. And how do you measure that customer sacrifice, determine dimensions along with customer sacrifice and then close that gap with individual customers?



There needs to be an understanding of where individual people sacrifice and, therefore, an ability to customize down to their particular needs. You can do so a way that doesn't cost a lot of money. It can be done on a low-cost basis, and that is where mass customization comes in, which is serving customers uniquely.

That's one of the things that banks need to do and increasingly are doing — modularizing their capabilities like building blocks where you bring together different blocks for different customers. For example, that is what Capital One Financial Corp. does with its credit card business. It customizes down to individual customers.



Q | What are the implications for bank management and staff?

PINE: Management does need to think about what people they want to have in place, what they want to focus on and who is responsible for the actual experience that customers encounter inside their bank. Having a Chief Experience Officer is a great step toward being able to do that. They also need to think again about how you measure and reward people, based off the experience, rather than merely based off the efficiency or service characteristics. And then, how they create, how they inspire the people to want to live in a world where their job is to create a great experience.

Q | So, how much would such business model changes cost and what are the buckets of cost?

PINE: One bucket is the place itself, the branch, and what you put inside of there. If you are going to be building branches anyway, and you are going to be renovating older branches anyway, now do it in a way that allows you to create a distinctive experience inside of that branch.

The second biggest cost is people and training for those people and you are going to need to undergo some level of training to be able to get people to think and act differently.

Q | But your project really spans all the channels...

PINE: Right. Over the phone and what are you doing online that creates a distinctive experience.

Q | The ATM? Voice response? E-mail?

PINE: Right.

Q | How much time does such a transformation take?

PINE: Well, it is so different for individual companies, but it is not something that is on the order of a year or two. It is something that is going to take a while to be able to accomplish and some people take decades to be able to do it and to do it well. Although it can take a while to do, that's no reason not to start now.

Q | What's your guess on the percentage of banks that are likely to move to experiences and what percentage will surrender to being in a commodity business?

PINE: We haven't really looked at that level of detail to know that, but I think it is going to be a bifurcation. Some people, if they try to do an experience, they are not going to get it right and they are going to get bought out. Industry consolidation is another sign of commoditization. You see that all over the place in banking.

And, you are going to see some companies that can, in fact, be successful in a commoditized market. But, generally it's only one or two in any market that can be successful when the industry consolidates, because only one or two can gain the efficiencies that it takes. So the others are going to have to compete based on the experience they create.

Q | You have described banks as the most commoditized businesses and maybe the most in need of this kind of a business model change. But are there any strengths of banking that make you think that the prospects are good to succeed with this?

PINE: Yes. One is cash reserves. Banks do have money that they can spend at this. Two, they do have points of interaction. They have places where customers still continue to go to, and therefore, you don't have to necessarily build out an entirely new network in that way. You have to re-design, particularly the interactions that happen inside of there, as well as the physical environment that is in there.

And, you do have a lot of banks that have a lot of goodwill with customers. That goodwill dissipates more and more every year. But I do believe that for many, there is a tremendous amount still.

Pat Allen is publisher and editor-in-chief of BAI's Banking Strategies.