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Relationship Value Pricing and Customer Profitability

By Jay Kenney, SVP & Southwest Regional Manager for PCBB



RELATIONSHIP VALUE PRICING CAN be an effective strategy for improving a community bank's fee income and determining the overall customer relationship's worth. This is especially important in the current interest-rate environment.

However, for relationship value pricing to work, your institution must carefully analyze each customer relationship's costs and profitability, 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 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 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 rates? 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 useful 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 relationship's stickiness.
- **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 your customers' problems, 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 loan. 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. 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.

If you need assistance with relationship value pricing or customer profitability, please contact Jay Kenney. ▶



Jay Kenney
SVP and Southwest
Regional Manager for PCBB
pcbb.com |
jkenney@pcbb.com

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