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A Customer-Centric Paradigm Shift in the UK Pensions & Investment Industry

White paper

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1. EXECUTIVE SUMMARY

Five years from now the UK Pensions and Investment industry will have transformed. The primary reason is the changing dynamics in investor behaviour that are influencing the way they interact across multi-channels to make more informed investment decisions. In particular, the over fifties segment, referred to as grey-power, whose ranks are being joined by millions of baby boomers are demanding greater say over their future destiny. Their demand for more transparency and control over their financial destiny is a powerful force that could stimulate deep rooted and dramatic change that goes beyond the investment industry.

Companies from other sectors, in particular retailers, have amassed considerable lifestyle data and have been pioneering more sophisticated self-service experiences and insights; inevitably this includes the grey-power sector. The combination of this shift towards empowering the customer and the increasingly crowded competitive marketplace is likely to lead to a significant change and more intense focus around winning a greater share of the 'investor's wallet'.

Insightful lessons can be taken from other market sectors that have recently been transformed by customer behaviour, where those organisations that set new market standards for delivering service experiences are favoured above the competition (Apple, for example). The speed of these changes happened far faster than many expected, especially the conservative incumbents who have now been displaced as market leaders.

The combination of these market shifting changes, when considered from a wider and deeper perspective, do demand attention sooner rather than later. This creates the impetus for a number of initiatives:

- Proactively targeting the grey-power market segment as a sustainable growth opportunity
- Redesigning and retooling the retail distribution channel including the associated processes and services
- Developing competitive advantage from improved and enriched interactions and experiences
- Increasing the volume of customer self-service using insights and knowledge as competitive differentiators
- Building a product innovation and development process that starts with the customer not the manufacturer
- Establishing a services platform for delivering superior multi-channel, consistent and transparent experiences.

Customers are changing the way they research and buy products from the UK Pensions and Investment industry. Corporations must learn to influence the behaviours of both the mass affluent and mass market by managing the customer's experience around their need for knowledge, insights and tacit interactions at key, and appropriate, stages of their decision-making process. Leadership of this en masse transition will trigger a customer-centric paradigm shift that will profoundly change the UK Pensions and Investment industry.

2. INTRODUCTION

This White Paper is designed to stimulate passion and debate around the future of the Pensions and Investment industry over the next five years. It makes the case for listening, understanding and responding to the behaviours and preferences of customers. The term customer is intentionally used rather than client or investor to reflect what is happening in the wider marketplace.

As power increasingly moves to the customer, attention is being focussed on customer behaviours and the uncertainties around interactions between the customer and the service provider. Evidence is mounting that customers are demanding more knowledge and transparency so that they can make better-informed decisions about their future.

The ability for customers to switch their loyalty en masse to those brands that can provide better and more sustainable experiences has already toppled the top incumbents in other sectors.

There is a growing perception that the Pensions and Investment industry could look very different within the next five years as customers change the dynamics of demand[i].

3. THE STATE OF THE MARKET

3.1 Experience is transforming market sectors

We have all witnessed the growing willingness of customers to switch en masse to a different brand because of their desire for a superior customer experience where price becomes a secondary consideration. The best example is with Apple. Firstly, they changed the music industry, repeated their winning formula for the mobile industry and repeated the success yet again for the PC Tablet industry. In doing so, Apple displaced the giant incumbent brands Sony, Nokia and Microsoft across three different sectors!

Why is this relevant? It is because Apple changed the rules of engagement relative to the traditional incumbents. They designed a very different yet highly controlled experience which, together with paradigm-shifting products, was executed superbly. Though customer investment decisions involve large sums of money, the Pensions and Investment industry no longer has the reputation of delivering superior customer experience. There is little doubt that there is a deep and growing latency of customer frustrations regarding the value of their investments which have been amplified in the last few years and demonstrated further as the number of complaints grows[ii]. Arguably, the mounting pipelines of regulation around know your client and treating the customer fairly[iii] are part of the systematic evidence that the modus operandi for servicing the customer is simply not good enough.

This raises the question of what will happen when the first mover delivers a step change in providing a superior customer experience and gains the advantage of insights from these improved interactions. The ingredients for a paradigm shift in the Pensions and Investment sector are now all in play.

3.2 Grey-power moves towards centre stage

The grey demographic sector is rapidly changing and becoming even more powerful. For a variety of reasons many manage a portfolio of both paid and voluntary part-time work. They are typically active web participants using a combination of mobile and personal computer devices. This means they have more time than ever before to focus on their investment and retirement portfolios including gaining new insights from research and social networking. This point is sometimes known as DIY retirement and downshifting:

> "As longevity increases, people are finding that they don't necessarily want to retire completely in later life. As a result we are seeing the rise of downshifting whereby people continue to be economically active and gain benefits of employment, but without the stress and long hours that they have experienced at other times in their career." Clive Bolton, Aviva Real Retirement Report December 2010

Grey-power is rapidly expanding as their numbers swelled by millions of baby boomers who have been at the forefront of demand changes since the 1960s. They are highly networked and are becoming more organised. This has already happened in the USA, the AARP (previously known as the American Association of Retired Persons) with its 35.7 million members aged over fifty, already has a formidable political and economic voice of influence over their national investment industry. For example, the AARP is the largest buyer of annuities. It is likely the UK will follow suit and already our equivalents, such as Saga, are learning from their American cousins.

The web provides a natural means for many individuals to come together with one voice and be part of formidable pressure groups. The web is already stimulating more structured social networks with the resurgence of investment clubs and the emerging of new intermediaries focused upon orchestrating class actions. The FSA is so concerned about this latter point that is has created a discussion document on how financial organisations can mitigate this risk[iv].

Arguably grey-power is creating an emerging vacuum in the marketplace that once satisfied could lead to a very different investment marketplace compared to today, impacting corporations, the wealthy, the mass affluent and the mass consumer markets in very different ways.

3.3 Market forces that are changing the patterns of demand

From the retail perspective grey-power is leading the biggest retirement demographic shift. This influential market segment is faced with serious problems:

- The decline of corporate defined benefit pensions and retiree healthcare
- The increase in life expectancy and its impact upon investment returns and healthcare costs – 10m British people alive today will live to be more than 100 years old[v]
- Increasing numbers have insufficient investment funding to cover twenty to forty years of ‘retirement’ with the expectation of further highly volatile economic cycles that could have a negative impact upon their investments
- The slowdown in property price growth over the next 10 years means the effect of “downsizing” their main homes to fund their retirement will be reduced
- The increased level of regulatory change affecting the future of pensions – and there is more on the way and more needed. For example: a recent FSA study[vi] covering pensions switching advice found a poor service in the majority of cases:
    - 85 cases (34%) as unsuitable
    - 78 cases (31%) as unclear
    - 88 cases (35%) as suitable.

These pressures are understandably causing customer anxiety. More importantly, there is growing evidence that the grey-power sector wants greater control over its own destiny.

In addition to the increasing power of the grey sector, the Pensions and Investment industries face further monumental problems related to:

- Institutional pension deficits which are likely to weaken further
- Changes to the evaluation and payment of investment performance
- Retail Distribution Review (RDR) regulation, which increases the transparency of what customers are paying for advice and the quality of that advice.

3.4 Large scale shift towards customer-centricity

The combination of market force drivers and the way customers are taking more control over their investment future is leading to a shift away from the traditional model of savings and accumulation to income generation and capital protection. This paradigm shift is likely to cause a reorganisation and strengthening of the Pensions and Investment industry from a product-centric offering to customer-centric services. Such a change could have a significant impact upon the organisational structure and operations of Asset Managers where customer servicing becomes the core competency.

Looking at service provision from the eyes of the customer and streamlining their interactions to reach the best fit outcome will change the way products are offered (refer to Figure 1).

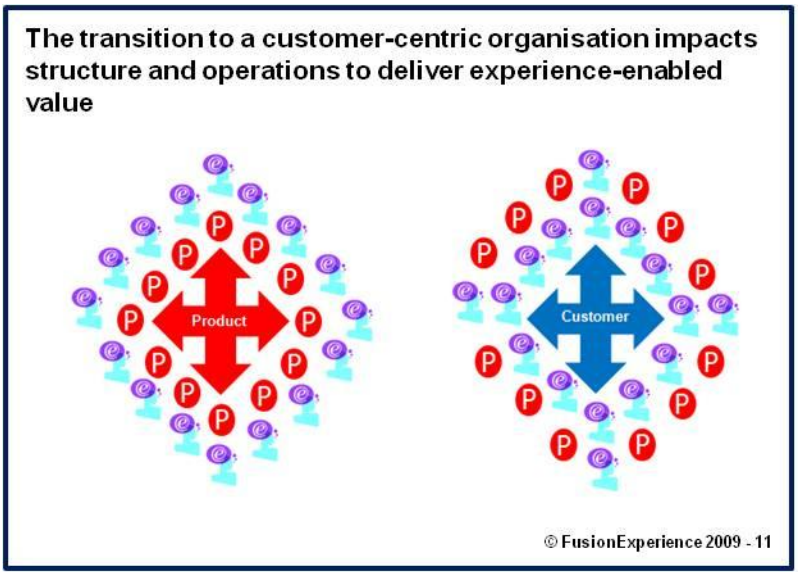

Figure 1 Transition to a customer-centric organisation

The winners are likely to be those that excel at delivering a superior customer experience, more akin to the way Apple has changed other sectors.

3.5 Market convergence around the customer

The shift in focus to the customer combined with their needs for income generation and capital protection will accelerate the battle around increasing the share of the customer investment wallet. This could mean that Asset Managers, Wealth Managers and Life & Pensions providers could find the customer-centric marketplace a lot tougher to compete in as other sectors converge further into this space.

Two further market disruptions could well occur over the next five years:

- First, the major supermarket retailers are already going beyond simple savings and accumulation products and could become a major niche player for income generation and capital protection services. They have the benefit of deep insights into customer lifestyle behaviours with far richer data than can be typically found in the Investment sector.

- Secondly, the customer now wants to limit their total risk exposure and not simply market risk. Taking a lifestyle risk perspective, this needs to include risks to mitigate exposures in heath care, inflation, longevity, taxation and other asset classes. This is already attracting further competitive players into the customer-centric market.

3.6 Insights and knowledge becomes the competitive differentiator

Insights and knowledge will become a core and competitive differentiator to meet the preferences and demands of both the customers and the advisors to those customers. This has several ramifications on the traditional status quo of many Asset Management, Wealth Management and Pensions organisations. For example, there will very shortly be, if not already, a need for behavioural and cognitive science capabilities to evolve superior experiences to their customers.

A major study[vii] by the Economist Intelligence Unit found that a better customer experience and engagement strategy would lead to:

- Improved customer loyalty (80%)
- Improved customer advocacy (79%)
- Increased revenues (76%)
- Increased profits (75%).

Across multiple sectors, it is 5 to 10 times more expensive to recruit new customers compared to retaining existing customers. This is part of the reason why improving customer loyalty and advocacy is so important to increasing revenues and profits.

This is increasingly important to the Pensions and Investment industry as there is a growing realisation that there will be increased customer volatility over the next five years. This means customer retention is already a high strategic priority. There is now increased urgency to tactically improve current customer experiences, whilst driving new value and avoiding the high costs of attracting new customers.

However, there are additional insights from other sectors that are also relevant. Providing superior experiences designed to increase customer advocacy will attract new customers without incurring the high costs of traditionally acquiring new customers. This has been made clear by a Forrester Research[viii] study that showed 67% of customers who have given and received advice about products express significant loyalty to that brand. In other words, the provisioning of well-designed social networking and community-centric services as an extended part of the customer service ought to drive advocacy and growth.

Another study from Right Now asked customers how a corporate could encourage them to spend more. The findings are quite pertinent to the Pensions and Investment industry:

- 66% of customers said improve the overall experience
- 61% of customers said accessible information before purchase.

Other evidence also shows the value from having better customer interactions. An extensive study by Millward Brown involving 28,000 brands worldwide found that having customers that are emotionally and functionally engaged leads to:

- Higher customer retention rates: 84% compared to the traditional modus operandi of 30%
- Higher cross sell and up sell ratios: 82% compared to the traditional modus operandi of 16%.

To gain competitive advantage from better interactions often requires a loyalty scheme to be interwoven into emotional and functional engagement. This is best illustrated by studying the USA Customer Experience Index 2010[ix] where only 10% of corporations[x] are rated excellent in terms of service by their customers. Our analysis shows that this top 10% mostly comes from retailers and hotel chains with only one financial organisation represented. All of the corporations in the top 10% have loyalty schemes underpinned by rich behavioural insights.

One interesting insight that could affect pricing strategies came from a Retail Eyes report when they found that 74% of customers would be prepared to pay more for a product if it came with a better service. This relates to our earlier reference to Apple – customers were quite prepared to pay the high price of an iPod, iPhone and / or iPad to gain the benefit of a superior experience. Apple customers tend to remain extremely loyal even though most of the competition offers lower prices for transactions and subscriptions.

The data from other sectors clearly states that superior experiences do create a competitive advantage from better customer interactions. To achieve competitive advantage requires smarter ways of managing insights and knowledge to create new value.

3.7 The widening competitive gap

As the rate of product complexity, velocity and volatility increases so does the intensity of knowledge needed for operational and service performance. The greater the dependency upon knowledge to perform business the greater the gap becomes between the first and last performers in a given sector (refer to Figure 2).

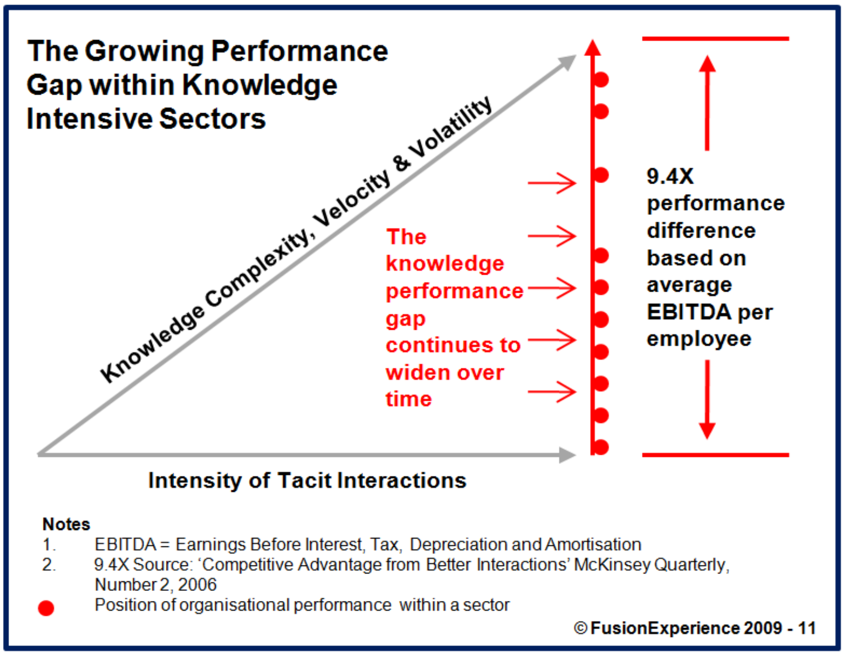

Figure 2 the growing performance gap

Studies have shown that knowledge intensive sectors, like Investment Management, have a 9.4 times[xi] differential between the first and last performers in the sector measured by the average EBITDA per employee. This macro measurement is the leading metric for knowledge worker productivity and performance.

As the intensity of interactions around tacit knowledge intensifies so the competitive gap widens. Over the next five years due to market shifts and the increasing reliance upon knowledge as a differentiator, it is likely that the competitive gap will continue to widen within the Pensions and Investment Industry.

4. GREATER CUSTOMER-CENTRIC KNOWLEDGE AT LOWER COST

4.1 Increasing sophistication from grey-power presents lower cost servicing opportunities

The market move towards income generation and capital protection services will materially increase the demand for knowledge. This knowledge needs to be readily available and be consistent at the point of need across multi-channel and all customer and employee touchpoints.

The cost of servicing this knowledge varies enormously between customer self-service and the labour intensive end of customer servicing where investigative work needs to be undertaken and the knowledge not being readily available (refer to Figure 3).

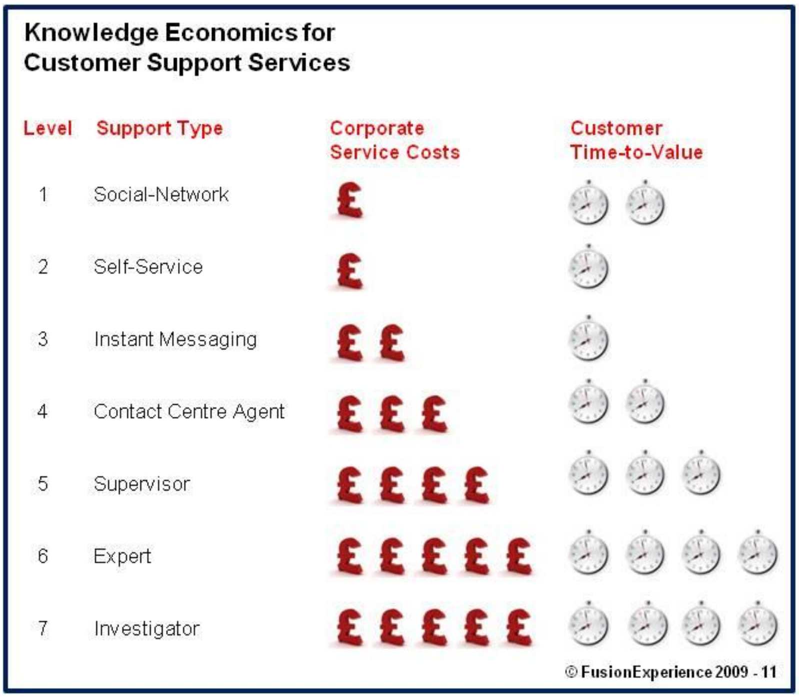

Figure 3 Knowledge economics for customer support services

The time-to-value is a key driver for delivering customer services and knowledge is regarded as a core element for delivering a positive experience. Recent studies by Gartner Group[xii] and Forrester Research[xiii] all state that knowledge is the most critical and challenging component for delivering a customer-centric strategy. In fact, what is known as 'Social CRM' is emerging as a must have capability.

The operational cost for self-service is materially lower compared to the operational costs of providing human support for customer interactions. A Forrester Research study[xiv] showed 72% of customers preferred self-service, this matches with the profile of the grey-power sector who are taking more control of their financial future. The same study anticipated that virtual agents will have an increasing influence upon automating interaction and thus will increase the demand for self-service.

4.2 The impact of long-term knowledge deterioration

Another consideration takes into account the economic costs of knowledge over time. For example, knowledge has two forms: tacit, the knowledge in people's heads and explicit, knowledge retrieved through documentation from or within a system.

For long-term product and service contracts the associated knowledge needs to remain fresh over the contractual lifetime. The risk is where the knowledge is tacit and there is reliance upon key people retaining this knowledge. Over time tacit knowledge will typically deteriorate or be lost when key people are no longer available. The other concern involves implicit knowledge that is hard wired into software applications and the rationality behind the rules becomes eroded over time and starts to constrain business flexibility.

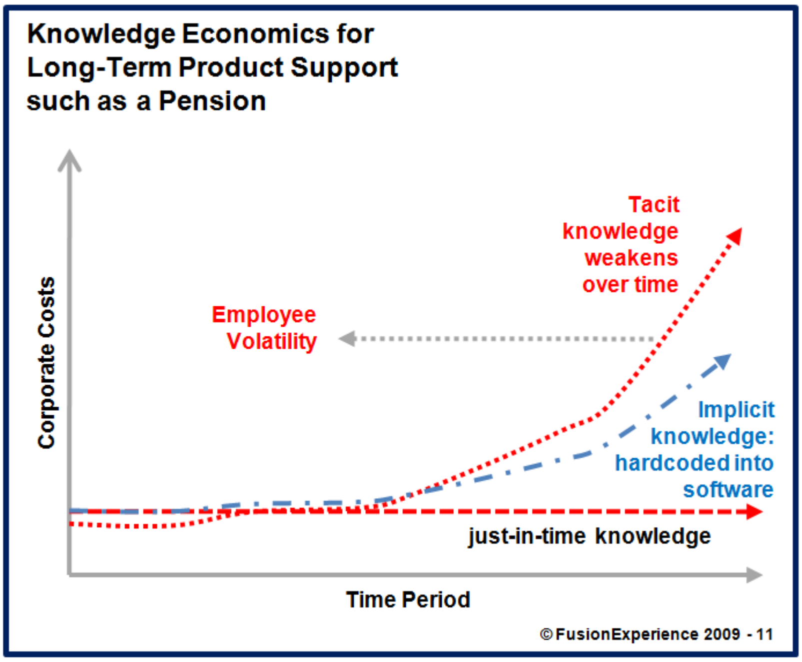

Figure 4 Knowledge economics for long-term product support

This exposure has become quite prevalent and is causing increased anxiety for corporates and customers alike. Such exposures can become a higher risk earlier than expected when there has been employee volatility[xv] – some exposures have been self-inflicted by corporates when they have downsized their work force without due consideration to the knowledge liabilities. This risk could be compounded as customers demand more sophisticated asset classes and personalised services (refer to Figure 4).

Capturing procedural knowledge and other forms of knowledge assets mitigates this risk whilst at the same time self-service drives down costs. This is known as and referred to as just-in-time knowledge. Supporting the production and monitoring of knowledge with embedded continuous improvement loops is a knowledge exchange[xvi], a natural extension of a services platform.

5. UNDERSTANDING THE CUSTOMER

5.1 Value streams for customer preferences

Delivering experience enabled value means understanding customer preferences and simplifying and streamlining their decision journeys; where customer decision journeys are designed to reach the customer's desired outcomes and meet their needs. In other words, the Value Stream that starts with customer preferences and ends with the best-fit customer outcomes needs to be intelligently designed so it works across all the affected business units involved with delivering the service (refer to Figure 5).

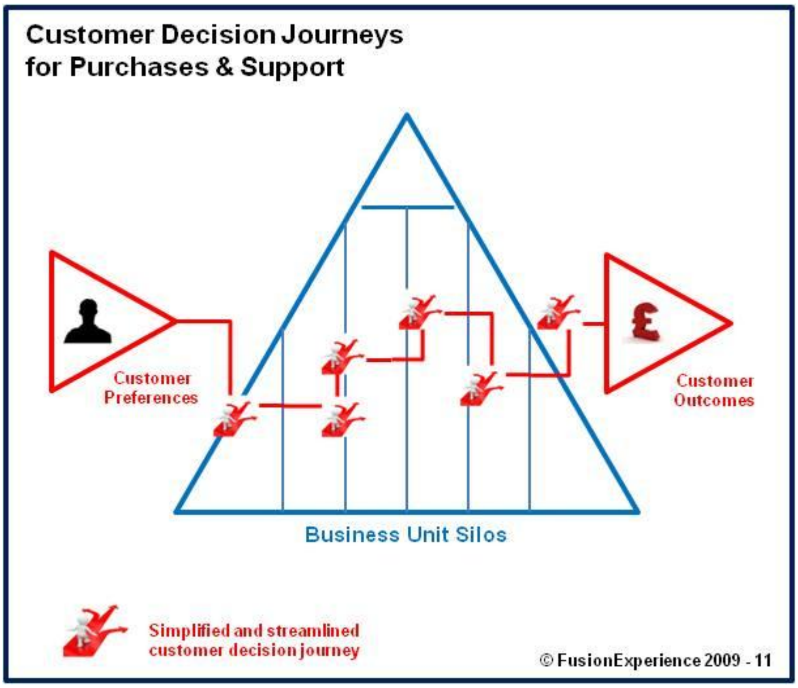

Figure 5 Customer decision journeys

A key element of the Value Stream is the customer decision journey. A recent study[xvii] has shown the importance of designing the decisioning flows that include:

- Deciding which decisions warrant the effort
- Identifying the biases most likely to affect critical decisions
- Selecting practices and tools to counter the most relevant biases
- Embedding practices in formal processes.

For example, part of a Value Stream can include providing better customer apps[xviii] with supportive contextual knowledge. As customers become more knowledgeable they will take greater control over their future, leading to more sophisticated demands and thus stimulate greater opportunities such as for new mobile apps.

The market leaders will be those that understand the socioeconomics of Value Streams in a way that drives down the costs of coordination related to knowledge transfer whilst at the same time increasing customer loyalty and revenue generation.

5.2 Customer insights for driving innovative growth

Increasing the volume of customer interactions creates additional value from the understanding of behavioural flows, patterns and outcomes. The advances in artificial intelligence and interactive data visualisation provide the means to understand emergent patterns of demand. Figure 6 shows the use of real-time interactive visualisation for sensing demand from emergent flows, patterns and outcomes.

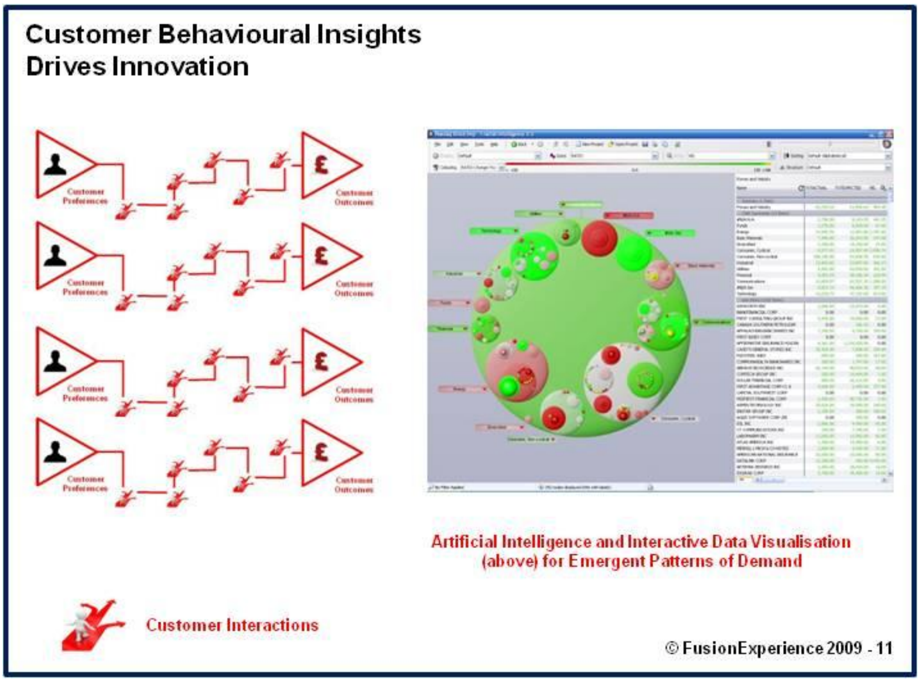

Figure 6 Customer behavioural insights

This capability provides an opportunity to create a Value Stream for new product development, including using simulation to engage customers during the product design. This technique has proven successful in other sectors and is likely to be well received by the grey-power sector that often has more time on their hands and a willingness to be proactively involved.

In Figure 7 it shows the customer can be involved in testing a new product using simulation with the benefit of being able to rapidly iterate changes. This approach means that customers are helping with product design, which often leads to better innovation and creativity. A recent example is a financial organisation tested new product designs with customers that had poor eyesight. This resulted with a better design that was well received by all customers.

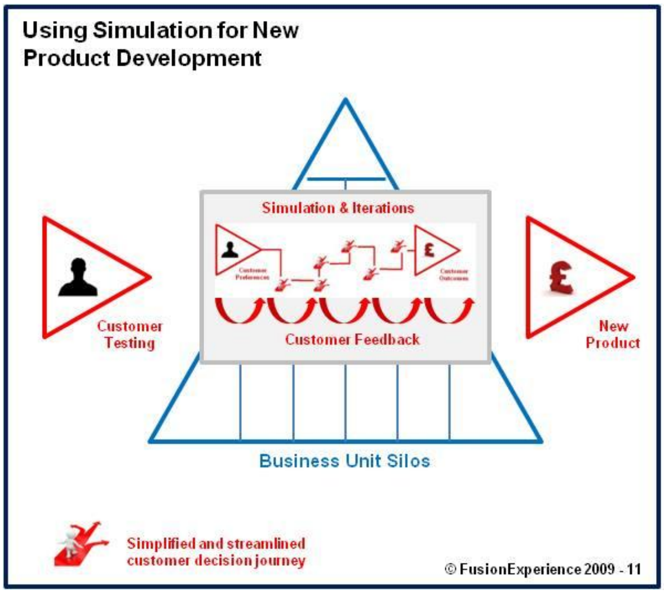

Figure 7 Using simulations for product development

6. SHIFTING THE PARADIGM

6.1 Planning for the shift

Fundamental to planning the way forward is gaining a common understanding of the business drivers. Engaging with different stakeholders through workshops, commencing with understanding the business imperatives and ending with detailed planned outcomes (refer to Figure 8) challenges the status quo and delivers consensus to quantify the future state.

The output provides the strategic baseline for all subsequent work including the Key Performance Indicators (KPIs) covering the market, revenues, costs and risk scorecard(s).

Figure 8 Stakeholder engagement

Developing an appropriate business reference model is vital to create a competitive advantage from better customer interactions. For example Figure 9 below shows a universal business reference model that could be overlaid and integrated with Investment processes, operations and control.

Figure 9 Experience business reference model

Modelling the current business from the customer perspective will drive out practical change plans including multi-channel, touchpoints plus all interactions and transactions that lead to measurable outcomes. The modelling includes revenue, costs, risks and the EBITDA to ascertain employee performance. This modelling can be implemented alongside formal benchmarking, such as CMMI-for-Services[xix] that deliver quantitative measures of each customer service against a maturity model (refer to Figure 10).

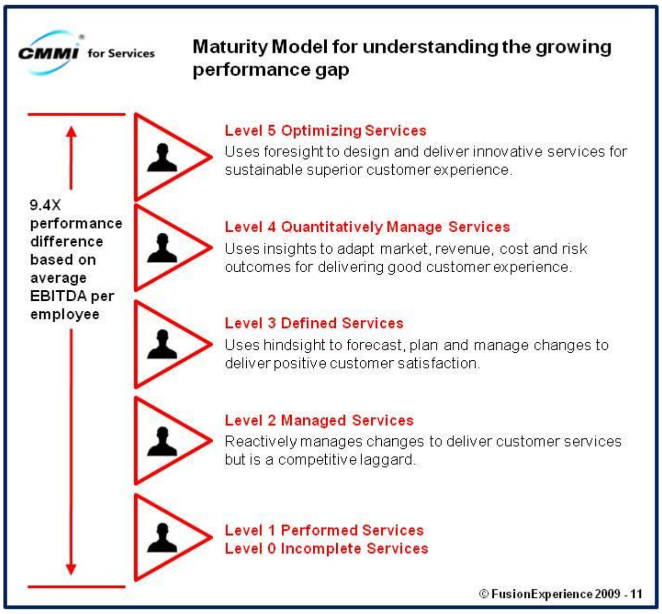

Figure 10 Maturity model for understanding the growing performance gap

6.2 Delivering the shift

Delivering the vision at optimum time to value involves simulation and visualisation of the customer experiences and the associated processes. The simulation and visualisation of the Value Streams for example enables all stakeholders to 'test run' the envisaged solution (refer to Figure 11). Refinements are made to the modelling, simulation and visualisation until consensus has been reached as to the best way forward for execution.

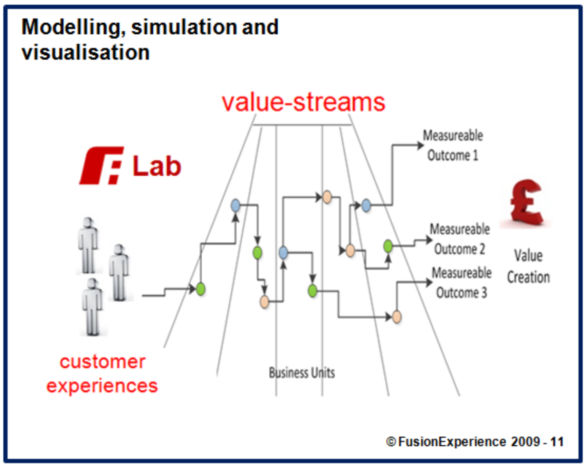

Figure 11 Modelling, simulation and visualisation for value streams

There are several practical options for delivering the agreed solution set that encapsulates the customer experience business reference model and the targeted value streams. For example, to accelerate the time-to-value it is best to use a services platform, where a significant part of the solution set can be configured. This approach is based on the principle of deploying reuse first, followed by only developing bespoke solutions for those parts that are truly unique (refer to figure 12).

Platforms such as the Service Cloud 2 have a rich capability that can be readily configured to support many parts of the experience business reference model including multi-channel, touchpoints, just-in-time knowledge and the data for hindsight, insight and foresight needed as part of the CMMI-for-Services Maturity Model. This approach reduces the time-to-value and the associated costs and risks. Other factors should be considered including critical areas like skills alignment and strengthening governance and controls.

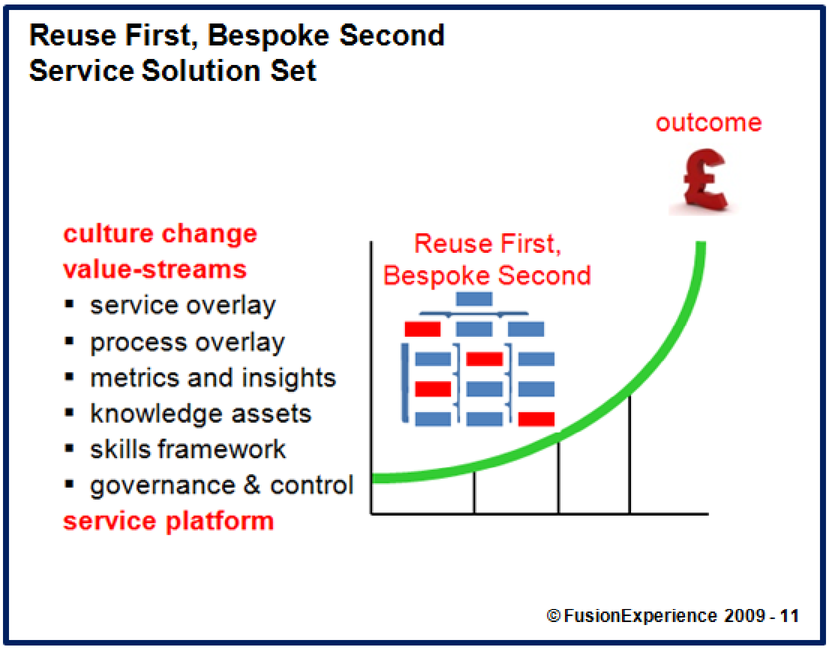

Figure 12 Reuse first, bespoke second

6.3 Measuring the benefits

Once the service platform is delivered it is imperative to capture and analyse rich sets of behavioural data and service performance data to continue to drive value for customers. Advanced forms of artificial intelligence and interactive data visualisation can be used to analyse patterns, flows and outcomes enabling business models to be updated dynamically to ascertain the next stage of evolution.

7. STRATEGIC CONCLUSIONS

The next five years are likely to involve rapid incremental change within the Pensions and Investment sector. As the mass affluent sector grows and grey-power increases customers will demand that they have greater say and control over their future destiny.

The battle ground and competitive advantage will be fought from a better understanding of customer preferences and interactional behaviours so that they can have much more personalised ownership over their future investment returns and risks.

As a consequence, behavioural economics will have a far greater influence upon designing experience-enabled services because from the customer perspective:

- Personalised long-term decisions are never simple to make
- Their decisions involving risk are far more susceptible to biases - ranging from over optimism to loss aversion
- Their requirements and preferences may not be aligned or understood by service providers
- Their decision-making will be influenced by whether they are time-poor or time-rich at the point of interaction.

As the pace of market change accelerates there will be a greater dependency upon managing insights and knowledge. Therefore, the performance gap within the Pensions and Investment industry will continue to widen making it more difficult for laggards to catch up as the leaders continue to unlock increasing value from customer loyalty through evolving insights and knowledge assets over time.

Finally, the boundaries will become a lot more blurred as other sectors compete for a greater share of the customer investment wallet. As the marketplace becomes more customer-centric, the Pensions and Investment industry will find behavioural insights becoming more valuable for evolving their competitive and innovative capabilities.

There is no doubt that the dynamics of the market are irreversibly changing as the competitive battleground gravitates towards better customer interactions where experience becomes the true differentiator.

8. FIGURES

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[i] The Nobel Laureate Douglass C. North in his book 'Institutions, Institutional Change and Economic Performance' covers the extent of economic change and its impact upon institutions.
[ii] Financial Services Authority publication: 'Review of complaint handling in bank groups' published April 2010
[iii] Financial Services Authority 'Treating the customer fairly' http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml
[iv] Financial Services Authority 'Consumer complaints (emerging risks and mass claims) March 2010
[v] Reported in the Telegraph 1st January 2011 http://www.telegraph.co.uk/health/8230749/10m-alive-in-Britain-today-will-live-to-be-more-than-100-years-old.html
[vi] Financial Services Authority: Quality of advice on pension switching: an update. Delivering higher standards through intensive supervision
[vii] Economist Intelligence Unit paper called 'Beyond loyalty: Meeting the challenge of customer engagement'
[viii] Forrester Research study called 'Measuring the total economic impact of customer engagement'
[ix] Published by the research company Forrester Research
[x] Top 10%: **Retailers:** Barnes & Noble, Amazon, Kohl's, JC Penney, Macy's, BJ's Wholesale Club, Costco Wholesale; **Hotels:** Marriot Hotels & Resorts, Hampton Inn/Suites, Holiday Inn Express, Comfort Inn, Hilton; **Financial:** Credit Union.
[xi] The McKinsey Quarterly 2006, Number 2: 'Competitive advantage from better interactions' by Scott Beardsley, Bradford Johnson and James Manyika
[xii] Gartner Group: Magic Quadrant for Web Customer Service, 10th September 2010
[xiii] The Forrester Wave: CRM Suites Customer Services Solutions, Q3 2010
[xiv] Forrester: 'It's Time to Give Virtual Agents Another Look' by Diane Clarkson for eBusiness & Channel strategy Professional s
[xv] Employee volatility can be caused by promotion, leavers, redundancy and retirement
[xvi] A knowledge exchange is a platform used for the trading of knowledge asset with production of these assets being controlled by Guilds, which is a formalised community of practice. A Corporate Knowledge Exchange is a natural extension of a service platform. Further information is available on request.
[xvii] McKinsey Quarterly March 2010: The case of behavioural strategy by Dan Lovallo and Oliver Sibony
[xviii] The term App is now being used for small applications or tools that are designed to perform a targeted function, service or interface for a customer. Mobile has become a popular touchpoint for apps.
[xix] The Capability Maturity Model Integration (CMMI) for Service Organisations is the leading benchmark from Carnegie Mellon's SEI.