WHITE PAPER

Relationship-based pricing (RBP) in Financial Services

Improve customer retention and market share with an innovative pricing approach

Customer retention, while cheaper than acquisition, is no easier for financial institutions

Studies show that attracting a new customer is 5 - 6 times more expensive than retaining an existing one. However, in the backdrop of increasing competition and erosion of customer trust following the 2008 financial crisis, financial institutions are also struggling to retain existing customers.

Firms that understand their consumers' behavior, analyze that data, and use the resulting insights to devise a strategy to price their relationships are likely to obtain optimum benefits in terms of higher revenues and improved margins. A well-thought out and executed strategy may also help firms get rid of consistently non-profitable customers and be more agile in the marketplace.

Business challenges

The recent past has been characterized by tough times for financial institutions, with simple survival becoming the biggest challenge for many of them. While growth has either been illusory or slow, many organizations have been thinking about strategies to retain their existing customer base. In a difficult business environment, considering ever-increasing and tougher competition, a lost customer means loss of business that may not be won back in near future.

As with almost all for-profit organizations, financial institutions are firmly occupied with the following questions:

1. How do I grow revenues?
2. How do I improve profitability?
3. How do I retain clients?
4. How do I fight competition?

One fundamental aspect that can lead to the answer is the organization-client relationship, which is the foundation of any firm's business architecture. Although all firms constantly look for ways to improve their relationships with clients, the reality is that most are confused as to the optimal approach. A great relationship with a client can significantly improve cross-sell opportunities and enable significant repeat business. It can improve stickiness of assets and build trust that the competition may find extremely hard to beat.

The concept of relationship-based pricing, when implemented in its true form, helps firms address the above business challenges in a sustainable way. It targets the heart of an organization – "customers". It deals with ways to influence their behavior and create a relationship that can potentially span generations.

What are the critical success factors for an RBP approach?

Shifting from a product-centric pricing approach to a relationship-based pricing one requires significant management support, since it requires breaking up organizational silos across lines-of-business (LOBs) and channels. Apart from management support, this change has the potential to get derailed by time, cost and political issues within an organization. Considering the current business environment, the shift to an RBP approach requires solid support from top management and a strong business case. The ability to show the bottom line impact of this RBP approach is critical for a successful business case.

- **Integrate siloed processes**

For the RBP model to succeed, modern systems (across all channels – branch, website, mobile, and social media) need to take an enterprise-wide, 360-degree approach that spans across asset classes, customer segments and geographies. Centralizing pricing and billing solutions will standardize and streamline pricing and billing processes across products and business lines. This will not only do away with manual processes but also provide a single view of the customer across lines of business. Moreover, techniques that involve complex methods of customer segmentation and developing pricing models will be critical in supporting relationship based pricing in the industry.

- **Effective customer segmentation**

Effective customer segmentation is the first step a financial services organization has to take in order to drive an RBP strategy. This starts with the study of customer past behavior, generating predictions using various modeling techniques, gauging their profitability and segmenting them appropriately.

Once the segmentation is done, an organization is in a position to design a strategy that can look at their relationship.

Integrated systems can promote a single view of customers. Financial institutions must be able to identify who their profitable customers are and how they stack up in terms of revenues and profits – based on both, historical and future transactions. To help firms achieve this, customer analytics needs to be improved and systems need to capture the data at a single place and provide information that is useful to managers.

A large private sector bank in India has benefited immensely from adopting a relationship-based pricing approach in its way of doing business. By deploying an RBP approach to its way of doing more meaningful business, the bank was able to mine and analyze large-scale customer data in a structured way to understand their behavior and expectations. By understanding their specific behavior and expectations, the firm was able to build products and services that are aimed at them and even price them according to their behavior.

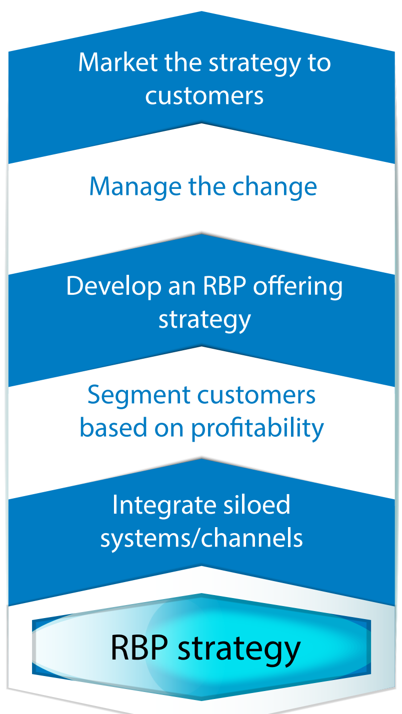

Figure 1: Critical steps in developing an RBP strategy

Segmenting customers based on their life time value (LTV) is becoming very popular among firms. Once this data is captured, it needs to be analyzed and, based on the customer's profitability and behavior across accounts, predictions can be made to generate the future value/usability of the customer.

The ability to calculate the value of the customer can help firms focus on customers who are profitable and fit the firm's long-term strategy. For example, a bank operating in the niche segment of High Net Worth (HNW) customers can, from time to time, conduct an exercise to find out if the customer portfolio represents the targeted customers who are HNW – do certain customers have to be "downgraded" or "upgraded"?, etc. By doing so, the bank can match its offerings with its target. The bank can additionally, leverage their retention strategy and focus on building an acquisition strategy for prospective clients.

- **Bundle your offerings**

Firms can benefit significantly if they bundle their products and offer their services as a package. This can work wonderfully for financial supermarkets (like retail banks) that have complementary products to offer. For example, if a customer avails a car loan, insurance can be sold to him at reduced prices or even bundled with the package for free. In the same way, a customer who opens a savings bank account can be offered a paid liquidity management solution to help him maximize returns. This way, the organization can minimize the overall costs of service delivery while simultaneously optimizing cross-selling opportunities. The customer benefits by paying a lower consolidated price for services availed using a bundled approach. Moreover, this approach helps save time in the form of buying multiple additional services from the same overarching service that was provided.

- **Manage the change**

The implementation of RBP requires a significant change in the way an organization approaches its customers or manages its business. Managing the change across systems, people and customers is a big task that can be time-consuming and laborious.

The change in approach requires multiple lines of business mangers (including product managers) to speak to each other and think like a single organization. In many cases, this is a key issue – some see it as a hazardous approach with several potential problems – overlapping authority, differences in opinion, etc. – that can disrupt the smooth functioning of the organization.Firms need to move out of this approach and talk to each other internally to see how this can work in the best interests of the firm. Also, the change in strategy has to be communicated to customers through appropriate channels – in branches, through phone conversations, advertisements on websites, etc. Customers must be able to realize the logic behind paying a certain price for a specific service that they are availing.

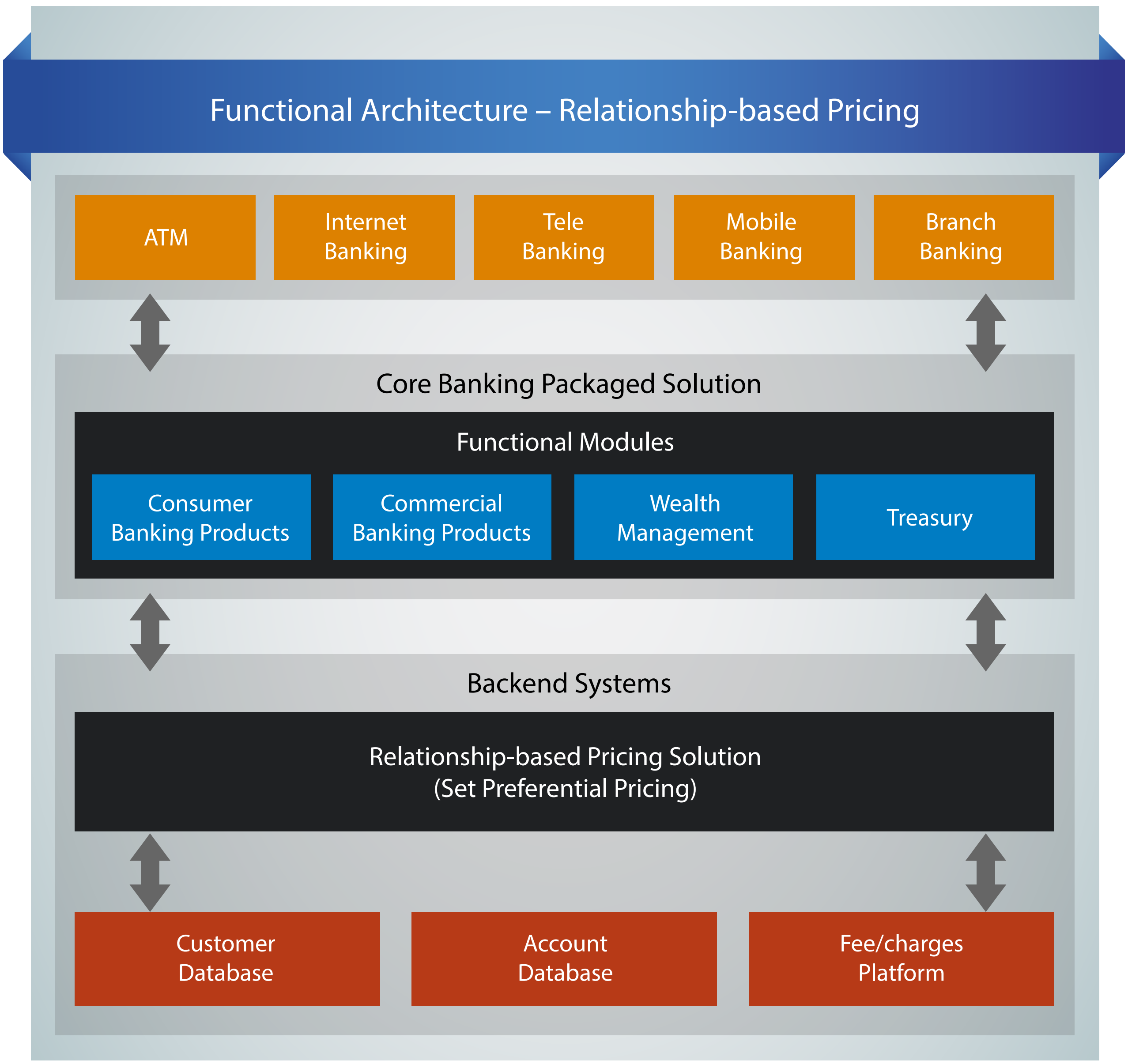

Figure 2: Relationship-based pricing – illustrative functional architecture

How can RBP benefit your organization?

RBP helps financial institutions switch over from a product-centric to a customer-centric pricing policy. It helps mitigate challenges around customer retention and revenue leakage. The RBP framework provides a holistic view of customer relationships and facilitates a focused sales approach to existing customers.

Using RBP, organizations can:

1. Minimize revenue leakage

RBP helps firms minimize opportunities for revenue leakage. For example, with an effective pricing and billing solution, banks can better price the customers so that no "unseen" revenues are lost. In the same breath, banks can avoid errors such as over- or under-charging customers. Also, effective monitoring processes can help banks identify actual—and potential—cases of revenue losses in the form of instances where a customer's savings balance may be shrinking steadily or he may be in the process of liquidating his investment account.

2. Improve bottom line

RBP can help banks improve revenues and reduce costs.

Figure 3: Tangible benefits an organization can achieve with RBP

By automating pricing and billing processes, banks can save a lot of money through consolidated billing, which requires lesser resources in the back office. In addition, the method of bundling or packaging products (as seen earlier) can help bring down the cost of selling new products. All these initiatives will contribute positively to the bottom line.

Case study: A large financial service organization in India benefited from the centralized billing approach advocated by the RBP concept. The bank was able to centralize billing across product categories, thereby reducing duplicate billing, operational costs, timelines while, at the same time, obtaining a comprehensive view of the revenues generated by a specific customer. The approach also helped the bank customize customer pricing based on their behavior with regard to other products used by them.

3. Reduce customer attrition

With RBP, customers will get the best deal possible, thereby saving them to realize significant savings. For example, a 50 basis point reduction in a home loan or getting free insurance for a car bought with a loan from the same bank can help the customer save a lot of money. Moreover, with a consolidated billing approach for all his relationships with the bank, the customer will be free from the hassles of managing multiple bills. These will improve customer satisfaction and, consequently, reduce churn.

Potential challenges during implementation of RBP

1. Integration of systems

In a majority of cases, firms have multiple product lines that are supported by multiple siloed systems. Achieving integration across both, front and back office functions for meaningful customer data analyses is a recognized challenge. Due to this integration limitation, firms are not able to put together a competitive response to changing market conditions. The current technology infrastructure also limits a firm's ability to bundle products and target pricing strategies at specific customer segments.

2. Data mining and cleansing

RBP requires, in real-time, the latest, and most accurate and relevant data about customers. However, in most financial services firms, this data typically resides in multiple legacy systems and is difficult to obtain in a comparable form. To top it off, the majority of systems are not able to generate a good, consolidated view of customers, which is a base requirement for a good RBP program.

3. Organizational issues

Shifting from a product-centric pricing approach to the RBP model cannot be achieved without support from the top management and a strong business case. The change will require breaking silo's across channels and LoBs. Resentment and conflict owing to differences in opinion on the proposed strategy across LoBs is inevitable. Overlapping authority and responsibility and additional workload can be serious impediment to implementation of a successful organization wide pricing model.

Devising a relationship-based pricing model requires the relationship manager/ product manager in an organization to play a significant role.

Figure 4: Challenges in implementing an RBP strategy

The product manager has to work in sync with the systems to see how best he can utilize the data generated to design a relationship-based pricing strategy. If the data resides in old and multiple systems, the execution of RBP can become a real nightmare.

4. Legal implications

There are legal limits to the concept of relationship-based pricing. If not done properly, the customer may question a bank's pricing strategy as unfair, resulting in a potentially costly loss of reputation, financial penalties and other legal repercussions. Moreover, legal dimensions – in terms of pricing – differ between lines of business and geographies, an aspect that can bring in further complications.

5. Consequences of a pricing mistake

It is possible that a bank may adopt a relationship-based pricing strategy that is not appropriate, and consequently, may not work for the institution. The cost of this error can be significant since, in most cases, a lot of money, time, manpower and effort have already been pumped into the implementation. This can directly result in loss of potential sales and customer dissatisfaction – resulting in the bank having to spend even more just to restore customer confidence.

Conclusion

The financial services industry is undergoing a comprehensive make-over. The traditional way of doing business is becoming outdated and the focus is shifting from large to small but efficient business models, particularly ones that enable a firm to read and analyze customer behavior to deliver more targeted products at the optimal price. On the flip-side, this is easier said than done. However, with relationship-based pricing gaining momentum, organizations are reaping benefits from their ability to mine and analyze customer data in a centralized way to develop a holistic view and develop price-effective and suitable solutions for their customers.

In doing so, challenges remain in both areas – man and machine. While data that resides in multiple disparate systems provides an integration challenge, there is considerable opposition to the cultural shift. However, this is changing slowly and giving way to a more systemic approach to doing business that focuses more on meaningful data and cultural collaboration. Firms that are fast to move are likely to be able to reap maximum benefits in terms of higher revenue, better stickiness of assets and customer loyalty.

About the authors

Swaran Kumar Patnaik

is a Principal Consultant with the Capital Markets practice at Infosys. Swaran holds an MBA degree in finance and marketing, and has over 11+ years of experience in the areas of research, analytics and business process consulting. Prior to joining Infosys, he worked with ICICI Prudential Asset Management Company and CRISIL. Swaran's expertise revolves around leading and executing business process management (BPM) projects in wealth management, asset management and brokerage.

He can be reached at swaran_patnaik@infosys.com and on LinkedIn at http://www.linkedin.com/pub/swaran-patnaik/7/691/b06

Pavan Jolly

is a Lead Consultant with the Banking Practice at Infosys. With over 11+ years of industry experience in the banking domain, he has worked on several client engagements for leading banks across Europe in the areas of account opening process, KYC compliance and customer alert management. He has been instrumental in helping Infosys clients with service orientation of their legacy systems. Currently, he is engaged on developing a customer review application for a leading UK bank.

You can contact him at Pavan_jolly@infosys.com

For more information, contact askus@infosys.com

Infosys *be more*