

The future is bright

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As the crunch sets in, it may be necessary for managers to seek a radical pricing solution and implement a price optimisation scheme, says Robert Phillips.

Since the advent of the global credit crunch, mortgage executives are increasingly challenged to determine how to realise the highest level of returns from their markets. Pricing optimisation is one technology that is becoming part of the strategic arsenal for many mortgage lenders.

The combination of the global credit crunch, declining home values, and increased regulatory demands means 2008 and 2009 are shaping up to be difficult years for mortgage lenders.

These external factors are compounded as mortgage executives are under intense pressure to meet business objectives, financial performance goals and credit mix targets.

The standard reaction to these types of shocks in the past has been for mortgage lenders to tighten their underwriting policies.

However, there is also the opportunity to look at pricing strategies, an important driver of performance and an area that directly impacts financial results.

Traditional pricing techniques typically ignore a fundamental consideration: consumer preferences and how they will respond to different prices and offers.

Most current pricing systems are based on spreadsheets and require heroic efforts from individual analysts and product managers any time that rates need to be changed.

Moreover, the impact of price changes is only understood from a narrow margin or risk perspective and current pricing practices do not follow a consistent, repeatable and efficient process that enables continuous learning and improvement of an organisation's pricing strategy over time.

For the savvy mortgage executive, now is a good time to invest to be ready for the next upturn.

At the centre of many banks' current investment initiatives is pricing. The practice of pricing has risen above a support function to a core competency based on the realisation that it is one of the quickest and highest leveraged processes that a lender can deploy to impact results.

In the mortgage industry, pricing optimisation is a key technology that provides insight into customer responses and how to improve the pricing of a complex offering of products and services.

As part of an overall pricing process, pricing optimisation is enables lenders to manage and improve the performance and profitability.

Pricing optimisation technology combines pricing analytics, optimisation and execution into a comprehensive pricing strategy. Implemented properly, it includes a dynamic process that helps lenders monitor, analyse, optimise, execute and learn on an ongoing basis.

Making pricing decisions within such a framework rather than relying on the ad hoc use of spreadsheets provides consistency and results in fewer errors.

By using pricing optimisation technology, lenders can simulate how price changes will affect profitability and lending volumes before executing them.

For example, a pricing manager could simulate a competitor price move, a change in interest rates or how an internal business goal might impact the bank's performance, specific to a segment and across the entire lending portfolio.

Armed with this information, a pricing manager can create a more competitive and compelling pricing plan that is supported with empirical data and accounts for all facets of market response to the proposed pricing plan.

One common misconception is pricing optimisation is simply a way to raise rates across the board. This is not at all the case.

When lenders first apply pricing optimisation they typically find about 40 per cent of their rates are too low and should be increased, 40 per cent are too high and should be decreased and about 20 per cent are about right and should stay the same.

Another benefit of a more rigorous pricing optimisation approach is it supports compliance. Price optimisation provides a clear, auditable and consistent approach to support fair lending and treating customers fairly guidelines.

Basing pricing on a clear and rigorous process based on documented objective analysis makes it easier to audit and defend pricing decisions, should the need arise. Most observers believe the next few years will provide unique challenges to mortgage lenders as they seek to maintain profitability in a chaotic market.

Improved pricing is one way executives can begin to deliver results quickly. Mortgage lenders that understand how their customers segments will respond to various offers and can quantify how prices influence product and portfolio performance will be better positioned to acquire and retain profitable loans and increase both market share and profit in the process.

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