James L. Bauer
is senior vice president at Chase Manhattan Bank in New York. He has held a variety of positions in such areas as marketing, online banking and strategic planning. He is the author of several books and articles on distribution strategy and database marketing for financial institutions.

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'Traditional' retail/financial institutions are facing multiple challenges from the Internet

Need to move from 'old' model of physical distribution to 'new' model of Internet based direct marketing and delivery

James L. Bauer,
Vice President,
Direct Financial Services Group,
The Chase Manhattan Bank,
140 East 45th Street,
New York,
New York 10570-7000, USA
E-mail: james.bauer@chase.com

Developing and branding innovative Internet-based delivery for financial institutions

James L. Bauer

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Abstract

The growth of the Internet as a marketing medium presents most 'traditional' retail financial institutions, in particular those with extensive physical and human distribution channels and established brands, with major challenges.

The branding quandary is the fact that success in the offline (or physical) world does not represent a guarantee of success in the Internet (or virtual) world. Early entrants in the Internet world have taken the lead in establishing powerful virtual brands. Since the Internet is still at the early stages of its evolution, 'traditional institutions' can be powerful Internet-based competitors, leveraging their existing assets, including their own brands.

The growth of the Internet as a marketing medium presents most 'traditional' retail financial institutions with significant challenges. A 'traditional' financial institution can be defined as one that offers one or more products or services to individual consumers or small businesses primarily through physical branch offices or through a field force of agents. The common theme is that marketing, sales and service are conducted through high-cost, physical and highly personalised channels. Were the products and services being sold complex, high value, high priced or high margin, such physical distribution channels could be economically justified. However, given the power of the Internet as a low-cost, mass-market marketing, sales and service channel, the growth of the Internet provides a major challenge to those institutions with extensive physical and human distribution channels.

For traditional financial institutions, the problem becomes even more complex because of the need to move from the 'old' model of physical distribution and personal service to the 'new' model of Internet-based direct marketing and delivery. Traditional products and services have one set of features, benefits, cost structures and pricing. Internet-based products, because of the nature of the delivery channel, have a significantly lower cost and delivery structure. The traditional products represent the source of current profits and funding for the development of new products. However, by offering Internet-based products with different pricing structures, the traditional institution runs the risk of cannibalising its existing profit stream as customers migrate to lower-cost offerings. Yet, at the same time, new competitors, unencumbered by

Brand is the major asset of traditional financial institutions

the existing infrastructure, can offer lower-cost Internet-based products and steal customers from the traditional competitors. Were these the only issues that needed to be addressed, they would present management with significant challenges. But another level of complexity is added by the fact that traditional financial institutions consider one of their primary assets to be their brand. For most traditional financial institutions, the brand has been established over a period of many decades. While the brand may include negative connotations based on such real-life experiences as poor service, inflexible policies, high prices or mistakes, most financial brands retain strong connotations of trust, stability and security. All these positive attributes of a brand can be of great value to traditional financial institutions in developing their Internet-based value propositions and marketing programmes.

Brand promise needs to be supported by service experience

While branding is clearly important for both products and services, it takes on special import for providers of services. With physical goods (for example, soft drinks or athletic shoes), the variability of the product is easier to control than with services. Assuming the product meets the manufacturer's quality control standards and the actual physical product meets or exceeds the consumer's expectations, the brand promise has been met. The physical product, combined with the consumer's expected experience, as generated by the marketing and advertising, should be complementary. With services, the brand promise needs to be supported by the actual service experience. This is particularly important in financial services, which, since they involve people's money, are a high-involvement, high-emotion experience. Consumers' interactions with their financial service providers are generally highly repetitive and long term, measured in years or even decades. For some products, for example transaction accounts, there are hundreds if not thousands of contacts or interactions each year. Other products, for example investments or insurance, may have fewer interactions but have larger economic or emotional value at stake.

Success in the physical world does not guarantee success in the virtual world

The quandary that most traditional financial institutions face with branding on the Internet is the fact that success in the offline (or physical) world does not represent a guarantee of success in the Internet (or virtual) world. In fact, many of the early entrants in the Internet world, both in financial services and in other industries, have taken an early lead in establishing powerful virtual brands. Perhaps the best example is Amazon.com, which, early on, has established a clear identity as *the* Internet-based bookseller, supplanting strong national brands such as Barnes & Noble and Borders, which have built their brands in the physical world. A similar phenomenon has happened in the financial services world, with companies such as E*Trade and Schwab establishing strong identities in the virtual world, rivalling the powerful brands of such traditional companies as Merrill Lynch that are primarily rooted in the physical world. One could even argue that a successful brand in the physical world could be a major impediment in the virtual world. The good news for most traditional financial institutions is that the Internet is still at the very early stages of its

**Financial services
are the most
appropriate to be
distributed over the
Internet**

evolution and that, given a well-thought-out strategy, traditional financial institutions can emerge as powerful Internet-based competitors, leveraging their existing assets, including their brands.

Among all products or services that can be effectively marketed or distributed over the Internet, financial services are one of the most appropriate. Financial services do not require delivery of physical goods; the purchase process is information-intensive and they easily lend themselves to comparison shopping. The early experience with Internet-based shopping supports this; of an estimated total of \$4.4bn in business-to-consumer purchases made over the Internet from June to December 1998, fully 33 per cent were for financial services.¹ The Internet also lends itself to strong, early entrants establishing leading market positions. While there are thousands of retailers on the Internet, the top ten commanded over 50 per cent of total revenues, based on the Boston Consulting Group's study. A further analysis by the same study found that within each category, for example online brokerage, the top three sites also accounted for over 50 per cent of the volume. These early market leaders, for example E*Trade and Schwab in the brokerage industry or First USA in the credit card industry, have a clearly defined strategy of establishing strong Internet brand identities and market presence early on. Not only does this help them acquire large numbers of new customers, but it establishes a strong identity in the minds of consumers that these companies' brand names are synonymous with the product or service category. Again, one can look at Amazon as being almost synonymous with the process of purchasing books online.

**Multi-channel
retailers have a real
advantage over
virtual-only retailers**

However, solely existing in the virtual world is not by itself a guarantee of success. In fact, multi-channel retailers — those companies that have both physical presence (which helps to promote strong brand recognition) and a strong presence in the virtual world — have posted significantly better results than do merely virtual-only retailers. Table 1 illustrates some differences in key metrics between multi-channel and virtual-only retailers.

Within the financial services industry, a number of companies that largely operate in the virtual or 'direct' world have been pursuing such a combined physical and virtual strategy. For example, leading US

Table 1: Multi-channel versus virtual-only retailing

Performance benchmarks	Online channel of multi-channel retailers	Virtual-only retailers
Annual growth rates	%	%
Unique visitors	315	343
Orders	245	93
Revenue	259	161
Order conversion rate (orders to total visits)	3.5	0.9
Buyer conversion rate (buyers to unique visitors)	6.1	3.0
Loyalty (repeat buyers as % of total buyers)	26	17
Marketing and advertising as % of revenue	52	90
Customer service contacts/order (numbers)	.4	1.1

Source: BCG

**Merely transferring
the brand identity
and physical
propositions will not
work**

companies such as Fidelity and Schwab, both of which conduct the bulk of their business by phone and the Internet, have a limited number of physical offices. These offices serve several purposes, including providing a place for the initial account opening and a place for prospective customers to get printed information and account opening forms. Beyond this, these offices have immense ‘billboard’ value. They are strategically located in high-traffic areas where target upscale customers are likely to see them. Actual evidence suggests that when one of these firms or their competitors opens a physical office in a given market, the number of new customers residing in that market increases significantly, even though only a small percentage of these customers ever walk into the physical office!

Brand is clearly a significant factor that differentiates companies that operate in both the physical and virtual worlds from those that operate solely in the virtual world. However, success in the virtual world is not automatically assured by merely transferring the brand identity along with the physical value propositions from the physical world to the virtual world.

Fundamental to being successful in the virtual world is defining a core set of strategic objectives. This is especially critical for traditional institutions that have established ongoing businesses (and revenue and profit streams) in the physical world. Institutions can stake out a position along a continuum of choices — which can generally be classified into one of three categories. First, an institution can be an aggressive innovator, focusing primarily on customer acquisition. Most

Table 2: Financial institutions have three basic choices for developing an Internet-based strategy

	Aggressive innovator/customer acquisition	Service existing customers retention/servicing	Do nothing status quo
Strategy	Acquire new customers through aggressive use of online channels	Develop online capabilities to service existing customers	Service existing offline customers as before
Products	Develop new online products and services with competitive pricing or value-added features for customers	Market existing products and services with existing pricing and features and delivery channels to current customers and prospects	Maintain existing products and services
Internet execution	Re-engineer existing infrastructure to be cost competitive in online world	Online becomes another end point, adding incremental cost with little incremental benefit	No changes needed
Examples	Schwab (existing largely direct company) Fidelity (existing largely direct company) NextCard (new Internet-only credit card company) E*Trade (new Internet-only stock brokerage company) First USA e*card Homeshark.com (new mortgage aggregator)	Merrill Lynch (physical offices, personal brokers/account representatives) Chase (traditional bank with physical branch offices)	Traditional US savings banks and UK building societies

**A variety of options
exist to make the
transition to the
virtual world**

of the new success stories, companies like Amazon.com or E*Trade, are in this category. The second category is those institutions that are focusing on using the Internet to service existing customers. These kinds of institutions have a strong, established delivery system, either branch offices or agents, and view the Internet channel as an adjunct or complementary to the existing systems. The third category is those institutions that, for a variety of reasons, choose to do nothing and preserve the status quo. Such institutions may have determined that they do not have the resources to compete in the virtual world or that their current and future customers are unlikely ever to be interested in using the Internet to purchase or conduct financial service transactions.

Having determined where on the continuum one wants to stake a position, the branding strategy becomes apparent. Institutions that choose not to utilise the Internet aggressively and maintain the status quo, for example traditional US savings banks or UK building societies, do not need to reposition themselves. The traditional branch-based model and traditional products and services will continue to be targeted against those segments of customers unlikely to gravitate towards the Internet and who value in-person delivery and contact. On the left-hand side of Table 2 are those institutions that will be aggressive innovators and focus on customer acquisition. Many of these are either new entrants unencumbered by traditional offices and products or are already 'direct' players whose value propositions are targeted at customers who are accustomed to dealing on a 'direct' (ie mail or phone) basis with the institution. For new players, the challenge is to quickly establish and develop a strong brand name and identity among prospective customers. For institutions with existing traditional distribution channels, it is not difficult to consider the Internet and all of its capabilities as another extension of existing direct channels.

**Aggressive innovators
vs traditional
institutions**

The inherent conflict and problem arises when one puts aggressive innovators against more traditional institutions. The aggressive innovators can clearly emphasise the benefits that the Internet-based business model enjoys, for example low cost or speed, which these players enjoy over established, existing companies. Several examples will make this clear. Among the leading US Internet-based stockbrokers, E*Trade emphasises low-cost execution and access to information for self-directed investors. Merrill Lynch emphasises advice and guidance, delivered on a personal basis through its network of account executives. Aside from the fact that their business models and infrastructures are at opposite ends of the spectrum, it becomes extremely challenging for an institution that is positioned like Merrill Lynch to develop a credible brand that would emphasise low cost and information for self-directed investors. There are other, similar examples. One new US Internet bank, Telebank, offers consumers significantly higher rates, citing the fact that they do not have to spend money on expensive branches and staff. This kind of branding and positioning clearly works for an Internet-only bank. However, a traditional bank that offers physical locations and staff absolutely cannot take the same positioning and maintain any kind of credibility in its brand in either the physical or the virtual world. As a

**'Richness' and
'reach' can be
melded on the
Internet**

result, the position of the traditional institutions seeking to operate in the virtual world can be seriously compromised. They are unable to offer the same kind of value propositions (ie low cost, better value) and remain credible. They are thus forced into a position of branding the Internet as merely another distribution channel with which to do business with the institution, with a far less attractive value proposition.

Fortunately, the capabilities of the Internet offer a way out of this quandary. While the Internet gives the ability to offer better value propositions because of its lower cost structure, it also gives financial institutions the ability to combine 'richness' with 'reach'. 'Richness' and 'reach' are the classical trade-offs that physical retailers must grapple with when allocating their marketing resources. Either they can have a great breadth of products or product information ('richness') targeted at a smaller population of prospective customers, or they can have a broad 'reach', seeking to target large numbers of prospective customers but either with fewer products or less information on each of the individual products. With its low creation and distribution costs, the Internet provides financial services companies with the ability to combine both 'richness' and 'reach'. This combination can be particularly valuable for financial service products, especially those that are more information-intensive or complex, for example investments or insurance. The ability to distribute large amounts of information cheaply and to provide interactive modelling and analytics gives the ability to offer the prospective customer a 'rich' experience.

What, exactly, is such a 'rich' experience and how can a financial institution use it to its benefit? Several examples will illustrate the point. In the area of mortgages, most institutions offer a large number of different products, each with different features, terms, rates and criteria for qualification. Most consumers only make a mortgage purchase decision a few times during their lives, and as a result are not familiar with the products, their features and the benefits or disadvantages to them. In many cases, price (or rate) is not the sole determinant of whether one product or another is better or worse for the customer. Adding value to the mortgage purchasing process for the Internet consumer is offering an interactive model that asks the consumer several questions about his/her finances, including financial goals, amount of time he intends to remain in the house, etc. The program then analyses the data and provides a recommendation and rationale of why one product better meets the customer's needs than does another. The institution that does this well can now brand itself as being the customer's ally, helping to make the best decisions for unique circumstances. This process does not have to be limited to more complex, less frequently purchased products such as mortgages, investments or insurance. It can apply to routine products such as credit cards or cheque accounts as well. Most institutions offer a number of different variations of such basic products, one or more of which would better meet a customer's needs than others.

By extending this kind of 'richness' and functionality to all its products marketed across the Internet, the institution can achieve several goals. First, it can develop a positioning and branding that is unique and

**Financial institutions
can create 'rich'
experiences**

**Ten guidelines for
creating a strong
identity**

less product-specific and that provides value added to the customer beyond the basic product. Secondly, it no longer has to compete solely on the basis of price alone, a position that, long term, is not sustainable.

There are some basic guidelines that can help institutions to develop compelling applications as a foundation from which to build a strong and sustainable Internet brand.

1. Understand customer needs. Customers who choose to use the Internet have very different needs and expectations than many traditional customers. The Internet itself creates expectations on the part of customers of ease of use, instant access and fulfilment and superior value. All of these expectations need to be factored into the development of products and services offered over the Internet.
2. Use richness to create value. Customers come to the Internet expecting a 'rich' experience that creates value. Value can be defined in many ways, including entertainment, information, and time and/or money savings. For financial institutions, given the complexity of many products and the large number of product choices, the Internet gives the ability to create additional value for the customer beyond the basic product features.
3. Design a scaleable and defensible business model. Many Internet efforts start out as adjuncts to the existing business models; they are not meant to be large scale and sustainable. As a result, the resources applied are inadequate and the efforts do not justify the (meagre) expenditures. If the Internet is going to be a major marketing or distribution channel, it needs to be properly financed and staffed. The business model needs to be defensible. This has profound implications for how products and services are manufactured and priced. Existing pricing for non-Internet channels may not be competitive in the Internet world; however, merely lowering the price on existing products without re-engineering the back office will result in selling products that will never be profitable. Most existing institutions' manufacturing costs are significantly higher than those of new entrants who are not saddled with archaic procedures or old technologies. To be competitive as an Internet provider, the back office manufacturing capabilities need to be highly efficient and cost competitive.
4. Offer common and compatible products and services across all channels. Customers, whether they use physical or virtual channels, are likely to use multiple channels. The service levels, information and ability to conduct transactions must be the same across all of the different channels to ensure that the customer gets the same experience, irrespective of which channel he uses.
5. Offer service on 'Internet time'. One of the characteristics of the Internet is that all activities are done online, in real time. Consumers have developed an expectation that all Internet activities will be conducted in this kind of time-frame. Unfortunately, most financial institutions have developed their products and services for a slower, less-demanding world and need to ensure that all products are now delivered to meet the expectations of the new world.

6. Leverage customer relationships. Customers are part of the product development experience for most of the successful Internet applications. In the case of Amazon.com, customers can become reviewers and submit their own book reviews. In the case of E-bay and other electronic auctions, the customers (the buyers and the sellers) are themselves actually creating the product on a continuous basis. For financial services, providing a 'rich' experience, including the ability for customers to explore interactively their own circumstances and help in selecting and developing their own products, is a way to leverage and solidify the customer relationship with the institution.
7. Brand the total experience (physical and virtual). With the exception of 'monoline' financial companies that only offer one product (for example, credit cards or mortgages), most companies offer a broad breadth of products and services. It therefore becomes critical to develop (and execute) a comprehensive brand positioning that not only encompasses all of the products but also the full potential that the Internet as a medium can provide. As has been discussed, this is a significant challenge for traditional institutions that have established brands, products and distribution channels across physical and virtual channels.
8. Shorten the marketing learning curve. Given the nature of the medium, feedback on the Internet is almost instantaneous. If a given message, product or price does not work, it can be changed immediately and measured in almost real time. This is often difficult for marketers, steeped in traditional production and response cycles, to learn to understand.
9. Exploit the connectivity of the Web. The most successful sites have developed thousands of symbiotic relationships with other sites; these are used to refer and direct clients from one site to another; a typical example is a review of books in the newspaper with the ability to go directly to the bookseller's site to order the book online. The ability to build these kinds of linkages is limited only by the creativity of the site developers and marketers.
10. Create 'sticky' relationships. The key to a profitable customer is to have him continue to return to the site to purchase additional products or services. The key to doing this is to develop applications that are of personal interest to the customer and that will cause him or her to return to the site on a regular basis. These can either be customer or supplier driven. Perhaps the best customer-driven example is the ability (as well as need) to check the prices in an online stock portfolio. A good example of supplier-driven 'stickiness' is the ability to use e-mails to inform customers about products or services they may be interested in so that they will return to the site. Perhaps the best example here are the profiles of consumers' reading or music interests that are developed by the online book and music merchants who can use this information to inform consumers via e-mail about books and music that would appeal to them.

**Re-positioning
the brand is the
critical issue**

Conclusion

Brand is one of the major, if not the major, asset that traditional financial institutions have in the Internet world. The challenge that traditional institutions have is to reposition themselves in consumers' minds so that their brand can encompass the physical and the virtual channels. There are a number of strategies that will lead to certain failure. These include totally ignoring the Internet as a channel or relying solely on brand, without making the other necessary adjustments required to deliver virtual products. While much is unknown about the future direction of the Internet and its impact on financial institutions, what is already abundantly clear is that the growth of technology, consumer acceptance and the compelling economics of the Internet have already started to shift the balance of power to those institutions that know how to compete (and leverage their brand) in the new world.

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