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Relationship Pricing Moves from Nicety to Necessity

When **Wachovia Corp.** returned to credit card issuance, it decided to market its cards only to established customers, featuring special perks, including low or waived fees.

"We thought it would be really inconsistent to say on one hand, 'Take our card, we value you as a customer,' and on the other hand, treat you how [another bank] would treat you," said Steve Boehm, the president of Wachovia Card Services. "This is a strategy that respects the relationship customers have with Wachovia."

It is also a strategy that reflects consumer demand. The Bank Administration Institute said in a recent survey that 52% of consumers thought their banks should reward them for longevity.

However, only 12% thought their banks were doing enough to reward them.

"Customers want things personalized to a greater and greater degree," Mr. Boehm said. "To us, relationship-based pricing is one more brick in the wall that says to customers, 'We understand you don't view the various products you acquire from us in a vacuum. We see the broader picture.'"

Relationship pricing - treating customers to preferential deals - is now becoming a competitive necessity rather than just a customer bonus. Mary Pilecki, a senior analyst at Forrester Research, said deregulation of the airline industry produced a similar situation. "Those who got into fee optimization survived, and if you didn't, you were dead," she said. Eventually, relationship pricing "will be a huge competitive advantage" in banking, she said.

The customer benefits come in many forms.

"There's not any one clear definition of what a relationship strategy is," said Richard DeLotto, a principal analyst at the research firm Gartner Inc. in Stamford, Conn. "From one bank to another, it is extraordinarily different."

But the programs all have essentially the same goal. "The driver is increased wallet share," Mr. DeLotto said.

REWARDS

Loyalty programs, easy to deploy and relatively easy for consumers to understand, are one tool banks are using to get more from their customers while at the same time giving them more. According to Mr. DeLotto, well more than half of banks have loyalty programs - particularly to help their credit card divisions increase transaction volume.

Wachovia's card rewards program is an example of newer ones that reward customers who have multiple products. Unlike traditional programs that bestow points for using either a credit or debit card, it lets customers combine points earned on both cards. Points can also be combined across consumer and small-business cards.

"It's a market-share strategy," Mr. Boehm said. "We want you to do more of your spending with Wachovia."

OFFSET ACCOUNTS

Moving up the scale of complexity from rewards programs, offset accounts, special mortgage accounts popular in Australia and the United Kingdom, are starting to take hold in the United States.

Offset accounts give consumers an incentive to combine a mortgage, checking, savings, and home equity line of credit into one account.

Funds are deposited and withdrawn just as they would be with any checking account. But the deposited funds go directly toward reducing the principal balance of the mortgage.

In effect, customers can pay off their mortgage sooner while earning the equivalent of their mortgage rate of interest on their checking and savings.

Salem Five Cents Bank in Massachusetts is one of only a few U.S. institutions offering an offset account. Janis Dodge, the \$2.4 billion-asset bank's senior vice president of consumer banking, said it has been opening offset accounts at a good monthly clip since it began offering them a year and a half ago (she would not cite specifics).

"The nice thing about it is it really gets the entire relationship," she said.

Bringing the Ultimate Account to market was not difficult from a technical or organizational standpoint, Ms. Dodge said, though that may have been because Salem Five Cents is relatively small. Showing mortgage reps how to present the account has been more of a struggle.

"It has to be sold, no question about it," Ms. Dodge said. "It's not the easiest product in terms of understanding it right away," but it has helped her bank bring in new customers. "I'm surprised more banks are not offering it yet," she said.

BUNDLING PROS, CONS

Far more common are packages that provide customers with discounts, rewards, or other benefits for bundling various products.

Wells Fargo & Co., widely recognized as having one of the best - if not the best - cross-sell ratios in the industry offers a Portfolio Management Account that encourages customers to buy their brokerage, checking, savings, credit card, certificate of deposit, mortgage, line of credit, and even retirement accounts all from Wells.

For keeping a minimum daily balance of \$25,000 (10% of a Wells mortgage can go toward that amount), account holders get fees waived on credit cards, lines of credit, checking and savings, and retirement accounts, as well as 100 free trades and bonus interest rates on savings accounts and CDs.

But analysts and other observers say that simply bundling products together is not nearly enough to persuade customers to do all their financial business at a single institution. Such packages tend to be rigid and include products that customers don't want or won't use, according to a 2006 Gartner report.

In addition, if customers happen to increase their relationship beyond the standard package, they generally get nothing to show for it. By the same token, if they scale back their relationship, there is no price adjustment, eroding bank profitability.

"Bundling is a starting place," Ms. Pilecki said. "But it's not incorporating the entire relationship." Bundling packages with specific customer segments in mind is closer to the ideal, she said.

The next step beyond better-targeted bundling would be dynamic relationship pricing, in which customers would be given a particular price, say on a CD, depending on information from their application and what type of relationship they have with the bank.

The concept also applies to services, such as wire transfers, Ms. Pilecki said. For instance, the ability to cut the normal fee for a wire transfer in half, to \$25, because of a customer's relationship could be a powerful asset, she said.

Achieving dynamic pricing has not been easy, though, because "many banks are very primitive in terms of how they apply relationship pricing," said Chris Burton, the president of the financial services division at Amdocs, a St. Louis company that provides billing, pricing, and customer management software.

Mr. DeLotto said one technique catching on is to revisit customer relationships quarterly or yearly and readjust pricing accordingly. That would be a first step toward instituting price changes far more frequently, much in the way high-net-worth or commercial relationships are constantly monitored and adjusted, usually by a manager who oversees the entire relationship.

Such a move would require a hefty technology investment, however. It could call for systems to track whether spending by one division delivers value or revenue to another area of business, or software to help forecast customer behavior and optimize prices.

No one expects dynamic relationship pricing to happen soon. The product silos that characterize banking could complicate things, as could compensation of product managers. A debit card that has been bundled with other products, for instance, may require a discount that the debit card manager would rather not offer if it would affect compensation.

SPELLING IT OUT

Then there is the matter of explaining to customers why their fees keep changing. "One thing we've learned is you need to have a simple pricing structure," said Robert Shenk, a senior vice president and the head of retail banking and customer experience at E-Trade Financial Corp. "Customers get quickly bewildered. A multitude of dynamic pricing options tends not to be customer-friendly."

One place to start down the path toward relationship pricing may be price optimization, but that could involve a whole new way of thinking. Instead of determining the price at which the bank is willing to sell a product, the goal is to figure out what the customer is willing to pay. Nomis Solutions Inc. of San Bruno, Calif., has developed a methodology that has helped some of its customers get 10 times their return on investment, said Dr. Robert Phillips, Nomis' founder, chief technology officer, and vice president of product management.

Nomis' software indicates the impact that slight price changes might have on customer behavior and product performance.

The software could predict, for example, that offering a home equity line of credit at 10% - 2% above the competition - would result in maximum profits of \$650 and a conversion rate of 33%. Alternatively, a 9% rate would result in profits of \$610 and a 48% conversion rate.

Knowing exactly how price affects profits and conversion rates can have a big impact on earnings. "We've seen gains in profitability and market share in the range of 10% to 20%," Dr. Phillips said. He added that a customer that is using his company's software in auto finance has increased its volume by 11% and its profit by 13% this year.

Nomis advises banks to use price optimization tools in one line of business to fine-tune the process and then apply it to others. "It's an evolutionary process," said Jakki Geiger, Nomis' director of marketing. "Banks are using it in one line of business today, but we envision they would use it across business lines."