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THE ROAD FROM DEPENDENCY TO EMPOWERMENT:

The Destination is Worth the Journey

Paper 141

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WORKING PAPER

THE ROAD FROM DEPENDENCY TO EMPOWERMENT: The Destination is Worth the Journey

by

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ABSTRACT

The traditional financial services industry is based on the principles that the customer is ignorant, incompetent, disinterested in money matters, and eager to delegate them to someone he or she trusts. However the psychology and behavior of consumers and the structure and dynamics of the financial services market are starting to shift in a very fundamental way. Information and information technology are the key driving forces. This paper describes how electronic commerce is changing established patterns of influence and control in markets. *e*-markets will be a harsher ecology, i.e., more crowded and much more competitive. But *e*-Commerce also will provide new opportunities for differentiation and innovation. Many markets are extremely vulnerable to “disruptive innovations” in product and content integration, in customer information management, and particularly in relationship propositions. The authors present a positive relationship proposition which reveals the dependency model for what it actually is: demeaning, controlling, and exploitative. Customer information management drives a dynamic model of relationship value. The model involves extremely powerful self-reinforcing mechanisms which can be either virtuous or vicious. Growing satisfaction and trust leads the customer to be more open regarding values and needs, and more willing to ***empower the service provider***. As an empowered agent it can search, evaluate, advise, and implement on behalf of the customer. The paper addresses these issues in the context of the UK financial services market, but the ideas and conclusions apply to many other markets.

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The Dependency Model

In 1996 a respected research organization said that the UK financial services market was dominated by "paranoid drifters." No, these are not American-style serial killers. Rather they are uninformed, insecure, apathetic consumers, fearful of making mistakes and unable to decide what to do. Paralyzed like rabbits in the headlights by low self-esteem they are willing to trust an apparent expert who says reassuringly, "Don't worry. Just leave it all to me."

The traditional financial services industry is based on the principles that the customer is ignorant, incompetent, disinterested in money matters, and eager to delegate them to someone he or she trusts. "People do not want to manage their financial affairs, and they would make a mess of it if they tried." Banking and life insurance reflect this point of view. It is a relationship model where the service provider holds all of the cards. The consumer feels weak and dependent.

At its best the result is a private sector nanny state. "Most people cannot be trusted to manage their finances, so some must do it for them." It sounds caring, but it is condescending. It appears necessary, but it actually is self-fulfilling. The psychological literature is replete with examples of why people's behavior reflects how they are treated. Treat them as irresponsible and, surprise, they will behave irresponsibly. Treat them as worthless and they will have little or no self-esteem. And treat them as victims and they will tolerate, even invite, abuse. Domestic violence is just one tragic example.

At its worst this paradigm is unconscionably exploitative. It creates seemingly irresistible incentives to take advantage of the customer's trust and lack of knowledge. They are sold products which are difficult to understand, serve the seller's interests far better than the buyer's, and burden the customer with the seller's cost structure however inefficient that may be. Mis-selling now is illegal. But for years it was business as usual.

But how could that happen? Shouldn't the market reveal and eliminate such practices through the classical competitive dynamics? In effect financial services became a monopoly industry. Not in the normal sense where one provider totally dominates the market, but in the psychological sense where the relationship between provider and consumer is so lopsided that the customer has no power. Within the context of a micro-monopoly relationship customers are isolated from "the market." They lack the initiative, information, access, and confidence to shop around for the best deal.

Drivers of Change

In the immortal words of Bob Dylan, "The times they are a changing." That is, the psychology and behavior of consumers and the structure and dynamics of the financial

services market are starting to shift in a very fundamental way. A revolution is dawning. Information and information technology are the key driving forces.

It all started with telephone banking and discount brokerage, e.g., First Direct. Financial services became more accessible, aggressively priced, and customer-friendly. The barriers to entry eroded. You no longer needed hundreds of branches staffed by thousands of people to be a bank or broker. A call center and a large advertising budget were sufficient. This meant unprecedented opportunities for economies of scale and low unit costs.

The next stage was facilitated by the development of intermediary markets for financial products and associated services. The emergence of excess capacity and outsourcing specialists meant it was possible to buy-in and then re-sell deposit accounts, mortgage loans, credit cards, and brokerage execution whilst outsourcing telemarketing, backoffice administration, and customer care. All of a sudden the traditional barriers to entry were far lower. Anyone with a strong consumer brand could be a virtual bank with no infrastructure, minimal staff, and little capital required. Welcome Virgin, Marks & Spencer, Tesco, and Sainsbury's.

Now financial services markets were becoming seriously crowded and competitive. The new-comers were different from the incumbents in three highly significant ways. First, consumer marketing was their core competency. Second, their relationship model was different. They actually tried to please their customers. And third, their cost structure in financial services was not comparable. For them it was virtually (pardon the pun) 100% variable costs whilst the incumbents were saddled with huge fixed costs and legacy inefficiencies.

Not surprisingly the newcomers used advertising aggressively and effectively. They flooded the market with *information* about better prices and different attitudes. At least some of the paranoids stopped drifting long enough to notice. "Hmm, maybe I should take a closer look. Ah, it seems like a better deal. Oh, I didn't realize I had a choice." The dependency relationship model is starting to crack!

The third and most radical stage of change in the financial services market is being driven by electronic commerce. *e-Commerce* is changing established patterns of influence and control in markets. Consumers are gaining access to huge amounts of information about products and providers. They can exchange information amongst themselves with ever greater ease. Product prices, features, and performance are becoming highly visible and readily compared. Consumers can shop for the best deal across a wide range of sources and markets, and even place or invite bids.

Increasingly products that traditionally were "sold," e.g., life insurance, cars, and investments, now are being "bought." *e-Commerce* is empowering consumers at the expense of salesmen and advisors. It is conditioning them to want and exercise greater control.

A New Market Ecology

As *e-Commerce* makes markets more transparent, they are becoming more sensitive to differences in pricing, service quality, product performance, marketing effectiveness, and brand power. Customers are increasingly aware of and responsive to such differences, i.e., they spot them more quickly, take smaller differences more seriously, and react more strongly. Thus *e-markets* will be different. They will be a harsher ecology, i.e., more crowded and much more competitive. But *e-Commerce* also will provide new opportunities for differentiation and innovation.

e-Commerce will accelerate the commoditization of free-standing basic products. Books, CDs, consumer electronics, computers, photographic equipment, sporting goods, groceries, cars, current accounts, long-distance telephone calls, financial information, holiday travel, stock brokerage and many other products and services will become complete commodities. Competition will be dominated by price, competitive advantage will come primarily from cost leadership, and all but a few cost leaders will have unsatisfactory margins.

Commoditization will accelerate for several reasons. First *e-Commerce* completely destroys traditional barriers to market entry. The start-up investment can be quite small. This will lead to a proliferation of new *e-merchants*. Plus *e-Commerce* is an appealing mechanism for established players to extend themselves into new markets. The Internet is ubiquitous, and the extra investment is small compared to building or acquiring physical presence. Hence many will try, few will succeed (particularly on a large scale), but markets will become more crowded and fragmented.

In summary *e-Commerce* offers unprecedented economies of scale and scope. It provides a rich array of new opportunities and a fertile environment for innovation. *e-Commerce* will cause totally new business models to emerge, for example, “demand aggregators” (next-generation media and malls which deliver large audiences to product providers), “empowered agents” (next generation servants who search, advise, and buy on behalf of consumers), and “platform operators” (next generation utilities who provide products, markets, logistics, and back-office services at a wholesale level).

Inevitably these developments will provoke a major shake-out and consolidation in the financial services industry. A few will prosper; many will disappear. In the future large cross-border groups will dominate financial services. This is analogous to current trends in the retailing, airline, and telecom industries. Consolidation is likely to be triggered by the combination of:

- A downturn in the UK (and also the US) economy and stock market;
- A capital crisis in the UK life insurance industry;
- The impacts on EMU on European financial markets;

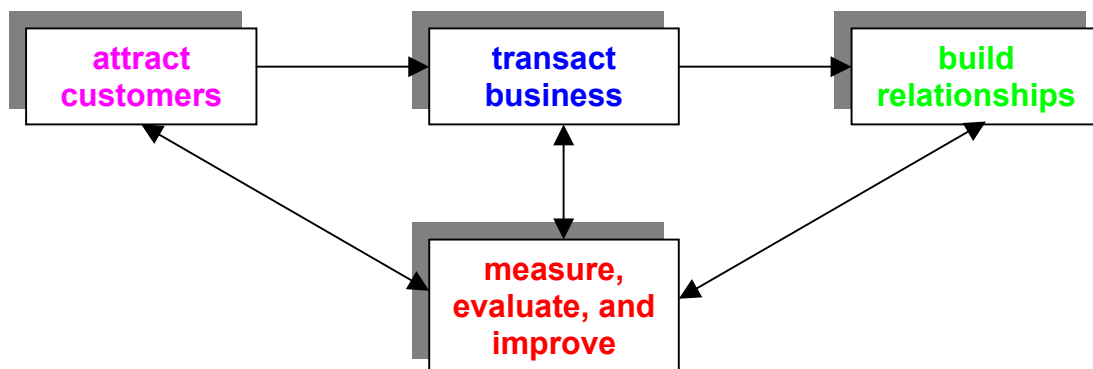
- Pension reforms in the UK, Europe, and the US;
- Invasion of the UK and Europe by US *e*-merchants;
- The development of substantial excess capacity in financial services; and
- Very serious erosion of the margins of traditional providers.

e-merchants have an advantage in de-commoditizing products. The *e*-Commerce environment provides powerful opportunities for differentiation through customer service, product integration, and new relationship paradigms. For example *e*-Commerce can offer:

- The convenience of twenty-four hours a day, seven days a week access to product and service providers from virtually anywhere;
- The choice of access through a PC, TV, telephone, wireless device, or kiosks in public places;
- A fully integrated, highly personalized relationship combining information, products, credit, and supporting services; and
- The ability to empower an “agent” (human or electronic) to search the market place on your behalf, evaluate and filter possibilities, advise you on what to do, and execute your decisions.

Success comes from changing the paradigms. A breakthrough in *e*-Commerce requires building powerful brand experiences, enhancing customer relationships, exploiting *e*-Commerce economics, orchestrating effective channel mix, and rethinking organizational structure. It is essential to align *e*-Commerce propositions with key customer needs, not with a company’s internal structure.

The Internet should support four interrelated aspects of *e*-Commerce.



Systematic measurement, evaluation, and improvement already are at the heart of a sophisticated catalogue-based retail operation. The Internet provides a richer flow of information, e.g., regarding customer visits, browsing patterns, use of information, and decision processes. The pay-offs should come from **both** revenue enhancement and cost reduction. It is important to look at the whole value chain.

The critical success factors in *e-Commerce* are:

- Target the right customers;
- Control, indeed own, the customer's total experience;
- Streamline business processes which impact the customer;
- Provide a complete picture of the customer relationship;
- Let customers help themselves;
- Develop personalized service;
- Create a sense of community; and
- Help customers do their jobs more effectively.

Having the right products is half of the answer. Having the right customers is the other half. It is essential to position brands and propositions to attract the attention of, appeal to, and build relationships with the "Internet generation." These are the primary users, and potential users, of *e-Commerce*. They start with young (age 25-35), well-educated, computer-oriented males. The second stage is retired people, particularly former office workers and professionals, who discover the Internet as way to develop new skills, keep themselves busy, maintain a sense of vitality, and make new friends. The third group is working women who attach great value to the convenience and sense of control they gain from *e-Commerce*. They too tend to be office workers and professionals.

Several trends will combine to reinforce the growth of the Internet generation:

- Penetration of personal computers and internet appliances in the UK will accelerate quite significantly;
- Convergence of telecommunications, cable, and satellite TV and intense competition among Internet service providers will drive down the cost of on-line access;
- Concerns about the reliability, security, and quality of on-line services will prove to be unfounded; and

- Increasing numbers of consumers will be regular users of electronic shopping and interactive multi-media services (“IMS”).

Over time young, sophisticated, computer-literate people will become the predominant consumers of financial services in the UK. They will have high requirements for convenience and control over their finances. Many will be active investors, intensive users of financial information, and interested in a wide range of securities, mutual funds, and derivatives. Analyses of other markets suggest that 30% or more of UK retail investors will be potential users of on-line brokerage services by 2005. The potential could be even higher in the long-term.

Survival of the Swiftest

Most companies and their leaders do not yet understand what is happening. Many are repeating the mistakes of the past, viewing *e-Commerce* as a new way to conduct business as usual. As with previous generations of computing, the technology is considered a means for refining the current paradigm, i.e., doing things “better, faster, cheaper.” Only a few see the prospect for radical change in how their business is conducted and the opportunity for anticipating, or indeed shaping, the new paradigm.

Predictably the traditional financial services industry is simply applying *e-Commerce* to the obsolete dependency relationship model. They continue to treat customers as inept, disinterested in money matters, and eager to delegate. They think they can capture customers, lock them into relationships, and then extract value as though they were so many chickens ready to be plucked. This model is cynical and condescending. In the world of *e-Commerce* it is a source of enormous strategic vulnerability.

The traditional providers are burdened with very substantial legacy baggage. This baggage includes antiquated systems, dependence on obsolete distribution channels, cost structures totally inconsistent with future price levels, and an “incumbent” culture rich in over-confidence and arrogance. Arguably, legacy baggage is the most daunting challenge facing these firms. It raises serious questions about how fast and far they can transform themselves.

The problems with legacy baggage are two-fold. First, the baggage is deeply embedded in a company, e.g., in its IT, business processes, people, and culture, and in the perceptions of the marketplace. It takes a long time to change these things, even with a concerted effort. Second, inherent in the baggage is a tendency towards myopia and complacency, i.e., not seeing the need for major changes, considering the changes to be easy, and believing that there is plenty of time to get the job done.

The critical consideration may well be time. In this rapidly evolving environment there is significant first-mover advantage and a limited window of opportunity to be ahead of

the pack. But most incumbents still do not seem to “get it.” They are convinced that evolutionary change will be sufficient. They are bogged down with polishing their current business models, pursuing economies of scale, controlling cannibalization, and defending the indefensible. They will fail to change at the required rate because of excessive caution or over-confidence. Many incumbents have performed impressively in the past year and feel altogether too comfortable. The risk of hubris is very great.

The current situation is unstable and unsustainable. It is extremely vulnerable to so-called “disruptive innovations” in product and content integration, in customer information management, and particularly in relationship propositions. These developments will happen faster than most people expect.

The Power of Positive Thinking

The first major player who achieves a breakthrough with its customer relationship model will create a crisis for the rest of the financial services industry. This competitor will seize the initiative, catching the others by surprise, throwing them off-balance, and putting them on the defensive. A new positive relationship proposition would reveal the dependency model for what it actually is: demeaning, controlling, and exploitative. This is a situation where “getting your retaliation in first” is essential. Whoever gets it right first will have the potential to dominate the market.

The most enlightened financial service providers talk earnestly about “empowering the customer” and becoming his or her “trusted helper.” Yet their thinking about relationships seems remarkably static and simplistic. They do not understand how and why a relationship develops over time, what empowerment really is, or the route to their desired objective. In important ways they have it all backwards. It is the customers who does the empowering, not the provider! And to think otherwise it to perpetuate the old dependency model.

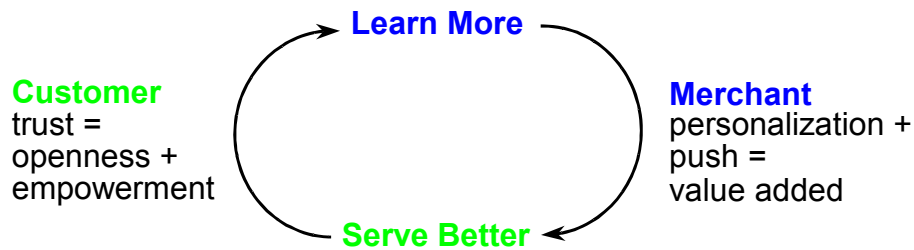
The primary source of competitive advantage, value added, and profits in the future will be effective customer information management. Customer information management drives a dynamic model of relationship value. The starting point is the customer experience, i.e., how is the customer treated, and how does he or she feel as a result? A positive customer experience is based on individualization:

- “We know and deal with customers as individuals;” and
- “We treat them with respect, honesty, and fairness.”

The model involves extremely powerful self-reinforcing mechanisms which can be either virtuous or vicious. Think of the virtuous version as “learn more/serve better.” In this mode knowledge about the customer is used to personalize the interface, create bespoke

service, and add greater value. Growing satisfaction and trust leads the customer to be more open regarding values and needs, and more willing to **empower the service provider**. The empowerment is critical. It gives the service provider license and credibility. As an empowered agent it can search, evaluate, advise, and implement on behalf of the customer. It can engage in acceptable, indeed appreciated, “push,” e.g., cross-selling and up-selling.

The simple diagram below illustrates this point.



Over time interaction with an *e*-merchant builds customer loyalty. The individual customers begins to feel part of a “community” arrayed around the *e*-Commerce proposition. Cumulating interactions facilitate personalization of the relationship (what goods and information are presented and/or the look and feel of the interface), chat among customers, polling of customers by the *e*-merchant, and feedback from customers about their requirements and satisfaction.

Thus the relationship becomes more valuable to the service provider who can, in turn, deliver greater value to the customer. A true “win/win” situation. The value of the relationship derives from its long-term profitability which, of course, depends in part on its persistency. As customer information management drives these dynamics, it becomes increasingly difficult for competitors to win the customer away. And it becomes less and less necessary to buy the customer’s loyalty through rock-bottom pricing.

If this relationship model sound a bit nostalgic, so be it. There was a time when the merchant in the corner shop knew you and your family very well, greeted you by name with a smile, and remembered what you liked. You were trusted and valued as a customer. Your purchases went on an account. You were shown the nicest merchandise. You generally followed the shopkeeper’s recommendations. And you had a strong loyalty to the shop and the merchant. The empowerment model is not an example of “back to the future,” but rather “forward to the past.”

There are some fundamental lessons here. First engaging the customer depends on delivering value. The “value” can come in a wide variety of forms, e.g., a better deal, greater convenience, a sense of accomplishment, recognition as an individual, a feeling of confidence and control. Second engagement over a period of time is required to build the

customer's trust. The easiest way to ruin an *e*-Commerce relationship is to frustrate, disappoint, irritate, or abuse the customer, e.g., by over-stepping the bounds of what he or she at any point considers "acceptable behavior."

By far the most important lesson is that *the service provider must cede control* of the relationship to the customer before the customer can empower the provider. This is another biblical truism in the spirit of "Noah built the ark before it started to rain." Here is the point is, "You must give in order to receive." The service provider must trust the customer to show the way in the relationship, to indicate how he or she wants to be treated and what constitutes real value, and to remain loyal and committed. The provider really has no other choice. Empowerment is a gift. An old Chinese cookie fortune says it very well, "You must possess something before you can give it away."

The empowerment relationship model is difficult to envision and complex to achieve. Success requires understanding, sensitivity, patience, commitment, and above all a positive attitude. Don't try to capture customers (i.e., hold them prisoner), captivate them. Don't think about extracting value from customers (i.e., a zero sum game), create and share value with them. The road from dependency to empowerment is long and winding, and always under construction. But to paraphrase the Guide Michelin's definition of a three star restaurant "La destination vaut le voyage."

A revolution is underway. As with many revolutions this one is not very visible or threatening at an early stage. But it is rapidly growing stronger. By the time it is obvious the *e*-Commerce revolution will have acquired enormous momentum. By then, for many elements of the old order, it will be too late to respond and adapt. Thus some great businesses, household names today, will not survive.