# PRICING INSIGHT FROM WALT

by Steve Brown

Disney World is a place where your dreams can come true. That is if your dreams consist of dropping $500 per day to stand in line and watch your fellow Americans walk around with a giant turkey leg. Don't get us wrong, we love Disney. The rest rooms are clean enough to conduct a brain transplant and the staff is so happy we swear they actually had brain transplants. The place is fun and also serves as ground zero to learn about marketing.

Take pricing for instance. If you want to learn about pricing strategy, take your executives to Disney World. The Happiest Place on Earth is also the most price optimized place on earth. As part of being a marketing juggernaut, Disney has figured out how best to set and package the price of its products to not only maximize revenue, but to maximize customer satisfaction. Consider that a Disney World adult day pass now costs $82.00. Following the law of diminishing return, Disney has found that while satisfaction for the 1st day is extremely high given that price, satisfaction for the 2nd day is a little less so. A park goers' 3rd day satisfaction is not only less, it is much less and 4th day satisfaction drops off a cliff. For the typical Disney World customer, satisfaction is not linear, which is one reason the day pass is priced accordingly. Buying 2 days at once gets you a 1% discount, but buying 3 days gets you a 9% discount. Buying 4 days garners a 30% discount and the 5th gets a 47% discount. Through this pricing schema, Disney has found that the discount drives the most revenue at its parks and better matches satisfaction. In addition to discount pricing wizardry, Disney excels in bundling their products, as you can purchase each park or entertainment venue separately, or as a package.

While this is all good for the Mouse House, if you are wondering how you can apply Disney-like pricing strategies to your bank consider a couple of items. First, understand which products result in diminishing utility when your customers use them (such as multiple checking or zero balance accounts) and which don't (like wire services or positive pay). For diminishing utility products, figure out how utility diminishes. Disney used to do this by physically testing different offers, but now it largely sets prices by polling its focus groups and creating a pricing model.

Checking accounts, it turns out, have a very similar utility curve as Disney Park admissions. Households and business usually find tremendous value in 1 or 2, but it drops sharply after that. Most banks usually don't think in selling more than one checking account at a time and thus, usually miss a large opportunity. Given a checking account user's utility or satisfaction curve, banks that offer a small incentive to open the 2nd account and then a deep discount for opening checking accounts numbers 3 and 4 not only find that more checking accounts are sold, but balances and retention increases.

For products such as wires, where utility stays somewhat constant for each use, a packaged pricing strategy is often the best way to optimize revenue. Offering an unlimited use package may not only drive revenue, but also increase satisfaction from your most important customers. Amazon.com did this extremely successfully with its "Prime" shipping package, as users pay $79 per year and can ship items for free. While Amazon is said to clearly lose money on 30% of its accounts, it makes up for it in increased sales, just like how increased wire activity usually results in higher balances. More importantly, Amazon has been able to grab market share, as customers feel that a fixed investment deserves more of their business.

Setting pricing strategy and tactics is an area where banks can extract greater value. Banks that utilize this more sophisticated pricing approach should not only find revenue increased, but also that shareholders, employees and most importunately customers find you the happiest bank on earth.

# BANK NEWS

**Bernanke on**

The Fed Chair said nothing new, but stated he is 100% confident the Fed can control inflation when the time warrants it. Bernanke also said that more QE is possible, which caused a rally in Asia.

**Early Bonuses**

Some banks are considering paying out year-end bonuses in Dec. to help employees avoid a higher tax bill.

**Communication**

A recent retail banking report by Varolii Corp. shows direct mailings (29%) and manual phone calls (22%) are still the most often-used means to communicate with bank customers, with text messaging at the bottom (1%). Oddly enough, only 35% of banks plan on using social media, a number we think will certainly shift the other way in 2011.

**Housing Defaults**

Investors in non-agency single family residential mortgage pools forecast about 85% of remaining subprime borrowers and 25% of prime borrowers will still default. That roughly translates into a projection of about the same amount of defaults in 2011 and 2012 as we have seen in 2010. As such, don't expect the residential market to spring back to life for at least that period of time.

**Delinquency**

Analysis indicates about 8% of homeowners with mortgages less than $1mm are seriously delinquent, compared to 14% for those above $1mm.