Customer Experience Influenced Risk Tolerance

Customer experience management can be used to increase customer's willingness to accept risk

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In financial services, one fundamental reality is that people want the greatest return but within their acceptable risk horizon. An individual's acceptable risk horizon is determined by personal disposition and external factors like interest rates, economic stability and so forth. The standard view is that external factors along with a customers' personal disposition determines the risk horizon they are comfortable with. Thus, the classic way of accounting for a customer's personal risk disposition is to simply assess in a straightforward manner how much risk they are comfortable with in order to create a risk tolerance profile. If customer experience is added to the equation we get a very different and insightful perspective. an business that deliberately and consistently evokes particular key emotions in its customers is, in effect, creating the situation where the customer feels comfortable and more confident in expanding their risk horizon. The other insight is that this effect is company specific. Thus, there is significant competitive advantage to be had. A person's overall risk tolerance profile will likely remain unchanged even though their company specific disposition has been adjusted.

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CE Influenced Risk Tolerance

In customer experience management (CEM), one fundamental truth is that the customer experience is made up of two halves: rational and emotional. In financial services, one fundamental reality is that people want the greatest return but within their acceptable risk horizon. An individual's acceptable risk horizon is determined by personal disposition and external factors like interest rates, economic stability and so forth. All of us in financial services clearly understand the importance and impact of the external factors. Whole fields of study (eg, economics, finance, and accounting) are devoted to better understanding these external factors. The personal disposition side of the equation is less well understood although many social scientists are devoted to understanding it. The goal of studying personal risk disposition tends to focus on identifying what a person's true risk disposition is – characterising it as high, medium or low tolerance to risk. As an example, two of the 20 straightforward questions asked on the MSN Money website[1] to assess your own financial risk tolerance are:

- "How do you feel when you suffer a financial loss"?
- "How far away are your major financial goals"?

Thus, a reasonable conclusion is that a customer with a high tolerance to risk (the gambler) will have a distant acceptable risk horizon. Many more financial waves may occur before the gambler becomes significantly worried. Likewise, a customer with a low tolerance to risk will have a risk horizon closer to shore. The non-gambler would essentially prefer to stay on shore rather than get wet in the waves. Thus, their maximum risk horizon is near.

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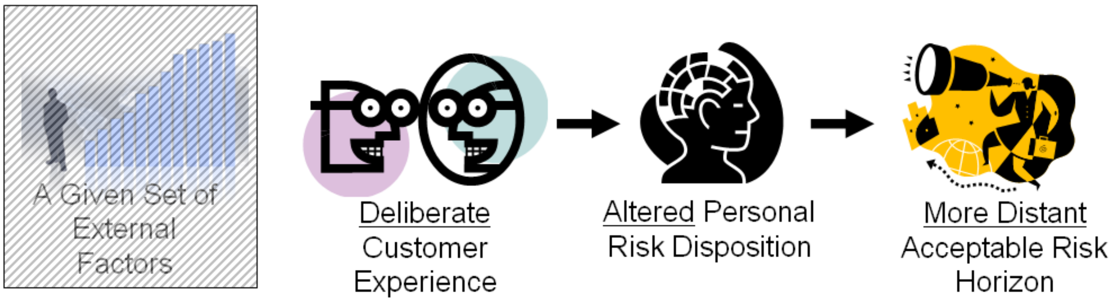
If CEM is added to the equation we get a very different and insightful perspective. CEM, properly applied presents an interesting opportunity to FSPs. Rather than just identifying a person's risk disposition as in the standard equation, CEM can potentially be used to help adjust a customer's personal disposition towards a more distant acceptable risk horizon than would be the case if the FSP did not employ CEM. The possibility presents itself once there is recognition that a customer's acceptable personal risk disposition is dependent to a significant degree on the emotional experience

[1] Go to http://moneycentral.msn.com/investor/calcs/n_riskq/main.asp to take the MSN Money risk tolerance assessment.

a customer has with a financial services provider (FSP). That is to say, an FSP that deliberately and consistently evokes particular key emotions in its customers is, in effect, creating the situation where the customer feels comfortable and more confident in expanding their risk horizon. If the FSP has done so, the customer is less likely to withdraw business and more likely to "weather the storm" in times when the external factors are adverse (eg, the US savings and loan crisis in the 1990s, the internet bust earlier in this decade, and the current sub-prime mortgage crisis in the USA).

Customer Experience Influenced Risk Horizon



For any given set of external factors (or as economists would say, if the external factors are held constant), a deliberate and consistent customer experience leads to an altered risk disposition that is at least slightly more risk tolerant.. Re-upping of risk tolerance leads to the customer's acceptable risk horizon becoming at least slightly more distant. Theoretically, the more deliberate and consistent the customer experience over time the more distant the acceptable risk horizon can be. In other words the better a FSB manages its customer experience, the more waves the customer will tolerate. Of course each individual customer will have their own starting set point. The insight is that the set point itself can be somewhat adjusted via CEM.

The other insight is that this effect is company specific. Thus, there is significant competitive advantage to be had. A person's overall risk tolerance profile will likely remain unchanged even though their company specific disposition has been adjusted. In effect, the company then has created a situation where the customer remains "calm" in turbulent times. The potential benefit of this customer calm takes several forms.:

- Loyalty – customers that simply stay with the business instead switching to a competitor or altogether opting out in rough times

- Cost Management – calm customers need less servicing in rough times and thus costs are better managed. There are less crisis related spikes to content with or at least these spikes are muted

- Advocacy – customers who feel calm in rough times are certain to demonstrate this to others and spread the word.

We are beginning to understand specifically which emotions FSPs should focus on in order to positively influence customers acceptable risk horizon. Beyond Philosophy has carried out two years of rigorous independently vetted research that identifies the emotions the drive and destroy value for

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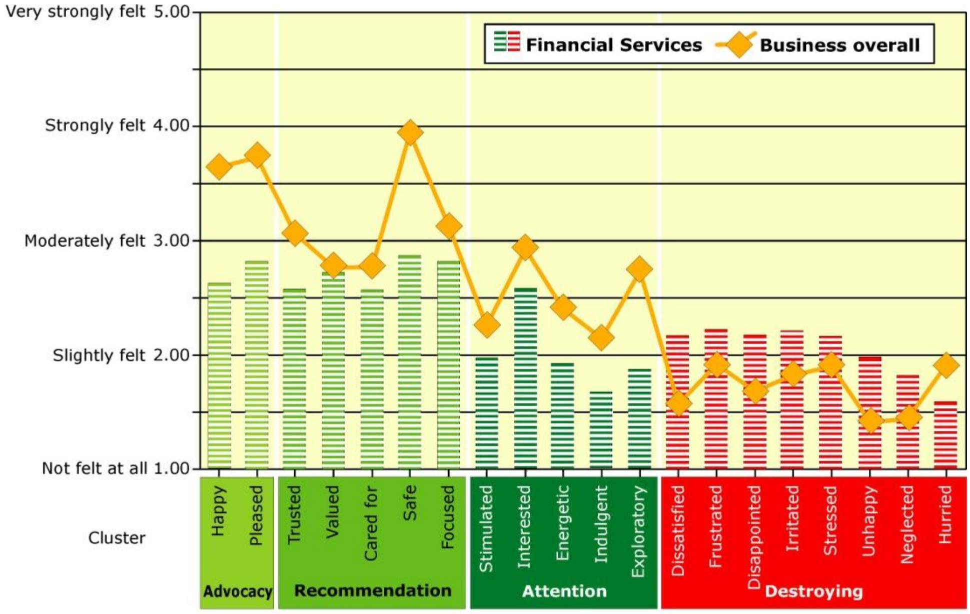
businesses."[2] It was determined that there are 20 emotions that are crucial to driving/ destroying value[3] for business in general. A variety of sectors were investigated including financial services. The emotional engagement of FSPs presents a characteristic picture. It's not pretty!



Financial Services vs Business overall

In the figure above, the "greens" represent the emotions that drive value. The "reds" represent the emotions that destroy value. In the chart, you'd want the greens as high as possible (ie, as close as possible to "very strongly felt") and the reds as low as possible (as close as possible to "not felt at all"). The line represents the average emotional engagement across all types of business (B2B and B2C). It is the truest representation of what an average customer's emotional expectation is. It is the customer's emotional engagement benchmark. The striped bars represent the level of emotional engagement for FSPs in general. The picture is not good. FSPs are higher than the benchmark on the "reds" and lower than the benchmark on the "greens". It should be pointed out that any particular company's profile will be different from the sector profile presented here.

The chart is similar in many respects to organisations that are low-end transactional in their orientation towards customer experience. These organisations tend to be solely focused on efficiency, short term gain and cost reduction. They recognise they have customers but believe that what customers really want is a fast efficient service. They usually employ some sort of customer satisfaction survey but that survey is usually only relevant to the rational side of the experience. That is to say, these companies neglect the emotional side of their own customer experience.

There are a number of insights that are relevant to the adjusted risk horizon discussion. One of these insights relates to "Safe", an emotional driver of value. There is a jarring disparity between the overall benchmark level ("strongly felt") and the FSP sector level ("just below "moderately felt"). It takes little insight to see how important this emotion is when external factors are adverse. The sub-prime mortgage crisis stemming from the USA is testament to this. Customers do not feel safe and what

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[2] Refer to "The DNA of Customer Experience: How Emotions Drive Value", Palgrave Macmillan, 2007
[3] Value equates to spend, customer satisfaction, preference, loyalty, tenure, etc.

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confidence they had has been severely shaken. The sector as a whole has been dealt a blow. As a result it is certain that cost to serve has sky rocketed for FSPs as customers seek reassurance.

For example those investors that have significant stocks positions with mortgage lenders and related supporting industries are increasingly worried about the safety of their investments. The CE Influenced Risk Horizon model presented earlier suggests that if any of these businesses had applied CEM with the expressed purpose of evoking and maximising the feeling of “safe”, many of these investors acceptable risk horizons would have been inflated leading to less worry and less need for subsequent worry related servicing.

Granted, there are several mechanisms that can lead to increased feelings of “safe” and investor confidence. Wachovia Securities reported a multi-billion dollar mortgage related loss but it’s stock prices rose 17% because investors understood that other aspects of Wachovia’s business (credit cards) are healthy. So well diversified FSPs may hedge or apply a portfolio management strategy to the problem. Less well diversified FSPs would do well to pre-emptively apply CEM as a key strategic solution to maintaining market position during turbulent times.

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