

P E R S P E C T I V E

New Segmentation Approaches to  
Drive Product Innovation



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## Need for Innovation in Segmentation Strategy

Although banks have practiced customer segmentation for the past decade or so, there is room for further refinement of their strategies. Having moved from a product-centric to a customer-centric approach, banks continue to employ broad brushstrokes to segment their customer base. In doing so, they risk attributing common characteristics to a large number of customers who may have been grouped together on the basis of a single parameter, such as relationship value. More importantly, their product and service offerings are likely to be tailored to the perceived needs of these segments.

At the same time, banking customers continue to demand more. They are no longer content to be viewed as faceless constituents of a large group; they expect their banks to recognize their individual needs and offer custom-made solutions to help them achieve their financial goals. Against this backdrop, banks must become more innovative in the way they view their customers as well as the manner in which they serve them.

## Beyond Relationship-value Segmentation

For a start, banks can look at refining customer segmentation by taking a multi-dimensional approach that goes beyond relationship-value. While segmentation on the basis of relationship-value is important in order to recognize and reward customer loyalty, it falls short of enabling banks to identify and attract new business opportunities. It is also possible that customers with vastly different relationship-values may be connected in other ways, and therefore, could be part of the same segment from an entirely different standpoint.

Hence, banks need an in-depth, well-rounded perspective of their customers before they can categorize them. This perspective must consider various factors besides relationship value including but not limited to demography, geography, ethnicity, gender and profession. As a matter of fact, banks are well placed to do so, since most, if not all of this information would already be available within their database. Analysis of comprehensive customer data can reveal homogeneous patterns that can be used to create new and more meaningful customer segments which can be targeted for tailor-made products and services.

## New Approaches to Segmentation

Customer segmentation on the basis of homogeneity of behaviour, aspiration, value, culture or habit can bring to light specific opportunities which may not be visible when only relationship value is taken into consideration. It is intuitive that those who share a common geography, language, profession or social status will also have, to a certain extent, similar values or behaviour. Therein lies vast, untapped opportunity – if banks can offer products and services that support such homogeneity, they are likely to reap big benefits by way of new business and cross-sales.

This view is best illustrated with some examples. A couple of prominent U.S. banks have gone after the 37 million-strong Hispanic population, considered an unprofitable customer segment by most of their peers. This group has very specific requirements – the facility to deposit pay-checks, make money transfers and maintain a zero balance in their account being the most important. The banks have accordingly introduced innovative products tailored to these needs. One bank offers more options to move money: as cash to cash or as cash to accounts or cards, being some of them. They also allow their customers to cash pay-checks. The other bank has pioneered a special zero minimum balance account just for Hispanic clients.

Geographic segmentation is another important possibility. A physical location can be a great determinant of customer needs – for instance, while all agricultural regions have large demand for farm loans or short-term trade financing, their demand patterns differ based on the crop and harvesting cycle. Another example is that of customers on the West and East Coast of the U.S., who hold different financial aspirations which cannot be met with the same suite of products. Although regional and rural banks cater to geographic diversity to a certain extent, national banks can follow suit by creating location-based sub-segments and targeting them with different offerings.

Segmentation by social strata is gaining currency riding on the concept of financial inclusion. Globally, banks are innovating their product and channel strategy to reach out to the unbanked population. Going forward, they must attempt to discover subtle patterns within these segments, so that they can target smaller sections with customized offers. Different generations display distinct behavioural

patterns. Aging baby boomers may seek personal guidance while planning their retirement savings; not so the tech-savvy and self-reliant Generation X. The 'digital native' Gen Y is technologically ahead of them all, and is at ease transacting over the internet, mobile phone or even social networking platforms.

Segmentation-driven innovation need not be confined to products alone. Several Canadian banks have set up multi-lingual branches, where employees speak up to eight languages, to cater to the vast expatriate community in that country. ATMs in rural India offer screens in vernacular languages to encourage usage among the resident population.

Banks can also benefit by segmenting their customer base along unconventional dimensions. An Australian bank offered a utility bill payment service in the form of a specialised loan to those customers who had difficulty keeping up with their monthly payments. By doing so, they earned interest from their customers and commission from the service providers. New methods of segmentation have also been considered within niche areas such as wealth management, with sub-segments being formed on the basis of source of wealth, customer sophistication, life-stage and geography.

Another approach advocates the formation of customer groups depending on their banking behaviour – which is either investment or borrowing/transaction oriented. Typically, investors comprise of older, more affluent clients who maintain high balances and are primarily concerned with growing their wealth for the future. Since this group is not focused on deposit products, it is not very sensitive to interest rates.

On the other hand, lower-balance transactors are young and just starting to accumulate wealth through employer plans, IRAs or similar avenues. Mostly, their needs are immediate – and hence, they lay greater emphasis on checking, saving and loan products and the interest rates associated with each.

Not surprisingly, their channel preferences also differ. High-balance customers want experienced branch staffers to whom they can turn in case of need. Their low-balance counterparts are happy using self-assisted channels such as PC/ Internet banking, ATMs and call centres.

Clearly, banks need very different strategies to tackle each of these groups. At the same time, they must recognize the interplay of multiple factors within each segment – for instance, some members of the Hispanic segment may have similar social, linguistic and economic characteristics. Another example of this is evident in the case of the high-balance investors discussed earlier, who, apart from having common financial goals, may also be at a similar life-stage. Thus, going forward, banks' segmentation strategy must create finer 'sub-segments' which are homogenous along different dimensions. This will lead them from customer-centricity to the more desirable state of customer-specificity or 'segment of one'. For instance, of the three broad customer segments, namely corporate, small business and retail, the latter can be grouped by generation, which in turn may be segmented according to geography, income, behaviour and so on. The corporate and small business client base can be similarly broken down.

### **Innovating to Create Relevant Products and Services**

A sophisticated segmentation strategy will achieve little unless it is backed up by innovative products and services relevant to the needs of different groups. Hence, banks need to map their 'offerings' defined by a combination of product, price, channel, timing and human resources to various customer segments. For instance, they can bundle a set of investment products for their Gen X customers and train a team of relationship managers to deliver them. Another example is the creation of small savings products to cater to the new savings consciousness emerging in the aftermath of the global crisis. Banks must also give due weightage to pricing to ensure that small-ticket vanilla products are not perceived as being expensive by the target segments. Timing is equally important – Gen Y customers have simpler, frequent needs and expect instant fulfilment, whereas mature clients are likely to have significant requirements at different life-stages, such as marriage, parenthood or retirement. A well-rounded segmentation approach must take all this and more into consideration.

### **Aligning the Organization with a Robust Segmentation Strategy**

While all of this is good wisdom, it is only part of the story. The goal of true segmentation is not merely to offer innovative products and services, but to ensure that the customer experience is raised

to a different level. Hence, the entire banking organization, including its policies, processes and people must be aligned with the segmentation strategy. KYC norms are a good example of how policies can be ‘turned on their heads’ to support segmentation – rather than following these norms purely as a compliance practice, banks can use the information to strengthen their understanding of various customer segments.

It goes without saying that banks will need resources as well as infrastructure to effect these changes. A sound technology platform is a necessary enabler at every stage – from segmentation to product innovation to customer experience delivery. To start with, banks need a 360 degree unified view of their customers across the organization – only integrated core systems have the capability to consistently deliver this information, no matter how large the scale. Technology is required to analyse huge volumes of customer data, discover patterns within them and engender the progression of broad-based segmentation to a ‘segment of one’. Again, quick roll-out of new products and services is only possible with the support of modern core banking systems. The same systems enable banks to optimise their channels and processes, making them more efficient but not less personalized, all of which contribute to the delivery of good customer experience. For instance, technology can be used to trigger an investment recommendation whenever a customer’s account receives sizeable inflows as well as alert the concerned relationship manager so that he may follow it up.

### Summary

Banking customers’ demands have kept pace with the rising complexity of their needs. They expect banks to address their individual requirements with relevant products and services. This implies that banking institutions must acquire a deeper understanding of their customers on a one-to-one level, and deploy that insight into product and service innovation. Customer segmentation is central to this objective.

Current segmentation practices are mostly unidimensional and based on a single parameter such as relationship value. Although the relevance of relationship-value as a measure of customer loyalty is beyond doubt, it cannot be the sole criterion for segmentation. Going forward, banks must refine their segmentation strategy by taking

into account a combination of demographic, social, economic, geographic and linguistic factors. Other innovative approaches to segmentation include grouping customers on the basis of financial behaviour, customer sophistication or life-stage. As broad customer segments are broken down into finer sub-groups, segmentation strategy shifts from customer-centricity towards customer-specificity. New business opportunities can be created by offering tailor-made products to each customer sub-segment. However, none of this is possible without the support of a strong technology backbone at every stage – whether it is the creation of new customer segments, roll-out of innovative offers or the alignment of processes and channels to provide a great banking experience across all segments.

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