

# “TESTING...1, 2, 3...TESTING”

Essay #2 in a Continuing Series on Current Banking Trends

## The Sales Challenge: Finding the Right Formula

The traditional mass market approach used for selling products has become increasingly ineffective, with real revenue growth and margin erosion being top-of-mind concerns for all major banks.

At the same time, several non-bank competitors like Merrill Lynch, Charles Schwab, and Capital One continue to win many new profitable customers and to expand their wallet share with them. For direct marketers like Capital One, for example, much of this success can be attributed to their proficiency in testing and iterative learning. At any given time, they are running hundreds of concurrent tests, and they have built up years of experience in focusing marketing efforts based on analysis of these tests.

Learning through experimentation and testing clearly is not the exclusive domain of direct marketers. Indeed, many of the most successful retailers like the Gap and Starbucks use in-market testing to refine and perfect what they do in their physical locations. They test all of the key variables which impact the purchase decision, including store size, format, location, promotional activities and cycles, signage, displays, etc..

By coupling advanced customer-based marketing with testing capability and a natural retail advantage, we believe banks have a major opportunity to break out of the revenue generation “box” they so often speak of and metaphorically occupy. Banks are, in fact, unique among financial institutions in their ability to leverage face-to-face customer contact. Unfortunately, this contact historically has been largely reactive and inordinately oriented toward the sale and purchase of transactional products.

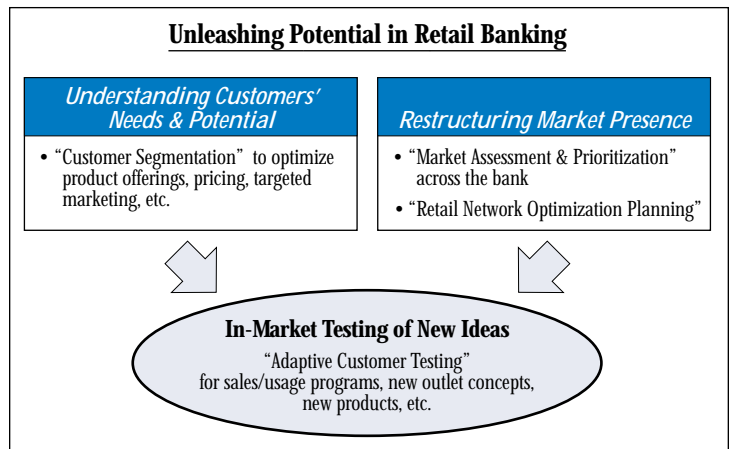
Going forward, banks need to adopt an enhanced marketing process that is designed to better understand customers’ actual behavior and to develop solutions better matched to their demonstrated needs. This involves implementing testing paradigms beyond the narrow domain of today’s direct marketing/mail campaigns and experimenting, for example, with new outlet types and formats, new locations and partners, and new ways of operating their network (staffing, staff incentives, retail content, promotional cycles, price tiering etc.).

We call this process Adaptive Customer Testing (ACT). We believe it is key both to delivery restructuring success and to achieving elusive revenue growth, issues worth hundreds of millions of dollars annually at the nation’s largest banks.

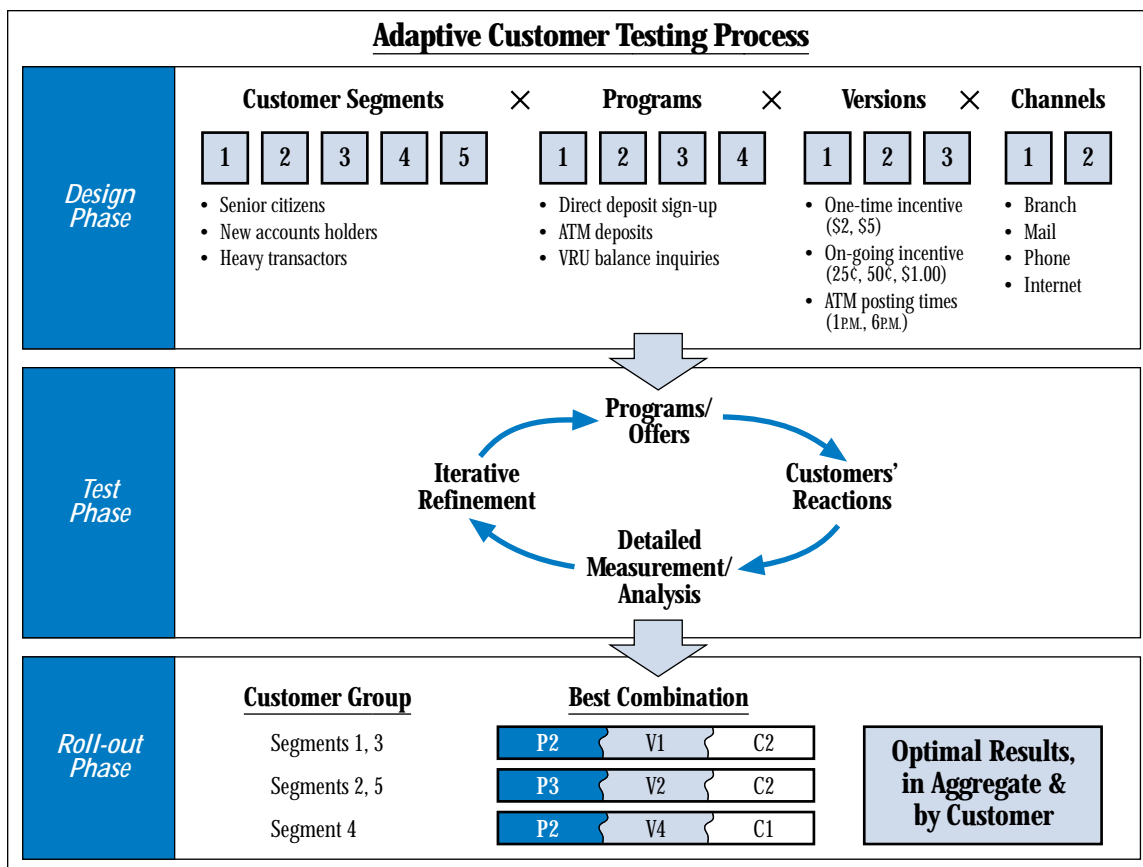
## Adaptive Customer Testing (ACT)

Functionally, Adaptive Customer Testing is a process for piloting several potential solutions to a business problem or opportunity in a real market environment. Through direct observation and rigorous analysis, multiple potential solutions are evaluated, updated, and retested until the best solution emerges. This process is rapid and iterative, allowing for substantial refinement and

Testing plays a key role in improving retail performance.



## Adaptive Customer Testing Process



The Adaptive Customer Testing process lets the market decide which components are best — individually, then in combination. The examples below catalog the use of ACT to increase sales by 50%/FTE and migrate transactions over time from tellers by >30%.

improvement, or abandonment of ideas at low cost, low risk, and relatively minor market disruption.

Whereas traditional bank marketing approaches rely on internal processes to make decisions, or, in some cases, supplement this with market research (typically focus groups or some sort of rough conjoint analysis), Adaptive Customer Testing relies on customer behavior data to: a) comprehensively guide decision-making; b) modify customer offers on an ongoing basis; and c) understand results (not only what happened, but with whom, why, etc.).

### Examples

Two examples may help to illustrate ACT's utility:

**I. In-store sales.** A large, super-regional bank planning to invest heavily in supermarket branches faced the difficult task of how best to attract sales in the new outlets. Rather than invest in a lengthy study of the new channel or implement a large roll-out with the wrong programs and incentives, the bank created

**multiple sales programs and implemented them concurrently. These programs tested selling different account types with different customer prices and varying employee incentives.**

While some programs worked well, others faltered. A dedicated sales management/testing team actively adjusted the sales programs in real time until they discovered the elements that worked most effectively. Through this process the bank gained valuable knowledge about how best to set incentives at other in-stores, which customers to target, with which products/product bundles, and at what price.

The consequent focused customer and employee incentives that were rolled out to other in-stores have increased sales by ~50% per FTE.

**II. Transaction migration.** In another situation, a bank needed to reduce teller-based transactions in order to trim cost and, importantly, to permit more extensive reconfiguration of its network. The bank set up testing areas and implemented multiple programs to encourage ATM and direct

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**deposit use, including incentives via direct mail, in-branch ambassadors, teller-based incentives, customer coupons, automatic account credits, and other self-service enablement and usage initiatives. Incentives varied in amount, the timeframe over which the incentive was offered (to check for reversion), and who received what incentive (customers or bank employees).**

Each month, the migration team reviewed analysis of customer behavior and determined how test programs were doing. Poorly performing initiatives were identified, studied, and improved. Combinations were fashioned.

Overall, the bank reduced teller transactions by ~15% in its test and is on track to ultimately reduce teller transactions across its system by 30%–35%, with none of the customer backlash or press coverage that has characterized banks which have used a blunt, punitive approach to reduce teller transaction levels.

### **Making It Work: Three Key Principles**

Adaptive Customer Testing frequently requires the development and application of new skills. Among the most critical are the following:

#### **1. Create a culture of “test and learn”.**

*Staying competitive requires a commitment to testing new ideas and learning from the consequences. Not just once or twice, but as an ongoing way of doing business.*

Some tests inevitably have to “fail”. Failure in individual tests needs to be seen as a positive way to learn and improve, not as a black mark. The optimal formula for success rarely emerges on day one.

#### **2. Establish “systems” for accelerated data acquisition and analysis, and for understanding the root “drivers” of success or failure (not just the aggregate level of success or failure).**

*One of the biggest challenges in Adaptive Customer Testing is collecting and analyzing data quickly enough to make timely adjustments. Traditional mainframe programming environments — which are really production environments — typically cannot respond in an adequate*

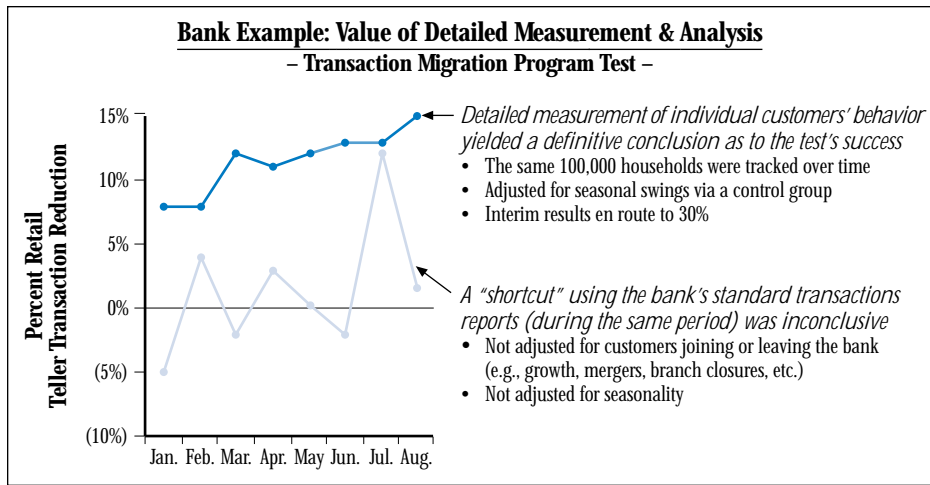
*timeframe, and often only can provide data that is too detailed, or too aggregated, for management to pinpoint the root causes of a test’s success or failure.*

Effective testing often requires establishing a team of business analysts with strong technical/computer skills to define, download and analyze the proper data on powerful desktop PCs (e.g., to track behavior at a household or customer level). Moreover, it is extremely important to separate long-term data production considerations from initial testing requirements (once proven and refined, the relevant information elements later can be incorporated into a mainframe production environment). And it is critical to be able to analytically read a test correctly, and then confidently convert its learnings into prescriptive actions.

#### **3. Test multiple components separately and then in combination to maximize results.**

*Successful testing programs break problems apart into the many components that drive success or failure and test each of them individually, before combining them into a single program or offer. This can be contrasted with a less successful but more widely used approach, in which managers try to pick the winning combination in advance, and use in-market test results to validate or disprove their intuition.*

Rather than simply modeling expected response rates, for example, a successful credit card company tested more than a dozen variables in a recent campaign, including first class vs. bulk mail, metered vs. stamped mail, the color of the envelope, whether it had a return address, whether it had a window, following up with a call or another mailing, the number of follow-ups and their timing, differential interest rates, etc. While several of these details seem unlikely to be important, in-market testing proved their combined effect to be almost as important as to whom the solicitation was sent. Measured results included not just response rates, but overall customer lifetime



Successful testing requires accurate measurement and robust analysis of results — plus working closely with the field to ensure effective execution and implementable results (valued here at \$30+MM per year systemwide).

net present values (NPVs), which is comprised of several components requiring measurement, including response, application, sign-up, usage, average balance, default rate, and churn.

The components to be tested obviously would be different in a retail setting from the above credit card example, but there is a similarity in these three regards: a) testing multiple variables yields superior results; b) the combination that proved most effective in the market could not have been predicted beforehand; and c) measurement must involve understanding more than the aggregate result.

### Conclusion

While banks are understandably reluctant to embrace the unproven, today's broadly commoditized pricing and product offers cry out to be differentiated, as do the structure and content of today's retail networks. This means trying what is yet unproven and capitalizing on it by building an understanding of the root "drivers" of success or failure.

Adaptive Customer Testing (ACT) is a powerful new approach banks can use to attain their growth goals and achieve meaningful, proven differentiation in the eyes of the customer. In the retail world, as in the consumer products world more broadly, to be undifferentiated is often the greatest failure of all.