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Internet Strategies for Financial Services Companies

By

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Abstract

This paper examines the phenomenon of the Internet from the perspective of financial services companies. It argues that the “evolving actuary” is well placed to “untangle the web” by applying core actuarial skills and techniques including the actuarial control cycle. The paper goes on to identify and assess strategies that financial services companies could adopt to maximise the opportunities that this rapidly evolving new medium offers. The appendices provide a glossary of Internet terms, overviews of the state of the Internet and references to financial services web sites.

Key words - Internet, financial services, strategy, actuarial

INTERNET STRATEGIES FOR FINANCIAL SERVICES COMPANIES

1	INTRODUCTION	3
1.1	Aims of this paper.....	3
1.2	Structure of the paper.....	3
1.3	The Internet - what is it?.....	4
1.4	The Internet - what use is it?.....	4
1.5	Internet use by financial services companies.....	4
2	THE ACTUARY'S ABILITY AND APPLICATION OF THE ACTUARIAL CONTROL CYCLE	5
2.1	The actuary's ability.....	5
2.2	An application of the Actuarial Control Cycle	5
3	THE INTERNET AND FINANCIAL SERVICES - A SWOT ANALYSIS	7
3.1	SWOT analysis	7
3.2	Most important attributes	7
3.3	Table 3 – Internet Attributes - A SWOT analysis.....	7
4	IDENTIFYING AND INCORPORATING INTERNET STRATEGIES IN CORPORATE STRATEGIES	12
4.1	Strategic planning	12
4.2	Strategic use of IT.....	12
4.3	Strategic use of the Internet	13
5	FIT OF INTERNET ATTRIBUTES WITH FINANCIAL SERVICES MARKET DRIVERS	13
5.1	Market drivers.....	13
5.2	Table 5 –Fit of Internet Attributes with Financial Services Market Drivers	14
6	INTERNET "GOODNESS OF FIT" TO FINANCIAL SERVICES CATEGORIES	17
6.1	Financial Services – Categories & Products.....	17
6.2	Customer focus	17
6.3	TABLE 6 Internet "Goodness of Fit" to Financial Services Category	17
7	ASSESSMENT OF INTERNET ATTRIBUTES FIT TO CUSTOMER PROFILE	19
7.1	Customer relationships and profiles.....	19
7.2	Customer propensities to buy	19
8	CONCLUSIONS AND RECOMMENDATIONS	20
8.1	Conclusions	20
8.2	Recommendations.....	21
8.3	Acknowledgements.....	21
9	REFERENCES & BIBLIOGRAPHY	22
9.1	Hypermedia references.....	22
9.2	Other media references.....	22
APPENDICES		
	Appendix A – Glossary of Internet Terms	23
	Appendix B – State of the Internet – March 1999	27
	Appendix C – Financial Services & Related Web Sites	28
	Appendix D – Actuarial Control Cycle – An Internet Example	29
	Appendix E – Financial Services – Categories & Products	31
	Appendix F – Financial Services Market Drivers	32
	Appendix G – Customer Profile Details & Propensity to buy	33

1 INTRODUCTION

A computer does not substitute for judgment any more than a pencil substitutes for literacy. But writing without a pencil is no particular advantage.

- Robert S. McNamara - The Essence of Security

1.1 Aims of this paper

In writing this paper I have had three specific aims:

- to introduce and explain Internet concepts and practices
- to demonstrate the “evolving actuary” is well placed to “untangle the web” of the Internet by applying core actuarial skills and techniques including the actuarial control cycle
- to combine this Internet knowledge, actuarial skills and methodology with a strategic analysis to identify and assess strategies that financial services companies could adopt to maximise the gains that this rapidly evolving new medium offers

Capping these aims is an invitation to discuss your thoughts on how the Internet can add value to your financial services company, using the facts and ideas in this paper as your launch site!

1.2 Structure of the paper

The rest of Section 1 provides some basic information on what the Internet is and its uses.

Section 2 discusses the application of actuarial skills and control cycle to Internet use.

Section 3 uses a Strengths, Weaknesses, Opportunities and Threats (SWOT) analysis to identify a list of Internet attributes and comment on their current and likely future impact on the financial services industry.

Section 4 revisits traditional strategic thinking from the perspective of the Internet. It identifies degree of relevance and changes of action and emphasis required for an Internet business environment.

INTERNET STRATEGIES FOR FINANCIAL SERVICES COMPANIES

Sections 5, 6 and 7 assess how these Internet attributes relate to financial services market drivers, categories of financial services and a range of customer profiles respectively.

Section 8 draws conclusions and makes a number of recommendations on Internet strategies for readers and financial services companies.

To minimise the length of the paper and to provide a broad framework for discussion - on a subject on which probably more has been written than any other in history - I have made extensive use of tables to note the key points. To this end also, within these tables I have exercised my personal judgement of the relative importance of these key points by ranking them in my perceived order of significance at this stage of Internet development.

1.3 The Internet - what is it?

The Internet originated in the late 1960s as a distributed communications network. Now, it consists of countless inter-connected networks and computers across the world, that allow millions of people to share information. [Ref 1]. Tim Berners-Lee's extensive work led to the World Wide Web debuting in 1991. Since then the number of people using the Internet has grown from close to zero to 159 million worldwide as at March 1999 [href 1]. In Australia there are now 4.4 million people (24% of the population) on line, while in the U.S. the figure is 80 million (30% of the population). It is expected that both these numbers will rapidly increase over the next few years. For example it is predicted that in the U.S. two-thirds of households will have Internet access by 2003. [href 1]. It's "newness" brings new terminology so I have included Appendix A - A Glossary of Internet Terms, to explain the more common terms.

1.4 The Internet - what use is it?

The internet can be used to move or view anything digital – text messages as in e-mail, information / data, voice, other audio or video. Most important perhaps, it can "move" money. This is the basis for "e-commerce" or electronic commerce. This very basic and clinical description does of course hide the colour and vibrancy of the Internet – the search engines which guide you to find the elaborate web site thus giving you the information you wanted to find on almost any subject. And it accesses this now – in real time.

1.5 Internet use by financial services companies

The ultimate goal of every financial services company is to sell and service products/services to both existing and new customers on a profitable basis.

The Internet can be used both for the actual sale and the post sale service, but also for the many intermediate stages before this point is reached. The tables later in the paper list and comment on many of these areas and applications.

2 THE ACTUARY'S ABILITY AND APPLICATION OF THE ACTUARIAL CONTROL CYCLE

Computers are useless. They can only give you answers - Pablo Picasso

2.1 The actuary's ability

Trevor Matthews, in his 1997 presidential address commented "the actuary's ability to analyse complicated situations, interpret complex documentation and stand back and look at the big picture provides her with an almost unique, competency in dealing with future financial risk. Others .. are less able to provide overall comprehensive business solutions. [Ref 6].

Trevor also referred to the Society of Actuaries' mission and vision statement including "the actuarial profession's ability to provide expert advice and relevant solutions for financial and business problems involving uncertain future events".

These sentiments are echoed in Richard Mitchell's 1999 presidential address on the Evolving Actuary in his referring to the Third Wave Information Revolution. [Ref 8] He states "knowledge is power"; "the actuarial profession is knowledge based and has the potential to benefit fully from these continuing developments". He specifically refers to the recent development of "the establishment of electronic commerce and other services through the Internet".

To my mind, the Internet matches Trevor's description of an area ripe for actuaries' work very well. Being an enormous, rapidly changing mix of facts and falsehoods, intellect and emotion, using and interpreting the Internet can smother the unprepared. At the same time it can have its valuable secrets at least partially unlocked by thorough actuarial, understanding, interpretation, analysis and assessment leading to specific recommendations and expected outcomes. A particularly strong skill of the actuary in a rapidly changing and information overloaded Internet world, is the ability to learn a lot very quickly.

2.2 An application of the Actuarial Control Cycle

To illustrate how the Actuarial Control Cycle can be applied in an Internet context let's set ourselves the task of - "Assess the profitability for a life company of selling on the Internet". Appendix D - "The Actuarial Control Cycle"

INTERNET STRATEGIES FOR FINANCIAL SERVICES COMPANIES

– An Internet Example” goes through the example and, as an additional illustration, compares the major steps against a more traditional life insurance assessment of “Assess the profitability for a life company of selling a trauma product”.

A key element underlying the assessment of the profitability of such strategies for the Internet is *predicting the level of future use of the Internet* for the financial services companies’ specific target market(s). These target markets are segmented by several demographics e.g. age, sex, socio-economic grouping/income level, geographic location etc. The internet offers the potential to add a range of other factors such as spending patterns, personal preferences for different types of products, services, news information etc. This is in addition to any other information the company or it’s data source has managed to determine directly from forms filled on the Internet, “cookies” or from other on-line or database sources.

A related key element is assessing the *degree of loyalty* of existing customers in these segments. Similarly the question of *what attracts and retains people* to/at a company’s website and what from there provides the *incentive to purchase* further products / services or to go elsewhere. Analogies in life insurance actuarial work are estimated on new business volumes and mix and policyholder profiles on persistency with cause of lapse/surrender being analogous to Internet user lack of interest. The actuary is building a database of experience but in the Internet’s case the experience we want to measure is related to behaviour of potential and actual customers.

The situation is not unlike that of development of trauma products some years ago where statistics are very limited, from another market, and the mix of policyholders is changing as the Product reaches a wider audience. In both the Internet and trauma examples illustrated in Appendix D, a best estimate is made of the future based on extremely limited data and the assessment is refined as the experience is analysed and fed back into the loop.

Use of the control cycle assists us to predict the future on the basis of a very limited past and limited parallels. As actuaries we can add value by applying our understanding of financial services, the financial mathematics underlying those products, the company's financial position and our commercial approach. Where individual actuaries can combine these skills and knowledge with technical knowledge of the IT Internet framework and the tools available, we have a very powerful toolkit. The key to devising sensible Internet based solutions is putting a structure/framework to the amalgam of changing information that is the Internet and then performing logical and thorough actuarial analysis.

3 THE INTERNET AND FINANCIAL SERVICES - A SWOT ANALYSIS

There is no reason for any individual to have a computer in his home.

- Ken Olson, President, Digital Equipment, 1977

3.1 SWOT analysis

This section uses a SWOT analysis to identify a list of Internet attributes and comment on their current and likely future impact on the financial services industry. These Internet attributes are applicable to most industries and markets, not simply that of financial services. The degree of applicability to financial services and in particular to each financial services company, will vary with each attribute. To facilitate the discussions, my comments and ranking of Internet attributes within this table and tables in later sections of the paper, convey my judgement on the relative importance of these attributes to financial services.

3.2 Most important attributes

Of the 35 Internet attributes identified and recognising there is some degree of overlap across many of those, I believe the most important attributes are:

<i>Strengths</i>	Low transaction costs
	Access to lots of people
	Integration of supply and delivery chains
<i>Weaknesses</i>	"Me too"
<i>Opportunities</i>	Develop relationships
<i>Threats</i>	Instant cost comparisons
	Acceleration of competition both domestically and globally

3.3 Table 3 – Internet Attributes - A SWOT analysis

This is the most important part of the paper. The table extends over the next four pages. It identifies the strengths, weaknesses, opportunities and threats that the Internet brings to the financial services industry and ranks them by my assessment of their relative importance. I comment on the current situation and consider the future position for each of the attributes identified.

TABLE 3 Internet Attributes - A SWOT Analysis

#	Attribute	Comment - now	Comment - future
Strengths			
1	Low transaction costs	Automatic processing - no human intervention. Number of transactions can rise greatly	Economies of scale will increase as number of transactions increase
2	Access to lots of people	Customers, potential customers, Intermediaries, Employees, Suppliers, Govt. Agencies	Access to broaden further. Web TV will have a huge impact
3	Integration of supply and delivery chains	Ability to integrate supply and delivery chains electronically via the internet is the heart of E-commerce. Increased cost efficiencies, speed and satisfaction.	Is starting to explode volume wise. Important not to get left behind as an inefficient operator.
4	A payments system	With increasingly secure encryption, more people are getting comfortable with making payments over the Internet. For small monetary transactions the lower cost makes this a double strength for the provider.	It will not take long for people to become as comfortable as quoting their credit card number over the phone.
5	Rapidly increasing user volumes	Rapidly increasing by number and as % of population	Within a few years will be most of Australian population
6	Global reach	Few state or national boundaries - seamless access. Potential new markets. A global "yellow pages".	Mostly currently "developed western world". Will spread over next decade to cover more of the world.
7	Data collection	User's details are easily or automatically captured. But privacy ramifications can be a turnoff for some people.	As people become more familiar with internet mechanisms such as "cookies" expect a reaction against sites that are not open and honest about capture and use of information.
8	Self-service option	Company knowledgebases on-line enable users to search and find the information they want. Meets customer needs.	As people become more familiar with internet mechanism eg powerful search capabilities, this will become generally accepted.
9	Instant access	Speed depends on access tool - 28.8K, 56K modem, ISDN, dedicated lines via workplace, Cable modem; Also varies with Internet Service Provider, geographic location of accessor and provider	Technological advances continue at a frantic pace even with the humble copper wire. E.g. "datacasting".
10	A delivery system	If it can be expressed electronically it can be delivered via the Internet. Financial services fit the bill for Internet delivery better than most other products and services. "The dollar is digital!"	As people become more familiar and more comfortable with the Internet, the PC and the Internet are moving even more towards the centre of family financial life.

#	Attribute	Comment - now	Comment - future
11	Instantaneous update	Information accessed and entered can be truly "real-time"	People using the Internet will increasingly expect real time information and will stay with / move to those institutions that provide it.
12	Low entry barrier	An individual or small company can establish a website and/or conduct e-commerce and communicate just as easily as a large company	Will always encourage people with new ideas from within or without financial services. Large capital is not required for highly targeted market niches.
13	Choice of service level	Company can set different levels of service and interaction according to user categories eg existing client, potential client etc by use of password/PIN	Levels could be greatly increased in number and focus fine tuned
14	Relatively affluent users	As penetration of population increases, % of users in higher socio-economic groupings is diminishing	Within a few years will be a lot closer to the general population and include a lot more young people
15	Brand name promotion	Web site enables strong promotion of Brand name. Portals can enhance this presence or diminish it as a subset	Brand name recognition will become more important as the volume of sites increases and selection criteria are refined
Weaknesses			
1	"Me too"	Lost in the crowd. With so much competition, easy to be ignored.	The crowd is getting even bigger all the time!
2	Hard to attract attention	The number of Web Sites is increasing rapidly. It gets harder to stand out and attract the passing trade	Further need to run hard to stand still. Need to assess newest technologies as they emerge. Develop relationships with "portals".
3	Small portion of market	Initially only a portion of your target market is on the internet.	This will ease rapidly over the next few years as more users come on line
4	Set-up & Maintenance costs	The costs are in the initial design, implementation and the ongoing review and improvement of a co.'s e-commerce & web-site facilities. IT specialists are in demand.	Software and hardware is getting smarter all the time. Specialised labour costs are likely to stay high.
5	Hard to measure success	How does one measure the success or otherwise of the web site in terms of general awareness, brand loyalty, influence on decision to buy/not buy?	Techniques will be invented and refined in the longer term. The problem is shared by many media.

#	Attribute	Comment - now	Comment - future
Opportunities			
1	Develop relationships	E-mail can be used to develop a relationship between the company / a person within it and a customer	Will become a key differentiator within service as time goes by.
2	Target niche markets	Smaller and smaller market segmentation facilitates focussing on narrow niche markets. Databases using information collected from both individuals and companies are being used to increase sales	Refinement will continue as databases grow in size, level of detail and processing efficiency.
3	Customise interaction	The website can be designed to manage several different interactivity routes depending on the profile of the user - ie their preferences based on their choices.	No other medium has this level of interactivity. Today's home based PC mounted camera hardware and software will be tomorrow's video and PC interaction.
4	New Distribution channel	The Internet can be used to "sell" certain financial services products. This is particularly the case for "commodity" products eg mortgages, pure term cover, on-line share trading etc.	As the Internet increasingly becomes part of "normal life" so too will carrying out these functions more often on line.
5	Ability to market directly one on one	The ultimate market segmentation is one on one. In the meantime the user who presents themselves to the company via a request or an e-mail is conveying their specific needs and the organisation can directly assess if or how it can meet those needs	Refinement will continue as databases grow in size and level of detail.
6	Younger users	Children now leave school with a higher comfort level and better knowledge of the Internet than the rest of the population.	A new Internet savvy generation is emerging. The purchasing power of this group will rise exponentially so factor them into your plans!
7	New Products	The depth, flexibility, immediacy and low cost of the Internet encourages everyone to be an entrepreneur and an innovator. New products and new variations can be tailored to match narrow target markets.	Innovations will spread faster than before as the Internet increases the transparency of products.
8	Impress people	Customers and potential customers can be impressed by: 1) the professional image of the website; 2) the quality and accessibility of the information presented at the site itself or referenced sites/portal(s); 3) the timeliness and quality of the response to e-mail.	Will be a continuing need to raise service to higher and higher levels as general customer expectations rise

#	Attribute	Comment - now	Comment - future
Threats			
1	Instant cost comparisons	Products and Services of a "commodity" nature ie directly comparable can be compared against other companies quickly and easily. Some third party sites already do this.	Companies will specialise in these comparisons. Imagine on line auctions for financial services products!
2	Acceleration of competition both domestically and globally	If you're not "in" you can't win. Knowledge of products and services can now be shared and accessed easily and quickly so comparison encourages competition.	Competition will increasingly spread across international boundaries as more people appreciate the transparency of pricing on the internet.
3	Instant comparisons of products both within Australia and compared to other countries	As well as the cost comparisons, specialists or individuals who have compared policy conditions and benefits will post them to the net	The specialist knowledge basis required for Financial Services will simply slow but not prevent the development of product comparisons on the Internet as has already occurred with other products eg specialist software.
4	Strategic loss of franchise or profitability	There is a real danger of cannibalising your own business by shifting existing profitable business to a more competitive Internet environment - but if you don't some one else will!	Innovation may replace current products with more electronic equivalents eg
5	Loss of credibility in eyes of customer	Side by side with the opportunities to impress or develop relationships, is the fact that if the company fails to live up to the customer's expectation, there is a negative impact. This could happen on the technical side as well as on the service or information side.	As time goes by support systems are likely to become more complex so the risk of loss of credibility increases. Risk management controls will be critical.
6	Inflated customer expectations	People using the Internet will increasingly expect real time information and will stay with / move to those institutions that provide it.	The pace is quickening! The expectation of higher service standards in all financial services will flow on quickly from experience of instant satisfaction in other areas on the Internet.
7	Security breaches and associated costs	Privacy and security of information is a major risk in an environment where information needs to flow freely to satisfy customer needs and expectations.	The increasing complexity and value of e-commerce and the greater dependancy of companies on communication networks will lead to stronger security solutions.

4 IDENTIFYING AND INCORPORATING INTERNET STRATEGIES IN CORPORATE STRATEGIES

The radio craze will die out in time. - Thomas Edison, 1922

This section restates traditional strategic thinking from the perspective of the Internet. It sets a framework for identifying degree of relevance in assessing changes of action and emphasis required for an Internet business environment.

4.1 Strategic planning

Strategic planning can be defined [Ref 4] as the process of developing and maintaining the strategic fit between the company's goals and capabilities and its changing marketing opportunities. At the corporate level the strategy will involve defining the company's mission, setting company objectives and goals and designing the business portfolio. This translates at the business unit, product and marketing level into planning, marketing, research and product development and operational strategies. The most relevant of these in the context of Internet strategy are

- operational changes
- the setting of marketing objectives and the products/marketing strategies to accompany them

For a financial services company, defining marketing [Ref 4] as the science and practice of creating value is appropriate. Creating value includes the lowering of operating including servicing costs. Creating customer satisfaction includes increasing service levels with more targeted customer interaction. How can we use the Internet to achieve these objectives?

4.2 Strategic use of IT

In their book *Services Marketing - Australia and New Zealand*, [Ref 5] the authors state that service industries depend increasingly on the strategic use of IT which gives

- Opportunities for faster and alternative forms of service delivery
- Closer relationships with key customers
- Customised customer-service solutions
- Enhanced information
- Increases in operational efficiency - especially if the service "product" is information based

with a big risk being the costs of IT developments. It can be argued that the risk is much bigger if you do the wrong IT development(s) or fail to execute the

INTERNET STRATEGIES FOR FINANCIAL SERVICES COMPANIES

required IT development correctly, both in pure \$ terms and strategically in time or market opportunities lost. The range and depth of IT tools available for Internet and supporting back-office developments is substantial. It should be possible for financial services companies to keep the costs of aggressively pursuing Internet strategies reasonable compared to the benefits.

4.3 Strategic use of the Internet

IT has evolved from a tactical tool to a strategic weapon for service marketers. The Internet as the latest IT revolution gives even greater emphasis to each of these items.

The key strategic issue for financial services companies is how to use the Internet to create and sustain a competitive advantage.

The goals are:

- Add value for and to customers
- Bring the organisation closer to customers and suppliers
- Leverage employee's work
- Make a positive effect on the bottom line

These are the basic questions underlying my assessment of Internet Attributes against financial services market drivers, financial services categories (product types) and customer profiles.

5 FIT OF INTERNET ATTRIBUTES WITH FINANCIAL SERVICES MARKET DRIVERS

I think there is a world market for maybe five computers.

- Thomas Watson, chairman of IBM, 1943

5.1 Market drivers

In the June 1997 Institute of Actuaries of Australia paper by McGing and Polic – “Friendly Societies - Where to now” [Ref 7], in considering strategies for financial services companies, market (development) drivers were identified as :

- Critical mass
 - Distribution management
 - Market convergence
 - Brand name
 - Technology
 - Tax
 - Customer sophistication.
-

INTERNET STRATEGIES FOR FINANCIAL SERVICES COMPANIES

See Appendix F – Financial Services Market Drivers – for full definitions of these drivers.

The two years since that paper was written have seen each of these drivers remain just as critical. The financial services industry continues to rationalise globally while also seeing existing and new companies target niche markets.

This section ranks these market drivers in order of relative significance in Internet terms. It also assesses how the Internet attributes identified in the SWOT analysis in Section 3 fit with this list of financial services market drivers from an Internet strategies perspective.

The assessment is presented in the form of a table matrix – see Table 5 below. Within each set of Strengths, Weaknesses, Opportunities and Threats I have ranked the relative importance of that Internet attribute. The result of this approach is that it is possible to quickly see most important interactions of market drivers and Internet attributes. These are the cells of the matrix with a high attribute ranking (close to 1) and a high driver importance (close to 1 / on the left of the matrix).

The relative imbalance will vary by financial services company depending on it's product mix, market, size, existing distribution channels, basis of operational support including IT, modus operandi etc up to now. Readers should assess where their company lies and what strategic options lie open to it.

Key points emerging from my assessment are:

- The Internet will accelerate convergence (similar products from historically different financial institutions) and will increase competition further
- The Internet offers ways of increasing efficiency in operations, administration and contact with customers / potential customers
- Small/new and large/long established companies can all benefit from incorporating and building on different Internet attributes that are particularly suitable for their size of business

5.2 Table 5 –Fit of Internet Attributes with Financial Services Market Drivers

See next two pages.

TABLE 5 Fit of Internet Attributes to Financial Services Market Drivers								
#	Market Drivers -->	Market convergence	Critical mass	Distribution management	Brand name	Tax	Customer sophistication.	Technology
	Importance (1 is highest)-->	1	2	3	4	5	6	7
	Attribute	Ranking of 1 is my view of the most important Internet Attribute for that market driver.						
Strengths		Ranking of 2, 3 etc denote my view of declining realtive importance. * 1*, 2, 3 are in bold.						
1	Low transaction costs	* 1 *	4	6	11	12	13	* 1 *
2	Access to lots of people	10	2	* 1 *	* 1 *	6	10	7
3	Integration of supply and delivery chains	5	* 1 *	11	7	8	14	14
4	A payments system	7	5	4	5	10	5	4
5	Rapidly increasing user volumes	11	15	2	2	7	11	8
6	Global reach	4	8	8	8	3	7	15
7	Data collection	3	6	5	12	2	9	3
8	Self-service option	14	9	7	9	13	2	5
9	Instant access	8	13	14	15	4	8	13
10	A delivery system	9	7	3	4	11	6	6
11	Instantaneous update	12	14	15	13	5	3	2
12	Low entry barrier	6	11	13	14	9	15	11
13	Choice of service level	15	10	9	10	14	4	12
14	Relatively affluent users	13	12	10	6	* 1 *	* 1 *	9
15	Brand name promotion	2	3	12	3	15	12	10
Weaknesses								
1	"Me too"	* 1 *	3	2	3	* 1 *	2	5
2	Hard to attract attention	2	* 1 *	4	4	2	3	3
3	Small portion of market	3	2	3	5	4	5	4
4	Set-up & Maintenance costs	4	4	* 1 *	2	3	* 1 *	2
5	Hard to measure success	5	5	5	* 1 *	5	4	* 1 *
Opportunities								
1	Develop relationships	2	5	7	* 1 *	6	* 1 *	2
2	Target niche markets	* 1 *	4	2	5	* 1 *	4	4
3	Customise interaction	3	6	5	3	3	2	3

#	<i>Market Drivers --></i>	<i>Market convergence</i>	<i>Critical mass</i>	<i>Distribution management</i>	<i>Brand name</i>	<i>Tax</i>	<i>Customer sophistication.</i>	<i>Technology</i>
4	New Distribution channel	5	* 1 *	* 1 *	6	4	7	8
5	Ability to market directly one on one	4	7	3	2	2	3	* 1 *
6	Younger users	7	3	4	7	8	8	6
7	New Products	6	2	6	8	5	6	5
8	Impress people	8	8	8	4	7	5	7
Threats								
1	Instant cost comparisons	2	2	2	2	* 1 *	3	* 1 *
2	Acceleration of competition both domestically and globally	* 1 *	* 1 *	* 1 *	5	4	4	5
3	Instant comparisons of products both within Australia and compared to other countries	3	3	3	3	2	2	2
4	Strategic loss of franchise or profitability	4	4	6	7	3	7	3
5	Loss of credibility in eyes of customer	5	6	4	* 1 *	5	* 1 *	7
6	Inflated customer expectations	6	5	7	4	7	5	6
7	Security encroachment and associated costs	7	7	5	6	6	6	4

6 INTERNET “GOODNESS OF FIT” TO FINANCIAL SERVICES CATEGORIES

Computers in the future may weigh no more than 1.5 tons.

- Popular Mechanics, forecasting the relentless march of science, 1949

6.1 Financial Services – Categories & Products

Appendix E - Financial Services – Categories & Products, identifies eight major groups of financial services categories (product groups) within the retail section of the market. It lists the product types, the product time horizon and examples of the specific financial services and their variations. Some of these categories can also be considered part of the wholesale financial services market, but would have, in that context, quite a different Internet focus.

This section provides a framework for strategically assessing relative “goodness of fit” of the Internet for building a profitable business in each of these categories. Table 6 sets out this framework. “Goodness of fit” rankings are my own judgements and are provided as a base point from which to carry out your own company or category assessments. Going through that assessment process and the others in this paper is the key to getting to an in depth understanding of what the Internet can do for a financial services business.

6.2 Customer focus

Key points emerging from the assessment are:

- Consideration of use of the Internet rapidly shifts the focus from product to customer. The financial services market is already well down this path and the presence of the Internet will accelerate this focus on the customer and all their product needs and aspirations as opposed to specific products. Having said that, the Internet’s flexibility and ability to deal one-on-one still leaves lots of room for single product promotions or companies. The catch is that to succeed you need to be the best in the eyes of the consumer (and the cost/value comparison sites that will bloom on the Internet) and you need to attract that consumer’s attention and retain it.
- There are synergies – administrative/operational and relationship building to be gained from interacting with the customer on all their product needs as opposed to one or two.

6.3 TABLE 6 Internet “Goodness of Fit” to Financial Services Category

See next page.

TABLE 6 Internet "Goodness of Fit" to Financial Services Category							
Bought / Sold Index	Financial Services Category (Product Type)	Level of "commoditisation" (note 1)	Market Size	Market Growth	Product Value Potential	Customer Value Potential	Internet "Goodness of Fit"
	<i>(in life cycle order)</i>	<i>Low / Medium / High</i>	<i>Small / Medium / Large</i>	<i>Low / Medium / High</i>	<i>Low / Medium / High</i>	<i>Low / Medium / High</i>	Rank (1=best fit)
1	<i>Money Management</i>	Medium	Each financial services company			High from combining all	2
2	<i>Loans</i>	High	must consider for it's target market,			High from combining all	4
3	<i>General Insurance</i>	Medium	the current and potential size of the			High from combining all	5
4	<i>Health Insurance</i>	Medium	market, the expected rate of growth			High from combining all	7
8	<i>Financial Advice</i>	Low	in that market and the potential			High from combining all	8
5	<i>Risk Cover</i>	Medium	value to the company of selling those			High from combining all	6
6	<i>Asset Purchase/Sales</i>	High	products. Then reassess "Goodness			High from combining all	3
7	<i>Investment Management</i>	High	of Fit" of the Internet to the Financial Services Category.			High from combining all	1
Sold							
Note 1:	Commoditisation arises where a product is so similar to a competitor's product that the only differentiation a customer will make is price						

7 ASSESSMENT OF INTERNET ATTRIBUTES FIT TO CUSTOMER PROFILE

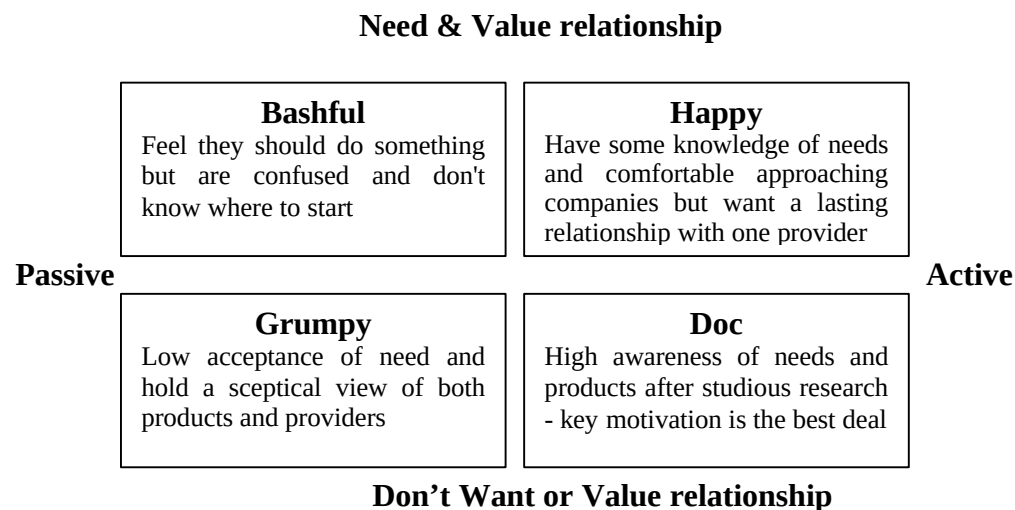
I have traveled the length and breadth of this country and talked with the best people, and I can assure you that data processing is a fad that won't last out the year.

- The editor in charge of business books for Prentice Hall, 1957

7.1 Customer relationships and profiles

Section 6 concluded, inter alia, that the Internet accelerates the market move in focus to customer from products. This section assesses how the Internet attributes identified in the SWOT analysis in section 3 fit with customer profile/types.

To illustrate a range of customer profiles I have taken the set of four distinct customer profiles which were used in a 1998 Staple Inn Actuarial Society paper by Gott et al entitled “Valuing our Customers” [Ref 3].



Further details on these profiles are shown in Appendix G – Customer Profile Details and Propensity to buy.

7.2 Customer propensities to buy

The key interest of the financial services strategy maker in these profiles is the different propensity of each customer:

- to buy one or more of the company's products and services
-

INTERNET STRATEGIES FOR FINANCIAL SERVICES COMPANIES

- to stay with the company for the longer term
- to use the company's administration services

Each of these customer actions can be addressed differently and in a more targeted manner using the Internet than has been the case heretofore. Most of the Internet strengths identified earlier are relevant. The assessments made in sections 5 and 6 should be considered in the particular light of your customers' profiles.

The key is to harness as many of these strengths simultaneously as part of your strategic approach to targeting and ultimately selecting those customers or prospective customers which have the higher propensities to purchase, stay and minimise servicing costs.

The Internet can be used effectively in

- targeting your market more accurately
- having the operations and administration infrastructure to make this successful AND to make it low cost (per unit transaction and customer.)

8 CONCLUSIONS AND RECOMMENDATIONS

It would appear that we have reached the limits of what it is possible to achieve with computer technology, although one should be careful with such statements, as they tend to sound pretty silly in 5 years - John Von Neumann (ca. 1949)

8.1 Conclusions

1. The pace at which the Internet's reach and capabilities is expanding is breathtaking.
 2. The Internet is here to stay and is rapidly integrating itself into all of our daily lives.
 3. The Internet is rapidly changing the landscape in which financial services companies operate and interact with their customers and potential customers.
 4. The Internet is increasing the level and intensity of competition.
 5. The Internet offers the ability to reduce operational and administrative costs.
 6. The Internet offers the ability to improve customer service.
 7. The Internet gives companies the opportunity to cultivate personal Internet relationships with their customers.
 8. The Internet can speed up the interaction between a company and its suppliers and customers.
-

INTERNET STRATEGIES FOR FINANCIAL SERVICES COMPANIES

9. The Internet is offering new real opportunities for those companies that are aware of the possibilities.
10. The pace of technology development and customer acceptance is such that today's strategic conclusions on use of the Internet may be different to those a few months later,
11. Actuaries, like others, need to be Internet aware, to carry out their jobs more effectively and efficiently.

8.2 Recommendations

At the personal level:

If you are not a regular Internet user already, start now! Become familiar with the Internet and its capabilities. Subscribe to an Internet Service Provider (ISP) – better still join a cable modem service and avoid the frustration of the world wide wait. Then use the Internet – send e-mail, attach files; surf the net – search for information on your favorite hobby; check the theatre listings, read book reviews, do your banking on the net; look up your super fund balances; check your frequent flyer points; buy something on line. Learn by use and enjoy the experience! It will also leave you better placed skill wise for your career in the new age of financial services the Internet is bringing!

At the financial services company level:

1. The Internet should be a key explicit consideration integrated into in all areas of strategic planning.
2. A review of how the Internet could help every aspect of the business should be carried out. A suggested order is
 - operational - internal, then external suppliers/providers, Govt.
 - customer administrative support
 - customer relationship building.
3. If the company has not got an extensive Internet strategy in place already, start with developing a strategy to keep your existing customers by establishing an Internet relationship with them. Acquiring new customers via the Internet can be a lower priority and can be tackled when the company has had some practical experience and built up some relevant knowledge.

8.3 Acknowledgements

While I take full responsibility for the content of this paper, I would like to thank Hugh McMullan, Hugh Sarjeant and Jules Gribble for reviewing various drafts and suggesting improvements.

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APPENDIX A GLOSSARY OF INTERNET TERMS**Sources**

I have sourced this glossary mostly from a mix of the glossary in the Commonwealth Govt.'s Creating a Clearway on the New Silk road [Ref 1] and the web site of Matisse Enzer [href 2].

For a more comprehensive and detailed glossary I recommend a visit to that Web site - Matisse Enzer / Internet Literary Consultants at <http://www.matisse.net/files/glossary.html>

Terms**Bandwidth**

The information-carrying capacity of computer networks includes telephone and network wiring as well as system buses, radio frequency signals and monitors. Bandwidth on the Internet is subject to a number of choke points, particularly the slower copper wiring, which mostly limits download speeds to less than 33.6 k/bits. Fibre optic cable, wireless and satellite systems allow faster data transfer. ISDN and ADSL technology allow faster transfer speeds through existing copper wire systems.

Browser

A browser is a software program allowing viewers to interact with Internet resources available on the World Wide Web. Common web browsers are Netscape Navigator and Microsoft Explorer.

Client

A software program that is used to contact and obtain data from a *Server* software program on another computer, often across a great distance. Each *Client* program is designed to work with one or more specific kinds of *Server* programs, and each *Server* requires a specific kind of *Client*. A *Web Browser* is a specific kind of *Client*.

Cookie

Cookie technology allows information on an individual Internet user's online habits to be sent across the Internet to online merchants. For example, Cookies allow online merchants and browser companies to develop a profile of users' online spending patterns and allow online merchants to tailor and customise offerings to customers on the basis of past habits.

Domain Name

A domain name is the unique name that identifies an Internet site. The Internet is made up of millions of computers and networks, all with their own domain name or unique address. Domain names always have two or more parts separated by dots. Domain names typically consist of some form of the organisation's name and a suffix that describes the type of organisation. For example, News Corporation registered the domain name 'www.news.com.au'

E-mail

(Electronic Mail) -- Messages, usually text, sent from one person to another via computer. E-mail can also be sent automatically to a large number of addresses (Mailing List).

FAQ

(Frequently Asked Questions) -- FAQs are documents that list and answer the most common questions on a particular subject.

Hit

As used in reference to the World Wide Web, "hit" means a single request from a web browser for a single item from a web server; thus in order for a web browser to display a page that contains 3 graphics, 4 "hits" would occur at the server: 1 for the *HTML* page, and one for each of the 3 graphics.

"Hits" are often used as a very rough measure of load on a server, e.g. "Our server has been getting 300,000 hits per month." Because each "hit" can represent anything from a request for a tiny document (or even a request for a missing document) all the way to a request that requires some significant extra processing (such as a complex search request), the actual load on a machine from 1 hit is almost impossible to define.

Home Page (or Homepage)

Several meanings. Originally, the web page that your browser is set to use when it starts up. The more common meaning refers to the main web page for a business, organisation, person or simply the main page out of a collection of web pages, e.g. "Check out so-and-so's new Home Page."

Host

Any computer directly connected to a network can act as a repository for services (such as e-mail, newsgroups, ftp (file transfer protocol) or *World Wide Web* borne pages) available to other computers on the network. Hosts include www.microsoft.com and www.abc.net.au.

HTML

(HyperText Markup Language) -- The coding language used to create *Hypertext* documents for use on the *World Wide Web*

Hypertext

Generally, any text that contains links to other documents - words or phrases in the document that can be chosen by a reader and which cause another document to be retrieved and displayed.

Internet

The Internet originated in the late 1960s as a distributed communications network. Now, it consists of countless inter-connected networks and computers across the world that allow millions of people to share information.

Internet backbone

This super fast network uses international telephone and dedicated undersea telecommunication networks to span the world. ISPs provide access to this network, using connections running at approximately 45 MBPS linked up at specified interconnection points.

Intranet

A private *network* inside a company or organisation that uses the same kinds of software that you would find on the public *Internet*, but that is only for internal use.

ISDN

(Integrated Services Digital Network) -- Basically a way to move more data over existing regular phone lines. It can provide speeds of roughly 128,000 bits-per-second over regular phone lines.

ISP

An Internet Service Provider is the institution with the computer system providing the Internet connection. ISPs accessed by modem and telephone line often are called dial-up services. Most ISPs have a network of servers (mail, news and the *World Wide Web*), routers, and modems attached to a permanent, high-speed Internet backbone connection. Subscribers then dial into the local network to gain Internet access without having to maintain servers, file for *domain* names, or pay for access to the *Internet backbone*.

Portal

Usually used as a marketing term to describe a Web site that is or is intended to be the first place people see when using the Web. Typically a "Portal site" has a catalogue of web sites, a search engine, or both. A Portal site may also offer e-mail and other service to entice people to use that site as their main "point of entry" (hence "portal") to the Web.

Search engine

A search engine is a type of software that creates indexes of databases or Internet sites based on file titles, key words, or the full text of files. The search engine has an interface allowing users to type their requests into a blank field. It then lists the search results. Search engines on the web return the results in *hypertext*, so users can click on any item in the list to get the actual file.

Server

A computer, or a software package, that provides a specific kind of service to *client* software running on other computers. The term can refer to a particular piece of software, such as a WWW server, or to the machine on which the software is running, e.g. Our mail server is down today, that's why e-mail isn't getting out. A single server machine could have several different server software packages running on it, thus providing many different servers to *clients* on the *network*.

URL

(Uniform Resource Locator) -- The standard way to give the address of any resource on the Internet that is part of the World Wide Web (WWW). A URL looks like this:

`http://www.matisse.net/seminars.html`
or `news:new.newusers.questions` etc.

Web, WWW

(World Wide Web) -- Frequently used (incorrectly) when referring to "The Internet", WWW has two major meanings - First, loosely used: the whole constellation of resources that can be accessed using Gopher, FTP, HTTP, telnet, USENET, WAIS and some other tools. Second, the universe of hypertext servers (HTTP servers) which are the servers that allow text, graphics, sound files, etc. to be mixed together.

APPENDIX B STATE OF THE INTERNET - MARCH 1999
Statistics***No. of people online [href 1]***

U.S.	80m	30% of population
Australia	4.4m	24% of population
U.K	11m	18% of population
New Zealand	0.6m	16% of population
Rest of world	63m	
<i>Total</i>	<i>159m</i>	<i>at March 1999</i>

Total *600-1,000m* *at December 2002 [Ref 2]*

No. of Internet Subscriptions [Ref 2]***E-Commerce revenues [Ref 2]***

	1998	2002 (projected)		1998	2002 (projected)
Australia	1.9m	4.5m		<A\$0.5b	A\$16b

A sample of what has HOT a year ago:

- Fancy looking Web sites
- Cable modems
- Encryption technology
- Portals

A sample of what is HOT Now:

- E-commerce (real!)
- Radio & video streaming
- Music download
- Internet based companies' share prices and market capitalisation
- Mergers & acquisitions

A sample of what is likely to be HOT in the coming year

- Web TV
- Mobile Internet
- Wider bandwidth
- More e-commerce

The changes illustrate the pace of the revolution!

APPENDIX C FINANCIAL SERVICES & RELATED WEB SITES**Comments**

1. The degree of sophistication of web sites varies from a basic information service to allowing on-line transactions. It varies according to the type of products and services being offered and the degree of Internet strategy adoption of the company. Of all the financial services companies sites, the on-line share trading sites would be among the most sophisticated allowing users to buy and sell shares in real time.
2. I have refrained from simply including a list of the “URLs” of financial services companies for two reasons
 - it would be very long as almost all Australian financial services companies now have a web site!
 - it hides the fact that the Internet has moved on from simply keying a WWW address directly into your browser. People now generally access such sites via a “portal” – (see Glossary). This might be your Internet Service Provider’s home page, that of a media company, your favourite PC magazine or very often one of the major search engine sites. These last sites contain directories of lists of financial services banks, insurance companies etc.
3. There is an increasing degree of common ownership across the categories and sites listed.

A selection of what’s on offer ..***Search engines***

AltaVista	http://www.altavista.yellowpages.com.au/
Yahoo	http://www.yahoo.com.au/

Media companies

Fairfax	http://www.fairfax.com.au/
NineMSN	http://ninemsn.com.au/homepage.asp

PC Magazines

Australian PC Magazine	http://apcmag.com/start/default.htm
PC Week	http://www.zdnet.com.au/pcweek/index.html

Appendix D Actuarial Control Cycle - An Internet Example			
Step / Task		Internet example	Traditional Actuarial example
Identify the task context and purpose		<i>"Assess the profitability for a life company of selling on the Internet"</i>	<i>"Assess the profitability for a life company of selling a trauma product".</i>
Collect the data			
	Collect internal statistics	on existing profile of policyholders for the specific Product	on existing profile of policyholders for the specific Product
	Collect external statistics	Collect Internet statistics on the use of the Internet by this segment of people in the wider population	Collect life and health industry, hospital & medica statistics on trauma diseases / events
Analyse the data			
	Identify assumptions for use in model later and assess variability and ranges	Determine profile of general population of Internet users	Determine profile of general population accessible through current distribution channels. Say via agents for this example
		Compare company customers demographics v Internet population in Australia	Compare co. customers demographics v life industry / general population in Aus
	Assessing mix in population	Determine profile of population of Internet users who may be interested in Financial Services. (Important to understand difference in general population v target market to understand future possible changes in co's target market.)	
		Determine profile of population of Internet users who may be interested in Financial Services (The general population and financial services sub-population is changing month by month)	
	Identify reasons for change in population profile	(a1) a move towards more equal usage by males and females (a2) towards relatively younger or older ages and (a3) towards lower income / socio-economic grouping	Population tranches - different risk factors - Sex, Occupation, socio-economic grouping
		(b) changing patterns of use – eg use of “portals” , change in major Internet co. alignments, possible more multiple use of financial services sites	

Step / Task		Internet example	Traditional Actuarial example
		(c) more and more wide ranging websites	
		(d) more sophisticated search engines	
		(e) more individuals with greater Internet knowledge	
		(f) web TV/digital TV	
		(g) extent of home versus work use etc.	
	Set demographic assumptions	number of "hits" - own site, via "portals"	
		number of pages visited / time spent - own, via "portals"	
		number of e-mails received from those visiting the website	
		% purchasing within 1, 3, 12 months	% conversions from cold calls, leads
		persistence of Internet purchasers into the future	persistence of (non Internet) Trauma business
	Set economic and other assumptions	Expense assumptions for transaction processing should be an order of magnitude lower than for non Internet transactions.	Similar methodology but likely to be higher transaction expenses and lower "one-off" acquisition expenses
Build & Run Model		Profit projection model using Product rules based on Product to be offered on the Internet	Traditional profit projection model using Trauma product rules and Agency distribution channel
Analyse results		Inter alia, compare all to model results from the company's other distribution channels	
Review assns, model (Feedback loop starts here)		Update with latest Internet information; decide on which data is misleading and replace with new model components and assns	
	Run the updated model	assess which products / target market combinations are worth pursuing. (Given the company's greater knowledge now of it's customers & potential customers)	
	Examine marginal changes	what areas need improvement/change	

APPENDIX E FINANCIAL SERVICES CATEGORIES & PRODUCTS

This table illustrates the wide range of financial services available in today's marketplace.

It is not and should not be taken as exhaustive.

The order is selected to reflect approximate "life cycle order" for a customer.

E.g. most customers' first financial service purchase is a deposit account.

<i>Financial Services Category</i>	<i>Time Horizon</i>	<i>Financial Services (Products) provided</i>	<i>Some further variations</i>
Money Management	Short term (≤ 5 yr)	Deposit / cheque accounts Credit Card	
Loans	Short term (≤ 5 yr) Longer term	Personal Home Loan/Mortgage	Secured/Unsecured Residential / Investment
General Insurance	Short term (≤ 5 yr)	Motor Insurance Buildings Insurance Contents Insurance Liability Professional Indemnity	3rd party/F&T/Comp Workcover
Health Insurance	Short term / Long term	Hospital Coverage	Plan levels, "Extras"
Financial Advice	Short term / Long term	Financial planning	
Risk Cover	Short term / Long term	Term Trauma/Crisis/Critical Illness Personal Accident Disability Income	YRT, Mortgage Prot'n
Asset Purchase/Sales	Short term / Long term	Stockbroker Real estate agent	Discount broker
Investment Management	Short term (≤ 5 yr) Longer term	Term Deposits Pass Book accounts Cash Management Unit Trusts Life Insurance Savings policies Life Insurance Savings policies Friendly Societies Bonds Life Insurance Co Bonds Superannuation policies Immediate Annuities	Managed/Capital Gntd Endowment/Whole Life

APPENDIX F FINANCIAL SERVICES MARKET DRIVERS

These definitions are taken directly from Section 6 - Strategies for Friendly Societies - of the paper *Friendly Societies - Where to now?* Sean McGing and Julian Polic [Ref 7]

Financial Services Market Development

We have identified a number of 'drivers' in the financial services market which need to be allowed for in formulating strategies for success.

Assessment of Market Drivers

Critical Mass - in order to manage fixed costs/overheads at a competitive level and to generate sufficient cash to invest in brand awareness a critical mass will need to be achieved.

Distribution Management - matching the most appropriate distribution channel to the products offered and target market(s) will need to be balanced against the expense of doing so. Distribution management will need to be able to manage the sometimes conflicting demands of each channel.

Market Convergence - regulatory convergence, product convergence and blurring of institutional, and therefore competitor distinctions will increase competition.

Brand name - as the distinctions between the products and services provided become blurred more focus will be paid to the image and reputation of the provider.

Technology - this has the potential to alter the competitive playing field in terms of both distribution and profitability. The resources to acquire the appropriate technology could very well be a function of critical mass and the need to do so is dependent on the target market and its requirements.

Tax - as the tax regime moves toward taxing products similar in substance on a similar basis it becomes less likely that tax will favour a particular provider structure over another. This further promotes a level playing field and greater competition.

Customer Sophistication - this leads to the customer questioning the value of the service provided and looking at alternatives. As the level of sophistication increases customers will become more demanding thus providing opportunities for competitors.

APPENDIX G CUSTOMER PROFILE DETAILS & PROPENSITY TO BUY

These details are taken from Section 6 and Appendix 4 of the paper *Valuing Our Customers* by David Gott, Gavin Jordan, Dave Mynott and Russell Ward – Staple Inn Actuarial Society - 1998 [Ref 3]

Customer Profiles

Our first step was to establish a set of customer profiles based on how customers want to do business with a financial services provider. The table in Section 7 of this paper illustrates the profiles used (the names being based on well known Disney characters).

Some implications for the customer management process from this simple classification are:

Bashful - the company must adopt a proactive approach to both establishing initial contact and then maintaining the relationship. Patience, empathy and clarity in all contact will be critical to success. The result may well be higher customer acquisition and servicing costs than for some other types. However, properly managed these could be your most loyal and ultimately profitable customers.

Happy - the company must provide excellent service to maintain the relationship. Important features are likely to be respect for the customer's knowledge, regular provision of information on current holdings, new opportunities and general financial issues and recognition of the customer's value.

Grumpy - these customers may ultimately be acquired but the costs of bringing them round will be high. Excellent relationship maintenance may improve their persistency but again at what cost. Ultimately, most of these customers will be loss makers and the company should identify and avoid them.

Doc - there will be little the company can do to influence the acquisition of these customers (other than offer the best financial deal and ensure that customers are aware of the availability of the company's products). The servicing approach must be efficient and professional whilst recognising that no amount of carefully considered management is likely to build loyalty.

INTERNET STRATEGIES FOR FINANCIAL SERVICES COMPANIES

Differences in some of the key attributes we might expect include

- The more active customers would be expected to have a higher propensity to buy financial services products. However, once contact is established, the company might experience better relative conversion of the passive types - they are less likely to consider alternative providers.
- More active customers should buy earlier in their lifetimes.
- Those who value a relationship with their provider are more likely to exhibit better persistency.
- Repurchase rates should be higher for those who value a relationship. The potential to improve repurchase rates will be much greater for customers who value their relationship with the provider.

Propensities To Buy

This part of the model consists of three elements:

- the probability that the customer buys a particular financial services product at all i.e. from any provider in the market,
- the probability that if the customer buys a particular product it is from our company,
- the distribution of purchase probabilities over the customer's lifetime.

The probabilities of buying the products and those of buying from our company given an initial contact has been made are driven by our customer profiles. The more active seekers of financial services (Doc & Happy) are more likely to buy each product. However, given an initial contact with each customer type the company has a better relative chance of converting the more passive types - they are less likely to consider alternative providers.
