

## What banks must learn from the current crisis: customer-centric strategies for profitable growth



**T**he current financial crisis is arguably the worst most banking managers have experienced in their professional lives. But we must remember that markets and industries are redefined in times of shake ups, not in times of stability. The current crisis should actually have a positive impact on those who develop the right strategies and take the right actions during the downturn.

In short, banking managers have to find a way to minimize the impact that declining consumer confidence and newly written, stricter laws and regulations will have on business volume, revenue and profit. From a broader perspective, banks will be forced to review their business models, “pull back” from riskier endeavours and re-focus on optimizing their core businesses. Above all else, managers must maximize the profitability of their current customer base.

This requires some fundamental changes in banks’ marketing and pricing practices. This article lists the five key initiatives banks should undertake.

### 1) Reestablish trust and improve price image

In general, banks have developed a poor image among consumer and commercial clients from years of dubious and poorly-communicated pricing practices. Now, to reestablish consumer confidence, these institutions must quickly shift towards customer-friendly pricing schemes.

First, a clear “pricing identity” must be developed by answering the following fundamental questions:

- How **easy** is it to navigate through our offers and prices? Do our sales teams as well as our customers understand why we price the way we do?
- Are our offering and price structures **simple and clear** (again, for our own sales reps as well as for our customers)?
- Is the pricing in line with our bank’s value **positioning**?
- What are the **price promises** made to the customer (e.g. always offer a fair price, be a low cost provider, charge a premium for premium quality/service, etc.)?
- Is the customer fully **reassured**? How confident are they of having made the “right choice”?

Only when a bank has addressed the answers to these questions will it be able to develop trust. Online and direct banks (like Egg Banking or INGdirect) have been particularly successful in capturing market shares because they were able to communicate on a clear price promise, simple pricing messages etc. – in short, they have a clear pricing identity.

## 2) Reward customers for their business and loyalty

The current “bonus” approach, which provides rewards to customers in the form of points, airline miles and cash back, has now developed into a “must-have” in many product segments and is no longer sufficient to develop real customer loyalty, due to the poor differentiation between offers. To achieve real customer loyalty, banks now have to **pro-actively** recognize the overall relationship a customer has with the bank (i.e. not only product by product). Today, when customers request discounts for every additional product they have with the bank, negotiations are too often at the sole discretion of the relationship manager and result in poorly controlled price concessions which are not employed strategically to grow the overall customer relationship.

A leading regional bank, with approximately £7bn. in assets, recently launched a “loyalty pricing scheme”, to reward customers for their overall relationship. The bank combined two dimensions, a “static” and a “dynamic” one. The “static” dimension recognizes the customer’s status (based on income, assets etc. of the customer), the “dynamic” one is a recognition of the customers’ activity (based by the number of transactions made by the customer or the growth of his assets). The bank achieved a significant increase in customer loyalty, measured by growth of assets and transactions from customers repatriating assets and consolidating their activities previously done with other banks.

Such smart, “power-pricing” concepts not only hold immense profit potential for banks from increased up-selling and cross-selling, but also help minimize the risk of further commoditization of their services.

## 3) Increase the profitability of portfolios by effectively managing discounts

For many banking services, particularly when it comes to private / commercial banking, customers rarely pay list prices as discounts are prevalent. While these agreements can severely cut into a bank’s profitability, the processes used to negotiate and approve discounts are often arbitrary, poorly analyzed and far from optimal. Banks must create a systematic approach for managing discounts reinforced by a sound, professional pricing system. Three steps must be undertaken:

1. Understand **what** drives customers’ sensitivity to prices for your products and develop like-minded “pricing segments”. Usually, the most important drivers include the competitive intensity in the specific area where the customer is located, customer size and behavioural characteristics, and any value-added services included in the product offering.
2. Determine **how** each of these drivers impacts customer sensitivity to prices. In other words, what is the elasticity effect of each driver? There are many methods to measure this, from pragmatic approaches based on structured expert judgement to customer surveys assessing elasticities using direct and indirect price questioning.
3. Based on the identified “pricing segments” and their respective elasticity, the optimal rate must be determined for each segment, and then communicated as a guideline to relationship managers (although flexibility to adjust rates should be lower with such an approach, RMs still need some room to manoeuvre).

This approach will reduce the gap between listed and realized prices and lead to the capture of additional income.

A niche lender with about £10bn. in assets recently followed this approach to better differentiate prices based on customer price elasticity. After intense portfolio analysis to identify pricing segments and drivers of elasticity, price recommendations were rolled out to relationship managers through a tool used to “score” each deal from a “value” perspective, in addition to a “risk” perspective. Based on the scoring and the database of past deals and rate elasticities, the tool provides relationship managers with a target rate. The approach has led to an increase in the net interest margin on loans by 8 bps and kept loan volume almost constant.

#### 4) Develop a clear and logical set of offerings

Currently, many banks' products and services (and their accompanying rate and fee structures) are poorly differentiated for the specific needs of different customer segments. Especially when considering complex services like financial planning or asset management, it is imperative that banks tailor their offering to the specific needs and willingness-to-pay of different segments. Some of the most successful and customer-oriented schemes to do that are:

- **Bundling:** rather than individually priced products, the customer is offered a combination of products with a discounted, group price. "Open bundling" has developed as an especially powerful alternative to pre-packaged offers, as customers can select the banking products they really need and get a customized price. One of our clients' retail banking division recently developed an online platform on which customers are able to choose their banking products (credit card, debit card, checks, savings account, insurance, etc.) and ancillary offers associated with those products (e.g. types of rewards for the credit card, level of insurance coverage, etc.). The platform automatically calculates and clearly communicates the resulting price benefit of adding a new product to the package (bundling) and of choosing the premium levels of each product. This customer-centric, open bundling approach fueled the growth of the customer base, significantly improved cross- and up-selling as customers chose products they previously did not recognize and improved the sales force's motivation by supporting the selling process.
- **Non-linear pricing:** this can take the form of a basic rate with a bonus depending on product usage (assets, loan volume, transactions), or of tiered rates. This is especially useful to reward and encourage customers to do more business with the bank. One example is of fund providers who offer breakpoints in sales charges when certain investment amounts are reached. One effective way to increase your number of customers is to offer these discounts on the consolidated assets of a related group of people (e.g. family members), giving customers an incentive to motivate others to use their provider (so called "multi-person discounts").
- **Channel-related product and price differentiation:** a successful way to attract new customers by catering to the specific needs of different segments using specific channels. In addition, attractive offers can be clearly separated ("fenced") against the standard offer (e.g. when attractive rates are only offered on deposits that are exclusively managed online), provided the rates are optimally set for each option.

#### 5) Focus on value, not price

All the approaches described above aim at reinforcing the focus of customers on the value delivered by their bank's products and services, rather than the price they pay for them. In addition to that, it is important that sales avoid concentrating on price in negotiations with their customers. In order to achieve this, front-line sales personnel must be able to clearly communicate the advantages of their products and services, and explain how these answer the individual needs of a customer.

Some banks have developed checklists for each type of product that relationship managers can use consistently to explain the value of their products in a systematic way and more easily defend a specific rate level or price. Another useful approach is for banks to structure the exchange of best practices. Some relationship managers are better than others at defending the product value and prices (we call them "value sellers"), but banks usually lack the appropriate processes, tools and platforms to spread these most efficient selling approaches to the rest of the staff.

Overall, banks must refocus their efforts on their most important asset – their customers. This requires that institutions walk a fine line. They must foster innovation in order to develop new and exciting offerings and customer-centric pricing strategies, while also making sure these enhancements always serve their customers' fundamental financial

needs. Innovation should always be applied both upstream (through products and price configurations based on customers' financial needs) and downstream (by improving the communication and delivery of a product's value-to-customer).

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