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CITIGROUP'S ACQUISITION OF EGG

Customer Value Management and the Intangible Value Management

This case study briefly describes the way the UK bank Egg established a creative customer experience model to build a strong brand but ran into financial difficulties that are being addressed by an acquiring company, Citigroup.

Background

Retail banking traditionally has been a low-margin business, albeit with a lot of money at stake. Since that money belongs to depositors, a bank creates significant market power by building a trusted brand.

A key part of a bank's success, of course, flows from what it can do with depositors' money to make a profit. Generally they invest these monies in various forms of debt-based or equity-based financial instruments. The propensity for a bank to take risks in order to simultaneously improve its chances for rewards depends to some extent on the culture of the bank. In the United States, focus is on managing assets using classic risk-based approaches. The impact of brand risk (reputational risk), and customer *brand equity* is normally not heavily considered in their calculations.

In non-US cultures, such as Canada, evidence shows that banks focus as much on customer relationships as they do on traditional financial management. (Source, Ogilvy One, in a CMAT assessment of US and Canadian banks.) While banks from Europe and Asia also develop market share and trust through brand management, increasingly international banking is performed within guidelines and practices designed to limit downside risks in case the global economy, or a regional economy, runs into trouble.

Part of a bank's arsenal of weapons to reduce risk is to determine the profitability of customers, based on how much return the bank gets from that customer. Customers with high deposit amounts, or high loan amounts (on which the bank can make interest income), are desirable customers, particularly if their credit is "good enough" to make them reasonably low risk, but "bad enough" that the bank can reasonably justify charging higher interest rates on short-term and long-term loans (credit cards and mortgages, for example).

This is the story of Egg and Citigroup. Egg, a pure-play online bank out of the UK, had a strong brand, huge subscriber base. Citi, a US-based bank, was profitable and interested in buying into new business models and markets, especially the potentially lucrative credit card market in the UK, which Egg dominated. "It's worth noting that although Egg proactively gathers customer feedback, the 10-year-old firm never raked in money for ex-owners Prudential. As it becomes part of Citi what happens to Egg's principled approach remains an open question," according to Bank Technology News (Customer Feedback: Will Egg's research Tactics Hatch at Citi? December 2007).

Citigroup
Citigroup wanted more of a footprint in the United Kingdom. When Prudential, the owner of online bank Egg, went shopping for a buyer, Citigroup was first in line to make a bid.

“Prudential PLC, the British financial services company, is to sell its loss making internet banking unit Egg to Citigroup for £575m ($1.127bn) cash,” reported Chris Williams in January 2007 (The Register).

“Since launching in 1998, Egg has become the world's largest purely online banking outfit, but last year made a loss on the tidal wave of personal debt which saw record numbers declare bankruptcy. Murmurs that the Pru would ditch Egg have been bubbling under for a while.”

“George Awad, EMEA CEO, Citigroup Global Consumer Group, said: ‘We like Egg’s brand; we like Egg’s platform; we like Egg’s customer engagement model; and we like Egg's customer set,’” continued Williams. Awad says (in an article by Julie Chan, *Banking Business Review*), "The combined business will have great brands, great people, great technology and great customer service. This acquisition provides us with meaningful scale in consumer financial services in the UK, a key strategic market, and enables us to enhance the value proposition for customers and grow our business. Citi is also learning from Egg's successful direct banking platform and customer service programs."

After the acquisition completed, Citigroup immediately became tied up in a scandal. In Sophie Borland’s article, “Egg faces inquiry into cancelled credit cards [The Telegraph]”, “The firm has sent letters to around seven per cent of its two million customers warning them that their cards will stop working within 35 days.” According to Borland, the bank said these customers has a less than acceptable risk profile implying that they were spending over their credit card limits. However, “many of those customers who received letters insisted that they always paid their bills on time and had excellent credit ratings. There have been accusations that the internet bank made the move because the customers did not make it enough money, which Egg strongly denies.”

QUESTIONS:

1. Is it fair to “fire” customers who are not profitable?
2. How does one go about assessing the profitability of a customer?
3. Was Citigroup’s move justified?

Egg
Banking Technology News recently described Egg's technology model, and suggested that Citigroup could do well to exploit it.

> 'Citigroup's purchase of the UK-based Internet bank Egg could have a much bigger impact going ahead than the $1.13 billion deal would indicate, bringing not only new accounts and credit card balances into the fold but also introducing Egg's practical, active market research practices to a much broader audience.
> As the global giant prepares to further absorb its new online lender, Egg customer experience management executive John Jennick is working with a team to figure how best to push its internal consumer tracking methods further into everyday business. That will be part of Citi's U.K. retail operations and sure to gain wider attention within an enterprise looking to remake itself from the ground up.
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> 'Egg uses a marketing research software suite from Confirmit, a vendor based in Norway and California, for 90 percent of its customer tracking, and has been doing so since 2002. Over the years it has used the in-house system to compile a record of consumer attitudes; it uses this experience to inform a constantly rolling poll operation of its customer base. It tries to get as personal as possible-pinpointing customer responses to actual individuals, rather than taking a small anonymous group and extrapolating from the sample.
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> 'In its modeling and research, Jennick says, it rejects the customer relationship management approach of rules-based systems tracking transaction patterns and mass balances in an effort to predict the future. Rather, it tries to move fast and be responsive to what customers say about their attitudes. Gary Schwartz, a Confirmit executive which has watched Egg develop how it uses the company's software, can point to a few instances of how that's making a difference in how the firm operates.
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> 'From the beginning Egg's been active in keeping in touch with customers, through e-mail or otherwise. Schwartz says the customer base is used to giving feedback to the firm on a regular basis. A couple years ago Egg started keeping data on an event-driven, rather than a periodic or scheduled, basis. "If someone contacted the call center, within 24 hours you might be asked: 'how did that call go,'" Schwartz says. "If it went poorly, within another 24 hours you'd be re-contacted. Within 48 hours after providing the feedback, Egg would be on the phone trying to fix it. ...Some customers were actually blown away by the idea that the bank actually did something with the feedback," he says.
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> 'Jennick says Egg still uses outside tracking and surveys, but that having nearly all of the market research in-house leads to speed and allows the company to organize around results. The firm introduced a new bank card, a hybrid credit/debit product, in the space of six weeks because it was able to go straight to the customer base in a space of 72 hours. If they'd outsourced to an agency, it would have taken weeks to get the initial data back.

‘Egg used Confirmit to help revamp its collections office as well. Using usual risk models and account data the firm identified at-risk customers and contacted them, saying "We need to talk;" it was a kind of marketing campaign. Egg took the approach that the conversation didn't have to be an awful one, however. It changed collections to "Borrowing Management" and figured, OK, skip a couple of payments, and then let's make sure we're on a schedule. The result was that the bank wound up being able to reduce loss provisions and increase the value of accounts.

‘The firm can quickly test assumptions, also. The firm wanted to understand what makes people happy with call centers, if and when that does happen. Egg execs figured that what customers really wanted was to get a person quickly on the phone. The options meant hiring more agents, or trying to get existing agents to speed up calls and take more volume. Instead, the feedback was that it's much more important for the customer to feel his time was well-spent: i.e., waiting a little bit is fine, as long as the person at the call center who eventually picks up is able to solve the problem.

QUESTIONS:

1. Why did Egg reject classic CRM direct marketing techniques?
2. What is a “moment of truth,” and does it truly have value in building strong customer relationships?
3. What do you think of the “borrowing management” technique of allowing people to skip a few payments? How would you measure the risks associated with this move? Examine the costs of acquiring new customers, the costs of escalating existing customers to a default state, costs related to outsourcing bad debt management, and the tax value of loss write downs.
4. How important is it that Egg can quickly test its assumptions, particularly with its call centers? Why are call centers so important to Egg?
5. What corporate asset is Egg building through such systems?

The scandal widens
According to the Borland article (op cit.), ‘Egg's decision to cancel the credit cards, in an attempt to stem further bad debts, was seen as an astonishing own [*sic]* goal, even in an increasingly difficult credit card market as customers struggle to repay debts.
This is the first time that a bank has cancelled such a large number of cards in Britain. There are fears that other firms may scrutinise their books as the credit crunch continues.

‘Profit margins are getting tighter, which means that credit card companies are trying to avoid bad debt.

‘One way of doing so is by dumping unprofitable customers who never pay interest charges.

‘Rival banks have not cancelled as many cards, but some have introduced flat fees for people who hardly use their credit cards.

‘Others have reduced the interest-free period for those who pay their balance in full each month… John McFall, the chairman of the Treasury select committee, has suggested that banks are taking cards away from reliable customers and giving them to high risk ones to boost their profits.’ Borland reports, ‘Nigel Griffiths, the Labour MP and former consumer affairs minister, said he was "in no doubt that is the reason".

‘His initial complaint to the Financial Services Authority has been passed to the OFT, which will decide whether to launch a formal investigation.’

QUESTIONS:

1. Again, does Citigroup’s Egg have a right to “fire” bad customers?
2. What are the reputation costs to Egg provided the investigation occurs?
3. To what extent will Citigroup’s move to fire solvent customers and attract riskier customers be viewed within the context of the current US-driven banking and economic crisis?
4. Do you think Egg’s brand can be salvaged?
5. How does the total lifetime customer value metric play into banking? What changes would you recommend to Citigroup for examining:
    a. Costs related to keeping solvent customers
    b. Opportunities for selling additional products and services to solvent customers
    c. How they executed their “firing” of “bad” customers?
    d. How they should manage their reputation?
    e. The impact on stock values during this period, and comparing to the financial improvements related to “firing” those “bad” customers