

PERSPECTIVE

Product Bundling: A Banking Perspective



The concept of product bundling is not new to organizations worldwide. Though the definitions may vary, product bundling is mainly the sale of two or more products and/or services as a single offering usually at a price advantage. Bundling can and usually is, designed to offer benefits for both the parties. The seller of the products / services¹ gets to sell more of his products in a single transaction while the buyer gets a benefit of reduced price / additional benefits. However, it is not necessary that the products be sold in a single transaction. Consumer, at the onset of purchase, is made aware of the package and the associated terms and conditions. This means, if product A and product B are sold as a package "AB" the customer can buy product A at one point in time and product B at another point in time, as long as this is permitted as part of the package contract.

It is important to note that depending on how the products are packaged there may or may not be a visible advantage to the buyer. In most cases, though, a package usually comes with a visible benefit – either in terms of price difference or additional products or services – and in this article we will assume that a package is one that offers some discernible advantage to the customer.

Value Perception

Consumer behavior is based on affordability as well as the perceived value of the products they buy and a customer would not buy a particular product unless she is convinced that the price she is paying is the right price going by the utility/demonstration value. The buyer normally buys a product/service if the perceived value is equal to or more than the price she is paying². Extending the same logic, the buyer will go for a package if she perceives that the total value is at least equal to the value of the individual components of the package. It is important to note the term 'perceives'. An overseas trip which comes with a free diamond ring would probably sell more readily than the package with a designer pen that costs as much as a diamond ring.

The customer's decision on going for a package also depends on the perceived benefit in the long run and this, in many cases could be difficult to measure. This is particularly in the case of most banking products where the service contracts are for a long term as opposed to "products" where it could be single transaction based with no (perceived) long term impacts. For the rest of the

article we will consider packages relating to banking business.

Product Bundling at Banks

Designing a package:

Coming out with a product package is not a very easy exercise. In case of packages offered by a bank, some of the factors to be considered are:

- Additional funds it is going to lend vs. additional funds it would attract as deposits
- Whether the discounts in pricing would be offset by the additional business that would flow in
- Whether the offer would result in increased customer loyalty

Consider a simple package consisting of just two products - a mortgage loan and a savings account. Let us assume that the interest charged by the bank for the mortgage loan is 8% and interest paid for the savings account is 3%. The bank offers a package of the two products where the interest rate on the mortgage loan is 7.75% and interest rate on the savings account is 3.25%. Is there a benefit to the customer? If so, how much is the benefit? This depends on the balances maintained by the customer in the two accounts over a period of time. For example, in the first year, if the loan amount is 1,000,000 and the balance in the savings account is 100,000 the customer gets a net benefit of 2,750. However, a few years later when the balance in the mortgage account would have come down to 500,000 the benefit would be 1,500 assuming that the customer continues to maintain the same balance of 100,000 in the savings account.

It is clear that the customer would make a profit in any case – no customer would sign up for a package which is seemingly non-beneficial, however small the loss. What is the benefit to the bank? In the above example, at a first glance it would appear that bank is making a loss of 2,750 in the first year. However, the equation is not as simple as it looks in the first place. We need to consider the transfer pricing aspects which the bank always considers in arriving at the profit/loss.

To understand how that works, assume that the bank has now got a new savings account (which it would not have got but for the package) with a balance of 100,000 and is able to lend this in the

market at say, 8%. Therefore, the bank makes a profit of 2,250 on this package offering. However, if the bank would have got the savings account anyway (for reasons specific to the market/customer type etc.,) the bank does not benefit in real terms.

That is not the end of the story. Assume that the bank is borrowing from the market at 7% to lend the mortgage loan at 7.75%. The equation quickly changes again. In addition to that, the rate at which funds are borrowed/lent change based on the maturity periods involved and keep changing all the time. Therefore, packaging decisions are wrought with a high degree of risk. When the number of products in a package is more than two the situation becomes rather more complicated and calls for complex mathematical models to arrive at the right mix of products. The fact that most of the lending products in the banks are basically for a long term makes the risk proposition even higher.

The need for packages:

In today's competitive banking scenario, packaging is emerging as an important and critical element from more than one perspective.

- **Customer Retention:** With increasing competition in markets world over, banks need to be seen as providing additional value to their customers to retain the existing client base and win new customers. Making sure that a customer buys multiple products as opposed to a single product is one of the important steps in this direction. Banks need to recognize that a customer with a single product is a potential takeover target.
- **Customer Profitability:** Customer profitability is a measure of how much the bank spends to service the customer v/s how much profit it earns from the business that the customer has with the bank. It is important that the bank retains the profitable customers. A customer with multiple relationships with the bank is typically more profitable from the bank's perspective.
- **Shrinking Margins:** With the margins under constant pressure, banks need to expand their product/service coverage to retain their profitability. While package accounts certainly provide higher value to the customers, at the same time they help banks to earn more by getting more business, float funds, additional services etc.

- **Source of Additional Income:** By packaging products and services offered by business partners, banks can offer additional benefits to the customers while earning fees for the service from the customers as well as business partners. In some of the markets, the main driver for package accounts is this additional income more than any other consideration.
- **Banks are now One Stop Shops:** Offering multiple products is no longer an option but a necessity in today's market. Banks are therefore offering insurance, investment, advisory services etc., in addition to pure banking products. Selling these products as packages makes a better business sense than selling them as separate products.
- **Product Differentiation:** Though the banks are today in a lot more deregulated environment as far as product offerings is concerned, the type of products tend to be more of less similar in a given market. For example, though known by different brand names, a savings account in one bank is likely to be virtually the same as offered by any other bank. With the margins under pressure, the differentiation in terms of pricing for individual products is limited. Rapid adoption of technology by the banks has resulted in products becoming bank agnostic. Product/service offerings through channels and the speed at which service delivery is possible today is no longer a differentiating factor. Product packaging opens new vistas for the banks that are able to put together packages with innovative pricing and benefit statements. They stand a better chance to garner a niche for themselves in today's highly competitive market.

The challenges:

Some of the challenges faced by banks and how packaging can be used as a tool to meet the challenges are articulated here:

- **Inducing Changes in Customer Behavior:** In most markets customers associate a certain type of product with a certain type of financial institution. It is not very uncommon to see a customer going to a large bank where a mortgage loan is offered at affordable rates while parking her funds in a building/co-operative society that offers a higher rate for their savings accounts while also providing a more personalized service. It is not easy to

change the customer behavior and/or preferences. It is even more so if the benefits of a package is seen more as a marketing gimmick rather than something that provides real value to the customer.

- **Creating the Goodwill:** The recent financial turmoil has had a big impact on the image of the bankers in the eyes of the public. It is necessary that one creates the right atmosphere. The sales pitch should not look like banks are trying to sell what they have created. Rather, it should look like banks have created what the customers always wanted.
- **More than a Banker - a financial consultant:** Before we go to a shop to buy an expensive television we do our home work alright, but we do depend to a considerable extent on the salesman to tell us the positive and negative features of the two or three models we have shortlisted for our purchase. The seller is expected to know what's good for the customer because he deals with the product everyday of his life. The same holds for the bank customers as well. With technology taking the mundane jobs out of the bankers' life, it is now time for them to do marketing and selling the smart way. It is extremely important that they project the package as a value proposition that brings in distinct advantage to the customer. Talk to the customer in the language that she understands and appreciates. Bring out the benefits clearly and in as much detail as possible. Being persuasive does not necessarily mean being aggressive.
- **Risk Management/Scoring:** When getting a new customer to sign for a package, banks need to do risk assessment taking into consideration multiple product features instead of looking at risk in isolation. This calls for complex risk modeling. Banks can hardly overlook this critical aspect when selling package products.
- **Data Ownership and Non-disclosure:** With more than one organization holding the customer data and sharing of customer data across business entities, the risk of accidental data leaks as well as data leaks due to non adherence to necessary standards by all the parties involved is a serious risk. With the regulators coming down heavily on any data breaches, banks need to put in place proper systems and controls to ensure that packaging does not lead to issues that can put their reputation at risk.

- **Targeting the Right Customer Group:** Not all packages are born equal. Banks need to identify their target customers by customer segment, region and other demographic and psychographic differences factors. A good understanding of the customer priorities is a good starting point to create the right packages and target them. The huge amounts of money and time banks have spent in the last few years to put in place their CRM systems should provide them a wealth of data that can be leveraged to come out with the right kind of packages for the right customer groups.
- **Complex Processing:** Package accounts introduce an element of complexity in terms of processing. For example, majority of the origination systems today are designed to handle single product origination. Package accounts would necessitate handling the whole bunch of products and services as a single unit since that's the way it is projected and sold to the customer in the first place.

Points to consider while designing a package:

Banks need to keep in mind certain critical aspects relating to product packaging while designing the packages. Some of these are:

- **Additional Value to the Customer:** The package should not just be perceived as bringing value but should in reality bring in additional value to the customer. Perceptions can work in the short term but reality wins in the long term. The typical management talk of 1+1 being greater than 2 clearly applies in case of packages.
- **Complementary Products:** The products that are packaged should complement each other. For example, a package that contains a mortgage loan and a car loan may be attractive to the customer and easy to sell but could be detrimental to the bank as well as the customer in the long run. On the other hand, a mortgage loan with a mortgage insurance compliments the loan product.
- **Transaction Cost:** One of the aims of the package is to reduce the transaction cost to both the parties. In the example of mortgage loan with insurance, the transaction cost is reduced for the customer (in terms of buying the insurance policy from another service provider) while for the bank it does not involve an additional cost since it is done as part of a

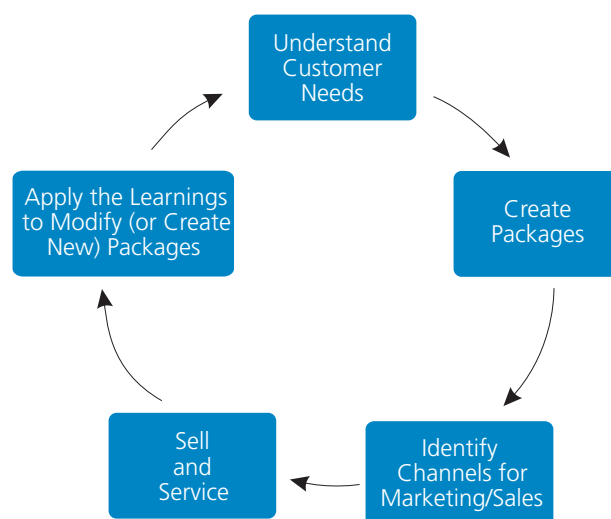
pre-existing arrangement with the insurer.

- Keeping it Simple: A mobile phone can often do hundred different things but most people would use no more than a dozen features. There is no point in creating a package with ten different products and/or services with the hope that the customers would understand/appreciate them. Examples of a product failing because the bank's own marketing/selling teams are not fully aware of all the facets of the product are not all that rare. A customer who signs up for a package without fully understanding the features and benefits is a potential dissatisfied customer. Also, creating and maintaining the package in the long run could cost more than the benefit accruing out the package itself. Banking products are long term contracts and locking into a product on a long term needs careful consideration.
- Perceptions Matter: If we were to assume that the customers are perfectly rational in their buying decisions, the following two scenarios should result in equal number of sales:
 - Product A sold at \$90 and product B sold at \$10 when bought with Product A
 - Product A + Product B sold as a package of \$100
 - Product A sold at \$100 with Product B offered as free

But customers are not necessarily rational in their buying decisions and option (c) would win over the other two options in most situations. However, as mentioned elsewhere in this paper the package should bring in real value and not just perceived value to win in the long run.

- Packaging as a Strategy: A bank can package a product that it wants to market (but is not yet popular owing to its novelty/market positioning) with a popular product. It is also possible that a product that is offered by its competitors and is highly successful in the market can be offered as part of an attractive package to woo the customers to its fold.

Life Cycle of a Product Package:



Source : Infosys Technologies Limited

Bankers have always faced the challenge of constant innovation to win and then retain the customers. In highly competitive markets, it is imperative that banks come out with newer ideas to sell their products. As is true with most other things, designing a package is a continuing process and banks may learn as they go.

Package accounts – the current scenario:

The packages offered by banks can be broadly classified into two types.

- Packages with only banking products and services: Examples of this type of packages are,
 - Mortgage loan with a savings or checking account with interest benefits for either one or both the accounts
 - Savings account with waiver of fees and free access (limited or unlimited) to internet banking, ATM, funds transfers etc
- Packages with a combination of banking products and third party products and services
 - A current/checking account with free car insurance
 - A mortgage loan with property insurance

The market for packages across the world presents a mixed picture. Banks in Australia have made good progress in creating and selling package accounts. According to a recent study almost half of the mortgage loans sold to

customers are part of a product package³. Typically Australian banks offer a large number of packages of the first type mentioned above.

On the other hand, banks in US have not been too aggressive in designing and selling product packages. For example one of the major players in retail banking in the US market launched its first product package consisting of a mortgage loan and a checking account as recently as 2006. Other banks have brought out their own packages but the market for package accounts is still nascent in the US. Most of the banks seem to provide very basic packages where a product like checking account is offered with a few free services.

Banks in UK too have fairly simple packages where the main component is a current account⁴. The package consists of a few third party products like car insurance, discounts on travel, free meal coupons etc. British banks provide a good example of the second type of package accounts mentioned above.

Banks in India are looking at package accounts as more from cross-selling point of view rather than as packages in the true sense. Clearly the markets around the globe are in different stages of maturity.

Leveraging Technology for Package Design and Delivery

As mentioned elsewhere in this paper, packaging calls for complex modeling and constant monitoring to modify/enhance the product offerings to retain the relevance of the packages under offer in the constantly changing market place as well as retain the interest of the customers in the packages. It is not possible or practical to create a package that would appeal to all customer segments. That means a bank should have the ability to create multiple packages to suit the needs of disparate customer segments. Today, the packages are not limited to banking products and services alone. Increasingly, banks are offering packages with products and services from third parties. Once the marketing teams come up with their business models, it should be possible to quickly create the underlying products, package them, sell them and more importantly service them efficiently.

Naturally, technology is not just a business enabler but a differentiator in the whole process. The need for integrating with other systems and

service providers adds a new dimension of complexity. All banking products/technologies are not created equal and the banks that adopt those which are extendable and able to easily integrate with other product and/or service providers will have a distinct advantage. Banking products that allow the business users to design packages provide a clear edge over those that need technical users to create the packages every time.

Conclusion

The fact that customers have lots of choices before them makes it imperative that banks keep innovating and bring in perceptible value to their customers. Packaging of products and services has the potential to emerge as the next big thing for banks that are looking for innovative marketing and positioning of their products. Packaging has the potential to emerge as the crucial differentiator in the otherwise level playing field. With the right kind of technology, it is easier than ever before to design and sustain package accounts and banks the world over are increasingly looking at leveraging this to their advantage.

References

- ¹Most of what we are considering in this article applies to packaging of both products and services. We will use the term product to refer to both unless mentioned otherwise.
- ²Economists call this consumer surplus. Consumer Surplus is the difference between the price the customer is willing to pay and the price of the product. Product packages try to enhance the consumer surplus and thereby increase the sales.
- ³<http://www.bharatbook.com/Market-Research-Reports/Bundling-in-Retail-Banking-in-Australia.html>
- ⁴Source: UK market study undertaken by Infosys

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