AiteNovarica

MAY 2022

RELATIONSHIP-BASED PRICING

DELIVERING VALUE THROUGH PRICING

GILLES UBAGHS

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IMPACT REPORT

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KEY FINDINGS

The key findings from this report follow:

- The need for improved pricing strategies is growing as banks face ongoing downward pricing pressures that show no sign of relenting in the near term.
- Digital transformation is enhancing bank capabilities. However, the need to show a return on investment (ROI) and a clear-cut business case for investing in these new technologies risks reinforcing existing bank silos as lines of business seek clear accounting and key performance indicators (KPIs) that may underplay overall customer profitability to the bank.
- Commercial and individual customers want more capabilities, personalized service offerings, and control over their banking services. Hyper-targeted personalization means one price or price structure is no longer tenable.
- The growing complexity of fintech ecosystems and bank integration with third-party platforms opens the door to new capabilities and sales channels. At the same time, it complicates revenue management. The need for improved revenue sharing and price management will grow as banks extend their fintech partner networks.
- Relationship-based pricing can help banks meet many of their pricing challenges and deepen their relationship with customers at all stages of their life cycles. This includes attaining, retaining, and growing profitability with their client base.
- Relationship-based pricing strategies require segmenting customers, bundling solutions and services, enabling dynamic pricing, and providing transparency on pricing at all stages.
- Implementing relationship-based pricing is becoming more scalable using new technologies from specialist providers. These platforms can pull in data from across the bank to provide holistic, real-time views of bank and customer relationships and reduce instances of revenue leakage.
- Organizational buy-in is critical to driving a successful relationship-based pricing deployment. Upper management buy-in ensures that strategies can move past existing silos and institutional roadblocks.

INTRODUCTION

The banking market is globally in a state of transformation driven by the possibilities of new technologies, shifting customer expectations, and dynamic competitive and macroeconomic forces. With so much change happening, it is perhaps surprising that banks aren't paying more attention to pricing strategies, including how these strategies affect their broader customer relationships and profitability.

This report looks at the drivers affecting bank pricing strategies and how institutions may overlook them. It also introduces how relationship-based pricing strategies can help meet these pricing challenges and help reduce revenues lost to banks. Technology now makes relationship-based pricing more scalable than ever and can help banks, their partners, and end customers grow the value of their relationships.

METHODOLOGY

This research was conducted using a combination of desktop research and Aite-Novarica Group's extensive database of insights into the banking and vendor space, including the results of several quantitative studies into bank and end-user attitudes. Additionally, Aite-Novarica Group conducted interviews with three fintech company senior executive teams active in the billing and revenue management space. This report also leverages the author's expertise and feedback that bank executives shared during ongoing conversations on this critical topic.

THE MARKET

Pricing pressures are becoming more complex as customer expectations shift, and the lack of consistent approaches in many banks is leading to lost revenue. The pressure is rising, but banks now have more opportunities to remedy this through technology-based pricing and revenue management solutions. These trends are highlighted in Table A.

TABLE A: THE MARKET

MARKET TRENDS	MARKET IMPLICATIONS
Most banks remain siloed across their lines of business, leading to complex pricing models.	Despite the stated goal of many executives, most banks are not customer-centric in practice. They continue to price on a per-product basis, leading to lost revenue through leakage due to poor processes, worsening customer outcomes, and hampering long-term retention and profit growth.
Competition is rising in the banking space from both new challengers and aggressive incumbents.	New challengers often price aggressively; some even offer solutions as loss leaders while offering greater visibility and control to their customers. Incumbent banks, in many instances, have upped their game in terms of digital transformation, only adding to the competitive pressure on banks to improve their services and do so at competitive price points.
The macroeconomic environment is shifting as historically low-interest rates begin to rise in many markets.	Low rates and new models driven by emerging fintech firms have led many banks to experiment with new revenue models, including fees and subscriptions. Customer appetite has grown for new pricing models, but macroeconomic shifts risk further upending pricing structures as interest rates begin to rise and inflation continues.
Customer expectations are shifting; end-users seek more control and visibility over their banking relationships.	Customers at all levels expect to see greater personalization in the services they receive; these expectations include greater pricing transparency. This is becoming more crucial as partnerships among banks, fintech firms, and third parties become more common.

Source: Aite-Novarica Group

THE NEED FOR IMPROVED PRICING APPROACHES IS GROWING

Banks have traditionally set price points using complex calculations, typically on a product-by-product level, and have thrown in the occasional discount or incentive offer. These pricing calculations are often undertaken using dedicated teams relying on arcane models and heavy manual calculations using Excel-based tools. Instances in which pricing reflects customers' total relationship with an institution require even more complex and manual processes. The sheer level of intervention required means that, in most instances outside of a preferential rate on some products or slab-based pricing, true contextual and hyper-personalized pricing has been available only to the top tier of bank clients.

These older approaches ultimately pose problems for banks: They do not adequately underline the potential for broader value exchange between FIs and their customers in an increasingly complex ecosystem. The piecemeal fashion of most bank pricing strategies is under pressure, from lost revenue through leakage due to fragmented and poor processes to poor accounting and missed cross-selling opportunities. These pressures will only continue to grow, affecting bank profitability regardless of the metrics they use.

BANK PRICING FACES PRESSURE ON MULTIPLE FRONTS

Most banks have done well since the recovery from the 2008 financial crisis. Efficient pricing structures and processes that can reduce losses and drive profitability have not always been at the forefront of FIs' thinking in an environment of overall growth. However, growth across most product categories has masked weaknesses in terms of pricing. Banks may not even be aware of the lost revenues and missed opportunities.

Aite-Novarica Group summarizes these pricing pressures in eight key drivers: technology impact, shifting customer expectations, demand for transparency and auditability, growing partner complexity, shifting macroeconomic fundamentals, growing competition, regulatory/compliant requirements, lost opportunities, and revenue leakage (Figure 1). These drivers represent ongoing pressures and, as such, will continue to be considerations for bank pricing strategies for the foreseeable future.

FIGURE 1: PRESSURES ON BANK PRICING

Source: Aite-Novarica Group

DIGITAL TRANSFORMATION RISKS LIMITING AN ENTERPRISEWIDE PRICING STRATEGY

Banks are racing to upgrade their capabilities from back-office core infrastructure to front-end, customer-facing services. The pace of these changes is undoubtedly increasing, but the development of new capabilities and enhancements to existing services remains uneven and piecemeal. Understandably, FIs and their partners cannot change everything at once, and priorities, including payments and core modernization, often take precedence over others. As a result, digital transformation remains at mixed levels of development between banks and within them. As banks race to navigate these changes, balancing pricing needs into this technology drive adds challenges.

In light of digital transformation, these pressures on revenues are becoming acute in some banking areas, especially payments. As highlighted in *The Payment Transformation Race: Criteria for Success,*[1] 82% of surveyed banks report that payments are becoming less profitable. This decline comes against a backdrop in which the total cost of ownership of payments (including hardware, software licenses, and

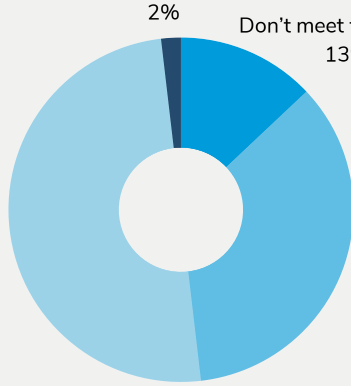
1 See Aite-Novarica Group's report The Payment Transformation Race: Criteria for Success, September 2019.

operations) is increasing. These conditions inevitably challenge profitability and complicate recouping costs on new product and service technology developments.

As highlighted in *Top IT Priorities in Treasury Management*,[2] the overall focus on investment into bank offerings remains very high. Large corporate customers are often a top priority for FIs and are frequently the first in line for new capabilities and functionality. Still, only 2% of surveyed banking executives said their current transaction banking and treasury management offerings fully met the needs of their large corporate clients (Figure 2). That suggests investment and transformation into new capabilities and services will remain high for the foreseeable future.

FIGURE 2: MEETING THE NEEDS OF LARGE CORPORATE CUSTOMERS

Q. How well are your bank's current transaction banking/treasury management products/offerings keeping up with and meeting the needs of today's more demanding large corporate customers? (Base: 54 senior executives at banks)



Source: Aite-Novarica Group survey of Corporate Banking Executive Council members, Q1 2022

Even where banks are rolling out new infrastructure, end-user products, and capabilities, the revenue models underpinning them may be secondary considerations to the challenges of standing them up. Many institutions build technology deployments based on complex business cases with detailed ROI metrics. Product managers and line-of-business stakeholders may be looking at these new capabilities individually rather than as part of the wider bank offering and revenue stream.

2 See Aite-Novarica Group's report Top IT Priorities in Treasury Management, April 2022.

These challenges are only further enhanced by a poor understanding of how new bank capabilities combine with other existing legacy bank offerings and the level of value provided to customers. This includes, for instance, older product areas that may have a roadmap to change but remain at an earlier stage of their transformation journey. The tendency to ignore pricing models on legacy product areas or those due for change may only be driving revenue loss and missed opportunities.

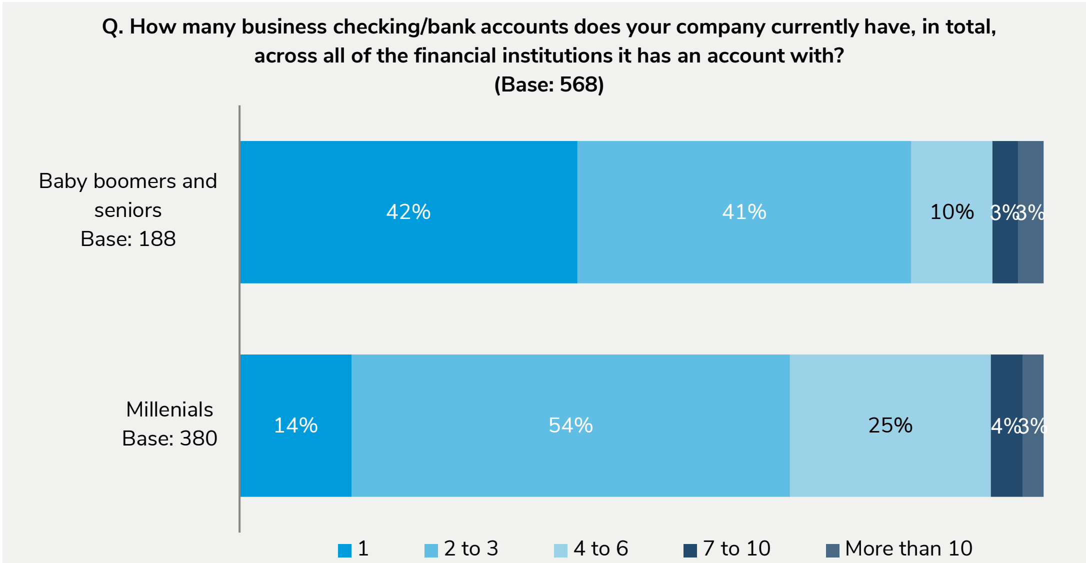
CUSTOMER EXPECTATIONS AND BEHAVIORS ARE EVOLVING

For commercial banking clients, there has historically been a perception, among banks and their clients alike, that there are benefits of concentrating banking relationships among a few key partners. Factors like convenience, consolidated accounting, reporting, and, for some clients, involvement with relationship managers have been important for forming and sustaining long-term bank-client relationships. Even if features or price points were better elsewhere, commercial customers were often considered sticky, particularly once a business or end customer became entrenched with an FI.

These attitudes are now shifting with many businesses, particularly those that younger generations operate and manage. Millennial-operated small and midsize businesses (SMBs) are significantly more likely to hold multiple business checking and banking accounts. They are more willing to work with a variety of FI partners and hold more banking products overall. Only 14% of millennial-run SMBs report holding only one business banking account, compared to 42% of baby boomers and seniors (those born in 1964 or earlier), as shown in Figure 3.

Younger generations are likely much more comfortable holding multiple banking products and working with many providers. These trends are unlikely to stay exclusive to SMBs as millennials age. They will likely become more prevalent across businesses of all sizes and consumer groups.

FIGURE 3: BUSINESS ACCOUNT HOLDING BY AGE



Source: Aite-Novarica survey of 1,002 U.S small-business financial decision-makers, Q3 2021

FIs that organize along product lines rather than customer-centricity may not know that their clients are working with alternative providers. Crucially, FIs may not be leveraging existing relationships to grow their overall business with customers. Pricing and incentives to expand relationships into new products and services play a critical role in attaining, retaining, and growing customers.

Customer Targeting Is Becoming More Granular

The commercial environment is seeing more solutions that cater to the needs of specific industry verticals—from lending to payments acceptance. These solutions are aided by Software-as-a-Service (SaaS)-based cloud, enterprise resource planning systems, and other software infrastructure. Key areas of focus include construction, real estate, manufacturing, and foodservice.

Vertical-specific and embedded financial service offerings are compounding customer expectation shifts. Hyper-personalized offerings within the retail banking sector target specific demographics or life stages; customers expect to find more contextually relevant products and services that better meet their specific needs.

In many instances, hyper-personalized and targeted offerings are intended by banks to serve as additional capabilities and alternatives that customers can use alongside other more general bank offerings. These targeted offerings risk taking potential opportunities away from FIs as specialists target the “long tail” of the market.

Significant changes in neobank and fintech vendor onboarding and approvals processes complement the growing openness of the market in terms of the ability to work with multiple FIs or other providers across solutions. Customers are more willing than ever to work with multiple providers. Institutions will miss opportunities if they do not understand their clients’ needs and price their offerings competitively.

TRANSPARENCY AND AUDITABILITY ARE NON-NEGOTIABLE

The growing availability of real-time data and information is a primary feature of the digital transformation sweeping the commercial and retail banking sectors. Up-to-the-second data can provide financial services firms insight into customer account activity, balance, liquidity, and cash positioning.

Significant bank and FI activity around reporting and transparency has focused on the basic consolidation of bank billing and accounts. Rather than receiving multiple statements and bills across various bank product lines, many FIs have spent years consolidating this data into simplified and unified digital portals that can combine greater functionality with greater useability.

The availability of consolidated activity reporting (often tied with greater usage of recommendation engines and contextually relevant next-step wizards) has increased expectations of transparency and insight into what FIs charge customers for and why. Explainability and traceability are approaching the forefront of user experience design; these features only become more relevant in real-time environments. End users and customers expect to see thorough accounting of what they are being charged and why. Enhanced capabilities are useful in attaining new customers and can benefit banks by limiting disputes and ensuring revenue collection.

THE PARTNER LANDSCAPE IS BECOMING MORE COMPLICATED

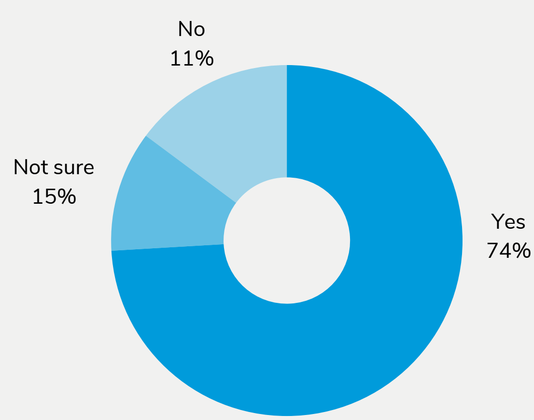
Fintech vendors are often portrayed as a direct threat to FIs and their customer offerings. In reality, bank and fintech vendor partnerships are growing at an even greater rate. Far more than just competitors, fintech solutions are increasingly being deployed as enablers of next-generation service capabilities. Fintech vendors are critical to enabling banks to pursue their broader digitization strategies and meet customer demands better.

They do so by delivering value-added services that may be adjacent to traditional bank offerings.

The relationship between banks and third parties is further complicated by the rise of embedded banking and open banking API deployments. Banks are now capable of delivering services directly to end users via other platforms and offering more contextually relevant services in areas such as payments, loan origination, cash management, and trade finance. Likewise, many of the core banking and critical infrastructure vendors that have long worked with FIs are launching fintech ecosystems and partnership programs. As Figure 4 illustrates, 74% of surveyed bankers and legacy technology vendors report they are currently working with an emerging fintech partner. This figure is only likely to rise over time.

FIGURE 4: BANK FINTECH PARTNERSHIPS

Q. Is your organization currently working with an emerging fintech partner?
(Base: 27 professionals from financial services or financial technology providers)



Source: Aite-Novarica Group survey of 45 professionals from financial services or financial technology providers, Q1 2022

The growing number of interconnected partnerships offers banks, fintech vendors, and third parties new routes to market and avenues for growth. Still, these arrangements introduce new complications in terms of revenue sharing and pricing transparency and structure. Cataloging every line item in a partnered relationship environment becomes complicated. Ownership of the customer is already top of mind for most institutions and their fintech partners. Still, revenue-sharing models are an overlooked aspect that can make or break the success of any deployment.

Many fintech vendors are also experimenting with new pricing models, ranging from the very aggressive with minimal cost to end users to developing outcome-based pricing and service level agreements for contractual terms. The growing mix of partners and third-party players risks further complicating value exchange between FIs and their end customers.

THE MACROECONOMIC ENVIRONMENT IS LEADING TO NEW PRICING MODELS

The pricing structures that financial service providers and other SaaS providers use have been shaken up in recent years across many markets. These changes have shifted end-user expectations and opened new pricing and revenue model possibilities. Historic low interest rates in many markets have underpinned these changes, forcing banks to experiment with pricing and revenue models that move beyond reliance on interest-derived income (e.g., fees, subscriptions).

Shifting customer expectations based on new market entrants and SaaS-based delivery models have aided the acceptance of these pricing structures. For instance, fee structures for merchant acquiring services were delivered on an annually contracted basis in the past, typically with a slow approval process. The rise of disruptive payment facilitators like Stripe and Square shifted the market with a simplified, less variable pricing structure in terms of cost per transaction. Their rates were often higher than those of traditional providers but were presented simply. Crucially, the models of these payment facilitators removed the typical 12-month contract, replacing it with a rolling monthly agreement with greater flexibility for merchants and simplified onboarding and approvals processes.

The macroeconomic environment of low interest rates underscores FIs' willingness to experiment with new cost structures. Banks feel the need to expand beyond a cost-plus basis, experimenting with fees, subscriptions, and other revenue models. This shift to new forms of pricing and revenue puts pressure on bank pricing strategies.

The Macroeconomic Environment Is Changing Again

The last several years have been a volatile time for the global economy: the shock of the pandemic, subsequent bursts of economic support from governments, and squeezes on supply chains. Global markets are now seeing the highest levels of inflation in years and the beginnings of uplift to historically low interest rates in many markets.

These economic changes present challenges and opportunities to banks and their customers. An environment of rising rates poses challenges to bank offerings. For example, cost-plus pricing models that rely on underlying prime rates will, in some instances, grow bank revenue. In others, they will limit the ability to attract new customers.

Cost-plus pricing models benefit from being transparent to and cost-effective for end users in a low-rate environment. Rising inflation rates are hitting businesses and consumers alike; banks must be sensitive to pricing concerns and ensure their offerings remain competitive relative to the broader market and end users' ability to afford them. Banks should also consider that earning credit rates (ECR) are often used to credit businesses for service fees for the value of deposits held by the bank. Rising rates will affect ECR across the bank. Some newer pricing models, such as through fees and subscriptions, may become less tenable in a higher rate and high-inflation environment. This again suggests that banks should experiment with pricing strategies.

COMPETITION IS EMERGING IN NEW QUARTERS

Competitive pressure is always one of the greatest fundamental drivers that affect pricing. Any organization, FI or otherwise, that offers pricing that is not competitive with its peers will immediately face critical problems. However, what is unique about the present is the growth in competition between FIs, new market entrants, and legacy players.

Challenger banks (neobanks) may get more attention in the market than they deserve relative to their market share. These challengers may be small, but they have the ability to shift customer expectations in terms of features, functionality, and pricing. Small-scale startups may be easy to ignore initially, but unresponsive banks will undoubtedly see long-term effects, particularly as other legacy players adapt and respond to these challengers.

Many fintech vendors are now partnering with banks and FIs in various ways, but some fintech firms undoubtedly compete with traditional banking providers more directly. In some instances, these players are aggressive in pricing and customer incentives. For example, the slew of new commercial card and expense management platforms, such as Brex, Divvy, Ramp, and Mesh Payments, offer payment services at little or no cost. Many leverage generous reward and rebate programs to grow their user base. Some third-party service providers in the financial messaging and payments space offer extremely low rates (or no rates) to help grow specific channels (e.g., real-time payments). The long-term sustainability of these models is unclear, but these offers put pressure on incumbent banking providers in the meantime.

FIs should not discount incumbent banks as their primary competition. Alongside their scale and client reach, most banks are undertaking digital transformation efforts, leading to an arms race of capabilities and services. These players are avoiding a race to the bottom via superior onboarding experiences, robust offerings, and proper expectation-setting.

REGULATORY REQUIREMENTS ARE CONSTANTLY EVOLVING

Regulatory requirements are a constant consideration for banks; they affect profitability and pricing significantly. Requirements range from the need for capital reserves and bank liquidity to the cost of doing business that fraud, AML, and compliance all generate. Compliance, auditing, and reporting are major undertakings for any organization. Operating these capacities affects the profitability of specific products and business units within banks and the institution as a whole.

Regulatory mandates can sometimes put caps on pricing; such is the case in Australia, which limits interchange rates on card payments. Other regulatory mandates dictate market access to the underbanked, as with upcoming regulation Section 1071 of the Dodd-Frank Act, which focuses on commercial lending rules. The regulatory landscape will continue to evolve, and all signs point to the need for more data, reporting, and compliance over time. These conditions will affect the underlying costs of offering any banking service; pricing needs to account for and reflect this adequately.

REVENUE LEAKAGE AND MISSED OPPORTUNITIES ARE A CONSTANT THREAT

Revenue leakage refers to when banks don't collect all the revenue they have earned from their customers. Leakage can occur due to inefficient processes and workflows, poor tracking of incentives and discounts, incorrect pricing, refund errors, poor reconciliation, poor dispute resolution, conversion losses due to FX rates, or some other technical or process mishap. Revenue leakage is a challenge intrinsic to most businesses that invoice their customers. However, the complexity and scale of most banks make leakage an ongoing challenge. Without an explicit strategy to remedy revenue leakage, it will likely continue to occur, often without even being noticed.

Revenue leakage can occur at all moments of the customer life cycle. A lack of visibility between lines of business within FIs can exacerbate it. This, in turn, can lead to lost earnings opportunities, particularly in terms of cross-selling, up-selling, or providing the correct incentives to grow business with the customer. Each stage of the life cycle—from onboarding to transaction processing, billing, account monitoring, and service termination—can lose revenue due to a bank's lack of visibility and interconnectedness. Over-reliance on manual processing on billing can lead to delays and even write-offs. Other examples include over-generous fee waivers by relationship managers, clunky introductory offers that do not revert to accurate pricing, or a lack of collection on account closure.

There is little hope that these challenges will resolve themselves. Reducing revenue leakage is an ongoing effort that requires dedicated focus and an explicit strategy. FIs need clear and strategic pricing plans that monitor revenue leakage across the institution. Otherwise, growth opportunities will be limited.

RELATIONSHIP-BASED PRICING HELPS BANKS AND THEIR CUSTOMERS

Pricing is a sensitive topic for FIs. Most organizations rely on complex models across product streams, and these models rely on variable fundamentals most customers don't understand well. The pricing mix of most banks includes their posted rates and terms, bundling, discounting for individual clients, discounting for acquisition campaigns, retention offers, a la carte pricing, return on equity, and risk-based pricing models for lending operations.

Price points are influenced by usage thresholds, interest rates, and potential loss leaders (e.g., billing services to grow deposits or other product usage). Further, relationship managers, individual bank branches, and even individual staff can influence bank pricing; they may have individual targets and incentives to drive sales and can distribute discounts in unclear ways across the bank.

The growing complexity of the fintech and partner ecosystem risks adding more complexity to bank and FI pricing strategies as revenue sharing models become salient in next-generation banking services and capabilities. A closed-garden approach to technology and integration is becoming untenable to most banks, particularly as API-driven open banking initiatives gain momentum. However, it is not a viable pricing strategy to throw caution to the wind. "Freemium" pricing models can be successful in the technology space, but they are decidedly less popular with bankers.

MOST BANK PRICING IS FOCUSED ON PRODUCTS

Today, most banks base most of their pricing models on a siloed product-by-product basis. This is understandable given the differing underlying economics of various bank offerings, such as lending vs. payments or deposits. The benefit of this approach is that the responsibility for pricing can be clearer cut within the organization: Individual teams and divisions can curate and manage their internal balance sheets and track profitability and other KPIs. However, what is good for one product silo may not reflect lost potential revenue in other product areas and underplay the revenue leakage to the bank.

A product-based pricing approach presents less beneficial outcomes for bank customers, who may receive no benefit to their overall banking relationships and subsequently weaken their overall loyalty to the organization. This is particularly true for SMBs, as only the largest businesses have the luxury of the manual intervention necessary to evaluate relationship-level pricing at the relationship. Even in the latter case, manual intervention often only occurs as a retention play or is triggered by some event or complaint.

A product-centric approach does not offer much visibility into client or prospect positioning or context, nor does it highlight what they see as valuable. This weakens cross-selling opportunities, and banks risk becoming purely commoditized providers rather than partners with deep customer relationships.

Without clear reporting and visibility into pricing across the bank from an enterprisewide perspective, it is extremely challenging to have an accurate view of the profitability of a customer relationship. The potential for revenue leakage remains very high in these instances. As a result, the bank loses money, and clients may not receive what they should at the correct price or take advantage of the right value-added services. This is a lose-lose scenario and leaves the door open to competitors.

Risk-Based Pricing Will Always Be Critical

Risk-based pricing models are critical to lending operations in the bank. Many institutions pursue complicated risk-adjusted return on capital (RAROC) modeling to help judge the risk factors underlying their lending operations. Risk-based pricing is not suitable for all product areas; it can be a time-consuming process that is difficult to scale.

Risk-based pricing remains critical, particularly in terms of lending. Aite-Novarica Group notes that advances in risk modeling due to increased computing power, artificial intelligence, and cloud-based services from fintech vendors mean that many banks and FIs can now offer more robust and nuanced risk modeling and loan pricing to reflect the level of risk they face with their client base. These developments bode well for banks and lenders; they can now offer lending and other services to businesses that may have previously been overlooked and grow bank balance sheets.

Ultimately, risk-based pricing will always remain critical for certain financial products, particularly within the pricing space. The challenge is not to replace these models outright but to have them interact with other components of bank pricing strategies so they can reflect overall bank profitability.

RELATIONSHIP-BASED PRICING HIGHLIGHTS THE VALUE OF BANKING RELATIONSHIPS

Relationship-based pricing, in contrast, can combine multiple pricing strategies with a focus on end customers and their relationships with the FI. This helps position the value of products to the customer better while reducing revenue leakage, driving sales, garnering loyalty, and mitigating customer attrition.

Relationship-based pricing aims to look holistically at a client's relationship with the bank and price accordingly. It can encompass favorable lending rates or overall service fees due to the size of deposits, lower payment fees due to transaction rates/high volume, or the bundling of additional value-added services. Crucially, relationship-based pricing is based on an individual client's contextual needs; it is dynamic and changes as a customer's situation or environment changes. Rates and prices can adapt as the client's relationship with the bank evolves, regardless of the size or circumstance of the business. Relationship-based pricing helps engender loyalty longer term and generate true value for the customer by accurately pricing products and relationships while reducing disputes and write-offs on mispriced products.

Delivering true relationship-based pricing is easier said than done. The process typically involves considering a significant amount of data points and careful balancing between banks and client needs. If pricing is too loose, it will lower FI profitability; if pricing is too tight, it will reduce clients' incentives to continue or expand their relationships with their banking providers.

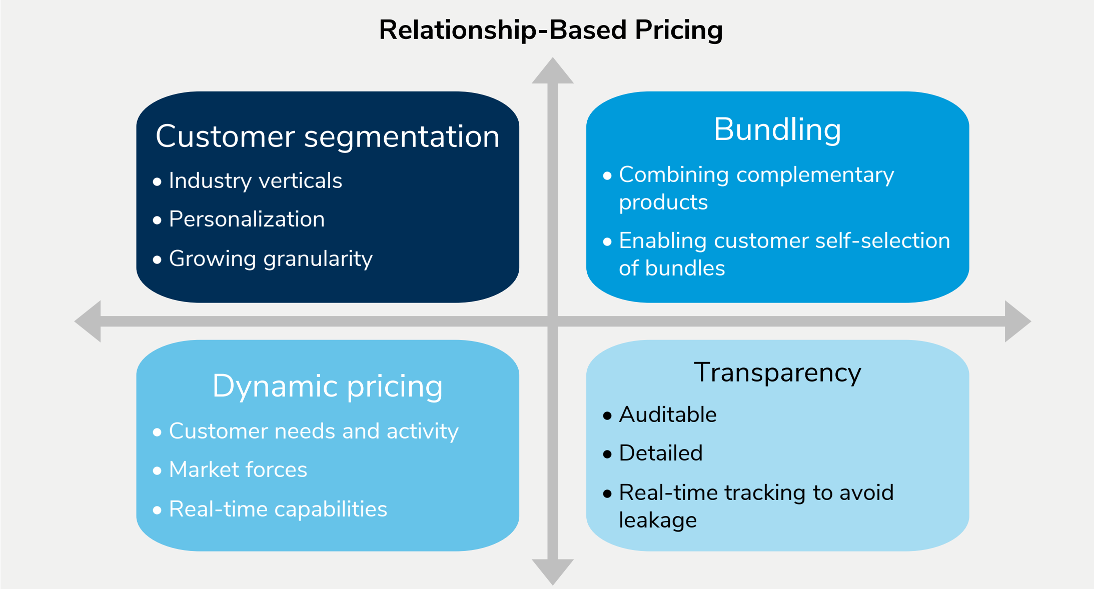
As a result of this complexity, much relationship-based pricing in use today is undertaken through manual calculations, often by bank relationship managers who know their clients well and have a solid understanding of client and prospect needs and challenges. It can be challenging to scale relationship-based pricing; banks tend to reserve this approach for top-tier customers.

The value that banks bring to their customers is changing, which includes using fintech and third-party value-added services. Aite-Novarica Group research suggests that businesses and end users often want to work with more fintech providers and expect their FIs to enable this for them. In essence, many businesses are looking for "one throat to choke" when working with fintech firms. Managing costs and pricing these partnerships are critical, let alone revenue sharing behind the scenes between the bank and fintech vendors. This suggests that relationship-based pricing is about more than upselling new products. It is about enabling broader value exchange among banks, partners, and customers.

THE FOUR TENETS OF RELATIONSHIP-BASED PRICING

There are four vital components to enabling effective, scalable relationship-based pricing that banks should consider when implementing a relationship-based pricing solution. It is not a one-off exercise deployed annually with the largest customers. Rather, FIs should consider these tenets in all their price and product offerings in each interaction, including with smaller clients. They are relevant at all stages of the customer journey. Figure 5 summarizes these tenets.

FIGURE 5: THE FOUR TENETS OF RELATIONSHIP-BASED PRICING



Source: Aite-Novarica Group

Customer Segmentation Is Vital to Relationship-Based Pricing

A thorough understanding of the client is central to delivering relationship-based pricing. This knowledge encompasses everything from current product holdings and usage to their broader needs and expectations and adapting to these needs over time.

One-size-fits-all solutions are becoming less relevant to businesses and bank customers. The demand for greater personalization and contextual relevance extends to the need to move beyond one “price” fits all. Banks and FIs can benefit by grouping their clients into broad categories, then segmenting the categories into more granular levels, including segmentation into specific market verticals and niches or the needs of specific demographics.

Enabling this segmentation requires significant use of data from within the bank and potentially third-party sources. Understanding customers is critical as the broader technological and service environment becomes increasingly personalized and contextually relevant.

Bundling Should Be Contextual

In line with the needs of specific client segments and verticals, client interest in particular bank products or offerings will vary, and banks should adapt to this. This can include interest in bundles based on the usage of other products—for instance, businesses with a high transaction volume on payments could receive preferable terms on commercial loans.

Banks now have more opportunities via fintech ecosystems and emerging partners to offer new bundles and services to their customers, potentially creating new growth opportunities.

While offering a variety of bundling that can meet customers’ needs, banks should be open to unbundling their offers and letting customers choose what any bundling may look like. The flip side of segmentation and personalization is granting more power and control to customers, allowing them to compose their own suites of bank products and services, including a la carte service packages.

As banking becomes ever more digital and data-driven, FIs will be able to cross-sell products and services based on data-driven intelligence. More organizations are leveraging machine-learning-driven analytics and other forms of customer intelligence to improve customer targeting and cross-selling. These technologies will affect the development of effective product and service bundles at increasingly target-specific and hyper-personalized levels.

Customer Needs Change, so Pricing Should Be Dynamic

Understanding the context of customer segments and bundling offers and services can help drive sales. However, these approaches could cannibalize sales if the bank relies too heavily on product-based pricing (i.e., one business unit within the bank undercutting another). Aside from the internal strife this scenario could cause, these risks can also lead to revenue leakage, particularly once incentives and other enticements are factored in.

It is imperative that pricing maintain an enterprisewide perspective and remain dynamic in line with customer activity, such as pricing in line with the existing size and value of the relationship, the volume of transactions, or loan risk. Pricing should evolve as customer relationships deepen and change over time.

Transparency Is a Differentiator

Many banks remain unclear internally on their pricing strategies, let alone when dealing with their customers. Aite-Novarica Group research suggests that pricing remains a critical consideration for customers even as newer digital capabilities take precedence among bank customers. However, pricing is not the only consideration for customer decisioning when working with an FI. Transparency in pricing can prove crucial to sway and retain customers who may be juggling a broad range of criteria when making product decisions.

Greater price transparency can help give clients greater control and understanding of their banking relationships. In turn, this will generate greater loyalty and deepen bank-client relationships, even if the bank does not have the lowest pricing on the market. Customers' willingness to pay increases if they can see the value of their banking relationships.

Further transparency on pricing will also be helpful within the banks and give lines of business greater visibility and understanding of the client relationships internally. This transparency will help provide context to all parties involved as the relationship evolves.

RELATIONSHIP-BASED PRICING IS BECOMING MORE SCALABLE

For many institutions, pricing is an extremely complex consideration that encompasses a range of metrics and KPIs. Some institutions or divisions within a bank may rely on RAROC, return on equity, economic value added, or other economic measures, and all institutions will face challenges when comparing products that are not easy to compare, particularly products with dissimilar cashflows and revenue streams.

Outside of the largest businesses, pricing is an issue without a clear chain of responsibility for many organizations. Little coordination exists across bank lines of business, and reviews are often infrequent. These conditions ultimately lead to revenue leakage and weaker profits.

Relationship-based pricing in financial services has historically happened manually, using complex models and calculations that few within the bank understand. Now, new technology and data sources make implementing a relationship-based pricing strategy more scalable than ever.

Table B highlights several key vendors currently active within the revenue management and relationship-based pricing space for the financial services industry. Aite-Novarica Group notes that relationship-based pricing is not exclusive to financial services and is also applicable to many other industry verticals in which billing needs may be complex, such as telecoms and healthcare. These platforms are distinct from many existing billing solutions available on the market; they focus on drawing in various data inputs, including from across the bank, to provide more composable pricing and billing capabilities.

TABLE B: KEY RELATIONSHIP-BASED PRICING PLATFORM VENDORS

VENDOR	PLATFORM	INDUSTRY FOCUS
Suntec	Xelerate	Financial services, insurance, telecoms, travel
Finastra	Fusion Revenue Manager	Financial services
Syntellis	Axiom	Financial services, healthcare, higher education
Oracle	Oracle Revenue Management & Billing	Financial services, healthcare, insurance
Zafin Labs	Billing Management	Financial services

Source: Aite-Novarica Group

Data Management Is Critical for Successful Relationship-Based Pricing Deployments

Central to deploying a more customer-centric pricing approach is the ability to gain a holistic view of customers and prospects, including their real-time positioning across the bank and its various data silos. The ideal relationship-based pricing implementation is an enterprisewide undertaking that rolls out systems uniformly across the bank. Many banks increasingly recognize the need to break silos and shift to customer-centric approaches to bank operations—relationship-based pricing would be a key outcome of this.

Most banks, however, are not operating in an ideal scenario. Instead, they operate across a wide stream of banking infrastructure and data, incorporating legacy and modern platforms in many instances. The need for data portability across the bank has led to significant investments in data management strategies in many institutions, including data lakes and orchestration layers in the bank technology stack.

The growing use of cloud-driven and SaaS services for relationship-based billing platforms and wider bank technology services is expanding the viability of deploying modern pricing and billing solutions. No bank is perfect, but newer data management techniques mean the underlying data essential to driving relationship-based pricing is increasingly accessible and useable.

Banks have always had access to significant amounts of data, but making use of it presents a challenge. Legacy homegrown pricing and billing solutions billing remain in use across many institutions. Partnerships with newer vendors and technology providers can significantly increase the results of using data to aid pricing capabilities.

Key Considerations for a Relationship-Based Billing Rollout

Relationship-based billing has obvious benefits for FIs and their customers, and rollout options are not as complicated as they once were. Aite-Novarica Group herein highlights several key considerations for any banks rolling out relationship-based pricing solutions.

Management buy-in is critical for rolling out relationship-based pricing, as is a top-down approach to implementation. In many ways, the biggest challenges with deploying relationship-based pricing are not due to technology but rather the organizational challenges brought on by institutional inertia. Various silos and business lines will be loath to see their balance sheets upended, even for the benefit of the wider organization.

A clear vision with consistent, top-down leadership is essential to drive relationship-based pricing deployments.

One billing vendor executive highlighted the above points in an interview with Aite-Novarica Group, explaining that "the biggest hurdle is not being able to get across the siloes. Unless it's a push from the top, it becomes siloed, and multiple systems end up deployed across the bank. If a bank wants to align and do it properly, it has to come from the top."

Despite the need for cross-bank coordination from a strategy and data perspective, most solutions available on the market today do not require enterprisewide "rip and replace" technology deployments. These platforms can often launch within a specific line of business while sourcing data from other parts of the banks, then roll out from there accordingly. This reduces the burden on banks in terms of rollout strategy and can enable a less disruptive transition.

Relationship-based pricing and revenue management platforms are evolving. There are several key considerations for banks when implementing pricing solutions, including ensuring that solutions can provide the following:

- **A thorough view of customers:** This should incorporate product holdings, payment rates, potential losses, risk considerations, deposits, prospects for cross-selling, etc.
- **Pricing controls:** Rules-based processes are critical to ensure that pricing adjustments do not undercut broader bank goals and profitability.
- **Real-time reporting and analytics:** Solutions need to be capable of tracking customer activity in real time, helping prevent revenue leakage.
- **Cross regional and multicurrency capabilities:** These are particularly crucial when dealing with larger customers. Corporate players are increasingly drawn to consolidated bank offerings, while shifts in the economic environment could limit profitability.
- **Scenario modeling and deal configuration capabilities:** These ensure bank staff and relationship managers can test pricing models and ensure maximum viability of pricing.

- **Integration with other critical core banking systems:** Digital transformation is an ongoing journey in most banks. Integration is critical for regulatory considerations, auditability, and accounting purposes.

Aite-Novarica Group notes that relationship-based pricing solutions are not always a replacement for other pricing platforms that are in use across the bank. The factors that banks must consider when setting pricing are complex, such as regulated liquidity buffers, interest rates, and interbank lending. Still, relationship-based pricing solutions add a significant layer of orchestration and interconnectedness to these other pricing platforms that can help to drive overall profitability and help banks meet their broader goals.

CONCLUSION

- Beginning with a conscious pricing strategy is critical for solving pricing pressures. Many organizations lack consistent approaches; prices emerge organically within each line of business. This leads to potential conflicts of interest when forming an effective customer-centric and relationship-based pricing strategy.
- The rise of fintech ecosystems poses great opportunities for banks to expand into new products and services and enhance their service offerings. Revenue sharing will remain crucial to these efforts in the long term, and banks need to invest in these revenue management capabilities to enable it. Relationship-based pricing can help lower the risk of new forms of revenue leakage via these emerging partnerships.
- Customer segmentation and thoroughly understanding clients and prospects are critical to effective relationship-based pricing strategies. At the very least, banks need to understand their clients' activities across their organizations in real time.
- Transparency is key to relationship-based pricing. Old "black-box" models are not effective, nor do they drive customer loyalty—they will only aid in driving disputes and write-offs. Reporting, accountability, and transparency should occur in real time to help banks and customers adapt to their evolving relationships.
- Support from upper management is a significant aid to relationship-based pricing strategy deployments. Upper management can cut across the politics and requirements of individual business lines. Shifting to a perspective of overall bank profitability can help mitigate organizational challenges.
- Relationship-based pricing solutions need to operate across several data sources and product lines within the bank. FIs should seek vendor partners willing to assist them with implementing these solutions across bank technology stacks and provide solutions that can adapt to ongoing changes brought on by digital transformation.

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Aite-Novarica Group is an advisory firm providing mission-critical insights on technology, regulations, strategy, and operations to hundreds of banks, insurers, payments providers, and investment firms as well as the technology and service providers that support them. Comprising former senior technology, strategy, and operations executives as well as experienced researchers and consultants, our experts provide actionable advice to our client base. The quality of our research, insights, and advice is driven by our core values: independence, objectivity, curiosity, and integrity.

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