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Customer Profitability and Customer Relationship Management at RBC Financial Group (Abridged)

- (1) *Who are our most important customers? (2) How do we put them in charge of our Company?*
— Screen saver¹ on the computer of Kevin Purkiss, senior manager, Customer Value Analytics.

Introduction

Richard McLaughlin looked again at the latest customer profitability reports. The new data mining capability that RBC Financial Group had pioneered was astonishing. The good news was that customer, customer segment, and product profitability numbers were more comprehensive and accurate than with the Bank's old profitability model. The bad news was that those precise numbers clearly showed major losses in the Bank's personal checking accounts. McLaughlin knew the Bank was also struggling with its seventh out of eight ranking among financial institutions in the Bank's internal value for money study. The Canadian public increasingly wanted value and personal service from its Banks. Competition among Canada's leading financial institutions was fierce as the industry responded to deregulation and new niche-market entrants. McLaughlin thoughts turned to how he would present this information to the Bank's segment and product managers, and questioned how the Bank should respond:

Now we have real customer profitability numbers and, through our customer relationship management (CRM) tools, we know an awful lot about customer preferences and needs. The question is, what do we do with this information? How can the Bank derive value from CRM and customer profitability? How can we turn unprofitable customers and products into profitable ones? Is there a way to enhance the Bank's value in the eyes of the banking public? How can we put the whole picture together and make decisions that work for both the Bank and our customers?

¹ Downloaded from <http://www.fastcompany.com/homepage>.

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RBC Financial Group

RBC Financial Group entered the tumultuous twenty-first century as Canada's leading bank. With Canada's finance industry in flux from changes in banking regulations, many smaller banks changed their focus away from retail banking or were acquired by larger banks. In the early part of the new century, RBC emerged as one of Canada's few full-service, national, and international financial institutions.

RBC Financial Group, headquartered in Toronto, had five main lines of business: personal and commercial (retail) banking (RBC Royal Bank), insurance (RBC Insurance), wealth management (RBC Investments), corporate and investment banking (RBC Capital Markets), and transaction processing (RBC Global Services). Canada's largest bank when measured by assets and market capitalization, RBC owned \$270 billion² in assets, had 23 million retail accounts,³ 700 products, 58,000 employees and served 10 million personal, commercial, corporate, and public sector customers in North America and around the world.

RBC Royal Bank (Royal Bank), which accounted for 50% of RBC's cash net income, had an extensive delivery network that included 1,300 branches, 4,800 automated banking machines (ABMs), 87,250 proprietary point-of-sale terminals, over 900 mobile sales staff, 1.4 million online banking customers, and 2 million telephone banking customers. The Bank also boasted an international network that included 300 offices in over 30 countries. The personal banking division encompassed consumer and small business banking and loans, while the commercial side served larger companies earning \$5 million to \$25 million. The multinational corporations were covered under the corporate and investment-banking business line and were not a part of Royal Bank. Royal Bank also included Card Services, which provided Visa credit cards and debit cards; RBC Centura, a U.S. retail bank acquired in June 2001; and RBC Prism, a U.S. mortgage originator.

History of RBC Financial Group

In the post-war era beginning in 1946, the Royal Bank devised the philosophy of being "all things to all people." It began an expansion nationally and internationally that broadened its delivery network, while simultaneously developing new products and services. In the 1960s and 1970s, the Bank increased its commitment to technology and decentralization in response to changing market conditions. In 1968, 25 automatic banking machines (ABMs) were added to domestic operations.⁴ During that time, the Royal Bank was already employing technology and a customer orientation philosophy to gain a competitive edge. As one history of the Bank cited:

The 1971 Annual Report provided an interesting account of how automated back-room transactions improved both the cost and quality of operations ... this also helped to free up front-line people to deliver the services that required a personal touch. New possibilities for specialization were directed toward improving service to the customer.⁵

² All financial data reported in Canadian Dollars.

³ Canadian population was estimated at 30.75 million in 2000, with the largest concentration of people in Ontario, Quebec, and British Columbia. Average income after taxes for two people or more in the same household averaged \$49,626 in 1998 (statistics provided by: www.statcan.ca, accessed August 27, 2001.)

⁴ James L. Darroch, *Canadian Banks and Global Competitiveness* (McGill-Queen's University Press 1994), p. 136.

⁵ *Ibid.*

The 1980s were turbulent times for Canadian banks, as changes to the Bank Act of 1871⁶ allowed foreign competitors limited access in the Canadian market (1980), and deregulation of the financial industry (1986 and 1987). Deregulation allowed crossover between the “four pillars”—banking, trust⁷, securities, and insurance—which had been kept separate since the original Bank Act.

Royal Bank responded by purchasing companies that allowed it to become a fully integrated financial service institution. By 1989 Royal had entered the securities market with a bang, capturing 50% of the mutual fund (offered through banks) market. In addition:

The 1990 acquisition of 70% of Marcil Trust Company, specialists in real estate, strengthened [Royal Bank’s] base in the trust industry. [...] Market-share received increased attention during the period because it was viewed both as a condition and a measure of success: size was important. The Royal did not intend to participate in domestic markets that it could not dominate. [...]

[I]n ... 1992, the Royal was the first to offer group retirement products. The thrust was to develop relationships with different target markets by offering products and delivery mechanisms that made customer feel comfortable as they discussed their personal financial affairs. Transactions at a teller’s wicket were no longer the model. Now bankers had to listen.⁸

Current Environment

Throughout most of Canadian banking history, the six largest Canadian banks enjoyed a relatively undifferentiated and “friendly competition” industry structure. By the late 1990s, however, changes were on the horizon. The advent of Internet banking and the continued lowering of protections for domestic banks spelled an end to the banking oligopoly. While the Internet represented both opportunities and threats, the insurgence of foreign banks coupled with the minister of finance’s halting of two important mergers was a warning call to Canada’s banks that they would soon face competition from large out-of-country banks that could rival or exceed their own resources.⁹

While the big banks cast one wary eye offshore, the other was trained on the small Internet upstarts that threatened to eat away at their bread and butter personal and small business accounts. Being “all things to all people” suddenly became a lot harder.

Kevin Purkiss, senior manager, customer value analytics, summed up Royal Bank’s perception of the competitive landscape:

We perceive TD Canada Trust as our nearest and most aggressive competitor at least as far as a full service bank is concerned. The rest of the large banks have slightly differentiated

⁶ The Bank Act of 1871 created chartered banks that could engage only in banking. The Bank Act and charters were to be reviewed every 10 years. (Darroch, Appendix Two).

⁷ Canadian Trusts were similar to U.S. Savings and Loans. They were typically smaller, regional companies that issued mortgages, set up and administered deposit accounts, wills, trust accounts, and engaged in estate planning. Some Trusts offered specialized investment services. Prior to deregulation, Trusts were the only financial entities allowed to issue mortgages.

⁸ Darroch, pp. 146-147.

⁹ Jordan Kendall, with Bruce D. Temkin, Emily Gaszynski, and Charles Finlay, The Forrester Report, *Canada’s Big Banks Unravel*, May 2001, pp. 6-12.

strategies in line with their expertise. The Bank of Nova Scotia, for example, has been redefining itself as a retail multi-national bank. CIBC (Canadian Imperial Bank of Commerce), the second-largest bank in Canada, is the largest bank credit card issuer and is also a close competitor in the Canadian mortgage market.

Other types of competitors pose different threats. What we think of as non-traditional competitors entered the market with specialized products and low costs. ING Bank of Canada, for example, is a virtual bank that offers a very attractive rate on deposit accounts. In order to access the deposit account, the customer must transfer money from their existing checking account (in a rival brick and mortar bank) to ING's electronic repository. ING can offer high rates because it does not have the physical infrastructure that a bank like RBC Royal Bank has to maintain. ING has since expanded into a more complete product offering including mortgages and loans.

Another emerging market is in "white labeling" or the use of bank services by non-bank companies. For example, one of Canada's largest supermarkets, Loblaw's, recently partnered with a division of CIBC to offer President's Choice Financial Services, which includes no-fee banking and a discount on groceries to Loblaw's customers. CIBC is providing the service, but it is marketed as a Loblaw service and physically located in the supermarket.

The common denominator in all these new products and markets is the customer. How a financial entity focuses on customer needs is the differentiation point in our industry right now.

Developing a CRM Philosophy

The ultimate goal of CRM was to bring together in one place a view of all contacts, transactions, accounts and interactions with each customer. A financial institution's fully integrated CRM system could allow its personal bankers (PBs) to access a customer's transaction history. For example, the ideal CRM system could provide the following information to PBs¹⁰ when triggered by a customer call or visit:

- address, age, and account balances,
- all contacts the customer had at any company location, phone center, or Internet site,
- what level of service the customer qualified for, based on current and future profitability,
- what products the customer held at the time of the call,
- what products the customer was targeted/approved for by sales and marketing,
- how the customer responded to targeted direct marketing campaigns.

Although the benefits promised to be great, CRM was expensive and difficult to deploy, particularly on a large scale. One U.S. industry journal survey in 2001 reported found that "although the vast majority of respondents—78%—consider CRM critical, just 35% have actually implemented it."¹¹ Costs could run into the millions for enterprise-wide systems. Various roadblocks stymied

¹⁰ Royal Bank did not necessarily provide or want to provide this kind of information directly to the desktop due to client confidentiality and privacy.

¹¹ Mario Apicella and Tom Yager, "Solid CRM is Difficult, but not Impossible," *InfoWorld*, April 16, 2001, <http://proquest.com>, accessed May 3, 2000, p. 55.

successful implementation, such as budget constraints, lack of coordination and cooperation within companies, lack of management commitment, unsupportive cultural climate, and inadequate technological infrastructure.¹²

Companies most successful with CRM created ongoing repeat purchase relationships with their customers and had the resources and infrastructure to capture detailed data about the customer's behavior when the customer purchased, used, and repurchased their products and services. Industries in which companies had made inroads to CRM included airlines, auto manufacturers, and financial services.

CRM at Royal Bank The seeds of the CRM program at Royal Bank were sown in 1997 as the result of several marketing projects within the Bank. The Strategic Marketing Research and Analytics (SMR&A) group had been conducting brand research, as well as segmentation and predictive modeling using information from Royal Bank's data mart.¹³ This research was conducted with the objective of determining the image perceptions of major financial institutions and identifying the optimum positioning for RBC Royal Bank. In response to the competitive pressures nipping at its heels, Royal Bank wanted to actively use the information that it had been collecting on its customers to interact with them in a more informed way.

One study conducted in 1997 asked 2,000 customers of the large Canadian financial institutions (FIs) what aspects of banking they most highly valued and juxtaposed those findings with an assessment of FI strengths (see **Exhibit 1**). The results created the "burning platform" for CRM within the Bank. As Gaétane Lefebvre, vice president of SMR&A, explained:

What was most important to the customer was customer intimacy. It encompassed issues such as trust, reassurance, a feeling that the bank knows them, understands their needs, recognizes who they are and values their business. Conversely, banks offered more concrete things like large branch and ATM networks, convenient hours, and easy access to accounts.

Richard McLaughlin, vice president of CRM and information management, added:

Conventional wisdom up until this point was that the key differentiating factor for banks was a 24/7 call center and a branch on every corner. This study identified a whole new area of differentiation that Royal could explore.

Differentiation among the leading Canadian banks in the newly competitive environment was highly sought after. CRM was pitched up the ranks from marketing to the head office of Royal Bank as a business philosophy crucial for developing an expertise in customer intimacy. Royal Bank chose to deploy CRM in points of contact critical to the customer experience such as call centers, branches, and direct mail.

Reorganization around CRM

Primary customer segments; Key, Growth, and Prime, were used to realign Royal Bank's business (see **Exhibit 2**). As Kevin Purkiss explained:

¹² Ibid.

¹³ The data mart at Royal Bank used a hardware platform provided by NCR called TeraData, which housed the Bank's customer information files.

The segment structure reflects life stages and the complexity of their financial needs. The groupings also reflect commonalities in service and product requirements. The interesting part to note is that the current profitability between these groups is quite different. For example, the Key group comprises four sub-segments—Youth, Nexus, Small Business, and Farming & Lifestyle Agriculture. These sub-segments have low current value, but many within these sub-segments have the potential to provide higher levels of profit for the Bank.

The Growth stage represents clients in mid-life, and/or businesses that are still growing their assets and have high credit and financial advisory needs. Our strategy is to retain, grow, and consolidate these relationships.

The Prime grouping consists of more mature customers in the accumulation and preservation phases with significant potential for full RBCFG offerings. The value proposition for the Prime segment is trusted service and referral to specialized resources.

Segment managers competed for resources along with product managers and functional area managers. This “friendly competition” was designed to foster close collaboration between functional areas, product and segment managers, and centers of expertise (such as marketing, CRM, and SMR&A). (See Exhibits 3a and b.)

The change, of course, was not entirely seamless. Richard McLaughlin recalled some of the resistance met by the new customer centered organization:

We had some very traditional product and functional silos in this organization that had limited motivation for moving toward a more customer centered framework. Part of the problem was our inability to fully communicate about how things would work. Our corporate processes were executed more from consensus and conversations than a clear road map, so when we started to insert new processes, we received some response that it would slow people’s decision making down. Another problem was the power shift. We were taking some power out the product managers and putting it in the customer manager’s realm. To make matters worse, customer managers tended to be marketing people, while product managers tended to be bankers. There was not a lot of understanding between the two groups about what each could bring to the table.

The consolidation of the regional sales and marketing groups meant that instead of calling regional offices for lead lists, branches received lists from the sales and marketing office in Toronto. Royal Bank also created a small, specialized group that produced ad-hoc or follow-up leads as requested by the branch. The goal was to replace the often-haphazard sales lead process at the local level with centralized and standardized sales leads.

Account Manager for Investments (AMI) Jamie Reich explained how the process of building and using sales leads had changed since the Bank adopted CRM:

Before CRM, every branch had a different way to generate sales leads and account managers were responsible for creating their own lists. One way to do this was to go to the regional credit department and ask for a list of people age 25 to 45 who held at least three products, for example. After a while the department would generate a list based on your query, and you’d make calls off that list. The leads were based on how good a query you put in, and you got new lists depending on when you had time to stop by the credit department. It wasn’t very consistent or accessible across all branches.

Now, the leads are generated centrally and everyone has direct access to them. The leads have gone from paper based to being available electronically. I also have seen the leads

improve from rather generic to more customized. For example, I used to get a lot of leads for customers who might be interested in credit products. These weren't very helpful to me since I deal mainly in investments. Lately, the lead lists sent to me have been much more focused on investments and products that are of real interest to my customers.

Reich's job was to manage the accounts of customers that were chosen¹⁴ for the Bank's relationship banking program. The program provided clients with a personal contact at the Bank who coordinated all aspects of the client's business with the Bank, from issuing mortgages, to lines of credit, to investment accounts. Reich managed roughly 200 clients at RBC Royal Bank's main Toronto branch. In a typical week, Reich would speak to twenty of his customers on the phone and meet another ten in his office. CRM helped him and other account managers work more efficiently. As Reich explained:

Account managers know their customers and know what their needs are, but these electronic lead lists help us to remember to call and offer products. They also save us time and are generating better and better leads for new clients.

Richard McLaughlin explained how centralizing profitability measurement in the corporate office freed the frontline staff from having to collect customer information:

We reach a decision in the central office, based on our information and analysis, about how valuable the customer is or will be. We then inform the sales person who works directly with the customer. This process eliminates the need for a salesperson to capture and process customer information.

In addition to allowing the Bank to centralize sales lead generation, locating the sales and marketing groups in Toronto also made it easier for them to interface with SMR&A, CRM, and information management teams. One of the areas where these groups collaborated was in using current and future customer profitability to determine targeted direct marketing campaigns, levels of customer service and other customer-oriented decision-making.

Customer Profitability and Potential Measurement at Royal Bank

Royal Bank had been experimenting with customer profitability measurement since the early 1990s. The marketing group deployed a model on the personal banking side in 1992 that used aggregate information rather than actual data. The Bank analyzed its then customer base of approximately 8 million customers and distributed the customer profit over deciles. The Bank learned that roughly 20% of its customers accounted for 100% of its profit. As Kevin Purkiss explained:

The model placed customers into three large "buckets": A, B, and C. The "A" customers made the most profit, the "B" customers made some, and the "C" customers broke even or lost money. This information was distributed to the field office. It helped align the sales force around customer profitability and planted the seeds for the new customer-centric organization. However, it wasn't refined enough for advanced channel optimization or relationship pricing. In addition, we realized later that in some instances, customers were treated without consideration of the potential business they could contribute.

¹⁴ Customers were chosen for the AMI program based on their current and potential profitability.

About the time Richard McLaughlin was hired to head the CRM implementation, the Bank realized it needed a “more robust profitability measurement.” The search was on for a better model. By 1998, marketing had developed a prototype of the model it wanted to employ. The group went shopping for software packages that would fit the bill. While none seemed to be exactly right, the Bank found that NCR was developing a package called Value Analyzer that looked promising.¹⁵ The Bank agreed to serve as a “beta site” for NCR, while tailoring Value Analyzer to its needs. The software promised to make profitability calculations much faster. The high volume and complexity of the Bank’s accounts required high processing power. Since many groups depended on this information downstream, the raw data had to be processed within a few hours.

The SMR&A group was quite excited about the level of detail that this new model promised to deliver. As Purkiss explained: “The new model was to be a vast improvement over the 1992 measurement system. We would be going from using muskets to rifles, or from having a machete to a scalpel.”

Once Value Analyzer came on line, the Bank found that profitability rankings changed by at least two deciles for 70% of customers. More accurate spread information, customer specific risk assessments, transaction based fee and costs elements contributed to these changes. However, the Bank realized that customer profitability calculations were not enough. As Lefebvre explained:

We came to understand that customers can be both profitable and have the potential to be profitable, and that the bank needs both kinds of customers. One big “Aha” came when we realized we had very deep relationships with wealth preservers, but very weak relationships with younger segments. We needed to shift our approach. We became willing to invest in some sub-segments such as Nexus, in order to nurture our relationship with potentially profitable customers. The customer potential calculation enabled us to determine on which customers we would be willing to take losses in the short term. SMR&A developed the notion of potential in 1997. This was part of the original reason for adopting CRM.

Our new strategy was to look at our customers’ total holdings and figure out how to deepen their relationship with the bank if they had potential. For example, were we losing opportunities to sell products to those customers? Are potentially profitable and profitable customers being lured away?

Royal Bank found that truly useful customer profitability models had to begin with detailed, accurate, account or customer level activity based costing information. Without this infusion of real data and accurate activity driver rates, customer profitability was scattershot. (See **Exhibit 4**.)

In addition to calculating current profitability for customers and customer segments, Royal Bank also began experimenting with ways to measure future profitability and lifetime value. The Bank looked at two ways to measure lifetime value, (1) assuming that the current profitability percentile of the customer would remain constant throughout his or her projected lifetime and calculating the present value of those profits, and (2) factoring in other variables such as: age, tenure with the Bank, number of products held, probability of acquisition (how likely to add products to portfolio), and attrition (of products). Lifetime value was calculated individually and could be aggregated up to segment level.

¹⁵ Other companies marketing CRM software at the time were: ABC Technologies, PeopleSoft, PMG Systems, Oracle, Fiserv IPS/Sendero, HNC Financial Solutions, and Metavante (Meridien Research, “Putting ABC into Customer Profitability,” *Customer Knowledge*, vol. 4, no. 1, September 27, 2000, p. 10.)

Using Customer Profitability for Customer Decisioning

Once the Bank determined customer profitability and lifetime value, it included those measures when determining customer decisions. For Royal Bank, decisioning encompassed customized marketing campaigns, alignment of pricing discretion, and alignment of level of service based on depth (how many products held) and potential (lifetime value) of a relationship.

As Gaétane Lefebvre explained:

Customer decisioning refers to the customer strategies that are built in our decision engine. This engine contains a multitude of category trees. One of the most significant trees leverages four strategic predictive models: profitability, client (credit) risk, client vulnerability (how vulnerable the Bank is to losing the client), and lifetime value. Depending on how people rate, (high, medium, or low) for each model, they are placed into one of fourteen categories, for which the Bank will have a primary objective: to retain, grow, manage client risk, or optimize costs. We can then use these categories (or grouping of categories) for marketing effectiveness, courtesy overdraft, allocation of rate discretion, and differentiated service. These categories are a proxy for the Bank's objectives, while the segments (such as Nexus and Wealth Accumulators) are a proxy for the client's needs. We strongly believe that it is the alignment of the Bank's and customers' objectives, which will allow us to differentiate ourselves in the marketplace. (See Exhibit 5.)

Although the marketing department started working with customer lifetime value and segmentation, the information given to the branches was limited to a profitability ranking that continued to use the three bucket (A, B, and C) system. Detailed information on segmentation was not disseminated to the branches.

Customized Marketing Campaigns

Customer profitability was one of the primary determinants the Bank used to segment its customers into groupings and sub-groupings in order to target these groups for marketing campaigns. SMR&A also conducted studies on customer segment goals, needs, likes and dislikes, the types of products from which they would most likely benefit, and developed models to determine their propensity to buy. Using this information, SMR&A targeted customers within segments or sub-segments for certain products, offers, and marketing channels (such as direct mail, telephone solicitation, or an in-person sales call).

As one report explained:

At the Royal Bank, the nine million personal retail clients are segmented into discrete segments based on attitudinal and behavioral factors, current and potential profitability, expected purchasing behavior, vulnerabilities, and channel preferences. Strategies are then developed, not only for each segment but also for hundreds of micro-segments within each segment—the ultimate objective of this quest being one-to-one marketing. Individual treatment strategies can be tested on small cells of clients to establish what works and what doesn't, and to test refinements on a continuing basis.¹⁶

¹⁶ NCR Case Study, "Royal Bank Finds Micro Markets with NCR Tool," <http://www.NCR.com> (accessed April 25, 2001), p. 5.

Rather than passing raw data on to the customer contact points, SMR&A inserted the sales leads into the customer's file. Purkiss described a typical scenario for a customer coming into a branch seeking to open a line of credit:

The customer enters the branch and gives the account manager her Royal Bank client card. Once it is swiped into the computer, the manager can access the client file, which includes information on her age, address, and what products she holds. It also notes that she has been targeted for a particular line of credit product. That information guides the manager through the interaction with the client. He no longer has to ask her for every detail about where she lives or what her financial situation is. He knows instantly that she is eligible for a credit line and can quickly and confidently answer her questions. This process is much more efficient and it eliminates a lot of stress for the customer. It also empowers the branches to make better, more informed decisions because they have good information at their fingertips. We don't pass on the specific customer category or segment information to the branches. We want our branch personnel to focus on the customer, not the category.

Levels of Service

The Bank also determined a set of customer treatment strategies—such as the decision to offer pre-approved credit for credit lines—by the customer segment and category.

Lefebvre described one example of how the Bank planned to use present and future profitability to help determine levels of service:

We are beginning to use the customer's category assignment to determine the length of wait time and the type of customer service representative that the customer talks to at our telephone-banking center. We always want to ensure that our very best clients, in terms of profitability and lifetime value, get the very best service. That's how we retain good customers.

Product Design and Pricing

Reich's decision The CRM system used customer profitability and future potential calculations to give pricing parameters to account managers like Jaime Reich. CRM and customer profitability was being used more and more by account managers to make difficult decisions on which customers to cultivate, how to treat existing customers, what products to offer, and what pricing levels were appropriate. Reich described his interactions with clients:

Usually in the early part of the relationship, customers tend to negotiate pricing. In general, products are priced appropriately and we do not need to give special deals, since the sales leads on our computer already have discretionary pricing built in. Once clients realize that the Bank's rates are competitive, they start to trust me and negotiate less. For the vast majority of clients, the pricing on our products is sufficient to make them happy. It is quite rare for me to seek approval for a better price from my manager.

Those rare instances usually came about because of some new piece of information unknown to the CRM system. One example of such a decision was an instance when one of Reich's clients, a long-term and important customer of the Bank, introduced him to her niece, a 23-year-old MBA who recently graduated from business school and who was not in the AMI program.

The niece was hoping to get a position with a Toronto advertising firm, but was currently unemployed. She had accompanied her aunt to Reich's office in order to request a car loan. She wanted to get a loan with the Bank, the niece explained, because the Bank had a more flexible loan program than the dealership. Although Reich did not ordinarily work with Bank customers that were not in the AMI program, he looked up the niece's profile on the Bank's customer relationship management (CRM) system. The system, which calculated the rate discretion for a customer based on their potential and profit, allowed her a maximum of a one-percent discount. The standard rate for the niece was prime plus 5%. The problem was that the niece wanted Reich to match what the dealership was offering—prime plus two and one-half percent.

Reich knew that making the niece a loan at prime plus 2 ½ would be extremely difficult. He would have to go to his manager and argue the case that the Bank should make an exception for this customer, and even then it was doubtful he would get more than a 1% additional discount. Although Reich did not have access to the actual profit and potential information on this customer, he did know that she held a savings and a checking account with the Bank and had historically low balances in both (see **Exhibit 6**). To complicate matters further, the niece had told Reich that although she had a competitor's credit card, she currently did not hold one of the Bank's credit cards. Reich knew that there was a very high likelihood that the CRM system would eventually prompt a personal banking representative to attempt to sell her a credit card.

In order to provide this customer with the loan rate she wanted, Reich would have to persuade his manager that doing so was a good move for the Bank. The questions in Reich's mind as he mulled his decision were: was this really the best use of the Bank's funds? Would she take the credit card if he did not give her the rate she wanted on her car loan?

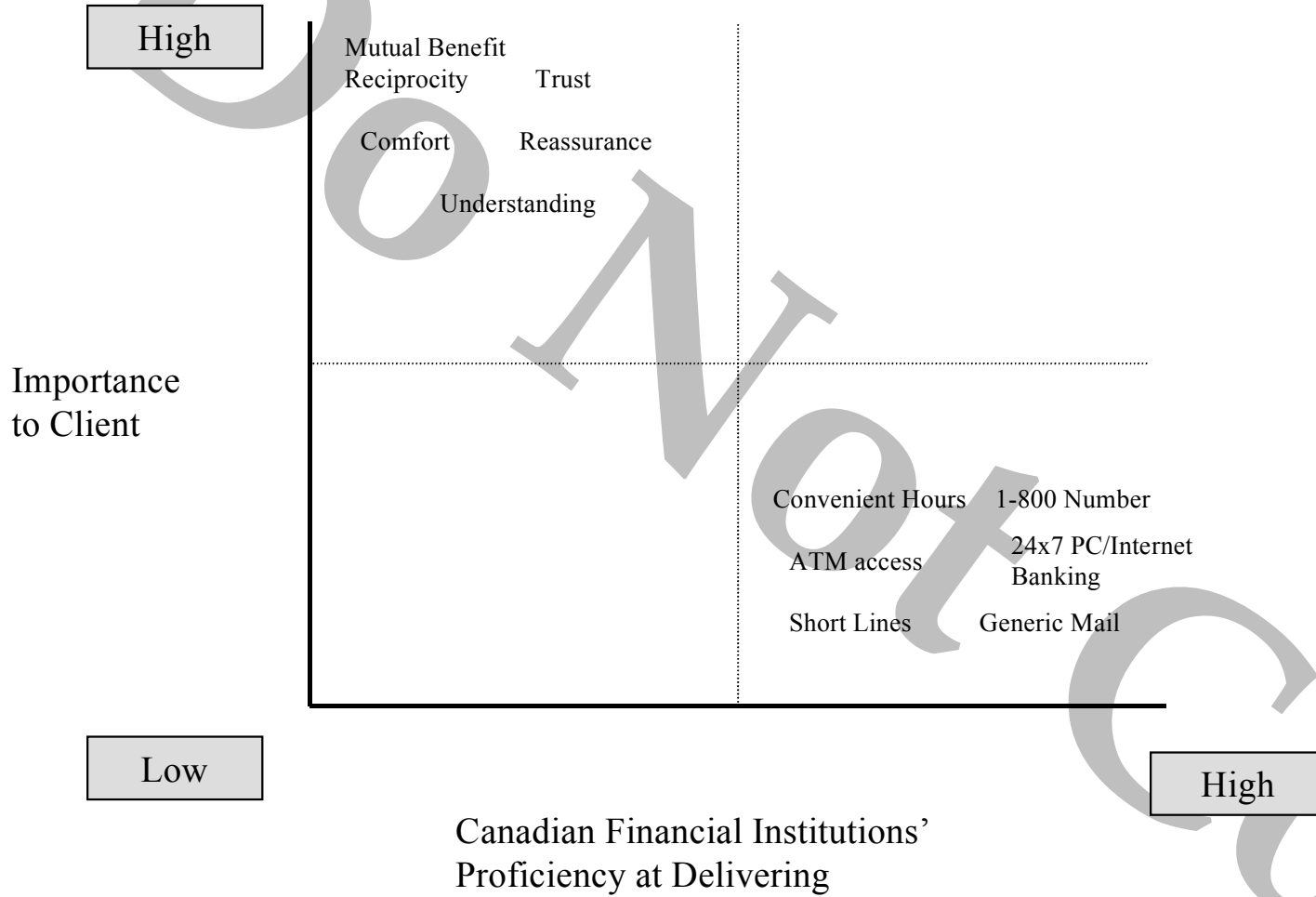
Packages versus fees: McLaughlin's decision Another way the Bank used customer profitability data was to inform the debate over whether to charge for services using flat rate packages or to charge fees based on the amount and type of transactions the customer was generating with the Bank.

By 1998, with the new customer profitability model in place, the Bank became aware that many of its personal accounts were losing money. Looking more deeply into the data, the Bank found that the delivery channel producing the biggest drain on profits was the practice of customers using ABMs to pay their bills. This practice was widely in use in Canada by the late 1990s. While customers viewed this service as convenient, it was extremely costly for the Bank (see **Exhibit 7**). These higher costs led to negative customer profitability, particularly for customers who did not carry high balances, such as those in the Key/Nexus segment. Recovering those costs could be tricky, since marketing studies showed that customer valued predictability, fairness, and simplicity in their banking relationships, and that they felt "nickel and dimed" by the transaction fees charged by some banks. Many at the Bank felt that flat rate packages were one way to cover costs without subjecting customers to pages of fees on their bank statements (see **Exhibit 8** for a sample of product pricing).

In addition to how to move CRM and customer profitability forward, the question for the Bank when trying to price products in the current CRM environment was: how to recover costs and make a profit while providing the type of service its customers would value and keeping customers that the Bank valued?

Richard McLaughlin knew that value for money was a particularly thorny issue for the Bank. The Bank asked customers to rank the leading Canadian banks in value for money, and RBC had ranked seventh out of eight. McLaughlin pondered how the Bank could boost the perception among its customers that they gained significant value for their money and guard against competitor encroachment, while simultaneously stemming the tide of red ink spilling from its personal accounts?

Exhibit 1 RCB Financial Group 1996 Marketing Study Results



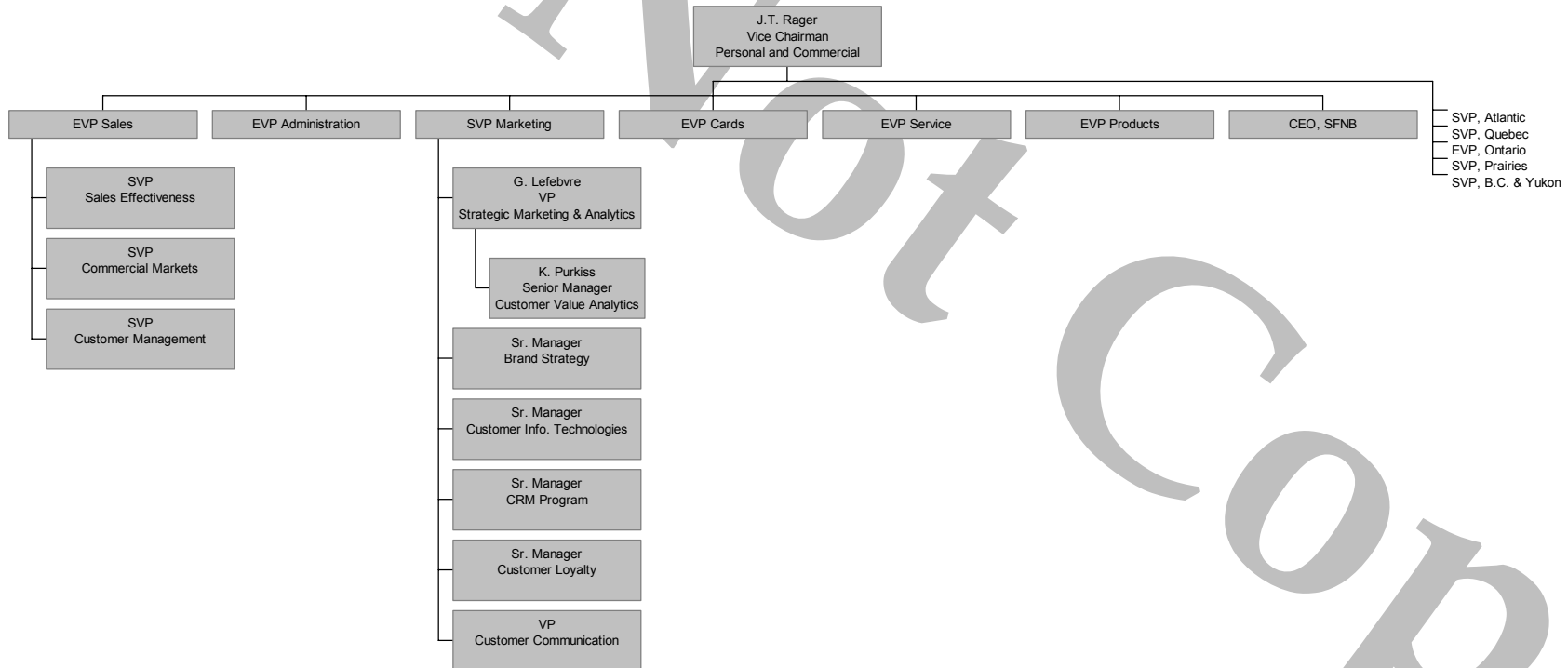
Source: Company records.

Exhibit 2 Royal Bank Personal Business Line Major Customer Segments and Subsegments

Key	Growth	Prime
Getting started stage—Youth Life stage 1—Nexus Small Business Farming & Lifestyle Agriculture	Life stage 2—Building Business Agriculture	Life stage 3—Accumulating Life stage 4—Preserving

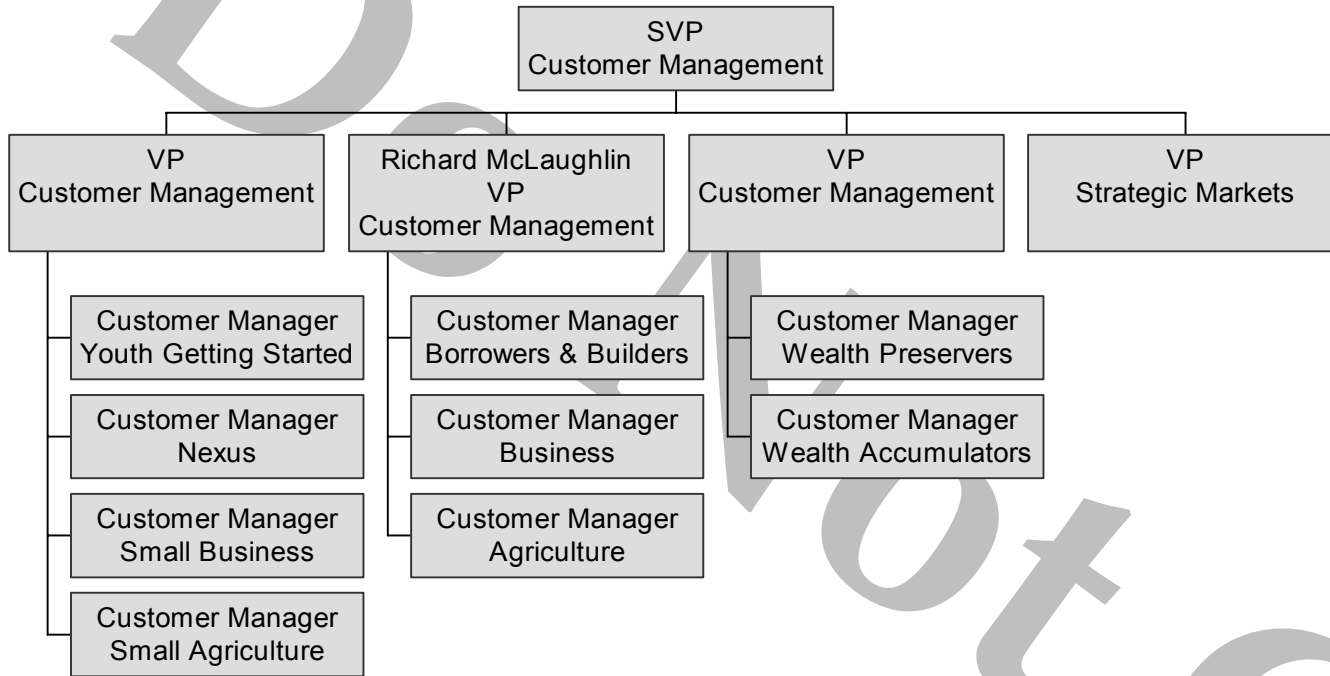
Source: Company records.

Exhibit 3a RCB Financial Group Personal and Commercial Division Organization Charts as of December 1999



Source: Company records.

Exhibit 3b RBC Financial Customer Management Organization Chart as of December 1999^a



Source: Company records.

^aIn 1999, Richard McLaughlin serviced as a vice president of customer management. In 2000, he returned to his prior position as vice president of CRM & Information Management reporting directly to the Senior Vice President of Marketing.

Exhibit 4 Components of Old vs. New Customer Profitability Model

As the following table illustrates, although the same process was used in the older profitability model, the new model required the ABC information to be much more precise.

Table A Old vs. New Customer Profitability Model

Input	Old Model	New Model
Interest Revenue (Funds transfer pricing)	Average revenue by product	Actual net interest revenue by account, using internal transfer pricing
Fees and Commissions	Average fee per product	Actual fees by account
Direct Expenses (event costing)	Average Activity-Based Costs	Transaction level cost, rolled up to individual account and customer
Indirect Expenses (overhead)	Allocated across products	Allocated across products
Risk Provision	Average risk per product	Expected risk score by account

Source: Company records and adapted from Meridien Research, Inc., "Putting ABC into Customer Profitability," *Customer Knowledge*, vol. 4, no. 1, September 27, 2000 and adapted from NCR Case Study, Royal Bank Finds Micro Markets with NCR Tool, <http://www.ncr.com>, accessed April 25, 2001, page 3.

Activity-based costs The Bank had been tracking ABC information for approximately 20 years. In the 1980s, it began to develop a system to calculate and update activity-based costs quarterly by transaction and product. The current system was implemented in 1991 and was enhanced during the late 1990s to differentiate costs by delivery channels such as branch, Internet, telephone, and ABM.

The cost system at Royal Bank started with the general ledger. Chitwant Kohli, vice president of costing and profitability, explained the ABC system:

As a services company, we are most interested in tracking labor costs, which make up over 60% of non-interest expenses. We extract expense data quarterly from the general ledger for each individual cost center. These cost centers are then grouped with like units based on products services and activities performed by the unit. We refer to this as the processing path.

For example, domestic branches, which sell and service the same product lines using the same processes, become a unit group. Similarly, call centers, business-banking centers, and service delivery units that perform the same product-specific activities become unique groups. Through grouping units by product line and processing path, channel views are created. Head Office groups, regional offices and IT costs are also identified in separate buckets.

Within the 30 to 40 unique unit type groups, we establish total staff time consumed by each activity based on unit time per activity multiplied by volumes processed. This enables the proper allocation of the unit's salary cost to products and activities and also forms the basis for apportioning premises and general operating costs. Once we have these drivers by product, activity and channel, we can aggregate costs across all units to arrive at both transaction and total product cost. These costs are then available for use in profitability models.

For example, we can report the full end-to-end product cost of residential mortgages including acquisition and renewal costs by channel, back office processing, call center support,

system costs, Head Office and regional overheads. For every customer we can then arrive at costs associated with “ownership” of each separate product in the customer’s portfolio, based on transaction usage and channel preference.

The amount of time spent on each activity is updated as needed. We have also recently instituted the idea of “champion branches”—a cross section of branches that provide activity times, volumes, and costs on an ongoing basis.

While labor costs are allocated based on studies of actual time spent on activities, indirect costs and the cost of excess capacity are allocated proportionately across all products based on the level of direct expense attracted.

Interest revenue and transfer pricing Royal Bank determined profits on an asset product, such as a mortgage, using actual interest income, less the transfer rate on the mortgage. Conversely, profits for a liability product, such as a savings account, were determined by subtracting the actual interest paid out by the Bank from the transfer rate on the money in the deposit account.

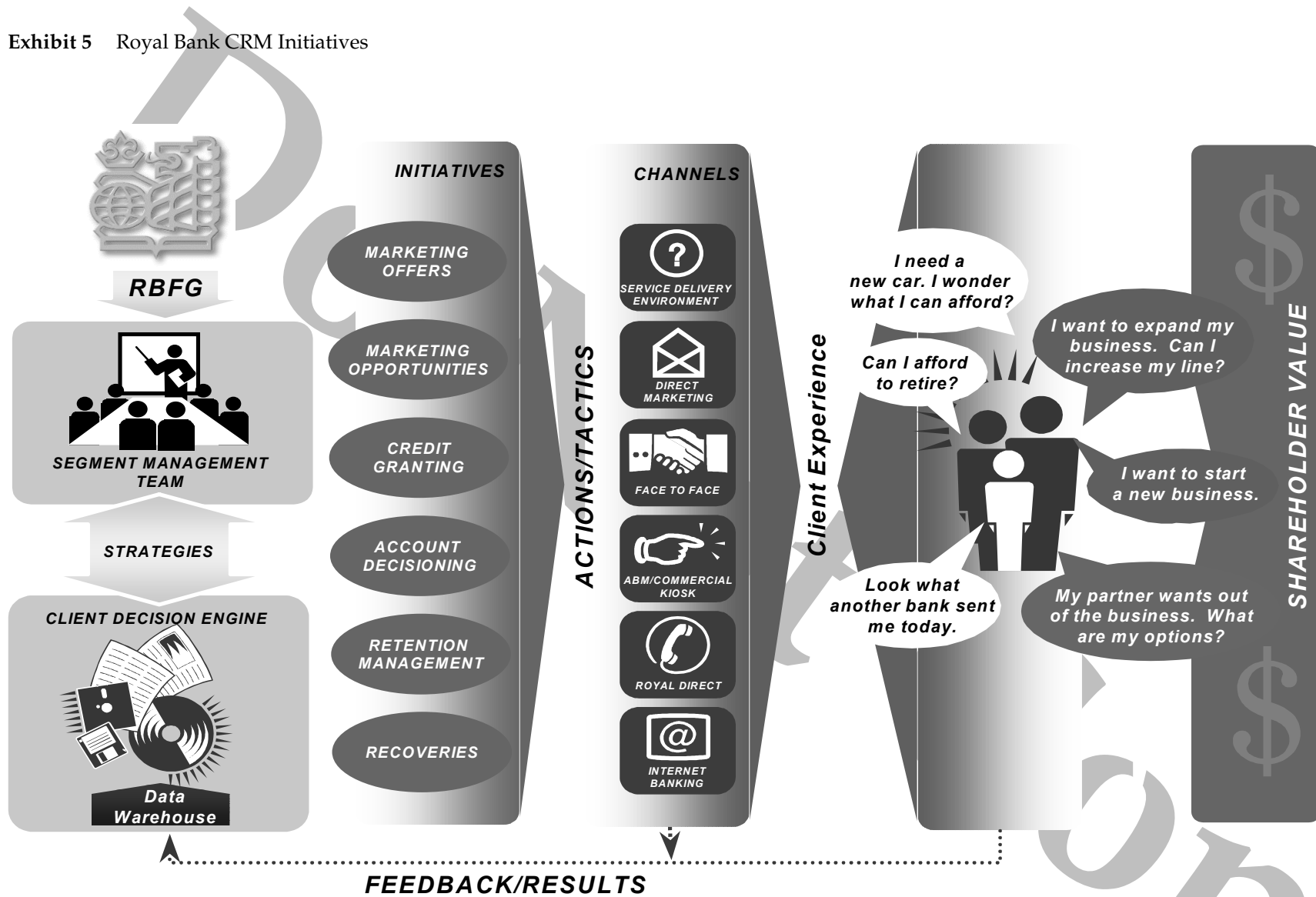
Risk calculation When a customer sought to purchase a loan product, the Bank determined whether to grant the loan, and at what price. The Bank used a number of factors, such as income, debt service ratio, cash flow, and third party- provided credit reports, to make this initial decision. Once the loan was granted, the Bank assigned a risk score (adjusted monthly) based on the nature and frequency of transactions in the customer’s accounts. The score was converted to a cost driver that was then used to allocate the cost of expected credit losses to that customer. Once all the inputs were entered, the customer profitability software calculated the customer profitability. For example, one customer may have two accounts with the Bank, a home loan and a savings account. Although one account was losing money, the other was quite profitable. The customer as a whole was making a profit for the Bank. (See **Table B**.)

Table B Sample Customer Profitability Calculation for Customer John Doe, January 2001

	Home Loan	Savings Account
Net Interest Revenue	\$60	\$2
Other Revenue	\$0	\$0
Direct Expense	\$3	\$5
Indirect Expense	\$1	\$1
Risk Provision	\$5	\$0
Total Profitability per account	\$51	(\$4)

Source: Company records.

Exhibit 5 Royal Bank CRM Initiatives



Source: Company records.

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Exhibit 6 Client Profiles^a

	Niece	Aunt
Age	23	68
Number of Products Held	2	8
Type of Products Held	Signature Plus checking account; Calculator Plus savings account	Signature Plus checking account, Royal Money Maker Plus savings account, mortgage on home, mortgage on second home, investment accounts, retirement account, line of credit, visa.
Tenure with Bank	6 years	50 years
Annual Income	\$23,000	\$240,000
Net Worth	\$5,000	\$2.8 million

Source: Casewriter.

^aAll information in this exhibit is disguised.

Exhibit 7 Royal Bank—Average Unit Costs by Channel^a

Activities	Channels							
	ABMs		Retail Branch	BBC ^b	Telephone Banking ^c			Mortgage Reps
	Full Function	Cash Counter			Agent	IVR ^d	Internet/Web	
Open Products approved (credit check)								
RD (telephone banking) Enrollment	--	--	\$104.03	\$365.72	\$158.36	\$97.15	\$194.35	\$983.15
Business Development (New Business/Growth)	--	--	--	--	14.89	--	--	--
Business Development (Retention)	--	--	67.44	90.36	4.26	--	--	--
Fulfillment	--	--	9.29	12.68	4.26	--	--	--
Renewal	--	--	19.14	17.16	--	--	--	--
Withdrawal	--	--	32.18	20.00	--	--	--	--
Deposit	0.40	\$0.55	3.80	--	--	--	--	--
Transfer	0.97	--	2.87	--	--	--	--	--
Bill Payment	2.26	2.38	21.36	3.84	8.39	0.30	0.18	--
Inquiry	0.90	--	2.69	--	8.15	0.30	0.18	--
Maintenance	0.31	0.54	9.19	7.18	8.52	0.30	0.19	--
Close	--	--	28.49	47.93	10.75	--	--	--

Source: Company records.

^aAll numbers in this exhibit have been disguised for confidentiality purposes.

^bBusiness Banking Center marketed to and serviced small businesses from a centralized location.

^cAll costs are on a per call basis as opposed to a per transaction basis. In addition, back office operation (support costs outside of Royal Direct hierarchy) are included in the respective unit costs. All IVR costs except for loan applications are based on the average time per call.

^dInteractive voice recognition.

Exhibit 8 1996 Personal Account Pricing and Service Levels

Name of Service	Signature Plus Checking Account	Royal Money Maker Plus Savings Account
Free Debits	2/monthly cycle and 1/payroll credit	2/monthly cycle and 1/payroll credit
Per Check Fee	\$0.60	\$1.35
In-Branch Withdrawals	\$0.60	\$1.35
PTB ^a Withdrawals, Payments, Transfers	\$0.50	\$1.35
Telephone Banking Debits	\$0.50	\$0.50
PC/Internet Debits	\$0.50	\$0.50
IDP ^b Purchases	\$0.30	\$0.30
ABM Withdrawals at other FIs	\$1.25 plus PTB Withdrawal Fee	
Flat Fee Options	15 full-service debits for \$5/month 15 self-service debits for \$3/month 25 self-service debits for \$5/month	None
Overdraft Protection Option Account record		

Source: Company records

^aPersonal Touch Banking is the Bank's proprietary name for their automatic teller machines.

^bDebit card payments at a retail outlet, such as a grocery store.