Pricing in Banks: The Key to Delivering Exponential Value

Point of View

In the new world that's emerging, banks must pay even more attention to pricing

The basis of relationships between banks and their customers has been changing over the past decade, thanks to technology-driven innovations such as the internet and smartphones. This process has accelerated in recent years, as a result of which banks find their customer relationships becoming not only more digitally disintermediated and less branch-centric, but also increasingly fickle.

Most banking businesses are still built around a set of core products. Regulatory restrictions or cost structures (e.g., prevailing interest rates in the economy) make it difficult for customers to meaningfully differentiate the core offerings of one bank from those of another. Indeed, 75% of the respondents in a survey conducted by Deloitte perceived products and services across banks to be undifferentiated.[i] The COVID-19 pandemic has made customers even more price-conscious and amenable to shift loyalties to benefit from better pricing.

In such an environment, banks will find it increasingly harder to win new customers and retain existing ones unless they consciously focus on pricing. Banks must consciously factor pricing when formulating strategies and plans to deliver "customer centricity" and "superior customer experience journeys". Not doing so will have an adverse impact on the bank's future growth possibilities.

The ability to contextually determine the "right price" for every customer with regard to every offering is a key first step. Just as important is the ability to present this price to prospects and customers on the engagement channels of their choice. This also requires systemic agility to adjust pricing "on the fly" in response to real-time or near real-time insights into customer behavior that are used as inputs to identify customer needs.

What is the "right price"?

By "right" price, we mean a price that consistently strikes the fine balance between two potentially conflicting requirements:

- attractive enough to persuade customers to make the purchase through the bank; and
- at a level that makes the deal adequately profitable for the bank.

The price must be "right" for every customer in the context of every product and service offered to him/her irrespective of the channel; it must also reflect the size and direction of growth of the relationship.

But there is also more to it than that. It entails understanding individual customers, they behaviors, the products and services they use, and their current circumstances and context to pitch the right product at the right price to them.

The "right price" also depends on factors such as how much the customer is willing to pay for the product in their existing circumstances. For instance, a coffee shop may charge a premium price for a Latte due to the perceived value associated with the brand – an ambient location, the exclusivity of the product, etc., thereby garnering patronage from customers. Similarly, a customer may be willing to pay a premium price to get a particular service because it is delivered in a quicker timeframe.

Further, traditional product-based lines of business have created silos in terms of technologies, teams, governance and mindsets. By continuing to focus on maximizing revenue and profitability for individual product lines, banks risk losing opportunities to create deeper customer relationships that could have enabled the bank to provide a larger range of solutions to each of its customers. It is reasonable to believe that such multi-product relationships will contribute to higher revenue growth and overall profitability, provided, of course, that each offering is priced right for each customer!

The "right price" alone will not persuade customers to buy products and services they do not need at that point in time. Therefore, closely linked with pricing is the ability of banks to accurately identify customer needs, recognizing that these needs are tied to every individual customer's context. Banks have made significant investments in analytics, AI and other cutting-edge technologies to help them identify customer needs. But are banks paying enough attention to pricing? We think not.

Pricing has not suddenly become center-stage

Since its early days, banking has been a relationship-driven business. Customers knew the managers and staff at their bank branches and remained loyal customers for a lifetime; often, these relationships transcended generations. Trust between banks and their customers was built between individuals, and responsiveness by banks to the articulated needs of customers was a critical determinant of relationship quality and durability. Customer-centricity meant personalized attention to customers, with the wealthier customers getting preferential service (e.g., better interest rates, some freebies, access to a relationship manager etc.).

This model has witnessed significant change in the past two decades. Banking strategies, operations and business models have all adapted and evolved under the influence of mobile technologies and the internet. "Customer-centricity" has increasingly meant access to digitally-delivered banking solutions anytime, anywhere and through multiple channels. As a consequence, there has been a marked "digital-depersonalization" of relationships.

Especially in the last couple of years, the notion of what customers acknowledge to be "value" has perceptibly shifted. While convenience, security, speed, basket of solutions etc. are still important, they have become hygiene factors. Pricing is becoming an important basis for differentiation. Customers, used to "discounts" in almost whatever they buy, now have similar expectations from banks as well.

Two specific megatrends have contributed to this major shift. The first is growing competition from Fintech players and Big Tech companies that have launched innovative payment solutions that are easier and quicker to use, and often cheaper as well. The largely-digital "neo banks" are able to compete more effectively on price than their traditional counterparts. This has caused major disruption. The second force of change is the coming together of players from multiple industries to form "ecosystems" that are able to offer customers a number of benefits, including one-stop access to a wider selection of solutions, and significant cost savings.

Such ecosystems also help reduce marketing and customer acquisition costs for the participants, who are able to target prospects better and achieve higher conversion rates. For example, if customers can buy tickets, hotel reservations, cabs, insurance, foreign exchange and tickets to popular tourist destinations in one customized and discounted bundle at one shot, why would they choose to buy them separately and pay more?

Banks must build further on their responses thus far

To respond to the changes in their environment, banks have begun to take actions on multiple fronts. They are building their own ecosystems and participating actively in others. They are developing their own payment apps to compete with what fintechs offer. They are putting in place technological capabilities to predict customer needs based on analysis of customer data, transaction data, location data, online interactions etc. They are honing their ability to target prospects and customers on digital and physical channels with appropriately-priced offerings.

All this is intended to ensure that banks offer every customer those products and services that the former believes the latter needs at that particular time. This logic cannot be faulted. But the key question that remains is this: how can banks ensure that for every customer, they consistently quote the "right" price point for every offering they pitch.

We believe there are four distinct but inter-related areas on which banks must focus in order to offer every customer the "right" contextual price each time an offering is presented.

Superior customer segmentation

Banks cannot stay with a one-price-fits-all approach. Segmentation is necessary to create smaller chunks of customers. However, this should not be limited to stratifying existing customers; it should also be a conscious strategy to target specific niches of prospects- for example, millennials, senior citizens, family businesses, SMEs, exporters etc. Banks should position themselves to serve the unique needs of each such segment. Both core and peripheral needs must be identified. For example, while senior citizens too need deposits and credit cards, many may not be tech-savvy or due to age-related physical/mental ill health issues, they may need additional help. Therefore, offering them specially-designed solutions that perhaps have a higher level of human interface (and are therefore priced higher) could well result in strengthening those relationships.

Smart bundling

Banks must develop the ability to construct with agility bundles of offerings that maximize attractiveness to customers.

Such bundles can comprise the bank's own offerings and/or those drawn from the larger business ecosystem.

For example, some banks offer incentives such as higher interest rates to customers who fulfil certain conditions (e.g., maintain a larger balance, or commit to a certain quantum of term deposits or partner with the bank for their payroll and corporate credit card solutions etc.). This gives banks the opportunity to expand their customer base by offering the families of employees a range of financial solutions. Or home construction loans can be bundled with discounts on fittings, furniture etc.

Dynamic pricing

Segmenting customers and prospects is necessary but not sufficient. It is essential for banks to acquire and hone their capabilities for "dynamic pricing"- varying price based not just on who the customer is, but also on engagement channel, size of existing relationship, profitability of the existing portfolio of the bank's products consumed by the customer, and other considerations (e.g., closing date for an IPO or a date after which new regulations come into force), attracting customers from competitors etc. Simply put, pricing tied to the context of the need (both of the bank and the customer). Dynamic pricing must ensure overall optimization of enterprise level profits and not be constrained by line-of-business revenues or profits. This is vital to prevent cannibalization, thereby leaving money on the table.

Empowering customers

One reason for customers losing faith in banks seeking to assume the role of "financial supermarkets" is the fear that the bank's interests may not always align with their own interests. By giving customers a wider range of offerings, more transparent information about each of them (pros/cons, costs, risks etc.) and more control over their decisions, banks can play a bigger role in promoting their customers' financial health. In turn, this will strengthen their relationships, restore trust levels, and improve experience, thereby boosting loyalty and growth in revenue and profitability. This view is supported by a Bain & Co. study that concludes that a 5% increase in customer retention can lead to a 25%-95% jump in profits.

The ability to price right needs the right technology capabilities

Every hero - mythical, movie or real, has something special to help them. Could Batman have done what he did without his cape or Clark Kent become Superman without the power of Kryptonite? Would Thor have been as powerful without his hammer? Would all those scientists who have worked so hard over the past 18 months to develop Covid vaccines been able to work their magic without the right tools? Clearly, no!

We believe that while pricing will be the "hero" of banking enterprises for the foreseeable future, banks cannot continue to rely on traditional pricing approaches and tools and hope for the kind of results they expect. The emerging environment is very different from what banks have been used to. Banks will need to quickly embrace relevant technologies to boost pricing ability and agility on the basis of criteria such as relationships across product lines and impact on enterprise profitability. And of course, banking leaders must play a more proactive role in changing mindsets, because, as Leadership Coach Marshall Goldsmith often points out presciently, "what got you here won't get you where you want to go." Are you ready for the ride?

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Source:

i https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-consumer-experience-in-banking.pdf

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