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"The narrower the hosepipe the more powerful the jet" Anon

Introduction

Why segmentation is important

In Chapter 3, there was a reference to American comedian, Bill Cosby's declaration that:

"I don't know the secret of success, but the secret of failure is trying to please everybody".

This truism serves as a watchword to advisory businesses when determining the kind of service(s) they wish to position with, and sell to, their preferred audience(s) or market(s).

In reality, many advisory firms fall foul of Cosby's mantra by "being all things to all people".
This approach makes a business vulnerable to the twin viruses of variability and inconsistency, introduced in Chapter 1.

Apart from the inefficiency and handbrake on cash-flow caused by these viruses, the value emerging from the business is diluted and spread thinly across a wide population with a myriad of expectations and a varying appetite for paying profitable fees.

Many existing businesses suffer from either or both "viruses" to a lesser or greater extent. The best preventative regime or antidote is to adopt a disciplined course of segmentation.

Segmentation is the process of categorising customers into different groups, or segments, where they share a similar level of interest in a comparable set of needs satisfied by a distinct marketing proposition.

Effective segmentation enables a business to organise itself to deliver value to groups of clients for whom it can offer meaningful, valued and viable (i.e. profitable) services. It helps business owners address the challenge of:

- deciding how selective to be about the types of client with whom they want to work
- developing, promoting and delivering a range of services appropriate to the different types
- setting price points which create profit for each

Segmentation converts:

- "being all things to all people"
  into
- "to people like this we provide ABC"
  "to people like that we deliver XYZ"
  "to people like those, we can't deliver profitably, so we don't deliver"

Segmentation is the result of three steps:

Market Segmentation – looks at how a potential market can be divided into smaller segments that can be served with greater focus.
The Medical market comprises doctors, consultants, nurses etc.
The Legal market includes judges, QCs, barristers, solicitors, "para-legals", clerks etc

Segment Targeting – determines which segments the business should target and how contact should be made.

Segmenting Service – creating a range of services to address the needs and expectations of clients within targeted segments. It is feasible to create a range of services which address different levels of need across more than one segment e.g. advice processes and review packages would look similar for most professions (clearly, advisers will need specific knowledge of the professions)

Segmenting Services

The level of fee clients will be prepared to pay can be said to be directly proportionate to the level of complexity they perceive in their financial affairs which they don't have the knowledge, time or inclination to resolve.

Every target market will comprise people who:

- perceive little complexity in their affairs and have clear ideas of the solution they wish to implement with no real appetite for ancillary planning or review services
  or
- require a "full-fat" lifestyle financial planning service with on-going support
  or
- a generic financial advice and review service sitting somewhere between the first two extremes

The business will need to decide how many strands or tiers of service it wishes to offer the types of client it decides to target.

The Medical Market as an example

A narrowly focused segmentation approach might be to target only GPs seeking a full financial planning and review service. This means acquiring specialist knowledge of the ins and outs of their work and pension benefits, job commitments and career options and tailoring everything to their needs and wants. The challenge here is can you access and gain commitment from sufficient numbers to make the proposition utilise the business's capacity to deliver and be profitable?

- Medical G.P's wanting a Full Financial Planning Service

- ABC's Full Financial Planning Service for G.P's

An alternative approach could be to target all GPs in their territory with a choice of Transactional, Financial Advice & Lifestyle Financial Planning services. This approach is still based on knowledge and understanding of a particular profession but widens the accessibility of service to a greater percentage of the chosen segment.

Medical G.P's
- Full Financial Planning Service for G.P's
- Advice & Review Service for G.P's
- Ad hoc advice for G.P's

A broader approach would be to offer a full financial planning and review service to the wider medical market. This would require a broader understanding of the differences between the constituent professions, but may increase the scope for enough clients to make it profitable.

An even broader approach would be to offer all medical professionals a range of services from Transactional to Financial Planning & Lifestyle Financial Planning. This does introduce potential for variability although it still represents a clearer focus than many other firms may achieve.
The potential to engage clients is widened but will require more resources and may be less profitable than a narrower focus.

Segmentation for Existing Client Banks

Many firms feel they cannot, or prefer not to, work to tightly defined target market segments. They enjoy dealing with people from different backgrounds and addressing a variety of challenges. Provided they adopt at least some criteria for the kind of people they can work most effectively with, and the depth and breadth of services they will provide at a profitable price, then they will have begun the process of limiting variability and inconsistency.

General Market
- Full Financial Planning Service C
- Advice & Review Service C
- Ad hoc advice C

Mass Affluent
- Full Financial Planning Service B
- Advice & Review Service B
- Transactional Service B

High Net Worth
- Full Financial Planning Service A
- Advice & Review Service A
- Transactional Service A

Even if the client bank was properly organised into clearly defined segments of say:
- High Net Worth,
- Mass Affluent
- General

with defined levels of service to ensure profitability, you can see how much wider the hosepipe is and less powerful the jet will be. So at one extreme we have one proposition for one clearly defined target market, to 9 propositions for 3 broadly defined target markets. There are a number of firms who have not even organised themselves to this level of simplicity and can effectively have almost as many propositions as they have clients!

In an ideal world the business would focus time and energy on delivering one or two segmented services. In that sense it would be better to either play in the low cost / transactional space or the service/relationship space and try to resist the temptation to compete in both camps and expect to beat firms specialising in one or the other.

Segmentation Brings Focus on the Prime Audience

The primary reason to adopt a segmentation discipline is to provide clarity of purpose for all members of the team as well as business partners and suppliers. Any resource expended should be directed towards activities which appeal to the audience the business wishes to serve.

For example, commercial television broadcasters rely on advertising revenue.
They create programmes to attract viewers who fit the target "demographic" for the product or service that major advertisers wish to promote e.g. 16-24 year olds, or the over 65s.
Advertising agencies create commercials which contain imagery, language and messages they feel will create the right impact with the target audience.
Broadcasters charge premium rates for inserting adverts during commercial breaks in programmes most watched by the target markets advertisers wish to "reach".

Many advisory firms operate a much blunter segmentation approach. Off the top of their heads, they know their best clients and make a point of talking to them quite often. However, very few have a process and strategy in place to derive the benefits from segmenting a client bank. In broadcasting terms, they are not selective enough about matching the right resources to the right audiences at the right times.

Segmentation Brings Focus on Profitable Activity

Pareto's 80/20 "rule" is validated in many aspects of business life.
Typically, 80% of a business's turnover emerges from activity with 20% of its client bank.

Segmentation principles can be deployed to ensure the drain on resources caused by the other 80% of its client bank is stopped.

Consider the impact of a business which ceases activity with the bottom 80% of its client bank and duplicates the kind of clients represented in its top 20%.

- Proactive Financial Planners Ltd has 3,200 clients and turnover of £1,000,000
- it re-classifies 80% (2,560) of the client bank as dormant/transactional only
- 640 remaining clients produce 80% of the turnover i.e. £800,000 @ £1,250 per client
- the firm attracts 640 new clients, all fitting the same profile as the remaining 640 clients

- the revised active client bank of 1,280 generates £1,250 per client = £1,600,000 turnover
- £1,600,000 turnover is an increase of 60% on £1,000,000
- 1,280 clients is 60% fewer than the original 3,200

The outcome of a simple but significant segmentation approach is:

- 60% more turnover from 60% fewer clients

The numbers used in this example are purely illustrative, (but an uncannily accurate representation of what I have witnessed in a number of businesses). The principles deployed are however fundamental

If many an advisory business could start again with a clean slate tomorrow morning, an important lesson to bring forward from the old regime would be to adopt a far more selective approach to the kind of clients they seek to serve.

Many firms fall into the trap of believing that clients who keep them "busy" are the lifeblood of their business. The 80/20 rule will tend to disprove that belief and segmentation is the discipline that closes the trap door!

Cutting Back to Foster Growth

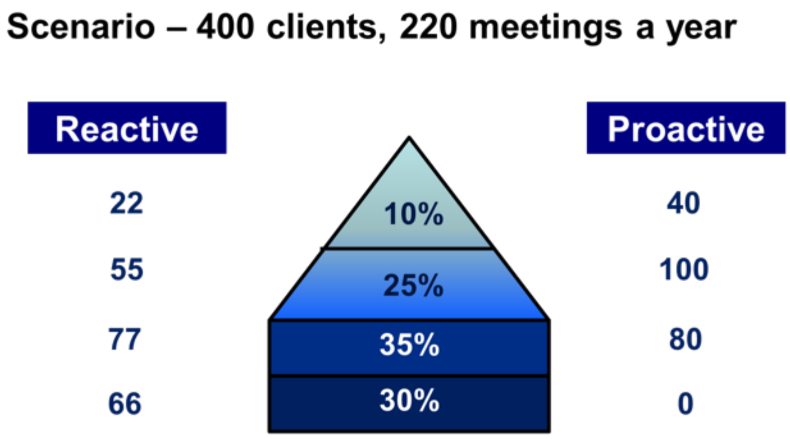
Trimming a customer base can remove complexity from a firm improving operational efficiency.
This can enable quality improvement. Developing service excellence is crucial. In order to do this really well you must understand what your clients truly value, and then deliver it to clients you have carefully selected and targeted.

Retaining unprofitable or unsuitable clients will prevent you reaching the ones you really want to keep and affect the team's morale.

Segmentation in Practice

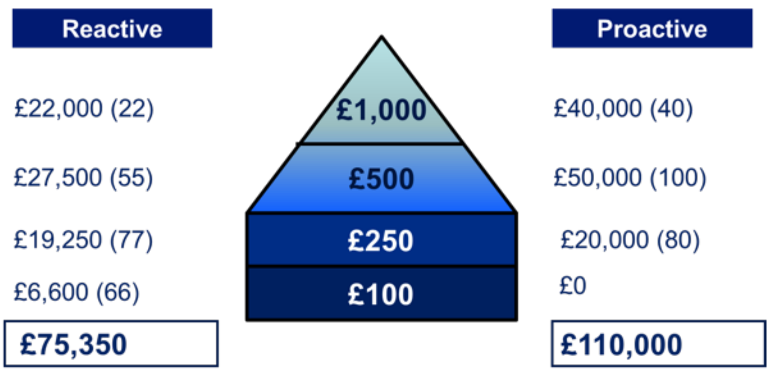
An example scenario helps to paint a picture of how a business can transition its activities to place itself on the right side of the 80/20 rule

- Adviser has 400 clients holds 5 client meetings per week 42 weeks in the year (220 meetings)
- 10% of clients are highly profitable yielding 10 x as much as the lowest value clients.
- 25% of clients are profitable to service today and yield 5 x as much as the lowest value client
- 35% of clients are unprofitable to service but occasionally transact so are attractive to retain.
- 30% of clients are unprofitable today and unlikely to be so in the future.



The adviser sees clients who ring up or calls those for whom some correspondence turns up.
Assume the adviser's time is spent reactively in proportion to the spread of clients. So, he spends 10% of his meetings (22 meetings) with the top 10% of his client bank of which there are 40 clients.
This means 18 of his top clients will not be seen. Similarly the adviser only sees 55 of the 100 clients in their second tier of clients

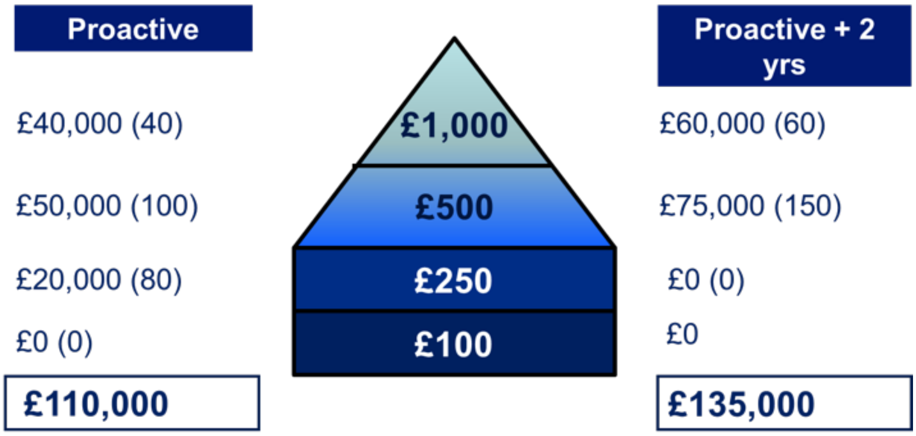
The revenue per meeting using the differentials by tier referred to above, is illustrated in the pyramid below.



If the adviser adopts a proactive strategy, prioritising meetings with the top layers of his client bank, this Proactive approach yields £34,650 or 46% more than the Reactive strategy towards client meetings

In addition, the Reactive approach may reduce the propensity of "neglected" top tier clients to refer this adviser and reduce the capacity of the adviser to seek new clients of the right type.

On the other hand, a focused and proactive approach to meeting the top 40 clients and seeking referrals to contacts with the same profile could increase the top segment by say 50% over two years and remove lower tier clients from the diary altogether.



The outcome in this case is a growth in turnover from £75,350 to £135,000 and a reduction in annual meetings from 220 to 210. This represents nearly £60,000 p.a. per adviser in terms of opportunity cost of not having segmented in the past!

Potential Barriers to Application of Segmentation Principles

Many advisers do not carry through a proactive segmentation approach with their existing client bank, despite the potential benefits. Why is this?

Time shouldn't be an issue. A week spent analysing and segmenting a client bank would reap dividends for the time invested very quickly over the next 51 weeks of the year, in terms of clarity of focus and attention to profitable, valued delivery etc.

Barriers typically emerge in relation to:

- advisers having spent a long career focused on the word "yes" – segmentation means learning to say "no"
- a feeling of obligation to clients who "got them to where they are today"
- the potential lottery winner hidden in the client bank
- the potential beneficiaries of significant inheritances
- feelings of friendship with clients who don't actually generate any profit
- fear of impact on cash-flow

Loyalty versus Obligation

Feelings of loyalty towards existing clients should not be confused with an obligation to provide a loss-making service above and beyond that already delivered in return for fees or commissions previously paid.

Often, firms have stayed in touch with clients in order to be regarded as the first port of call should the need for new business arise. However, "staying in touch" has been vaguely interpreted as an on-going service, usually more in the mind of the adviser than the client.

Segmentation doesn't have to mean "sacking" clients. However, it should lead to the decision about how to manage everybody's expectations. Being available through being viable must be every business owner's motto.

A firm could choose to stay "available" to any number of previous clients or customers without spending money on delivering unprofitable services. It may mean pointing them in the direction of an alternative source of advice. There will remain a degree of admin cost, distraction and environmental clutter that will present a drag on the business if a firm opts to retain these clients.

It may help to assuage an adviser's sense of "owing my clients" if they reflect on the wealth of value, we referred to in the last chapter, delivered to many clients who now generate no profitable or even any on-going income related to policies or funds administered by that adviser.

Remember: **"What have the Romans ever done for us?" - People's Front of Judea (Life of Brian)**

The Windfall Principle

How many "unprofitable" clients have experienced a financial windfall in the past? Where is the line drawn in terms of how much money and resource will be spent on every single unprofitable client in the hope that one of them will generate sufficient revenue to recover all that expense as well as recover the revenue not earned by dedicating time and effort on attracting and serving ready-made profitable clients. For instance in our example above where turnover grew £34,650 in year 1 & £60,000 in 2 years - how big must the lottery win be, or how frequently must a windfall crop up within the client bank to recoup this sort of opportunity cost?

Letting Go

When firms organise their "400" clients per adviser into the relevant service "camps", they place greater emphasis around growth in the service areas. They then begin to feel more comfortable about referring transactional clients elsewhere, ending up with between 120 & 150 clients they actively service and for whom they do a better job, leading to higher quality referrals.

Cash-flow Issues

Curtailing service delivery does not mean automatically losing great swathes of existing pre-RDR trail commission made up of many small individual sums. However, many firms do not realise which parts of their trail stream actually contribute to positive cash-flow and which parts are costing them cash-flow to maintain.

Time spent attracting, advising and dealing with a client whose fee is not profitable cannot be recovered and used with clients who represent the ideal "sweet spot" for a firm's marketing efforts.
At the very least, a business needs to ring fence income streams and expenditure to be sure about where cash-flow "leaks" occur.

Again, the simple question here is "If you were starting afresh tomorrow, how would you allocate your effort, time, expertise and expenditure?" A fresh start is not a luxury most firms are afforded. However, clarity about moving away from an operating model clouded by vague notions of who gets what for the revenue we received would be a breath of fresh air in the existing business.

Our team has helped many firms create messages to existing clients to help them decide whether they wish to sign up to a new, re-priced proposition or opt for a reactive "we're here when you're ready" approach or "we are no longer the right firm for you and your needs". For potential clients of the right type, simple email marketing tools can be employed.

Client Bank Management Segmentation Process – How to get started

Often it appears a huge job. That is why whilst many people are aware of its benefits, don't implement it, or satisfy themselves with a mental note of at least their very best clients. This still falls way short of deriving the real benefits of a full segmentation and client bank management process. You therefore need a process to work to and accept that first time round it may only be 75 – 80% right, but it will probably only ever be 90 – 95% right. The system itself should mean that over a couple of years it will become reasonably accurate and highly productive for the business.

The process

- Define the segments
- Establish servicing or contact strategy
- Evaluate client bank and put them under headings
- Set up Client Bank Management System
- Cleanse the database
- Review each client every time you speak to them

Define the segments

As we have highlighted there are a number of ways of viewing your Target Market and the segments within them. We cannot illustrate a method for every approach as everyone will have different definitions. We will simply define four segments as A, B, C or D client. Typically 10% maximum of clients will be A's (of which 1% will A* & 9% A), 25% are B's, 35% are C's & 30% D's.

- 'A' class clients are people that add significant value to your business year on year in terms of business they do and/or people they refer you to and you can see yourself getting good value from them for many years to come. If you could double the numbers of these people in your client bank, business would be booming.
- B class clients add more than average value to your business today, on a fairly regular basis and are likely to for a few years to come
- C based clients are people who still add value but only on an ad-hoc basis. You won't want to expend energy & cost looking after them year on year, but you will get some reasonable to good value at a given time in the future which might warrant annual phone or letter contact.
- D class clients cost the business far more than they make, they rarely earn you anything and when they do it is almost more costly to process than what you earn from it and / or they are constantly complaining or ringing up for free advice.

In terms of establishing clear benchmarks to segment you should select what is important and appropriate to the size and shape of your business, below **is simply an example**:

Category	Description
A* (1 or 2%)	Very high net worth individuals or Senior Executives in Successful Businesses (define in salary / asset terms your benchmark for this). They add well over 10 times my average for earnings from a client per year (define this). They see you as their only financial adviser.
A (max 10%)	As the above, but just not quite in their league, but still add significantly more value than the average say 3+ times.
B	Good relationship, see you as their only financial adviser, value financial planning, will pay an annual retainer or do business regularly at an above average value.
C	No merits or desire to do business on a regular basis, but will add more than £x at a given date in the future from a maturity, mortgage clearance, retirement etc and so worth staying in contact with by phone, or post, for when that Golden Moment arises.
D	Low value, irritants, little chance of any future significant returns and even if so, is it worth the hassle in the meantime?

You'll notice that I have added an A* category – I think this is self explanatory, but these really are only likely to be your top 5 or so clients.

<u>Establish servicing or contact strategy</u>

Category	Service strategy
A*	These are people if you "wow" them and they recommend you to someone like them you are likely to add more value than if you add 10 or 20 new B clients. Promote the widest possible service offering, potentially almost acting as their agent if that would be of benefit or value to them. Be clear as to what they value and want, don't deliver stuff that is meaningless to them and whilst maintaining consistency of process, be prepared to bespoke.
A	As above but perhaps lower frequency on the more costly elements to you as a business
B	These clients need to fit into a clearly defined offering, all be it the frequency of that offer may vary from annual to bi-annual to tri-annual depending on need, value and profitability.
C	These people have not requested or do not warrant providing a regular service, but do have a good transactional opportunity in the future for business. You may consider keeping this group and sending an annual mail-shot with feedback questionnaire and maybe have someone make an annual phone call or bi-annual call to ensure they are still there and their circumstances have not changed. Don't get drawn into a meeting unless there is either a clear sales opportunity or a change that may mean an Annual Service Agreement might be of value and interest to them. However log on the system a couple of months ahead of the next specific significant event (Golden Moment) that you are aware of, this maybe 4 or 5 years ahead even. You should definitely seek to get in front of this client at this moment then.
D	Archive & separate from the main database. Do not get drawn into providing a service.

<u>Evaluate client bank and put them under headings</u>

- Firstly look at a list of your clients and work through them as quickly as you can, segmenting them as best you can from looking at a list of your clients into A*,A, B, C, D, U & any other codes you see as necessary. (U's are unknowns, people not seen or you have no records on to remind you of who they are) You're A*'s, A's & D's will jump out at you, you are unlikely to allocate an A to C status and if you use the system properly you are less than 12 to 18 months away from picking up any initial oversights you make at this stage.
- Your database should have the facility to tag each client with its category somewhere, so you and any of your staff can quickly see what type of client they are. You can also create useful lists of each category and ideally be able to use for ease of mailshots in the future.
- Then work through and hold Service Agreement meetings with each of the A* & A class clients. Following each intervention with the clients establish whether your categorisation was correct, amend if appropriate and enter the next contact month in the database. With an average adviser client bank that might be 4 meetings a week for 10 weeks in the first quarter.
- Then work through the B's in the same way & then the U's (unclassified) to establish what category they should fit in to. These may take the adviser the rest of the year, 5 a week for 30 weeks to work through.
- Create a mailing list for the C clients and either design a we won't call you approach or set up the client to expect a courtesy call with an invitation to a meeting. In any event it would be better to stagger these over a period of time to ensure the business has the capacity to act on any enquiries and doesn't create a wave of work it can't manage and detracts it from its core clients and service.
- You will need to devise letters as to what these should say. C class letters could include a statement along the lines of, "we are aware that we have not been in touch for some time and would like to ensure our records are up to date. Rather than trouble you with a potentially unwelcome call, can you please take a couple of minutes to either call us to answer the attached questions or return the attached questionnaire". (You may choose from time to time to have someone phone them, maybe bi-annually, in which case remove the part referring to not calling them). Perhaps include within the letter a list of things that may be effecting them that you could discuss.

The questionnaire could include:
- do they wish further contact?
- Is there anything in particular they want to discuss?
- Are there any significant personal or financial changes in their circumstances since you last met?

For the U class clients you can draft a similar letter. Rather than leave it for them to respond you could say you will be giving them a courtesy call and send out a certain number a month, that you know can be followed up within a couple of weeks.

<u>Cleanse the database of D's</u>

You cannot begin to evaluate the drain this population is on the business in terms of paper administration let alone enquiries and any service calls.

You could write a one off letter to them, perhaps including some comment around "due to market pressures and new regulatory drivers instigated by the Government & Regulator, in the interests of the long term ability of the firm to offer an on-going service to your clients you have needed to introduce a menu of annual servicing fees. You might supply 3 or 4 options – a maintenance only retainer (e.g.£10 per month to maintain files), or the minimum rates for each level of service as offered to the B segment, some may elect to take it! If they wish you to continue to monitor and look after the files and interests then they should complete and return some attached documentation (an agreement), including a direct debit. If not then you may simply say you understand if they feel the need to seek future advice elsewhere, but thank them for being a client of yours and wish them all the best for the future.

Summary

As a business consultancy team, we have worked with numerous advisory firms. They always wish they had tackled segmentation many years sooner. Indeed a firm of 3 advisers I began working with in 2011 grew turnover from £450,000 to £500,000 in 18 months with one less adviser. In that time, recurring revenue of as a percentage of overall turnover rose from 30% to 60% and profitability doubled. They also sold more than half of their client base and the growth forecasts for this year are impressive.

Given what we know about the impact of variability those that can be highly focussed will have the potential to reduce variability and be more productive and as we extend the boundaries and options the more complicated and problematic the processes become.

Rationalise your client bank to meet the resources you have available and in so doing better define your target market and what you want to offer them that meets their needs. Going back to our motorway analogy and constraints in Chapter 2, it is about controlling the flow at 50mph and not creating a jam in the system. If an adviser can only service effectively around 120 clients what is the benchmark that should be applied to ensure you meet the goals of the business that meets the personal objectives of the owner / adviser? If that benchmark is set too low then you constrain the likelihood of the goals being met and the services you promise being effectively delivered.

Segmentation for the first time may seem a daunting task. The opportunity cost and risks associated with not tackling this aspect warrants taking a week out of the business to deal with it. The returns reaped in the remaining 51 weeks of the year will make it worthwhile. If you have not applied segmentation before or reviewed it recently, can you afford the opportunity cost any longer?

If you need help with identifying and understanding your target and / or your segmentation approach then e-mail us at support@12man.co.uk to see how we could help.