

# Pricing in the new Retail banking paradigm



SunTec

White Paper

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## Introduction

The banking industry, across the globe, is witnessing a renewed focus on retail banking, a trend often attributed to the stability and profitability of retail activities. Moreover, big corporates are circumventing banks to raise money through the debt market and commercial papers, which are cheaper than bank credit.

To make up for this, most banks have devised strategies to go for retail banking as a major driving force. Risk, in retail banking, is distributed and it is a huge market waiting to be explored. Inevitably, the retail banking industry will soon emerge as a global arena, since it is heading towards a new landscape with increasing cross-border collaboration, emergence of large-scale financial super markets and regulatory changes.

Banks now recognize customer experience as the key to meeting challenges like increasing customer loyalty and slashing customer churn. Consequently, within the retail banking world, there is a lot of action these days: like customer-centric initiatives, increase in fee-based income, product bundling and personalized product offerings, increased cross/up selling and also regulatory changes like Euro payments, SEC rulings on transparency of billing, KYC, operational risk standards, etc. Some of these trends are detailed below.

## Financial supermarkets

In an attempt to become a one-stop financial shop offering all financial solutions, the retail banking segment has been evolving, to offer a broad array of banking and investment products under one roof. Banking, insurance, mutual funds and brokerage products, which were earlier offered by specialized financial firms, are now offered under one umbrella.

Across the globe, financial institutions are moving towards universal banking. The philosophy behind this is that, expanding the customer's portfolio by selling more products to each customer, when accomplished intelligently, should improve a firm's top-line and

bottom-line. Also, surveys show that many consumers, faced with a growing complexity in financial products, are looking for a reliable financial advisor to guide them through the maze of personal finance choices. Other significant factors influencing consumers to desire a single provider include a consolidated statement, easy fund transfers, a clearer presentation of one's financial situation, and better pricing.

## Effect on pricing

Several banks do not directly provide non-traditional services like insurance, mutual funds, etc., but they partner with third-party specialist providers for these services. Banks can partner with multiple providers for the same service. The price charged from the customer for the service could be complex, based on multiple conditions. For e.g. If the transaction is from provider A, and the SLA with the provider is B, and if customer chooses plan C, then a particular price is applicable. Or a percentage rate is added to the price given by the provider to arrive at the final price offered to the customer.

## Product bundling

Product bundling is an intelligent strategy that is becoming increasingly popular in the banking sector. According to this concept, banks offer multiple financial products and services to customers as a package. Bundling is generally recognized as a potentially appropriate means to tackle competition, to acquire new customers, to cross-sell new services to the existing customers and to retain the existing customers, who are getting increasingly savvy and sophisticated. Bundling helps to boost profits substantially by increasing the opportunity to cross-sell. It is also a great method for increasing the sales volume of products that are not in high demand.

Bundling is not a new concept in retail banking. It has been existing for more than a decade-and-a-half, but

there is a shift in focus now, as a result of which, it has gained popularity. Earlier, banks were mostly concerned with increasing the effectiveness of the use of its core banking products like current accounts and daily transaction-based activities. In the last few years, the priority has shifted to actively improving product penetration into the existing customer base, increasing sales by attracting new customers, innovating the product offerings, and lastly but most importantly, retaining and enhancing customer relationships and basing price reductions on the total volume and/or desired use of services. A derivative benefit of bundling is the reduction in costs of selling and servicing to customers.

### Effect on pricing

Product bundling is basically a pricing strategy, where price of products/services in a bundle are more competitive than their segregated prices or some free services are offered along with certain products. Different bundling and pricing strategies are used to gain different benefits.

Some examples of retail product bundles being offered by banks:

- If a customer maintains a defined amount of savings and has taken a defined amount of loan, then discounts are offered on interest rates, auto loans, free phone banking, counseling once-a-year, etc. Here again, there can be a tiered approach i.e. when balances/loan amounts increase, more discounts and additional free services are provided. Strategy: cross-product discounting
- Segment-specific bundle, for e.g. student bundle offered to students of a particular age group, where the interest rates offered on savings account are higher if phone banking is used, higher interest rates if money is held in current account for the whole month, free debit card and heavily discounted check services. Strategy: acquire new customers
- A customer, who avails a current or savings account, payment service and telephone service, will get higher interest rate on current account. Strategy: expand customer's product portfolio
- If a customer satisfies two of the four requirements – a current a/c, save a certain amount every month to a savings a/c, savings greater than a limit, loans greater than a limit – then he gets several discounted free services. Strategy: give customers a choice of bundles, thereby retaining customers
- A bundle with lower monthly recurring fee, if a customer uses self service as compared to a bundle, wherein the customer approaches the bank branch. Strategy: encourage customer's self service, so that the bank can allocate resources to other more profitable functions
- If the total relationship of a customer and his family is greater than a limit and regular income is greater than a limit, then better interest rate, discount on payments services and free subscription to a magazine. Strategy: encourage not just the customer, but his family also to use the bank's services, thereby increasing customer loyalty
- A bundle with discounted services, wherein a personal contact is included as part of the bundle. Strategy: reduce customer uncertainty and counteract any switching possibility

### Delivery channels

To stay ahead in the competitive banking arena, successful banks are investing in channel solutions that provide differentiating services on customers' demand. After the success saga of the ATM, internet and call-center, the retail banking industry still has many new delivery channels to explore and exploit. The mobile phone is already being touted as the next big trend in the coming years; interactive TV (iTV) too will be a potential channel.

ATMs are here to stay and the internet has become almost a necessity as a channel. Partnerships and joint ventures between banks and telecom companies enable customers to make card-less interactive micro payments via the mobile phone. Retail banks are also carefully considering the new iTV delivery channel. Surveys predict that, in Europe, iTV households will exceed internet households very soon. iTV will help banks reach out to a much larger customer market.

While e-channels are attested to be indispensable, the retail banking industry is making giant strides in the development of banking infrastructure with the ability to deliver banking services through other business partners. For e.g. banks with a small branch infrastructure, are tying up with a network of thousands of motor dealers, who initiate loans for cars at the point of sale. This business-to-business-to-consumer approach provides the bank with the benefits of both market reach through distribution and brand extension. Around the world, post offices, retailers and niche financial services suppliers represent the next opportunity for growth for the established banking institutions.

Multi-channel strategies clearly enable banking organizations to extend their reach and increase their contact with multi-platform customers.

### Effect on pricing

Banks encourage product/channel usage by price. They promote one delivery channel (say internet) over another (say branch), if the cost of servicing through that channel is lesser. Retail banking organizations can actively drive customers to the preferred channel by means of price variance.

In case of non-financial partners like post-offices, motor dealers, retailers, etc., the prices of services depend upon several parameters like location, contract, infrastructure costs, etc.

## Customer centricity

Market consolidation, steadily burgeoning retail banking portfolio, increasing levels of commoditization, and fierce competition have changed the face of retail banking from a plain vanilla product-centric approach to a customer-centric delivery model.

Commercial banking has long been based on customer relationships, but today retail banks also recognize the importance of an effective customer relationship strategy, and the need to become more customer-centric to ensure long-term success.

Financial institutions have begun to recognize the significance of customer retention on their bottom-line. They are devising strategies to reward customers for continued loyalty and offering them services in line with their value proposition, in order to sustain profitable relationships. Personalized services and prices hold the key to gaining customer mind share. Success is easily measured by their level of client retention and repeat business.

### Effect on pricing

As an offshoot to customer-centricity, banks now turn to relationship-based dynamic pricing, which advocates that each customer is unique, and deserves to be treated differently. In relationship-based pricing, the price of a product or service, or a bundle of products and services is based on the value of an individual client's relationship with the bank.

The value of a relationship can be measured in many ways, including the duration of the relationship, the current or potential profitability from the client to the bank, and the importance of the client to other key product areas of the bank. Dynamic pricing is the change effected in pricing schemes in real-time, depending upon several parameters. The changes are made either by the relationship manager or automatically.

Some examples of relationship-based pricing:

- If a customer maintains a certain average monthly balance across several accounts, he earns certain privileges like 'x' free transactions per month
- If the number of transactions done by the entire customer relationship (i.e. all accounts and branches) exceeds a threshold, offer discounted price on future transactions for the same or different products
- If a customer does not comply with the agreed SLAs of balances or volumes, automatically increase price
- If the value of cross-border payments reaches a value, offer 10% discount on the fees

## Regulatory changes

Intensified regulatory measures have dominated the boardroom agendas of banks for the last few years. Here's a list of some of them:

- Basel-II is driving institutions to take a far more detailed look at the operational and portfolio risks they carry and to report accordingly
- Anti-money Laundering legislation and KYC are demanding a level of customer intimacy, once seen as aspirational rather than practical
- The Sarbanes-Oxley Act stipulates that companies must establish a financial accounting framework that can generate recurrent financial reports, which in turn, are facilely verifiable with traceable source data that must be maintained for a stipulated period of time
- The objective of Single Euro Payments Area (SEPA) is to create a Euro area in which all payments are domestic, where the current differentiation between national and cross-border payments no longer exists

## Effect on pricing

Some of these regulations have an impact on pricing. For e.g. one of the Basel-II requirements is that economic capital has to be allocated for all business activities.

As a result, banks price a product or service as the cost plus economic capital plus profit. The SEPA directive will cause a price change of payments products, since now the price for both domestic and cross-border payments would become standard. Also, SEPA has made it mandatory for corporates to use IBAN and BIC numbers in payment messages, following the standards of IPC. If this is not followed, banks are allowed to charge their customers 'repair charges'. This requires conditional pricing, where the customer is charged a penalty if certain conditions are not met.

## Technology

The cornerstone of a successful consumer banking strategy is to have a technology platform that can allow easy implementation of all the above pricing strategies. An ideal solution is to have a pricing solution with the following features:

- Ability to do relationship-based pricing. To allow this, the solution must be capable of maintaining multiple levels of customer hierarchy, so that it can offer pricing based on the entire hierarchy of relationship
- User-friendly GUI to create product bundles on the fly
- Rules-based; where pricing can be conditional and based on multiple parameters and attributes
- Price modeler and 'what-if' analysis tools to run simulated pricing plans and analyze trends
- Dynamic fee plan configuration across products, channels, customer groups
- Ability to compute profitability at micro-transaction level and roll it up to sub-product, product, service category and business unit
- Transparent clearing and settlement process
- Centralized; so that it can do pricing across different business units and offer a single view of the customer
- Extremely flexible and configurable to cater to local taxes, regulations, trends
- Multi-currency, multi-language system

## Conclusion

All the trends and their impacts lead to the conclusion that in today's changing market conditions, pricing — already the most common criteria consumers use while selecting a financial institution — will become increasingly important as a tool to attract new customers and strengthen the existing relationships. A competitive and precise pricing strategy will be the key determinant in successfully implementing a value strategy.

Banks that commit to developing a sophisticated pricing solution with dynamic relationship bases, analytical, rules-based pricing and product bundling abilities will have a distinct advantage. While their peers struggle to respond to complicated pricing challenges, they will have the insights and organizational conditions necessary to grow revenues and profits faster than competitors – and also the new entrants knocking loudly on the door.



## About SunTec

SunTec Business Solutions, the first CMM Level 5 transaction billing company, is a leading provider of transaction value management solutions for the telecom and financial services industries. We leverage our extensive domain experience, acquired since inception in 1990, to successfully deliver timely and cost-effective solutions. Our concept of Relationship-based Pricing has been endorsed by industry leaders and innovators across the globe. Our product offerings, the TBMS-T Suite for telecom and the TBMS-F Suite for financial services, provide comprehensive solutions to our customers for measuring and monitoring transaction value and enable tighter control on their profitability. SunTec has a global presence with offices in US, UK, Germany, Singapore, Thailand and India.

### Our clientele include:

**Financial Services:** HSBC Group • Lloyds TSB • ING Bank • ICICI Bank

**Telecom:** Comcast • BSNL • @Home • Bakrie Telecom • Bahrain Telecom • Cable One

visit us at [www.suntecgroup.com](http://www.suntecgroup.com) or e-mail us at [info@suntecgroup.com](mailto:info@suntecgroup.com)

#### USA

Tel : +1 609 520 8223

Fax: +1 609 520 8331

#### UK

Tel : +44 20 7517 3670

Fax: +44 20 7537 3098

#### Germany

Tel : +49 69 274015 831

Fax: +49 69 274015 111

#### Singapore

Tel : +65 6866 3291

Fax: +65 6829 2138

#### Thailand

Tel : +66 2 343 1676

Fax: +66 2 343 1818

#### India

Trivandrum

Tel : +91 471 3918300

Fax: +91 471 2433578

Bangalore

Tel : +91 80 41523780

Fax: +91 80 41521511

New Delhi

Tel : +91 11 41436080

Fax: +91 11 41437899

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