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Egyptian Banking Institute

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MARCH 2024

Current Trends

“ Dynamic Pricing ”

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Background

As banks are increasingly shifting from a product-centric to a customer-centric outlook, placing customers at the heart of their product and pricing strategy is even more necessary in the post pandemic world. Well-thought pricing strategies aligned with bank-wide goals, therefore, can go a long way in retaining customers and growing revenue.

Introducing automated and personalized pricing engines can bring significant benefits, providing financial institutions with a powerful tool to drive sales, boost customer satisfaction, and stay competitive in a crowded marketplace.

Dynamic Pricing has been a long-standing practice in various sectors including retail, airlines, and recently, has found its application in the banking sector. Its potential to maximize revenue, optimize resource utilization, and offer personalized pricing has been acknowledged.

Defining the Concept:

Dynamic pricing refers to the ability of financial institutions to adjust pricing of their products and services in real-time or near real-time based on various factors. These could include market demand, customer behavior, competitor pricing, and more. This pricing model is especially prevalent in the loan sector where interest rates may be adjusted based on various criteria.

By embracing this innovative pricing model, banks can navigate the complexities of the financial landscape with agility, responding to market dynamics and customer needs in real-time. As the banking industry continues to evolve, dynamic pricing stands out as a strategic tool for those looking to stay ahead in an ever-changing financial environment.

As more companies use dynamic pricing, the approach becomes more sophisticated. Today, airlines also consider factors like browsing history, purchase patterns, and even the type of device used for booking, enabling them to personalise prices further.

Dynamic Pricing Examples Across Industries: Dynamic Pricing in the Hotel Industry, Dynamic Pricing in Ridesharing Services (Uber), Dynamic Pricing in Accommodation Sharing (Airbnb), Dynamic Pricing in E-commerce (Amazon)

Importance:

The importance of data driven pricing for banks are strategic:

• **Customer Loyalty & Stickiness:** Increased customer insight can help with increased contextual awareness of customer needs, leading to improved customer loyalty, leading to potential re-bundle & cross-sell opportunities.

• **Immediacy:** Real-time data (internal as well as external) allows for dynamic updates & adjustments to pricing. Asynchronous approaches to pricing lead to deviations from demand functions & pricing strategy due to current dynamic environments.

• **Pricing Granularity:** Alignment of pricing strategy with overall business strategy (e.g. relationship wins vs. revenue maximization) at a micro-segment or individual customer level.

• **Pricing Automation:** Data driven pricing can completely or partially automate price adjustments – depending on business needs. Pricing algorithms evaluate several internal and external factors to generate prices that align with bank's pricing strategy.

Challenges:

Here are some of the challenges often encountered:

• **Regulatory-driven transparency:** Increase in regulations and oversight by regulators, which constrains pricing flexibility

• **Banking services as a commodity:** Commoditization of services leads to increased price transparency and prices under strain

• **Lack of customer contextual awareness:** Insufficient understanding and differentiation of client segments

• **Lack of relevant data:** Limited availability of relevant, high-quality internal (historical customer and transaction data) and external datasets (comprising competitor pricing decisions and accurate demand data for products and services)

• **Inadequate technology platforms:** Lack of pricing inputs for relationship managers and other business stakeholders who need pricing insights

[1] AI black box refers to an artificial intelligence system where the internal decision-making process is not visible or understandable to the user. In other words, it's like a mysterious machine that produces results without revealing how it works.

Practices in the banking sector:

Types of Dynamic Pricing Used in Banking & Finance

Risk-Based Pricing:

Risk-based pricing is a pricing method where the price or rate of a product is determined based on the risk profile of the consumer. In the banking sector, this is often seen in lending where the interest rate on a loan is set based on the borrower's credit risk.

Example: A bank might offer a lower interest rate on a mortgage to a borrower with a high credit score and a stable income compared to a borrower with a lower credit score and less stable income.

Relationship-Based Pricing:

This pricing model considers the relationship or loyalty a customer has with the bank. It rewards customers who have multiple accounts or products with the bank, or who have been loyal customers for a number of years.

Example: A bank might offer a lower interest rate on a personal loan or waive certain fees for a customer who has been with the bank for over 10 years and holds multiple accounts.

Performance-Based Pricing:

Performance-based pricing takes into account the performance metrics of a loan or other financial product. This could be related to payment history, the utilization ratio, or other performance indicators.

Example: A bank might lower the interest rate on a loan if the borrower makes timely payments for a certain period or reduces the principal balance below a certain threshold.

Competitor-Based Pricing:

Competitor-based pricing strategy involves adjusting prices based on the competitors' pricing strategies to stay competitive in the market. This could be in terms of interest rates, fees, or other charges associated with banking products.

Example: If a competing bank lowers its interest rates on auto loans, a bank might similarly lower its rates to retain and attract customers.

Behavioral-Based Pricing:

Behavioral-based pricing analyses a customer's financial behavior to determine pricing. This could include spending habits, savings behavior, and other financial behaviors.

Example: A bank might offer a better interest rate on a savings account to customers who regularly deposit money into their accounts as opposed to those who do not.

Tiered Pricing:

Tiered pricing involves having different pricing structures for different tiers or levels of services. This can be based on the amount of money deposited, the number of transactions, or other tiered services.

Example: A bank might offer lower transaction fees or higher interest rates for customers who maintain a higher balance or make a higher number of transactions.

Segment-Based Pricing:

Segment-based pricing involves adjusting pricing based on different customer segments such as age, income level, or geographic location.

Example: A bank might offer a special lower interest rate on loans or higher interest rate on savings accounts for senior citizens as part of a segment-based pricing strategy.

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