Pricing Excellence in Corporate Banking: The Pressure is On

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Pricing transformation: Why now?

New banking regulations are putting the traditional corporate banking value proposition at risk, while demanding ever-increasing capital investment. But there is an opportunity for astute banks to leverage the required technology spend for compliance to simultaneously drive excellence in another area: pricing.

In the pursuit of regulatory compliance, banks incur direct costs associated with higher staff count, new technology investments, changes to processes, and increased reporting to regulators. These are, of course, in addition to the indirect hit to overall profitability from carrying lower gearing.

These costs could, however, serve as a driver for banks to change outdated pricing practices. At a minimum, banks need to incorporate all of these costs into their P&L and find ways to continue to provide value to both customers and shareholders. In this case, pricing is one of the first levers banks can turn to. But banks have faced cost increases before, so why change deeply embedded pricing practices and systems now?

Other pressures on profits. In addition to the very large regulatory costs, low interest rates and flat yield curves continue to apply downward pressure on profits. Despite these pressures, banks must continue to meet their growth obligations to shareholders.

Strong focus on risk management. Nearly all bank regulations introduced post-credit crisis have been focused on de-risking banks and the collective banking system. By default, banks have been very focused on strengthening their enterprise risk management. Two ways banks are mitigating interest rate and market risk is by diversifying their revenue streams and seeking more fee-based revenue, which – being independent of interest rates – offer the advantage of stability.

Some regulations demand better pricing. Some new components of regulatory compliance require greater pricing discipline and coordination across lines of business or product lines. Basel III's Liquidity Coverage Ratio (LCR), for example, links deposit balances to operational services, such as treasury management and other transaction services, which are generally fee-based. To comply with LCR, banks must demonstrate the linkages between deposits and other banking services – which, in effect, will force banks to harmonize their internal systems to monitor client relationships more holistically (including pricing).

These drivers make the need clear: make up for new costs and grow fees. But many banks do not do a good job of managing pricing for commercial fee-based services, especially treasury management or transaction services.

They often:

- Leave money on the table because they have little control over discounts and waivers;
- Leave money on the table because services are not priced for value;
- Confuse their clients with price lists containing hundreds, if not thousands, of price points;
- Retain embedded, outdated practices that have not kept up with other industry advancements;
- Fail to invest in their IT infrastructure, preventing pricing at the relationship level; and
- Lack transparency around how they manage and set prices – an area ripe for new regulatory oversight.

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While in the throes of regulatory firefights, however, an important opportunity for banks to overhaul pricing practices is emerging. By piggybacking on the budget designated to satisfy these regulatory and other pressures, banks can achieve pricing excellence by transforming pricing strategy, practices, and systems – and have a significant positive impact on future bank profitability.

Defining pricing excellence

Given pricing has historically been challenging for banks, what would pricing excellence look like? Let's start by defining its three critical foundational pillars:

Make pricing a true discipline. This includes allocating the appropriate supporting resources, from people and access to client data to funding for required tools and technology. Banks also need to establish strong governance over pricing practices, documented and enforced pricing policies, and effective metrics to gauge performance. To make pricing a business discipline, banks must have a strong executive mandate, involvement, and support.

Establish a pricing strategy. While this may seem basic, most banks do not have a formal, documented strategy. This leads to misalignment in pricing practices, as well as the perpetuation of outdated practices. Banks also need to review and update the strategy at least once per year and/or when major market and competitor events happen.

Determine the appropriate technology required to deliver more sophisticated pricing capabilities. The bank will need technology to hit short- and medium-term goals, and to build in inherent flexibility to respond to an uncertain future.

Only after establishing these foundational pillars can banks confidently move toward making pricing a centre of excellence within the organization. Next, let's define the elements of a pricing excellence model (see Figure 1 below).

Figure 1: The pricing excellence model

A CLIENT EXPERIENCE DRIVER

Clients experience pricing in a way that aligns with the bank's overall desired client experience.

Client relationships and behaviours drive pricing – optimal behaviours that are beneficial for both the client and the bank lead to optimal pricing.

Pricing communicates value to clients.

Pricing reflects a proactive view of customer needs.

A REVENUE DRIVER

Provide a single, consolidated bill according to detailed usage of products and services.

Create clear, enforceable exception policies.

Automate processes and systems to monitor and plug revenue leakage.

DATA-DRIVEN

Pricing decisions incorporate accurate and relevant market data, such as scale dynamics, deal and portfolio information.

Pricing decisions incorporate customer behaviour dynamics and customer value.

Robust data drives revenue goals from pricing changes and helps to set realistic, achievable goals that garner organizational support.

Pricing decisions leverage detailed activity data from existing bank systems.

Banks have the ability to track and analyze customer activity.

GOVERN SALES AND RELATIONSHIP TEAMS

Clearly define the role of sales teams, including boundaries on exception pricing and new deal support.

Encourage collaboration on price changes and structures before implementing new prices.

Facilitate ongoing sales education based on needs-based selling.

TRANSPARENT

Comply with regulatory requirements around transparency.

Create clear, easy-to-understand pricing policies and terms.

Both clients and bank staff have a consistent view of product and pricing propositions.

TARGETED

Target pricing by industry, segment and customer.

Price based on customer behaviour down to the account level.

Track and incentivize customer loyalty.

Provide a detailed view of how products and services might be used, including channel, time, and quality of execution.

Price based on a combination of attributes, and modify attributes based on changing regulations and experience.

FOCUSED ON ONGOING PERFORMANCE

Deploy tactics and metrics for continuous improvement.

Account for client lifecycle activities, such as new deals, client acquisition, new product roll-out, and other day-to-day scenarios beyond annual price increases.

FLEXIBLE

Modify pricing and billing to accommodate new products, hierarchies/structures and bundles.

Price based on a 360-degree view of the client relationship.

Simulate the impact of pricing changes on the customer value proposition and the impact of alternative pricing strategies on profitability.

Automate processes and systems to execute and monitor pricing policies.

Source: Treasury Strategies and Zafin

Impediments to pricing excellence

So what are the impediments preventing banks from achieving pricing excellence?

First, at the most basic level, many banks have taken a very narrow view of setting and managing pricing (especially for fee-based commercial services), with limited reference to an overall business strategy or even a product-level strategy. As such, banks have managed pricing with an exclusive focus on execution, with annual re-pricing projects designed to gain a one to three percent lift in fees through line item increases. Bank product groups then typically wait another twelve months before reviewing price points again.

These annual events also rarely focus on changes to pricing for clients with discounts or waivers, perpetuating longstanding discounts – with minimal, if any, price increases over time. Since banks generally realize relatively low increases in fees from these events, it's been hard to make the business case for further investment in the pricing discipline.

Second, banks struggle to access and leverage internal data to create more intelligence about client behaviours, price elasticity and value. While banks usually generate myriad data about the price sensitivity and pricing behaviours of clients, they typically do not have the structure and analytical capabilities needed to identify these tests, execute them, and incorporate the findings into the pricing strategy.

Third, banks often perpetuate bad pricing habits that leave money on the table:

Treating all clients and products equally. In many cases, there is little differentiation in pricing approaches and structure for commercial services, especially treasury management or transaction services. Yet differentiated client segments will not value the same solutions equally. Pricing often does not reflect the product lifecycle or the value that the service offers to the client.

Not charging for all services provided to clients. At many banks, some services do not even have a fee! Banks are often "missing" service codes because they either don't recognize a service as a distinct value point for the client, have outdated pricing structures, or lack the ability to modify billing systems to accommodate new price points.

Making price exceptions and waivers "ingrained" practices. Banks often do this with both their clients and sales teams, especially when they lack a pricing strategy that is easily communicated internally and externally. For example, we have heard anecdotes of commercial banks waiving outright any contested fee up to $250. Additionally, some sales and relationship managers define their role as "advocating on behalf of the client to the bank," which often means price discounts. Banks often do not set budgets for discounts or waivers, rigorously track their P&L impact, or make discounts part of sales performance metrics.

Finally, for most banks, legacy core banking and other product systems are decades old, with layers of changes made to accommodate business, customer or regulatory demands. Like their organizational/operational counterparts, they represent silos that do not communicate easily with each other, making it difficult to price at the enterprise level for a specific customer, segment, or industry relationship. Further, due to limitations of architecture and implementation, they are difficult and costly to maintain and modify – particularly in the current climate, where competitive and regulatory-driven changes are demanding a level of flexibility and responsiveness that these systems are not likely to deliver.

Banks, then, typically lack the three fundamental pillars of pricing excellence described above: a clear pricing strategy, an organizational focus on pricing as a discipline, and a pricing technology platform. If banks cannot make a strong case for investment, they will continue to struggle to get the funding and resources they need to improve pricing practices.

The path to pricing excellence

There are immediate and practical steps that banks can take to make meaningful progress toward pricing excellence. Start by assessing the current state of pricing within the bank by analyzing all factors impacting pricing and resulting profitability:

Level of success within the customer base. Through rigorous data mining of internal systems, is it possible to determine the share of customer wallet we currently have, how much we deserve, and how much we can likely get?

Reasonableness of revenue targets. Recognizing customer sensitivity to price increases, are current revenue targets sensible or too aggressive? Finding a realistic framework where price increases stick is key.

Organizational support for pricing. How effective are the bank's component organizations in securing the desired revenue targets – pricing committees, product organizations, sales/RMs, and billing teams?

IT infrastructure supporting pricing. How automated and how effective is the pricing and billing process? Where do manual processes "fill in"? What is the level of monitoring and control over revenue targets? How easy is it to make changes that may be driven by competition, regulations, and bank policies?

Tally dollars that have been left on the table. For most banks, going after revenue not realized for a variety of reasons can be a significant incentive and funding source for pricing transformation.

Establish a pricing strategy that aligns with bank-wide strategic goals. Incorporate clearly-defined objectives and identify key pricing drivers, such as profitability, growth/client acquisition, risk management and channels/access.

Build an investment case encompassing the organizational and technology changes necessary to achieve pricing transformation. Consider revenue leakage that will be plugged, new fee revenue opportunities and regulatory budgets impacted by pricing. Many banks are looking to specialized business and technology partners to make the investment case more palatable rather than "going it alone."

Implement the required organizational changes. Ensure consistent administration of pricing policies, delivery of effective pricing across the enterprise, and monitoring of performance against revenue targets.

Create a flexible pricing automation platform for the future. Consolidate the patchwork of product-specific systems and processes (both automated and manual) to provide the required pricing and billing flexibility. It should support an enterprise-wide view of customer relationships across lines of business and encompass flexible pricing models, hierarchical customer billing scenarios, offer management, and pricing and profitability analytics. Specific capabilities should include:

- The ability to readily add, change, or delete product/pricing attributes;
- A rules-based architecture that permits business-driven changes without code changes;
- The ability to target pricing across the customer hierarchy down to the account level;
- A billing component for comparable charging across the customer hierarchy down to the account/SLA level; and
- A range of analytical tools, including pricing simulations, revenue leakage analysis, and profitability assessments.

Continue to focus on the customer base to determine the effectiveness and sensitivities of pricing policies. Also, consider incorporating customer loyalty programs that track enterprise-wide product/service purchases, transaction activity, and usage behaviour to incentivize customers to expand their existing relationships, reduce attrition, and increase profitability.

Summary

Success in the post-crisis world for both banks and their corporate customers will depend heavily on their ability to adapt and respond to change. While investments in organizational improvements and technology must be made to keep up with regulatory requirements, there is an opportunity to leverage compliance spending to simultaneously develop pricing excellence.

Simplifying processes, operations, and product design/delivery can help contain costs, make it easier to understand how well the bank is responding to the demands that this new world imposes, and – perhaps most importantly – help banks grow in the face of it.