A NEW OUTLOOK ON PRICING AND REVENUE MANAGEMENT FOR BANKS

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THE BANKING INDUSTRY HAS not escaped the severe direct and indirect effects of the COVID-19 crisis. Revenues from wealth management have suffered while the declines in capital markets have reduced the value of clients' assets under management. Stay-at-home orders and lockdowns around the world generated more loan applications at corporate banks, but also increased credit risk, as companies need cash to bridge shortfalls. Many retail banks have seen fewer loan applications, with job losses and wage cuts leading clients to postpone vacations and major purchases.

The ongoing effects of the crisis include behavioral changes—resulting from customers redefining their needs and shifting their businesses (by choice or necessity) to remote interactions and digital channels. Some of these shifts may be temporary, while others will alter banking patterns for years to come. The transition to digital must now move from a gradual transformation to a much more aggressive approach. Otherwise, the banks risk conceding too much share to the digitally native competition.

Collectively, these elements are forcing banks to plan for a future that will be markedly different from the one they may have imagined even six months ago. Institutions will need to assess and manage increased levels of risk accurately and collaborate more closely with governments to preserve the health of the economy. At the same time, they will need to build new capabilities and fundamentally adjust their operations, not only to navigate the current crisis effectively, but also to reach the new future in a position of strength. Pricing and revenue management (PRM) will play an essential role in this transformation by helping banks reshape their products and value propositions while managing customer lifetime value through prospecting, cross-selling, upselling, and retention.

The Changing Role of PRM

The pandemic has led to three macro- and micro-level considerations that will influence how banks should approach PRM and differentiate their price structures:

- **The crisis is affecting everyone differently.** While some sectors of the economy are flourishing, many others have experienced sharp downturns. Both the duration and the extent of these effects remain uncertain, but it's clear than many businesses and consumers will never fully return to their previous levels of revenue or income. Banks need to quickly assess both the long-term value of their customer relationships and their customers' chances of surviving the crisis in order to determine whom they can best support. The opportunities to grow their lending share of wallet and build stronger relationships—perhaps by cross-selling or offering crisis-related advice—may outweigh the dangers of exacerbating losses by making poor credit-risk decisions in the short term.

- **Past insights and benchmarks are becoming rapidly irrelevant.** Banks can no longer rely on accrued knowledge and historical data to make current and future PRM decisions. This applies to benchmarks, trends, data patterns, and conventional wisdom. What is the value of looking at a company's financial statements from 2018 or 2019 to make a credit decision in 2020, knowing that the world of 2020 looks much different than it has in the past? It's become difficult to make longer-term predictions, both at the macroeconomic level, regarding GDP growth and interest rate levels, and at the microeconomic level, for price elasticities of different clients or client clusters. For these reasons, banks will need to change the way they make decisions. They must emphasize speed and agility and use the most recent data, rapid testing (if reliable data is not available), and iterative prototyping to launch new products faster. The process of making forecasts will also change as banks combine the analysis of short-term trends with domain knowledge in order to assess how the future will develop. These steps will require a more integrated, cross-functional way of working.

- **The move toward digital is accelerating.** Both consumers and businesses are accelerating the industry's shift toward digital—thanks to still-closed bank branches, fewer stores accepting cash, and people converting to contactless payment for hygienic reasons. We expect many customers to stick with these new behaviors for a variety of reasons, including government restrictions, fear, or the belief that these new behaviors are superior. Additionally, people now forced to do their banking remotely might not be eager to return to physical branches because they see that having no commute or wait saves considerable time. Banks will need to redefine their product proposition to serve new needs and improve data-driven personalization in remote channels to offset the loss of human interaction.

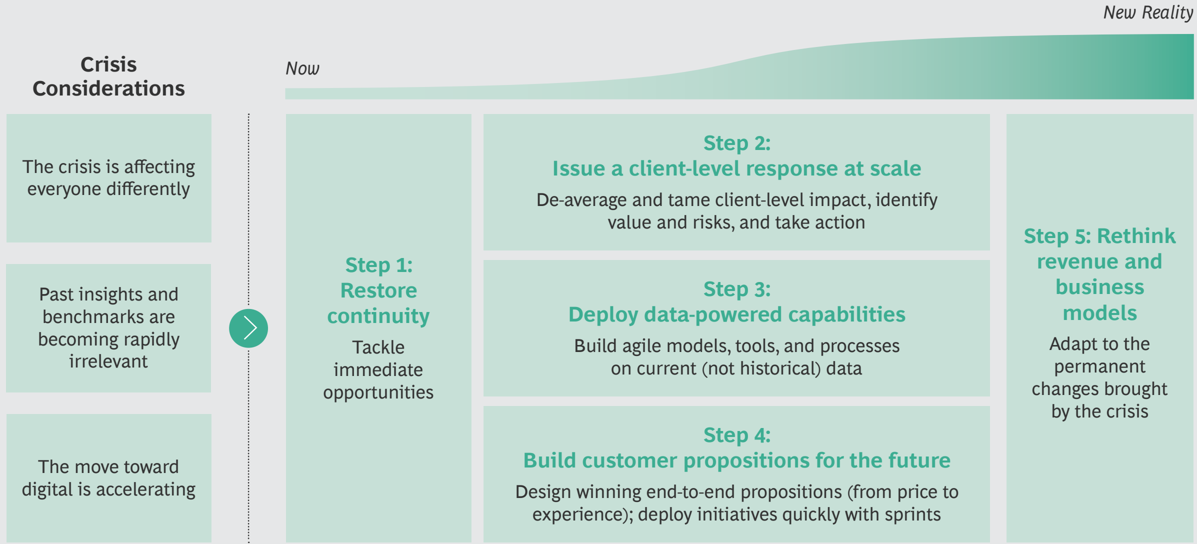
The Critical Actions Banks Must Take

To respond effectively to these macro and micro shifts and prepare for the future, banks need to act immediately, and then, adapt, refine, and embed new practices into their ways of working over the coming years. To emerge as winners, banks must drastically alter their approach to PRM. (See the exhibit.)

Restore continuity. Immediately, banks must enable clients to continue their banking activities as smoothly as possible. They must identify where they have the greatest exposure across segments and products in order to prioritize their responses.

Providing relief and implementing new government-mandated liquidity measures (such as payment-moratorium periods) can help customers directly, while other PRM changes can influence customers' behavior. For example, banks can pursue various measures to increase contactless transactions. First, they can cooperate with regulators and payment organizations to promote no-PIN transactions and increase respec-

The Building Blocks for Pricing and Revenue Management in Banking's Future



Source: BCG analysis.

tive limits. The Netherlands has already raised the limit for such transactions from €25 to €50 to help customers during the crisis; Poland has made a similar move. Second, banks could enable and incentivize card migration to mobile wallets—which require no PIN authorization from the phone, independent of the transaction amount—while at the same time increasing fees related to branch and cash transactions for consumers and businesses.

Beyond that, banks can enhance their service levels by establishing new guidelines for relationship managers to navigate the upcoming months—perhaps through virtual engagements and by reaching out more proactively to high-value customers unlikely to use digital channels.

The next three steps involve a renewal and upgrade of banks' advanced analytics capabilities, including the data they use, the speed and manner of their decision making, and how they can apply insights to reshape their customer propositions with the future in mind.

Issue a client-level response at scale.

Banks must quickly assess the impact of the crisis on each client, including indicators such as liquidity and credit risk, and how those indicators will evolve over time. We recommend that banks use advanced analytics to look at the discrete distribution of their individual clients across these indicators rather than looking at averages. They can adopt this de-averaging approach by relying on real-time data that comes from current account transactions and cash flows and supplementing it with their internal sector expertise to understand differences across industries and jobs. Based on the distribution, the bank can define actions not only to mitigate risks, but also to strengthen customer relationships. These actions can range from accelerated collections, restructured terms and conditions, and repayment holidays, as well as cross-selling, advisory services, and external-debt consolidation. Such steps should be employed across all channels, from advisors to call centers, emails, and mobile apps, with the priority placed on those clients with the highest-expected lifetime value. To do this, banks must have a keen understanding of the individual client's credit risk, purchase likelihoods, and retention chances.

Deploy data-powered PRM capabilities.

Banks can overcome the irrelevance of historical insights, data, and benchmarks by adjusting their PRM models to look at short periods of more recent data, which we refer to as "lead" data, to search for trends. These new data-powered PRM capabilities can cover ongoing A/B testing, include self-learning algorithms on very short time frames of recent data, and tap external data sources. Yet at the same time, the models should aim to inform decisions based on full customer lifetime value, beyond just the current crisis. Banks have a window of opportunity to implement new, differentiated approaches that can pave the way for personalization.

But banks will only be successful if they rethink and reconfigure existing processes. For example, they may need to review which department or team owns decisions on PRM activities such as pricing and promotions. They must also manage the pace of implementation, balancing the need to respond quickly during the crisis with the need to institutionalize, scale, and enhance what actually works.

Build customer propositions for the future. Finally, banks must also redesign their customer propositions, not only to facilitate the move to digital channels, but also to reflect the decreased use of cash and in-person interactions. This redesign will cover three areas: price structure and levels, features and functionalities, and the customer experience and user interface. But in contrast to previous changes of this nature, most banks cannot afford to wait for a Big Bang launch once all the pieces are in place. In line with the rapid decision making required during the crisis, banks can introduce these changes faster than they have in the past if they break down their initiatives into smaller sprints, some of which can be completed easily and quickly, and others which are more complex and could take longer to flesh out.

Rethink Revenue and Business Models

As our new reality sinks in, banks should prepare for the boldest step of all: rethinking their entire revenue and business models to account for the permanent changes that the crisis is likely to leave in its wake. Perhaps the most far-reaching of those changes is the drastically faster implementation timeline for going digital. This trend could allow banks to earn more money from alternative fees based on transaction behavior and accelerate open-banking-enabled services and their associated revenue streams. They could also monetize their more-advanced data capabilities.

Banks can expect shifts in their product segments thanks to the increased demand for contactless or even card-free payment solutions. They may see a decrease in the number of international transactions depending on how international trade and travel rebound, as well as a higher propensity to save among risk-averse clients. These shifts can have significant impacts on all key traditional revenue streams, including loan production, savings demands, and spreads, resulting from measures taken by central banks and governments.

Assessing these top-line impacts should then allow banks to understand what cost level and structure they can support, and therefore how much they need to adjust their underlying business and operating model. The extent of adjustments can vary considerably. While digitally oriented institutions like fintechs are already likely well prepared for the new future, traditional branch-based banks will need to undergo more radical transformations. A retail bank may need to streamline its lineup of daily banking bundles, for example, by rethinking the logic, content, and communication related to these bundles, while also finding an effective formula to monetize them. That may require a move from the outdated good-better-best paradigms or all-for-free models.

A bank that caters to corporate clients and small businesses may see the need for a finer customer segmentation that reflects full lifetime value. That would enable them to offer differentiated products alongside bundles with standardized pricing, leaving little or no room for price negotiations for smaller clients. Wealth management departments may see an opportunity to enhance their advisory models and review their pricing structures, perhaps with an eye toward performance-based fees. They could also add videoconferencing capabilities to support their relationship managers. Because of the crisis, it may also be important for banks to link their individual and corporate propositions, as entrepreneurs look to transfer private wealth to sustain their businesses.

Winning the Future

The existing processes, governance, and organizational culture in most banks were not designed to support the steps outlined here. Implementing them will require a top-down, well-planned effort in change management. Operational teams will need the authority to make tactical pricing decisions—informed through continuous testing and learning—without the need for organization-wide checks, approvals, and committees each time. Branch or remote advisors will need updated KPIs and incentives aligned with the bank's objectives so that they are motivated to make the best use of the new tools they receive, such as recommended target prices by customer or specific cross-selling offers. To succeed once the crisis has subsided, banks must transform their PRM approach today—and take these four steps to make it happen:

- **Act immediately.** Banks need to respond to the most urgent priorities. Clients' liquidity needs and their lifetime value are paramount, so players should adopt a differentiated approach to address these elements on a case-by-case basis. Banks also need to start upgrading their analytical capabilities and operations procedures to meet demands for faster responses in the new reality.

- **Create a clear vision and roadmap for transforming their approach.** This step will help establish strong buy-in so that teams can take ownership of their transformation goals and work to achieve them quickly. By setting a longer-term objective combined with a compelling story for change, banks can enable autonomous teams to progress toward that objective with an agile "test-and-learn" approach.

- **Change operations to support sprints.** As part of the "test-and-learn" mindset, cross-functional teams need to work iteratively in sprints, rather than in traditional waterfall development cycles that culminate in Big Bang launches. Frequent iterations allow teams to learn from failures and scale successes more rapidly. The organizations, in turn, can reap the upside earlier to reinvest the money and learnings earned in the process.

- **Overhaul all aspects of their analytics and digital platforms.** Advanced analytics and digital platforms are often viewed too narrowly as the realm of data scientists and engineers. When banks build new capabilities to support data-driven and digital approaches, they also need to change the mindset across business functions, from segment and product management to sales. For example, the use of A/B testing to optimize product propositions or price levels is not only a technical skill, but also a soft skill that encourages critical thinking and identifying best practices. Product teams should be asking themselves, "How do we build and constantly refine our proposition over time?" Frontline sales teams should ask, "How much can we trust the system's recommended price or next-best offer?" Asking and answering these questions will provide teams with a mindset that fosters confidence in the process and its results.

Preparing PRM for the new future is only one of many aspects of a bank's overall response to the crisis. But the window of opportunity to mitigate short-term risks will close rapidly unless banks get started immediately. Depending on its segments, geographic locations, and client base, a bank may need multiple differentiated responses to address the wide variety of ways the crisis is reshaping economics around the world, and then, course correct over the months and years to come.

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