Uncovering *implicit* customer needs for *explicit* product positioning:
Growing Prudential Annuities’ Variable Annuity Sales

**Jac Herschler**
*SVP and Head of Business Strategy, Prudential Annuities*

**V. Kumar**
*Lenny Chair Professor*

**Denish Shah**
*Assistant Professor*

*Prudential*

*Georgia State University*
*J. Mack Robinson College of Business*
Prudential is one of the leading providers of Variable Annuities

Prudential Financial:
- Assets under management: $641 Billion (09/30/09)
- Approx. 41,000 employees in 37 countries (Dec, 2008)
- Businesses: Life Insurance, Annuities, Retirement-related Services, Mutual Funds, Investment Management, Real Estate Services

3Q 2009 Asset Rankings ($ millions)

Variable Annuity Assets Under Management\(^{(1)}\)
- MetLife: $86,115
- Hartford: $83,324
- Prudential: $61,54
- AXA
- Lincoln
- Ameriprise
- Hancock
- Pacific Life
- ING
- AEGON

1) Source: VARDS 3Q'09 report. Advisor-sold, excludes group/retirement plan contracts.

Withdrawal-Based Lifetime Income Guarantees Now the “Norm”
Variable Annuities (VA): Popular retirement investment product.

- A VA is a combination of an insurance contract and a financial investment.
- Market flooded with VA products
  - Over 1000 VA products from 100+ companies

- Earns a monetary return
- Offers protection against certain risks such as longevity risk & sequence risk
Project Team Composition

Marketing Communications
- June Amori
- Tom Winer

Marketing Research
- Lee Haydon

Business Strategy
- Jacob M Herschler

Academic Researchers
- Dr. V Kumar
- Dr. Denish Shah

Corporate Communications
- Lisa Bennett
KEY SEGMENT: Investors in the Retirement Red Zone®

KEY OBJECTIVE: Grow Prudential’s VA business

POTENTIAL OPPORTUNITY: Behavioral Risk* not effectively communicated by competitor firms

KEY CHALLENGE: How to leverage the concept of Behavioral Risk?

*Risk of emotionally driven behavior adversely affecting one’s investment decisions.
Leveraging the concept of Behavioral Risk

Conventional Marketing Approach

Buy this VA. It will also protect you from Behavioral risk.

- Risk theories get complicated
- Executed at aggregate customer level
- Easy to replicate by competitors
Proposed Approach:

A Framework for Uncovering Implicit Needs for Customized Product Positioning
Blending Marketing Theory, Research & Science

**Marketing Theory & Research**
- Research latent needs for the product/service

**Key Stages of the Framework**

**PHASE 1**
- Uncovering the implicit needs

**PHASE 2**
- Quantifying the implicit needs

**PHASE 3**
- Implementing customized product positioning

**Marketing Science**
- Apply Multivariate technique for uncovering & optimizing the number of dimensions
- Specify and estimate a suitable statistical measurement model
- Apply a scientific method for measuring the financial impact of the strategy
Blending Marketing Theory, Research & Science

**Marketing Theory & Research**
- Focus Group
- Literature Scan
- Market Survey

**Key Stages of the Framework**
- **PHASE 1**
  - Uncovering the implicit needs

**Marketing Science**
- Exploratory Factor Analysis, Varimax Rotation

**Scale Development**

**PHASE 2**
- Quantifying the implicit needs

**Econometric Model**
- Forecasting Model
- Bayesian Estimation

**Adapt proactive market orientation theory**

**PHASE 3**
- Implementing customized product positioning

**Hierarchical Bayesian Measurement Model**

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PHASE 1: Uncovering Implicit Needs

What emotions* influence investors’ retirement investment decisions?

* For the purpose of this study, emotions broadly refer to affect, feelings, attitudes and behavioral tendencies that potentially contribute to behavioral risk in the Retirement Red Zone®
Questionnaire Design

**Preliminary Questionnaire**
- 11 constructs
- 33 measurement items
- 200 Investors

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<thead>
<tr>
<th>Constructs</th>
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<td>Complacency</td>
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**Final Questionnaire**
- 5 constructs
- 14 measurement items
- 1008 Investors

- Study administered online from: Nov. 23, 2006 to Dec. 3, 2006

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<td>Susceptibility</td>
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Establish **CONSTRUCT VALIDITY**
PHASE 2: Quantifying Implicit Needs

*To what extent are the relevant emotions prevalent in investors?*
Hierarchical Bayesian Measurement Model
- Individual emotions are specified as latent factors

Model Results are employed to compute the Retirement Emotion Quotient (REQ) as the weighted sum of factor scores of each respondent.
Interpreting the REQ Score

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<th>REQ Score</th>
<th>Percentile</th>
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<tr>
<th>REQ Score</th>
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This means that 40% of the U.S. population in the Retirement Red Zone have a higher degree of emotions when the REQ Score is 36.
Two respondents with the same REQ Score (= 36) but different mix of emotions

- Percentage Individual Emotion Score (PIES) – indicates which emotions dominate within each individual
- For Martha: $\text{PIES}_{\text{Inertia}} = \frac{\text{Score on Inertia}}{\text{Maximum score possible on Inertia}} = \frac{8}{16} = 50\%$
PHASE 3: Implementation

How did Prudential leverage the knowledge of implicit needs of the customers for customized product positioning?
EQ Tool was packaged as an electronic tool resident on a secure server. It was remotely accessible to Prudential's 60,000 FPs across the United States.
Prudential’s Retirement EQ Survey
Help Your Retirement Red Zone Clients Guard Against Behavioral Risk

Take the Survey

Clear Answers
Fill Out Questionnaire
Get Results
Get Blank Questionnaire

Prudential and researchers at the University of Connecticut collaborated on a study of how emotions influence the investment decisions of Americans in The Retirement Red Zone®. The study:
1. Calculated an investor’s Retirement Emotion Quotient (EQ) Score—the degree to which emotions play a role in investment decisions; and
2. Identified five primary emotions that influence how investors make decisions about their retirement assets.

Now you can help your clients and prospects better understand how behavioral risk – the impact of emotions on investment decisions – can play a role in their investing strategies for retirement. They can take the same survey used in our research project to see how they compare to 1000 other Americans in The Retirement Red Zone.

Instructions
1. Get a blank questionnaire for your client to fill in and return to you (you will need to fill in your client’s answers online in order to generate a client report) or fill in the questionnaire online with your client present.
2. After you complete the last question, you will automatically return to this screen. Click “Get Results” to generate a customized report.
3. Get the 4-page report to share with your client.

Variable annuities are for retirement purposes and are subject to market fluctuation, investment risk, and possible loss of principal. Annuity contracts contain exclusions, limitations, reductions of benefits, and terms for keeping them in force. Your licensed financial professional can provide you with costs and complete details. Tax deferral is already provided by a qualified plan such as a 401(k). For additional information, the participant provides a nonforfeitable death benefit for eligible annuity contracts.
Research Academics at the University of Connecticut partnered with Prudential to study how emotions influence the investment decisions of Americans in The Retirement Red Zone.

**What Is Retirement EQ?**
Participants were asked a series of questions to measure the degree to which these emotions influence their retirement investment decisions. The research concluded that indeed everyone in the study was influenced by one or more of these emotions when making investment decisions.

**Your Retirement EQ Score**

- **Why Is Your Retirement EQ Important?**
  
  As an investor, you make decisions based on your individual needs and respond uniquely to the uncertainty of investing. Understanding your retirement investment decisions at this critical point in your life will help become better prepared for the challenges facing every retirement investor.

- **Your Retirement EQ Score**
  On a scale of 14 - 90, your score is 45.

- **Compare Your Score to Participants in The Retirement Red Zone**
  Your score indicates that 15% of investors in the research study are more likely than you to be influenced by emotions when making investment decisions.

**Screen-shots of the EQ Tool Report**

- **What's Influencing Your Retirement EQ Score?**
  - **Fear**
    - You may invest with a strong focus on certainty and protection against loss.
    - You prefer to have a return that is certain compared to a larger return that is uncertain.

- **Work with Your Financial Professional**
  If you are in The Retirement Red Zone, your Retirement EQ profile is only one factor of many in evaluating a strategy for successful retirement planning. It is important to work with your financial professional for a comprehensive understanding of all factors influencing your retirement investment strategy. Together, you should review your goals, consider suitable solutions, and create a plan that will help you live your retirement dream.

   Prudential is committed to ongoing research that will help understand and address the needs of retirement investors, particularly those in The Retirement Red Zone — perhaps the most important time of their investment lives. For the published report on the entire study, please ask your financial professional.

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Variable annuities are for retirement purposes and are subject to market fluctuations, investment risk, and possible loss of principal. Annual account values, returns, and benefits are not guaranteed and are subject to the terms and conditions of the annuity contract. The variable annuity provides a guaranteed death benefit and the ability to receive lifetime income. To obtain a complete prospectus, contact your financial professional. Read it carefully before you invest or send money.
How was the EQ Tool implemented? (cont.)

- Five FP Guides (corresponding to the five dominant emotions) were generated to explain how to interpret the results of the EQ Tool and tie those results to sales efforts.

Recall Fred’s Profile

Are Your Clients’ Investment Decisions Influenced By a High Degree of:

- Aggressiveness?
- Susceptibility?

Now that you know how your client's EQ Profile correlates:

- 6% Fear
- 0% Regret
- 100% Aggressiveness
- 17% Inertia
- 13% Susceptibility

Indicating that aggressiveness helps understand how his/her planning for retirement.

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How was the EQ Tool implemented? (cont.)

**AGGRESSIVENESS:** Typical investment attitudes and behaviors may include

- **Growth is imperative**
  The potential to make money is more important than avoiding loss.

- **Upside potential is a priority**
  They tend to invest aggressively during The Retirement Red Zone in order to gain a better chance at upside potential.

**PROTECTION FROM AGGRESSIVENESS?**

- They can still invest for growth within their risk tolerance. At the same time they can protect against sudden dramatic market downturns. Because regardless of how the market performs, the money they will count on to generate lifetime income is guaranteed, even if their account value falls to zero (assuming no "excess withdrawals").

- They can find upside potential on money needed to generate retirement income through a guarantee that allows them to lock in market gains if and when they occur.

**Reminder:** Your client’s survey results may indicate that he/she is influenced by aggressiveness, as well as, some combination of other emotions. This may lead clients to conflicting feelings about which investment strategy is best. Be sure to view the additional FP Guide pages that help explain other emotions that may be affecting your client.
How did Prudential market the EQ Tool?

Launch was accompanied by:

- A research report summarizing the findings of EQ research
  - Title: “Behavioral Risk in the Retirement Red Zone”

- Training seminars for FPs to understand behavioral risk and its implications for investors
  - 100+ Seminars attended by about 2000 Financial Planners

- Technical support
  - E-marketing team
  - Traveling website experts for on-site support

- Press Releases/Webinar
How was the EQ Tool implemented in the marketplace?
Impact of EQ Tool

Prudential

EQ Tool Impact

Financial Planners

Customers/Investors

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Measuring the impact of EQ Tool by employing empirical models with Bayesian estimation

Model
Prudential’s
VA Sales

Firm specific Factors

Industry specific Factors

Macroeconomic Factors
Forecasting Model

VA sales = \int \left\{ \begin{array}{l} \text{Advertisement} \\ \text{Number of Products} \\ \text{Unemployment Rate} \\ \text{S&P 500} \end{array} \right\}

*Estimation Approach: Bayesian*

Model Calibration Time: 35 months (Time before EQ Tool launch)

MAPE = 6%
Forecasting Model (cont.)

EQ Tool Impact = Difference in VA Sales (Actual-Predicted) during the prediction period

Model Prediction Time: 13 months (Time after EQ Tool launch)

EQ Tool Impact = $455 to $480 million
(Based on repetitive draws of the parameter estimates)
Impact on Potential Customers/Investors

- The EQ Tool enabled the investors to learn about their own behavioral tendencies and made them more receptive to Prudential’s VA products.

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<tr>
<th>BEFORE USING THE EQ TOOL</th>
<th>AFTER USING THE EQ TOOL</th>
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<tbody>
<tr>
<td>60%</td>
<td>75%</td>
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<tr>
<td>felt that they did NOT exhibit any Behavioral Risk</td>
<td>desired protection against Behavioral Risk</td>
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Impact on Financial Planners

“……This is an invaluable tool for field agents as we participate in those important conversations about a customer's plans for the future……..”

Francis Marantal
Field Sales Associate

“The EQ tool proved successful …….. new, unique and user-friendly ways to help investor's understand the psychology of investing……. helpful and engaging way to bring the concept of behavioral finance to life.”

Elaine Chen
Manager of Agency Training, Northern California Agency
...Emotions can cause consumers to react to market uncertainty in ways that could harm their portfolio.”
Impact on Prudential

- Customer-centric product positioning and differentiation
  - Sales presentations now differentiated for each customer

This VA product will protect you from vulnerabilities due to **Fear & Inertia**

Prudential’s FP  Martha

Fear = 94%
Regret = 17%
Aggressiveness = 0%
**Inertia = 50%**
Susceptibility = 0%
## Impact of EQ Tool on Prudential’s Business Practice

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<tr>
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<th>Before EQ Tool Launch</th>
<th>After EQ Tool Launch</th>
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<td><strong>Product Positioning</strong></td>
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<td><strong>Market Orientation</strong></td>
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<td><strong>Sales &amp; Marketing Approach</strong></td>
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<td><strong>Average Quarterly Sales Growth Performance</strong></td>
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<td><strong>Incremental Sales Lift Due to EQ Tool</strong></td>
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2009 Boomer Market Advisor magazine’s “Reader’s Choice” Award:

- 5th consecutive year for having the #1 living benefit “that best addresses the income and longevity issues clients face.”
Looking Forward…..

- EQ Index

- Work with Prudential for the 40-year old cohort
THANK YOU!