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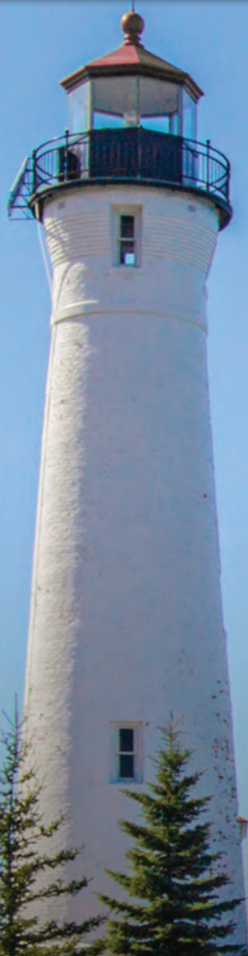

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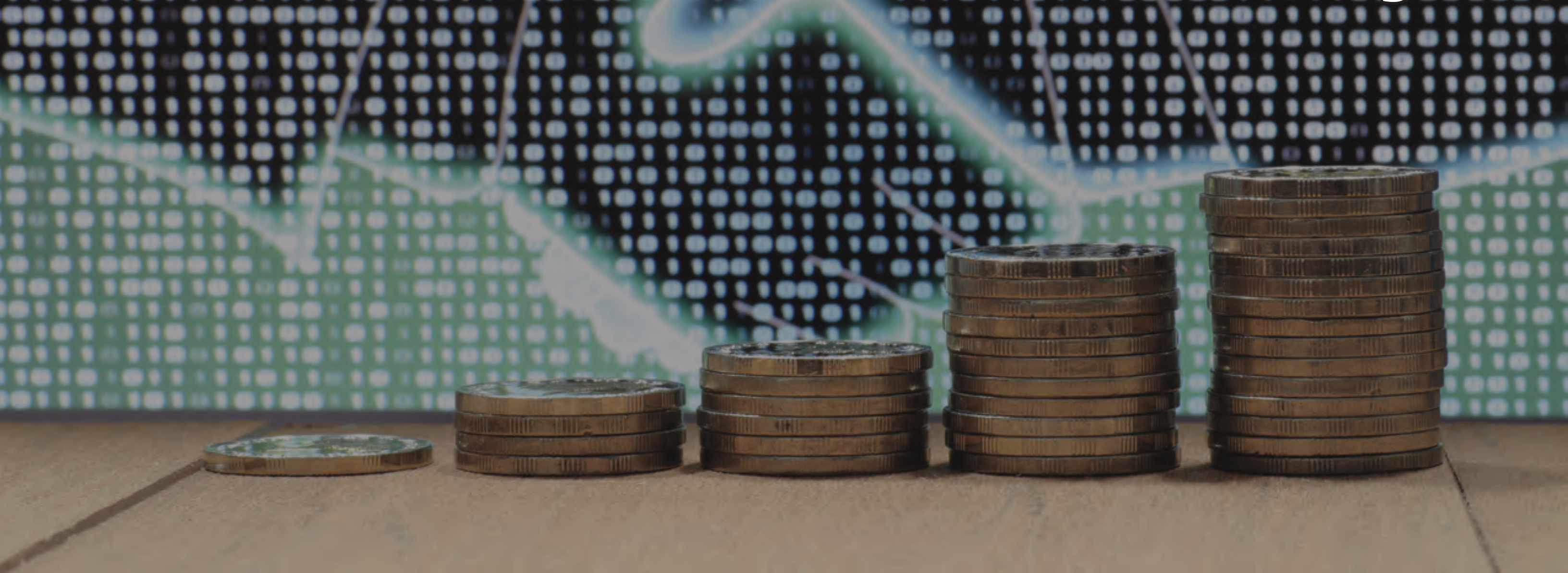
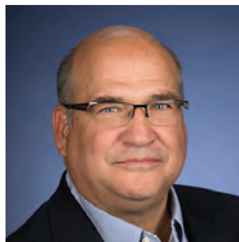
FEATURE STORY

Relationship Value Pricing and Customer Profitability



By: Earl Charneske



Relationship value pricing can be an effective strategy for improving a community bank's fee income and determining the worth of the overall customer relationship. This is especially important in the current interest-rate environment.

However, for relationship value pricing to work, your institution must carefully analyze the costs and profitability of each customer relationship, have systems that monitor the relationship, and think creatively about what it can offer preferred customers.

Defining Relationship Pricing

In relationship pricing, a community bank adjusts fees and rates for a deal, based on the overall relationship it has with the customer and their related parties. This links the value of the deal to the profits of the institution.

Typically, this means you can structure deals for products and/or services that make sense for the institution and the customer. For instance, by adding an operating account that generates transactional fee income, the lender can offer a more competitive rate on a loan and still meet the same ROA/ROE or lifetime income.

Sometimes bankers are asked to increase the rate they're paying on a money market account, CD, or a credit product for a client. But a client relationship is more than a single rate — it's the total value that the relationship brings to the table.

Provide creative customer offerings. Rather than negotiate solely over rates, talk to your customers about what they value. Are they willing to move their operating account or excess deposits? Would they consider trading fees for interest rate? Or are they interested in different

structures? Knowing this increases their value to you as a customer and your ability to compete and close deals.

Some helpful and innovative options could include:

Ask for the deposit. Some customers are awash in cash these days, while others are cash strapped. By asking for their operating accounts, you can help your institution reduce its overall cost of funds while increasing the stickiness of the relationship.

Look for fee income. Some business owners may need a little extra help these days and would even be willing to pay for it. Consider your natural prepayment rate and prepayment penalties for longer-term obligations, or increasing fees for longer fixed-rate terms.

Consider different structures. Term may matter. Is it fixed or floating, and when are rates reset? How are you setting up payments? Could you be creative, meet lifetime income thresholds, and match your borrower's seasonal cashflows?

Take a holistic view. Once you have solved some of the problems your customers are facing, be sure to look at the entire customer relationship. It is not just about one product vs. three products either. Sometimes, you have customers with three loans that don't add as much value as the customers with one. By analyzing the whole customer relationship, including grouping customers by their related accounts, you can provide additional services or discounts based on the total relationship profitability, not just the number of products used. In order to assess properly and efficiently, profitability modeling is recommended. You get an objective view and can drill down into the data, making it easy to adjust offerings, as needed.

About the Author

Earl Charneske is the Senior Vice President and Regional Manager of PCBB.