Financial Services
Banking

Mobile banking and payments: emerging price models

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Introduction

Banks have a track record of giving new technology to customers for free. It started with the internet and, until recently, mobile was going that way too. However, mobile network operator (MNO) O2's intention to charge customers for peer-to-peer (P2P) mobile payments ("Money Messages") may signal the end of the 'free' business model and give banks the opportunity to monetise their mobile innovations. O2 is not alone in monetising mobile payments. In fact, there are a growing number of cases in North America where Remote Deposit Capture (RDC, paying in a cheque via mobile) commands a fee. These real-life cases, combined with research from Simon-Kucher & Partners, point to emerging best practices of pricing mobile banking services.

Making money from mobile

While investments in mobile services are running into £billions, banks give these innovations away for free. Why? Costs per action in branches range from £0.60 to £4.50 compared with less than £0.05 for mobile[1]. If customers start using mobile services rather than go into branches, the reduction in servicing costs outweighs the cost of investment, resulting in a net return. Banks therefore require mass migration between these channels, thus they offer the service for free. However, services that deliver a benefit to customers by meeting their unfulfilled needs can be monetised. This is the basis of value-based pricing and something that UK banks have yet to fully embrace.

There are three layers of mobile banking, and value-based pricing models can be applied to all (see Figure 1). The first wave of services that reached the market, were offered by RBS / NatWest in 2010. These informational services are free and will always be free – these are hygiene factors. However, as the scope of service matures and the value to customer increases, there are opportunities to monetise the offering. How? We envisage three possible revenue models.

1 Source: McKinsey, Booz, Fiserv, Tower Group, Harvard Business School, Simon-Kucher & Partners Analysis

Figure 1:
mobile banking business layers

1. **Transaction pricing.** Monetises any number of specific events that customers initiate proactively, such as payments (retail purchases, remittances, bill payments, etc.), share trading, SMS alerts, and ATM withdrawals.
2. **Versioning and packaging.** Creates intelligently designed packages that offer distinct combinations of basic services and value-added services and features suited to customer needs. An increase in the value delivered by these packages commands a higher fee.
3. **Mixed pricing. Combines Transaction pricing and Versioning.** This relies on more accessible (and cheaper) packages for core services and offering customers the opportunity to purchase add-ons.

All three models are used successfully in a wide variety of industries, including banking, and the number of cases that leverage Transaction Pricing for mobile payments is growing.

Mobile payments: the case for Transaction Pricing

There have been two significant developments P2P payments in the UK in 2012. Barclays launched Pingit in February and

O2 launched its mobile wallet in April. Barclays offers the service for free whereas O2 charges £0.15 per P2P payment after a free introductory period of 6 months. The difference in pricing leads to some interesting conclusions. First, business models are still evolving and these two cases underscore the traditional ideologies of the banks (free) and MNOs (price for services). It is unsurprising that Barclays offer the service for free whereas O2 monetise the offering. Second, the fact that two different industry segments are actively competing for share of wallet will likely drive competition through a mixture of innovation, branding and pricing. This is compounded by the inclusion of the tech innovators (PayPal and Google) in the digital arms race. Finally, and importantly, there is a willingness to pay for these mobile payment services that Banks in the UK, such as Barclays, are yet to tap into.

There is no doubt that the O2 wallet offers more functionality than Pingit. As such, there is a halo effect from the combination of features (retail purchases, special offers and the linked 'physical' card) which 'transmits' a willingness to pay for the P2P payment functionality. Research from Simon-Kucher & Partners suggests that the price model for O2 is suboptimal. A Discovery Panel of over 300 participants in the UK assessed preferences for different types of mobile payments, preferred price structures and price levels. The Panel's price structure preference for P2P payments was a single flat fee (between £0.50 and £1.00) to load a wallet, and then make unlimited transactions until the funds were spent. This structure contrasts with overseas remittances where customers prefer to pay a fixed per transaction fee (between £1.00 and £2.50). The difference in price metric preferences (a one-off fee to load a wallet compared with a fixed per transaction fee) and price level clearly highlights variations in the perceived value of the services. P2P payments offer convenience whereas mobile remittances offer a solution to an emergency or a cheaper alternative to an international 'to account' salary transfer (e.g. MoneyGram's $5.00 fee to send money to mobile accounts in the Philippines)[2].

What can we learn from developments overseas? There are cases in North America were mobile banking and payments

2 Source: http://www.moneygram.com/MGICorp/campaigns/mobilesend (accurate at 25 June 2012)

incur a fee. Bank of Montreal, for example, charges for mobile bill payments at $1.00 per transaction. The transaction cost to the bank is in the range of $0.01 to $0.10 meaning that the $1.00 fee is a highly profitable. This shows how banks are tapping into the willingness to pay for mobile payments.

RDC is another case in point. Two banks in North America, BB&T ($175bn in assets) and US Bank ($340bn in assets), both charge $0.50 to deposit cheques via mobile. In a recent interview[3], US Bank's Head of Mobile Banking, Niti Badarinath, said, "we talked to our customers and they kept saying, 'Why can't I make deposits with my mobile phone?'". This clearly demonstrates the need for banks to develop propositions that align with customer needs. It also shows that customers will pay for services that support their needs. Currently, RDC is only offered by 7 of the top 20 banks, suggesting the service will become a competitive hotspot in the near future.

Where next?

While hygiene factors (basic informational services) must always be free, it is clear that certain value-added features carry the potential for monetisation. Banks can learn from the MNO's that the 'free' pricing ideology need not apply to mobile banking and payments. To successfully deliver on this mind set change, and tap into customers' willingness to pay, banks must address two important questions. First, what will customers pay for (the proposition)? Second, what is the optimal price model to maximise attractiveness (value to customer) and use (value to bank) of the service? Identifying this delicate equilibrium, which we term 'fair value exchange', is the critical next wave of development for the industry and it becomes ever more important as traditional banks go head-to-head with MNO's and tech innovators (PayPal and Google) with similar services targeting similar customers.

3 Source: Bank Systems & Technology, March 2012

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