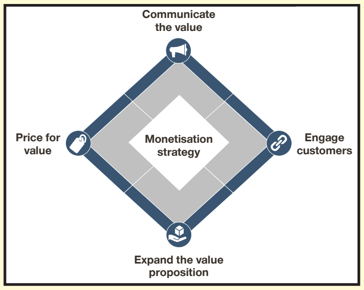
Digitalisation: Getting the Price Right



Consumers are demanding increased digitalisation from companies in virtually every market. This presents specific problems for pricers who must develop strategies to monetize innovations. This article focuses specifically on the challenges of digitisation and pricing in the Retail banking industry, but also provides insights and strategies that can be valuable to pricers in multiple markets. Wei Ke is Partner at Simon-Kucher's New York office. Gianluca Corradi is Director and Joanna White is Consultant at Simon-Kucher's London office. They can be reached via www.simon-kucher.com.

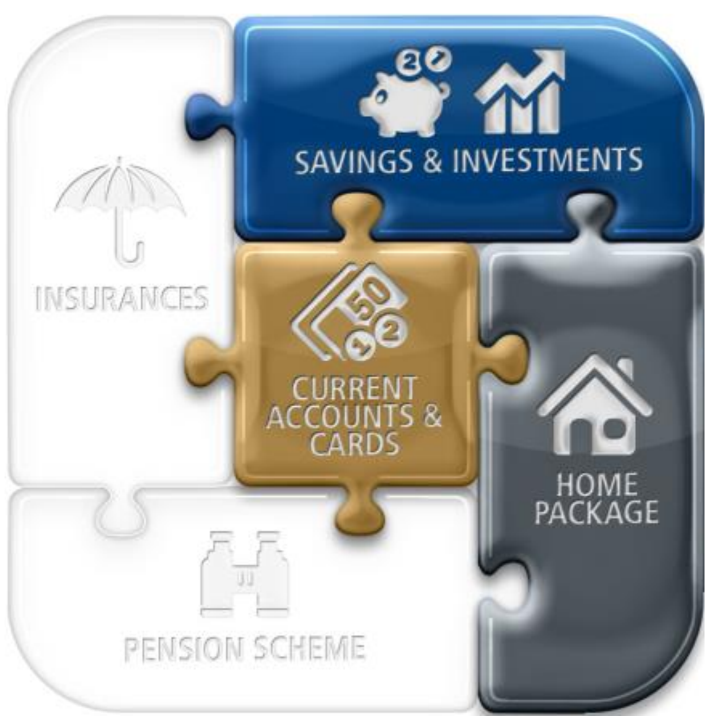
Consumers are rapidly adopting digital solutions across a full spectrum of services, forcing established players, including Retail banks, to innovate traditional revenue models and pricing. This presents new challenges and opportunities for Retail banks.

Firstly, customer preferences and behaviours are changing. Interactions and transactions are moving away from branches to more "convenient" channels, with customer expectation that these services should remain "for-free." Online is increasing and mobile banking use has doubled in two and a half years[1]. A multi-channel offering has now become vital. Today 10% of basic banking products are primarily sold digitally, however it is estimated that in 5 years this will increase to 70%, making digital the predominant channel[2]. Simon-Kucher's annual Global Pricing Survey found that banks remain one of the more skeptical about digitalisation than other industries and are struggling to monetise on innovation.

Secondly, banks are facing challenging times as retail margins remain under pressure. The "lower-for-longer" rate environment is squeezing profits, with Bank of England rates expected to stay below 0.5% until 2021[4]. Costs are driven by a high fixed base of retail branches, as well as increasingly stringent regulatory requirements around capital and liquidity. The global pricing survey conducted by Simon-Kucher & Partners found that 41% of companies from the banking industry were unable to improve their margins in 2016[3]. All the while, banks must heavily invest in technologies for digital capabilities.

Finally, competition is fierce as new market entrants develop digitally-driven, transparent and convenient value propositions that attack profitable banking areas such as card payments. These entrants are nimble and are not impeded by clunky legacy systems that reside at traditional banks. 68% of banking executives surveyed believe that the growth of FinTech will completely redefine the market in the next five to ten years[5]. Many FinTech firms attribute their success to delivering an outstanding service in areas often neglected by major banks.

Figure 1



Successful solutions for banks

Currently, banks are mainly approaching digitalisation from a cost saving standpoint, but are overlooking the opportunity to increase revenues offered by this tectonic shift in customer behaviour.

To compensate for margin pressures, adapt to customer habits and fend off competitors, banks must therefore construct a value-based monetisation strategy around digitalisation.

How can banks do such thing? Banks must understand the true value of a digital proposition and adapt their pricing, communication, engagement and product strategies:

1. Price for value – The problem today is that banks see the cost advantages of digitalisation, e.g. lower in-branch servicing or reduced paper statements, and pass on the entire benefit to customers through a "cost-plus" approach. This results in lower prices that will ultimately cannibalise revenues as more customers shift to digital.

The solution is for digitalisation to be priced for the value deliv-

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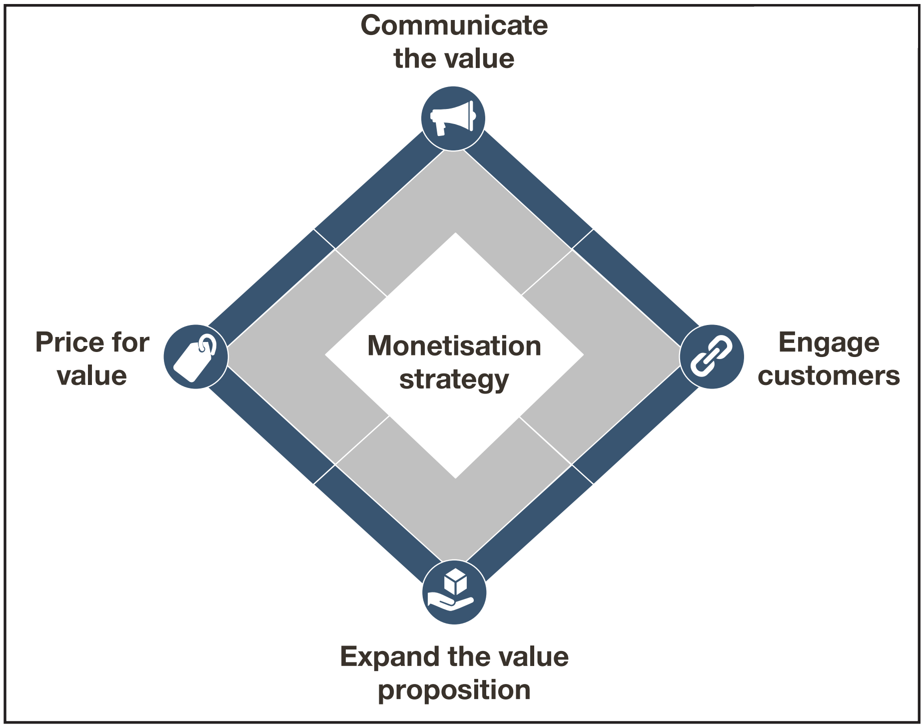
ered in a smart and simple way. Value should be extracted by integrating prices for all value-add digital services. An example of this is Osper, a mobile banking app that allows younger people to manage money. They charge a £12 annual subscription fee for the provision of a prepaid debit card and a mobile banking app. Additional fees are charged for card replacements, mis-payments of annual fees, purchases abroad and ATM withdrawals[6]. Here, features are priced separately to highlight the value delivered to customers. Monzo, a UK digital challenger bank also plans to use smart, targeted, mobile prompts to offer additional and convenient, chargeable products. This makes the point-of-purchase easy and "on-the-go[7]."

Furthermore, if banks are worried that charging for digital can upset customers, a 2015 current account study by Simon-Kucher and Partners also found that customers are willing-to-pay for certain money management and peace-of-mind features[1]. The important thing is to choose the right pricing model – how you charge is a lot more important than how much.

Figure 2



2. Communicate the value – As previously outlined, UK customer expectation is for banking products and services, e.g. current accounts, digital money management features, to be provided for free. However it is critical that the value delivered through digital is communicated effectively to justify a price point, either now or in the future. Banks must be perceived as a solution provider instead of a product manufacturer. This will allow customers to focus on the value first, whilst creating comfort and transparency around price.

What methods can banks use? By using a mix of behavioural techniques with a seamless digital interface, banks can guide customer decision-making, differentiate themselves away from competition and enhance initial uptake and cross-buying. A behavioural example includes the "endowment effect"[8]. This found that when a customer is provided with an initial "all-in" product where features can be removed, versus a "basic" product where features can be added, the "all-in" option resulted in a higher number of features selected. Banks can use this to position a targeted customer solution with a price. Once willingness to pay has been measured, banks can provide a paid-for "all-in" digital solution, with the value of each feature clearly communicated. The customer can then customise their offer by removing unwanted features. This will result in higher digital revenues, as well as increasing the customer's value perception of the offer.

3. Drive loyalty by engaging customers – Following on from the financial crisis, banks are still battling against customer distrust and disengagement, with strong competition existing to win over customers and establish a solid banking relationship. Current bank websites do not aid this problem, with many presenting complicated choice architecture, unappealing interfaces and confusing jargon.

Although banks are making concerted efforts to improve, when compared with websites outside of banking they still have a long way to go. In addition, easy-to-use aggregators are commoditising banking products, further disintermediating the customer from the bank. Digital channels present a huge opportunity for banks to re-engage and delight customers and increase loyalty.

In this respect, customer engagement can be achieved by understanding customer psychology. Gamification is one of the methods that banks can use. Not only does it drive customer engagement and loyalty, but it is also a way to organically transition customers away from the branch through increased mobile usage. An example of successfully executed gamification is Commonwealth Bank in Australia. They developed a property investing game to allow customers to "try before they buy." This helped to educate customers on real-estate literacy and helped to generate a significant number of loans within one year of launch[9].

Furthermore, banks can use the digital platform to deepen customer relationships. The screenshot in Figure 1 highlights how a German regional bank has achieved this.

This bank presents all customer needs in one place and rewards multiple product holdings to drive cross sales. Customers are incentivised and rewarded for completing the puzzle, while the three colours represent different levels (basic, middle and premium). This creates customer desire for a matching status and drives profitable product acquisition, whilst earning the loyalty of the customer. This increases the likelihood to capture all profitable financial needs throughout a customer's life-cycle.

4. Expand the value proposition – In order to counteract the commoditisation of retail financial products banks must rethink of themselves as solution providers and "solvers of customers' needs." Nowadays customers face increased uncertainty about their future due to fast-paced technological

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and globalisation trends. Consequently, they have become more financially savvy and expect financial institutions to provide them the means for planning their future independently.

In the recent years, the market has seen a proliferation of budgeting services, expenses aggregators and financial planning tools. In this respect, companies like Mint.com have been able to position themselves as leaders in this space far quicker than banks which are now slowly catching up with their "roboadvisor" solutions. Understanding customers' needs beyond pure financial products, developing solutions accordingly and delivering them seamlessly through the digital channel will be key drivers of a successful monetisation strategy.

In summary

Digitalisation presents a huge opportunity for banks. However success is reliant on thoughtful consideration and execution. Pricing must be aligned to customer value and not costs, while communication must effectively focus on solutions and the value-delivered. Banks must also focus on strategies to engage customers and improve loyalty to really stand out from the ever-growing crowd. Finally, banks must innovate their value proposition by stepping into their customers' shoes and understanding their needs.

References

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8. Levin et al. 2002

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