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BRIEF

The Business Case for Customer Centricity

Customer centricity is, at its core, about understanding and meeting the needs of customers (see Box 1).[1] From a business perspective, this means that generating greater value for customers is good for business because it increases product use, satisfaction, and loyalty while reducing costs. Research from a developed market context has found that a 2 percent increase in customer retention leads to a 10 percent decrease in cost (Murphy and Murphy 2002). Other research has shown that a 1 percent increase in customer satisfaction leads to a 2.37 percent increase in return on investment (ROI), while a 1 percent decrease in satisfaction leads to a 5.08 percent decrease in ROI (Gupta and Zeithaml 2006).

The point where value for the customer and value for the firm intersect is not always easy to identify. This can be especially the case in the financial inclusion space, where revenue per user of financial products is often low, and where there is little available data to use to assess value. This Brief helps to guide financial services providers (FSPs) in making informed decisions around customer centricity that are grounded in an understanding of the costs and benefits for the organization and what it means for customers.

There are several compelling reasons that can motivate FSPs to implement a customer-centric initiative, or even go further to implement a comprehensive customer-centric strategy. The following five business objectives generally motivate firms to explore and invest in greater customer centricity:

- Increase customer uptake and use.
- Improve market position in a competitive environment.
- Use technology to tailor products to specific customer segments while driving down costs.
- Respond to regulatory requirements on consumer protection.
- Achieve social impact to fulfill its mission.

Increase customer uptake and use. Access to formal financial services is only a first step. Limited use of financial products remains a major challenge for meaningful financial inclusion. Data from the World Bank's Global Financial Inclusion database (Findex) show that about 20 percent of adults in the developing world who have an account—either at a financial institution or through a mobile money provider—did not use the account for at least a year (Demirgüç-Kunt et al. 2015). The challenge of use is similarly prevalent when considering only mobile money. According to 2016 GSMA data, of the 227 million registered mobile accounts in sub-Saharan Africa, only 100 million were active on a 90-day basis—an activity rate of 36 percent.

Box 1. Defining Customer Centricity

CGAP defines customer centricity as the ***ecosystem and operating model*** that enables an organization to design a unique and distinctive ***customer experience***. This architecture enables the business to ***acquire, retain, and develop*** targeted customers efficiently for the ***benefit of customers and the organization.***

To increase uptake and use, FSPs should strive to understand and meet customers' needs. FSPs have not traditionally been adept at implementing customer-centric approaches to meet their customers' needs (McKinsey 2012 and Narayan and Brem 2002). This is especially true in the context of serving low-income consumers, who are often offered highly standardized products that were created with the intention to keep costs low. Lack of customization can contribute to low take-up and retention, high account dormancy, and customer misunderstanding that can lead to dissatisfaction and mistrust.[2] In light of these challenges, FSPs have increasingly recognized the commercial benefits—and sometimes the commercial necessity—of customer centricity. For example, since its founding in 2003, Yes Bank in India has differentiated itself from its competitors by focusing on customer needs and customer service. It credits this approach for driving compounded annual growth rates in deposits of 74 percent per year and profitability levels in line with much larger competitors (Bapat and Naik 2013).

Improve market position in a competitive environment. In a mature, highly competitive market, customer centricity could be a differentiator to retain current customers or acquire new customers from competitors. Geric Laude, president and CEO of Pioneer, a microinsurance company in the Philippines, reflected on a need to "anticipate what our client wants from us . . . to stay ahead of the curve. In this market, clients know that they have choices, and clients know that they can make demands. Any sort of market leadership you have can vanish if you don't meet their needs." In contrast, in a "blue ocean" environment,[3] FSPs may prefer to focus on quick wins, such as branch expansion, to acquire clients.

Use technology to tailor products to specific customer segments and drive down costs. FSPs can leverage digital distribution channels and rich user interfaces to enhance customer convenience. By using technology innovations, services can be brought to customers' doorsteps and can be personalized to address specific customer needs. Enlisting technological advances could uncover customer-centric solutions and provide opportunities to lower costs of distribution at scale. Technology can be a strong enabler for customer centricity, specifically in environments were customers are tech savvy and the use of cost-lowering technology responds to a true customer need.

[1] Definition adapted from Leather (2013).
[2] Less than 30 percent of registered mobile money accounts were active as of 2013 (Pénicaud and Katakam 2013). Common reasons for choosing to be unbanked are high cost, lack of convenience, and distrust of FSPs (Demirgüç-Kunt and Klapper 2013).
[3] "Blue oceans" are new, uncontested market spaces that allow a firm to succeed by reaching previously untapped segments or demands, rather than battling competitors (Kim and Mauborgne 2005).

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Respond to regulatory requirements on consumer protection. Regulatory requirements can be another incentive for FSPs to become more customer centric. Regulators are putting pressure on institutions to protect their consumers, treat them fairly, reduce fees, and increase transparency of fees (Burritt and Kilara 2016). The Reserve Bank of India (2014), for example, has included the "right to suitability" into its definition of customer rights, which implies that a product "should be appropriate to the needs of the customer and based on an assessment of the customer's financial circumstances and understanding." It is therefore in the interest of FSPs that are aiming to put such requirements in practice to implement a strategy as well as internal processes and policies that are customer-centric, thereby ensuring products are truly suitable for customers' needs (Prathap 2017).

Achieve social impact to fulfill a strategic mission. Many FSPs have dual objectives, including both financial and social goals. Investments in customer centricity can promote social goals related to financial inclusion. Excluded customers require products that are appropriate for their unique needs and that can improve the resilience of their households—these products need to be integrated with a high level of customer care and protection (Kilara and Rhyne 2014).

What Does Customer Centricity Mean to FSPs?

A wholly customer-centric FSP is driven by customer needs. This often means a total shift in a firm's culture, structure, and investments to develop internal capacities related to data analytics, market research, operations, sales, human resources, etc. (Maguire et al. 2012). While most FSPs agree in principle with this approach, practically speaking, such a large shift is difficult to achieve. However, FSPs can take an incremental approach to customer centricity as they address internal capability gaps and align their strategy and processes to customer needs. Adopting a customer-centric strategy means FSPs need to take steps to understand and serve their customers better and to develop an organization-wide focus on customer centricity.

Customer-centric financial institutions abide by five foundational principles:

- Committed leadership and a cohesive, customer-focused organizational culture.
- Operational functions—such as compliance, risk, and IT—that focus on the customer.
- Capable and empowered employees who have access to a full set of tools and insights to better serve customers.
- Exceptional customer experiences that are continuously enhanced based on customer insights, good service design, and delivery at scale.
- Value generated through the customer-centric approach for the customer and the firm.

When FSPs want to serve existing and potential new customers better they need to take a long-term view to achieve business success. For example, acquisition and retention costs over time differ from one customer to the next. For some customers, these costs may be high and, therefore, may take more time to amortize. The same can be said of the value a firm thinks a customer represents. This value can increase over time as customers register for additional products and services and/or increase their level of use. This underscores the value customers generate over their lifetime interacting with a firm—customers' lifetime value (CLV).[4]

Measuring and comparing CLV allows firms to create value propositions for different customer segments. Assessing the value that customer segments generate over time can strengthen a business case for customer centricity for all customers an FSP wants to serve, including lower-income clients.

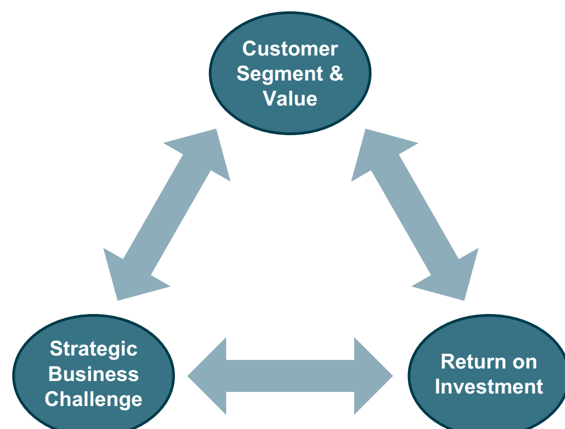
By looking at CLV through a financial inclusion lens, it becomes clear that large segments—even the poor, who at first glance do not seem to hold value—can generate substantial value for FSPs over time through cross- or up-sell. Customer-centric investments also help to strengthen a firm's brand and name recognition, leading to trust in the brand and organization, comfort in using its products, and strong referral rates over the long term. These long-term benefits are compelling reasons to invest in customer centricity, even in the absence of a quantifiable, short-term return.

Value-Based Decision-Making

The value-based decision-making model helps firms align their investment decisions with their motivations for customer centricity. The three dimensions of the business case, outlined in Figure 1, are the cornerstones of value creation for a firm. The framework considers a firm's strategic business challenges and opportunities that can be addressed through a customer-centric investment in the needs and preferences of existing and potential new customer segments. It helps FSPs analyze the expected return from a particular investment over the lifetime of a customer, thereby optimizing investments in both social and financial contexts.

Indian microfinance institution (MFI) Janalakshmi is a good example of this approach. Janalakshmi is a pioneering urban MFI that is headquartered in Bangalore and serves 5.1 million clients through 352 branches across 18 states. Since it was founded in 2006, its loan portfolio has grown from US$463,000 with 8,700 active borrowers to US$605 million with 5.1 million active borrowers.

Figure 1. Three Dimensions of the Business Case



[4] CLV is a prediction of the provider's net profit that can be attributed to the entire future relationship with a customer, across products.

Strategic Business Challenges and Opportunities

Customer centricity can help firms address strategic business challenges to enhance overall business performance. As such, firms need to clearly identify what these challenges are. For example, an FSP might want to reduce dormancy or dissatisfaction rates that result from customers' misunderstanding of products and services. Or, a firm might want to expand its customer base or better serve current customers. The firm might undertake customer research to learn more about specific customer segments and to identify opportunities to serve them better. These opportunities are likely to be most relevant and profitable when they stem directly from an understanding of customers' needs and preferences.

As Janalakshmi began to expand its services and client base beyond traditional microfinance, and with its imminent transformation into a small finance bank, it needed to develop new approaches to better identify the needs of clients, across varying segments. For Janalakshmi, three business challenges and opportunities emerged: (*i*) better understand and manage the costs of serving very low-income customers, (*ii*) acquire new customers in rural areas to comply with regulations for small finance banks, and (*iii*) show a financial case for serving these customers.

Customers and Customer Segments

After identifying a problem or opportunity, FSPs should turn to the customers, customer segments, or potential customers to understand who they are and what their needs are. Customer segmentation is a critical component of this process. The FSP may identify, for example, microentrepreneurs, low-income women, educated young people, or urban salaried workers as a key constituency that it wishes to serve more effectively. In some cases, more information may be needed to identify useful segments or pinpoint their most important and salient needs. This can be difficult when customer data are limited or when internal research and data analysis capacities are not strong (CGAP 2016).

Once Janalakshmi identified this business opportunity, it turned to its customers and made efforts to listen to and understand customers by interviewing client households, doing customer segmentation, and developing in-depth customer personas. This research indicated that one small segment of low-income customers had the potential to drive the most growth over the long run: these were customers who graduated from small group loans to individual business loans. Census data suggest that there are 25 million of these potential customers, and that more than 90 percent of them lack access to formal financial services. Although this segment may not offer much financial value today, retaining these customers presents a business opportunity for long-term value. Based on these new customer insights, Janalakshmi developed a retention strategy that specifically targets these group loan customers to help them to graduate from group to individual/enterprise loans and to ensure that these customers are selecting appropriate products and services at the right time, including loyalty programs and advisory services. Janalakshmi put in place a strategic framework for analyzing each segment and developing a customized offering called SOLACE: S for segment, O for offering or value proposition, L for loyalty, A for advisory services, and CE for channel/customer experience.

Return on Investment

ROI incorporates expected revenues, operational costs, capital expenditures required, and the need to amortize fixed costs of a client-centered investment over the average lifetime of the customer. By calculating an internal rate of return and comparing it to that of alternative investments, this framework helps FSPs to hone in on the interventions and investments that will maximize their returns for a particular customer segment or across different segments. Capital expenditures often start with investments in data collection (qualitative and/or quantitative) and analysis, without which it is difficult to analyze behaviors. These expenditures can be outsourced initially. Having a clear sense of the cost of acquiring, servicing, and retaining clients is often a precursor to the full implementation of customer-centric activities.

Janalakshmi, with the business opportunity identified and the necessary customer insights analyzed, was able to assess how group loan clients are contributing to its bottom line. A detailed analysis of Janalakshmi's revenues, costs, and profits from serving its different customers was undertaken. For this purpose, Janalakshmi needed to update its data management system to go beyond a transaction and product view and assign each client a unique identifier. Management was then able to analyze the cost and revenue drivers at the level of each customer, allowing the institution to move from a product view to calculating the value of customers in each segment in the near and long term. The results confirmed that customer retention is an important factor in determining the profitability of a customer since the longer customers are retained, the more profitable they can be to the firm. The analysis also allowed Janalakshmi to rebalance its portfolio and ensure that lower-value clients are counterbalanced by those with higher current and future values. Janalakshmi determined that customers with low future value need a simple competitive product offering that allows the institution to maintain these clients without excessive costs. This means that group loan customers with potential for growth would have to be nurtured and retained to graduate them to individual loans. This approach also allows Janalakshmi to amortize current fixed costs and additional capital expenditures required to retain its high future value customers (such as developing loyalty programs and advisory services) over the lifetime of the customer.

For Janalakshmi, knowing how poor families contribute to its bottom line allowed it to consider how many of these customers it can afford to serve, and with what value proposition. Although the cost of serving its poorest customers is relatively high, rather than eliminating services to these customers, Janalakshmi supported its mission to include these groups by reorienting its strategic approach. This meant using lower-cost delivery channels for small group loan customers, and offering products and services such as savings, advisory, and pension products that address customers' lifetime needs.

For Janalakshmi, it is not enough to measure value purely in financial terms. Some elements that contribute to financial value are intangible and hard to measure. For example, having low-income and lower-value clients allows Janalakshmi to position itself in low-income communities as inclusive and, thereby, attracting a wider range of households to its brand. And, serving this segment fulfills the organization's social mission of inclusive urban growth.

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Challenges and Considerations

An organization's assessment of the value of its customer-centric investment opportunities can be used to secure internal stakeholder buy-in. If stakeholders are initially reluctant to endorse a customer-centric approach, FSPs are advised to take small steps that will eventually reveal the benefits and the business case of a customer-centric approach.

Before launching into this approach, FSPs should consider their readiness, in terms of internal capacity, data, and resources. For example, there may not be sufficient information about customers' lifetime costs and revenues to justify amortizing a customer-centric investment over the lifetime of a customer. Measuring and interpreting CLV can require companies to make initial investments in data and analytical capabilities. Such an investment can make sense because FSPs may find the longer-term business case compelling. However, this approach can be at odds with short-term shareholder expectations. To ease into this approach, companies may want to assess the value of their customers in the short term, in one-year or even shorter cycles that are linked to products and transactions rather than to a customer's long-term value proposition. In the long term, high CLV may mean a customer-centric approach will generate value for FSPs.

Conclusion

There is no single approach to customer centricity—FSPs have different goals, market contexts, target customers, internal capacity, and resources. But there are common underlying principles that apply to many FSPs. Customer centricity can be viewed as a strategy for maximizing the value of all customer segments over the long term. A firm that invests in activities to gain social or other intangible benefits, despite a low or uncertain ROI, can signal to customers that the firm values them and genuinely wants to address their needs regardless of their relatively low short-term profitability. Some FSPs might be tempted to focus on the short-term value of specific customer segments. However, a long-term assessment of CLV can reveal the business potential of customer segments previously considered unprofitable and can thereby establish the value of a customer-centric approach. FSPs can think of customer centricity over the long term as a means to achieve higher returns from a larger number of customers while at the same time achieving social objectives through increased financial inclusion.

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