Financial Services
Banking

Price compression in Transaction Banking

Opportunities for revenue growth: Price Setting

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Smart profit growth in Transaction Banking – the power of strategic price management

Price compression is leading to a decline in profits for traditional revenue streams in transaction banking. Strategic price management is an underused lever to boost profits and maximise client relationships. In this series of white papers, we give guidelines on the necessary steps to bring strategic price management to life through value-based pricing. This includes redefining the way pricing is conceived (Price Strategy), designed (Price Setting) and delivered (Price Implementation). In this article we focus on Price Setting – the design of new price models that align with client needs and tap into their "willingness to pay".

Value-based pricing: determining the scope of service

What do clients seek from transaction banks? The ability to make a payment or the ability to make a secure payment, accurately, quickly and initiate it on-demand, remotely? For some clients it is the prior, for others the latter. There are two important points raised here. First, is that different client segments have different needs. Second, is that products and services are characterised by a set of parameters, not just function. Understanding these dimensions in detail is the basis for value-based pricing.

Broadly speaking clients can be segmented based on their size (total revenues), relationship (volume of business with a transaction bank), geographic coverage, industry etc. The needs of these segments must then be characterised in order to understand their 'willingness to use' products and services. Needs-based segmentation considers two factors. First is the perceived importance of a transaction bank's products and services. Second is the performance of the transaction bank in providing a high quality service when compared with the competitor set. Strategic competitive advantages, where transaction banks provide the best in-market performance for the most important products and services, are the best candidates for monetisation. An example might be superior tools to monitor and manage global cash pools in real time. Underperformance in high client priority areas are candidates for investment and improvement. High performance in areas of relative unimportance to clients serve as opportunities to increase the perceived value of the product or service.

This type of analysis helps set the basis for value based pricing but the full potential requires one further level of detail. That is, how, specifically, clients use the service. Incident management, for example, is a hygiene factor – every client expects their transaction bank to fix issues of their own doing. However, where a transaction bank knows that they are top performers and that clients consider incident management an essential part of the service, there is an opportunity to monetise the offering. A free, entry-level service could be offered on a 'best endeavours' basis. A paid-for, mid-level offer could guarantee response times of 72 hours and resolutions of 5 days. A premium service could provide response times of 2 hours and 80% of non-critical incidents resolved within 24 hours – a premium service, commanding a premium price. These parameters and options form the basis for the design of a needs based price model.

Designing a needs based price model

A price model consists of a price structure (grouping of products / services), price metrics (the way a fee is incurred) and a price level (the amount paid). Transaction banks use many different price models for different parts of their product and service portfolio today. Broadly speaking, price models vary along a continuum of disaggregated (functional, every item has a fee and is charged on a per-use basis) to aggregated pricing (the ultimate bundle – pay a single fee and usage is free). The range between the two offers a plethora of 'mixed pricing' options (figure 1).

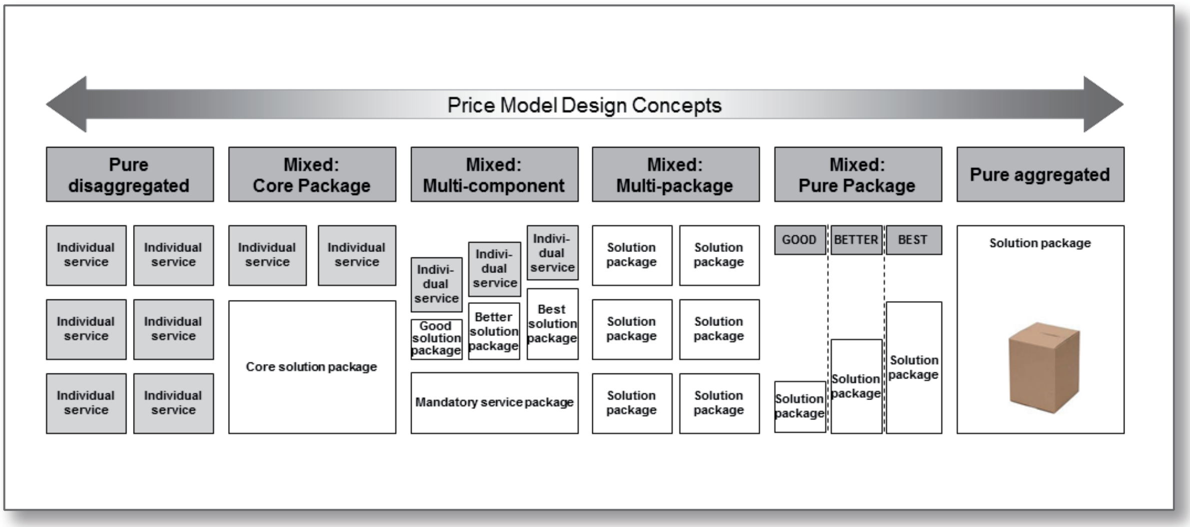

Figure 1
Price model design concepts for Transaction Banking solutions.

Scanning publicly available price lists from transaction banks, it is clear to see that a number of price models exist (figure 2). There is a strong case for disaggregation in the price model. A survey from Equens[1] in 2010 suggested that clients will pay for Additional Optional Services[2]. These include e-mandates, e-payments and conversion of payment formats. Clearly, where there is some form of regulatory intervention, there is a willingness to pay for support. Product and service innovation, the top strategic priority for transaction banks[3], is another opportunity for disaggregated pricing. Innovations such as real-time payment monitoring, cash flow forecasting, tools to automate sweeping and mobile payment authorisation are being developed to meet new client needs and can be monetised in their own right.

However, the case for aggregated price models is also clear. The intelligent configuration of products and services that align with client needs ensures that the broadest possible scope of service is accessible. This supports the transition from 'functional' to 'solution' pricing. As such, mixed price models offer the best overall approach for transaction banks. Multi-component price models (figure 1) provide the best

1 Banks & Future 2010, Survey on the European Payments Market
2 According to Section 2.3 of the SCT rulebook, Additional Optional Services (AOS) are services that a) enable full use of the scheme and b) enable compliance with the scheme
3 Misys: Trends in Transaction Banking report 2011

Bank Name	Bundling	Per action / event fees	Time based fees	Recurring monthly fees	Incentives	Free services
BNP Paribas	✓	✓	✓		✓	✓
Deutsche Bank		✓		✓		
HSBC	✓	✓		✓	✓	✓
ING		✓		✓		✓
SEB		✓	✓	✓	✓	✓
Standard Chartered		✓		✓		✓
Société Générale	✓	✓		✓	✓	✓
Unicredit		✓		✓		✓

Figure 2
Price models used in Transaction Banking[1]

opportunities for transaction banks and their clients for the following reasons:

1. Flexibility (configuring the scope of service; levers for trade offs during negotiations; allows flexible use of products and services)
2. Profit potential (monetise free / utility services via a mandatory service package; clear up-sell path)
3. Value enhancement (aligns client needs with scope of services; a seamless solution)

Typical parameters that differentiate solution packages include different usage thresholds (number of transactions per month), access to services (in-hours / out of hours), channel (self service / relationship manager) and value of business (size of balances). These parameters need to be carefully configured to ensure that the perceived value meets client needs and the price level is considered fair.

1 Analysis based on publicly available information from internet searches

Pricing it right:
measuring the willingness-to-pay

There are a number of methods for setting price levels. Tapping into the experience of sales and product teams (Expert Judgment) is a powerful way to develop a first view of price levels. However, client input is essential as value based pricing is about tapping into clients' willingness to pay. Naturally, talking to clients about price levels is a delicate topic so there are a number of open questioning methods to hand.

The first is the Van Westendorp which quantifies price level ranges through indirect probing for acceptable and unacceptable price levels. This method, however, does not measure demand as a function of price (elasticity). It is therefore difficult to forecast the impact of price levels on volumes.

The best method to determine price levels, often starting with the mid-point from a Van Westendorp analysis, involves testing clients' likelihood to reduce their use of a product or service as price levels increase. By modelling the cost and the price response function, it is possible to calculate the profit-optimal price level.

Fair Value Exchange

Value based pricing optimises client / supplier relationships. Clients buy 'solutions' and suppliers compete less on utility and more on value. The net result is a deeper client relationship and more profitable business. We term this pricing philosophy, 'Fair Value Exchange'.

Bringing new price models to market is the third stage of strategic price management and the subject of the next and final paper in this series. Price Implementation requires 1) a systematic policy for using the levers within the price model while contracting, 2) the development of concise value statements to articulate the benefits of solutions and 3) a mind shift in client engagement. These themes, and others, will be covered.

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