Impact of product bundling in indian retail banking marketing essay

Finance, Banks

The retail banking is the growth trigger of the banks. Even though there is a phenomenal opportunities for growth in retail banking, the challenges are also daunting. Banks are struggling to retain its customers through retail banking. According to Reichheld research, a 5 per cent increase in customer retention can increase profitability by 35 per cent in banking business. The pervasive practice of bundling the products by banks, have built up so much momentum over the past few years in Europe, Asia and Pacific countries. The concept of product bundling is not widely used by Indian banks, since it is not legally accepted by RBI guidelines. Private sector banks are having this type of retailing products in non-core areas of banking. For example, ICICI bank is providing home loan insurance cover exclusively to its home loan customers with tie-up with ICICI Lombard insurance. Previous researches proved that bundling strategies not only retain the customers but also reduces the variable cost of the products.

The primary purpose of the research is to find out the cause and effect of product bundling in financial quality system of banking. The retail marketing factors are measured with service marketing factors ie, ‘ product’, ‘ price’, ‘ promotion’, ‘ place’, ‘ process’, ‘ physical evidence’ and ‘ person’. The financial quality system is identified based on the CAMELS system ie., Capital, Asset quality, Management quality , Earning quality , Liquidity and Sensitivity to market risk. Primary data were collected from the 200 customers of ICICI Bank home loan borrowers. Cluster analysis is used to group them. The effect on financial quality is measured based on interview conducted among the 25 regional managers of the same bank.

The results show that the retail marketing factors are having high impact on financial quality system. Hence product bundling concept balances the operational and financial risk to have financial sustainability in retail banking.

Key words: Product bundling, CAMELS, Core banking.

Introduction

The banking sector has witnessed wide ranging changes under the influence of the financial Sector reforms initiated during 2009. The approach to such reforms in India has been one of gradual and non-disruptive progress through a consultative process. The emphasis has been on deregulation and opening up the banking sector to market forces. The Reserve Bank has been consistently working towards the establishment of an enabling regulatory framework with prompt and effective supervision as well as the development of technological and institutional infrastructure. Persistent efforts have been made towards adoption of international benchmarks as appropriate to Indian conditions. While certain changes in the legal infrastructure are yet to be effected, the developments so far have brought the Indian financial system closer to global standards. Banks are now moving towards Universal Banking, which is a combination of commercial banking, investment banking and various other activities including insurance.

Banks will need to create value in new ways, notably through differentiation on offers and services. Banks have to strengthen the added value they bring to clients by personalizing their customer approach and developing their advisory capacities. By international standards, however, there is still much scope for retail banking in India. After all, retail loans constitute less than seven per cent of GDP in India vis-à-vis about 35 per cent for other Asian economies – South Korea (55 per cent), Taiwan (52 per cent), Malaysia (33 per cent) and Thailand (18 per cent). is a likelihood that the growth numbers seem to get somewhat exaggerated. Hence there is a need of constant innovation in retail banking. This requires product development and differentiation, innovation and business process reengineering, micro-planning, marketing, prudent pricing, customisation, technological upgradation, home / electronic / mobile banking, cost reduction and cross-selling. Service bundling offers one method of cross-selling that places less of the burden on the bank employee who, despite training, often simply lacks the skills and/or motivation to be an effective salesperson, and more on the design and promotion of the product. Due to bundling of services and delivery channels, the areas of potential conflicts of interest tend to increase in universal banks and financial conglomerates.

A product bundle as a bilateral contract must guarantee a possibility to obtain extra profit /or saving/ for each partner /bank versus customer/ at agreed price level /or discount/, but as well as both of them must accept some uncertainty or risk of lost. Bundling means offering two or more products together as a package..

Bundled accounts have built up so much momentum over the past few years that they have become a dominant focus of the retail operations at many banks. The practice is pervasive in the banking industry. Application of bundling strategies in retail banking reduces a bank’s variable cost for selling, secures both stable and higher income by periodical fees for covering high fix running costs as well. The biggest opportunity for current retail banking is building a strong relationship with customer by cross- selling extra bundled products, which leads to a higher retention and loyalty of customers. Empirical findings prove the paradox, that product bundles with discounted price for customer generate extra profit for bank, hand in hand with a still increasing customer satisfaction. Clever construction of bundles and bounded rationality decision making of customer offers a solution of ' profitable discounts' not only for a banking sector, but at least for sector of services.

According to a research by Reichheld and Sasser in the Harvard Business Review, 5 per cent increase in customer retention can increase profitability by 35 per cent in banking business, 50 per cent in insurance and brokerage, and 125 per cent in the consumer credit card market. Thus, banks need to emphasise retaining customers and increasing market share.

Review

The Dynamic Pricing and Product Bundling application standardizes a bank's pricing and product bundling processes and allows the bank to reduce maintenance costs and increase its cross-sell opportunities(Morphy, 2006). The easiest way to retain the bank customers is to test the market by shuffling the existing product mix and creating new bundled offerings to optimize deposit growth (Barham, 2007). Clever construction of bundles and bounded rationality decision making of customer offers a solution of ' profitable discounts’ not only for a banking sector, but at least for sector of services.(Peter).

The result is that customers generally get a superior annual percentage yield (APY), while the bank gets higher profit and volume. The secret by-product of bundling is the superior APY; it is what customers seek, it has the potential to drive balance with profitability, and it is a strategy largely overlooked by community banks.

Concept of Product Bundling

Product bundling is an intelligent strategy that is becoming increasingly popular in the banking sector. Banks offer multiple financial products and services to customers as a package. Bundling is generally recognized as a potentially appropriate means to tackle competition, to acquire new customers, to cross-sell new services to the existing customers and to retain the existing customers, who are getting increasingly savvy and sophisticated. Bundling helps to boost profits substantially by increasing the opportunity to cross-sell. It is also a great method for increasing the sales volume of products that are not in high demand. Bundling is not a new concept in retail banking. It has been existing for more than a decade-and-a-half, but there is a shift in focus now, as a result of which, it has gained popularity. Earlier, banks were mostly concerned with increasing the effectiveness of the use of its core banking products like current accounts and daily transaction-based activities. In the last few years, the priority has shifted to actively improving product penetration into the existing customer base, increasing sales by attracting new customers, innovating the product offerings, and lastly but most importantly, retaining and enhancing customer relationships and basing price reductions on the total volume and/or desired use of services.

STANDARD CHARTERED Bank (SCB) is giving its Priority Banking customers up 12 per cent interest earnings through its latest wealth management offerings. In its new exclusive promotion, SCB Priority Banking customers will enjoy " attractive interest rates" on a Brunei Dollar fixed deposit when they invest in a unit trust at the same time. An intelligent pricing strategy that is becoming more and more popular in banking is bundling. One example is the NatWest package " Advantage Gold". This bundle costs £6 per month and combines a current account with lower interest rates for loans, rebates in certain insurance policies as well as various additional services such as lowest price guarantees for different articles, discounts for videos and DVDs, a customer magazine, commission-free traveller cheques, rebates for hotel stays, etc. In the Dutch market most cross selling in the consumer market is of a soft variety, that is, price inducements are offered to accept a bundle of services rather that exclusive tying arrangements.

More often, bundle design decisions are based upon short term objectives such as attracting new customers, increasing fee income, or merely matching competitive offerings.

There are two basic forms of bundling, pure and mixed. In pure bundling, the products or services cannot be purchased separately. They are available only in bundled form. In contrast, mixed bundling allows the consumer to purchase one or more of the services individually or to purchase the bundle

Some examples of retail product bundles being offered by banks:

If a customer maintains a defined amount of savings and has taken a defined amount of loan, then discounts are offered on interest rates, auto loans, free phone banking, counseling once-a-year, etc. Here again, there can be a tiered approach i. e. when balances/loan amounts increase, more discounts and additional free services are provided.

Cluster analysis is used for classifying the consumer satisfaction variables into relatively homogeneous groups. The respondents were clustered on the basis of satisfaction level sought from the different attitudes under seven service marketing mix. The variables' satisfaction levels are measured through five points's summated rating scale i. e., strongly dissatisfied, dissatisfied, neutral, satisfied and strongly dissatisfied. The ratings are made as 1, 2, 3, 4 and 5 respectively for each point. ' Product' level satisfaction level is measured with the variables quality, scalability, multiplicity, reliability and security. ' Price' level satisfaction is measured with the variables ' fair pricing', ' interest' and ' transaction charges. ' Promotion' level satisfaction is measured with the variables ' informative', ' awareness', ' receptive' and ' attentive'. ' Place' level satisfaction is measured with the variables ' accessibility', ' convenience' and ' diversified place'. ' Process' level satisfaction is measured with the variables ' bundling', ' integration', ' processing time', and ' error-free process'. ' Physical evidence

(Documentation)' level satisfaction is measured with the variables ' easy to go through', ' less documentation', ' unambiguous' and ' legality'. ' Person' level satisfaction is measured with the variables ' involvement', ' technical support', ' friendliness' and ' trust'. The measure of similarity is measured by euclidean distance model. The reliability and validity of cluster analysis was done by making multiple runs using different order of cases. The clustering criterion was the Akaike's Information Criterion. The number of clusters was determined based on the minimum six-cluster solution. Based on the cluster group centroids of each service marketing mix, the level of satisfaction are labeled as impressive (> 4), stirring (3. 5 to 4. 0), striking (3. 0 to 3. 5), modest (2. 5 to 3. 0,) un-impressive (2. 0 to 2. 5) and mediocre (<2). The results are displayed in Table -1.

Two-group discriminant analysis is used to find out the disriminant factor among the existing customer and new customers using the product bundling . The independent variables are customer service level satisfaction variables i. e, ' product', ' price', ' promotion', ' place', ' process', ' physical evidence' and ' person'. The responses are rated based on the cluster centroid of each customer service level variables. The ratings for impressive, stirring, striking, modest, un-impressive and mediocre clusters are 6, 5, 4, 3, 2 and 1 respectively. The grouping variables are ' existing customer' and ' new customers'.

Because there are two groups, only one discriminant function is estimated. The eigen value associated with this function is 1. 64 and it accounts for 100 percent of the explained variance. The Wilks' ë associated with this function is 0. 312, which transforms to a chi-square of 32. 45 with 7 degrees of freedom. This is significant beyond the o. o5 level. Hence null hypothesis is rejected. The structure matrix is displayed in Table-2.

It appears that the existing and new customers are more widely separated in terms of price than that of other variables. The canonical correlation associated with this function is 0. 783. The square of this correlation 0. 61 indicates that 61% of the variance in the dependent variable is explained by this model.

In 1995, RBI had set up a working group under the chairmanship of Shri S. Padmanabhan to review the banking supervision system. The Committee certain recommendations and based on such suggetions a rating system for domestic and foreign banks based on the international CAMELS model combining financial management and systems and control elements was introduced for the inspection cycle commencing from July 1998. It recommended that the banks should be rated on a five point scale (A to E) based on the lines of international CAMELS rating model. CAMELS evaluates banks on the following six parameters :- CAMEL approach will serve as an important. This will help lead to a low-cost high-quality result with secure profit levels.

Capital Adequacy : Capital Adequacy is a measurement of a bank to determine if solvency can be maintained due to risks that have been incurred as a course of business. Capital allows a financial institution to grow, establish and maintain both public and regulatory confidence, and provide a cushion (reserves) to be able to absorb potential loan losses above and beyond identified problems. A bank must be able to generate capital internally, through earnings retention, as a test of capital strength. An increase in capital as a result of restatements due to accounting standard changes is not an actual increase in capital.

Asset Quality : Asset Quality evaluates risk, controllability, adequacy of loan loss reserves, and acceptable earnings; and the affect of off-balance sheet earnings and loss. The quality of a bank's assets hinges on their ability to be collected. Asset quality determines the portfolio quality, the portfolio classification system (aging schedule and the methodology to classifying a receivable) and the fixed assets (the productivity of the long-term assets, for instance the branch network).

Management quality : Management quality envisages the strategic planning applied in each level of flow of funds. It is reflected by the ownership structure of the bank, branch network , loan portfolio management, credit administration, policy development, employee training, audit oversight, quality of governance and quality of information technology system

Earnings : Earnings determine the ability of a bank to increase capital (through retained earnings), absorb loan losses, support the future growth of assets, and provide a return to investors. The largest source of income for a bank is net interest revenue (interest income from lending activity less interest paid on deposits and debt). The second most important source is from investing activity. A substantial source of income also comes from foreign exchange and precious metal trading, and commissions/transaction fees and trust operations.

Liquidity : Liquidity measures the ability of a bank to meet the demand from demand deposits in a particular year. Liquidity is what a bank requires if funding is interrupted and the bank must still be able to meet certain obligations (bank’s ability to repay depositors and other creditors without incurring excessive costs). The liquidity is affected by the institution’s liabilities, including their tenor, interest rate, payment terms, sensitivity to changes in the macroeconomic environment, types of guarantees required on credit facilities, sources of credit available to the institution and the extent of resource diversification. A bank’s least expensive means of funding loan growth is through deposit accounts. When this is not available, banks must rely on more expensive funding sources such as borrowing funds at wholesale rates or liquidating investment securities portfolios.