

MARKETING OF FINANCIAL SERVICES

Lecture Seven

Pricing of Financial Services

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WEEK SEVEN

7.1 Introduction

Welcome to week seven lecture! We have now started the other half of the course and hope it will be great excitement for all of us. We continue to discuss the marketing mix for financial services with a focus on pricing. This week we will delve into ways of setting prices for services and how to use pricing as a marketing strategy.

7.2 Intended Learning Outcomes

At the end of this lecture, you will be able to:

- a) Describe the pricing concept in marketing of services
- b) Discuss factors that influence pricing strategy
- c) Evaluate pricing methods
- d) Determine appropriate pricing strategies

7.3 Description of Pricing Concept

Pricing is perhaps one of the most challenging concepts in marketing of services. There is no clear way of determining price which also appears in different forms. Tina (2000) describes pricing in marketing of financial services as one that may mean interest charged on loan; the penalty incurred on early withdrawals; fee charged for advice given; commission paid to an intermediary such as broker; premium paid on insurance and transactions costs among other charges. Kotler and Keller (2007) notes that pricing is the most flexible elements of marketing mix as it can be altered very easily and as the most significant in that it is the one that determines the revenue generated.

According to Kotler and Keller 2007, pricing is significant to a financial institution in different ways. First, it indicates the cost involved in producing the product or the service in terms of personnel, technology, rent taxes and other costs. Secondly, price signifies the revenue that can be generated from the sale of service. The higher the price, the higher the revenue generated. This is however a complex component that we will continue to consider. Third, the price charged may be the determinant of profit generated which affects the long-term survival of the financial institution. If the profit generated is not sufficient, the financial institution may not survive in the long run. Fourth, price may indicate the financial institution's ability to respond quickly to the changing market conditions and it is the only element of the marketing mix that can be changed easily.

On the other hand, price is significant to a financial services consumer in a number of ways. Price represents the cost of service to the consumer. This is often very significant especially when a consumer is buying a product like a credit facility. A one-point difference can easily make the consumer change the service provider. Price also signifies the quality of service. In Kenyan banking industry, prestigious account is charged more in that the customer has expectation of better services. This understanding is important to financial service provider as it informs marketing strategy to be developed. Pricing also affects demands of a service directly. The marketer is more concerned on how to regulate demand of the service by either increasing or lowering the price. We

can also say price is important to the customer in that it acts as determinant of value. Value is the ratio between perceived benefits and costs incurred. If the benefits exceed the costs, the customer feels there is value and vice versa.

7.4 Factors that Influence Pricing Strategy

Determining appropriate price for a financial product is one of the biggest challenges for the marketer since the customer cannot see or taste the service before consumption. The marketer must consider a host of factors before determining the appropriate price. These factors include government, costs, company marketing goals and objectives, marketing mix strategy, other marketing mix variables, market intermediaries, firm employees, competition, and many others. Each of the mentioned variables is described briefly.

From customers perspective, the market demand for a service affects pricing decisions. The customers perception of the financial firm, his purchasing power and the extent to which the customer is in need will inform purchase decision. When the demand for the service is high, the price goes up but when it is low the price also comes down.

Price of financial services is greatly affected by the government regulations in the country. In Kenya for instance, the central bank determines the interest rates by setting the ceiling that the banks may charge. This greatly affects the lending rates of all financial institutions in the country. This rate is reviewed on monthly basis and may determine the cost of financial services in a country.

The price of financial services will also be affected by the company marketing objectives and goals. The firm objective may be to penetrate the marketer and therefore it will lower the costs of its services and avail them everywhere the demand will increase. The firm may also want to target a certain clientele and therefore position its services for that clientele. Some firms may target upper class and therefore offer prestige account at higher cost compared with ordinary services. The most common marketing objectives will revolve around survival, maximizing market share, profit maximization, market skimming or penetration among others.

The contribution of the price to marketing strategy will also be considered. The firm will develop product, design appropriate promotion, and avail its product to various customers. In this case the role of pricing will have to be aligned to the marketing strategy of the firm.

If the firm is working with intermediaries such as bank agents or insurance agents, the cost incurred in working with them will also be considered. Intermediaries often make the cost of goods high but also increase availability. The marketer will do a tradeoff between the cost of intermediaries and the convenience that comes to the customer due to use of intermediaries.

In addition to these factors, the firm will consider the costs incurred in developing and delivering the said services. This will constitute payment to employees, the infrastructure and promotional cost among others. All the costs incurred will have to be factored in determining the price to be charged for a particular service. A financial institution can reduce cost by automation of services, restructuring, outsourcing some services, working with cheaper suppliers and many other ways.

Competition is also one of the important considerations in setting prices for financial services. The marketer must set the price within the range that competitors have set. For most financial institutions in Kenya, the interest rate charged on credit facilities ranges from 12% to 17% at any given time. Any firm that would charge beyond this may not attract customers in most cases. The other major factor is the shareholders demands. Shareholders want to earn dividends and higher prices for their stocks out of their investments. The financial services provider will try to maximize the firms' earnings through pricing which will in turn affect demand for the firms' services. These factors must all be considered in determining appropriate prices for financial services. The marketer must also consider the political climate of the country and its influence on pricing strategy.

7.5 Steps followed in price setting for a financial service

Like any other product certain steps are followed in setting price of a financial product (Kotler 2003). These steps are outlined below

1. Selecting the pricing objective: this could be market penetration, marketing scheming or any other objective as discussed in the previous section.
2. Determining demand: this is done by examining trends in the environment. Demand implies not only those willing to buy but also those having the financial capability to do so.
3. Estimating costs: it is quite difficult for a marketer to estimate the cost of financial service. Costs such as cost associated with interest paid on deposits, cost of money acquired from wholesale market and cost of risk capital supplied by shareholders, salary's cost, security, maintenance cost, marketing cost among others
4. Analyzing competitors' prices and strategies: this consideration is important in price setting as price is the most flexible element of marketing mix. The competitor will react to any price change hence the need to determine his actions in advance and develop appropriate response strategy.
5. Selecting a pricing method: this may include cost-based pricing, value-based pricing or competition-based pricing. Each of these methods will be discussed in the next section
6. Setting the final price: the final price will reflect market positioning of the financial product.

7.6 Pricing Methods

Lovelock and Wirtz (2011) have identified three main pricing methods used by service firms that include cost-based pricing, value-based pricing, and competition-based pricing. Each of the methods is examined briefly below

Cost based pricing: this is where the financial institution would consider all costs incurred in production of the service and set the minimum price that can be charged for a service. This is however difficult since the financial product will mainly be among many services that the firm

will be offering. Most firms adopt activity-based costing whereby the firm determines all costs (direct or indirect) associated with production, distribution, and selling of financial products. This allows the firm to estimate real profitability from different consumers of its services. There are several benefits of cost-based pricing. First the method ensures all production and overhead costs of the financial institution are catered for. The method also ensures the company generates profit even when the cost rises. Further it is easier to convince customer of change in price and customize pricing for the individual customer. The method is also easy to use.

On the other hand, the method has some drawbacks: first the method ignores the law of demand and supply in the market and only focusses on companies' wellbeing. It is therefore not market oriented and may not survive in a competitive market. It also ignores the activities and reactions of competitors. This pricing method may result in price that is different from market rate, and this may affect customers perception of the firm. The company may also not be cost sensitive as it will try to pass all the cost to the buyer. It is therefore prudent for the firm to be more considerate when adapting this pricing method.

Value based pricing: this is based on consumer perception of the value they are getting. As pointed out earlier value is the ratio between perceived cost and benefits received from the service. Consumers always want the benefits to be more than the cost incurred. Perceived value is made up of various elements including the customer's image of the product performance, Company's reputation, customer service, ease of delivery, warranties offered as well as elements of service environment. Financial service providers must strive to deliver more value than the competitors to be able to charge for this premium. Value is mainly added on extra supplementary and complementary services offered.

There are several advantages associated with value base pricing: this method enables a firm to charge higher prices for its product and therefore generate more revenue for the business. Every businessperson would want this. We also find that the method increases customer loyalty. This is because of the value they attach to the brand and therefore they may be willing to stay with it. Value based pricing also enables the firm to create eve more value for its brand resulting in expanding customer base. This method also helps to assess demand of the company's products and the ability of the firm to meet this demand.

However, there are also demerits of this method: the method often results in higher cost of services as the firm endeavors to increase quality of service. The firm may also not be able to match with competition and therefore may lose some of its current and potential customers. The firm is also likely to find difficulties if it wants to venture into other markets due to its high prices charged.

Competition based pricing: This is where the financial services provider sets price in comparison with competitor. The marketer may set price higher to, equal to or below the competition. This strategy enables the firm to either become competitive or may just follow the market leader. Johan (2015) notes that with many competing services and wide availability of substitutes, price competition usually intensifies and that non-price factors, such as time of delivery, service site location and service features reduce the need for intense competition based on price. It is however

worth noting that customers are more sensitive to aspect of switching financial service providers and therefore the firm should focus more on enhancing customer experience.

There are merits of this pricing method: the method enables the firm to guard or even increase its market share as it considers the effect of competition. The firm is also able to respond quickly to any change of price in the market and therefore maintains its position in the market. We also find that many customers today compare prices online before making purchases. The marketer is therefore able to be at par with other financial institutions and will easily attract new customers if his price is competitive.

There are also disadvantages of this method: premium products don't sell well when based on this strategy as the consumers want to feel special by paying higher prices. The strategy may lead to underpricing of one's products resulting in huge losses. It's also important to note that competitors may not always price their product accurately and this may affect brand perception or even margins made. The method also does not guarantee that all costs of production will be met.

7.7 Pricing Strategies

Berry and Yanda (1996) have identified three main pricing strategies that could be employed by service business. These include satisfaction-based pricing, relationship pricing, and efficiency pricing.

Satisfaction pricing strategy focuses on reducing customers perceived risk and uncertainty associated with service business. Under this method the firm may offer service guarantees, benefit-driven pricing, and flat-rate pricing.

- **Service guarantee** strategy is the situation where the firm makes promises to customers that certain services or product will be delivered according to agreed terms and conditions. A financial institution can differentiate itself through this strategy by promising customers on delivery of certain services and ensuring that it keeps its promises.
- **Benefit driven pricing** occurs when the financial institution can identify specific benefits from purchase of certain products and associate the price with these benefits. This is then communicated to a customer which reduces uncertainty and justifies the price. For example, a saving account may come with benefits such as account statement being sent monthly, access to cash on ATMs, insurance services and even account transactions notification on mobile phone. The marketer may charge each of these benefits a certain amount of money and make known to the customer the cost per benefit.
- **Flat-rate pricing** occurs when a firm charges a fixed price for a particular service it offers. The strategy reduces uncertainty to the customer and enables the firm to manage its costs well given that it knows how much to charge a particular client at a given time

Relationship pricing strategy is applied when a financial institution uses price to build and maintain long term relationship with a customer. This may take the form of long-term contracts or even price budling (Johan 2015). Long term contract involves a situation where a customer is charged lower price over a long period of time. The financial marketer can also sell many other

services to the customer due to this long-term contract. This strategy works well for corporate customers who may buy several services at a lower price enabling the firm to recover its costs. Price bundling is where the firm puts combines several services together to enable a customer to make one purchase. This saves the customer time and resources on one side and makes it easier for financial services provider to sell a particular product.

Efficiency pricing. Aims at delivering the most cost-effective service to customers. The firm reduces cost by engaging customers who are cost-sensitive, applies technology and eliminates activities that are perceived by customers not to add any value to the transactions. Efficient pricing ensures maximum utilization of resources at the lowest cost possible.

7.8 Review questions

1. Describe the significance of a price to a financial services marketer
2. Evaluate the role of price to a financial services consumer
3. Citing relevant examples, discuss pricing strategies employed by financial institutions in your country
4. Discuss ways of employing efficient pricing strategy in an upcoming financial institution
5. What steps would follow in coming up with a price for a financial service
6. Critically examine pros and cons of a competition-based pricing strategy

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