KEVIN CURRY

Bank deposits get **interesting**

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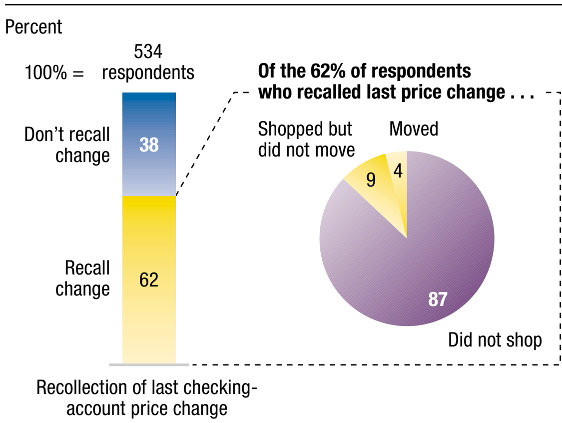
Contrary to industry folklore, customers are fairly tolerant of changes in the price of retail deposit products. In fact, very often they aren't even aware of these changes.

Many banks believe that their customers are extremely sensitive to changes in fees and interest rates for retail deposit products. But recent research shows that in reality customers are fairly tolerant of such price changes. This is good news for banks: if they had more flexibility to price retail products without sparking widespread customer defections, they could boost their bottom-line retail earnings by as much as 5 to 7 percent.

In a 2001 market research study of more than 500 banking customers in the US Southeast and Midwest, we examined responses to price changes in checking accounts and certificates of deposit (CDs).[1] Our findings suggest that few customers actually change banks as a result of changes in the cost of these products.

EXHIBIT 1

How did customers react?



Source: 2001 McKinsey survey of >500 retail-banking customers

Checking-account customers, for instance, are surprisingly "sticky," citing convenience, the quality of service, and their relationships with bank personnel as reasons for not switching to other banks after price increases. More than one-third of these customers do not even recall the last price

[1]The study, which controlled for age and income levels to reflect their frequencies in the general population, involved customers of a wide variety of banks. In addition, we conducted a number of focus groups to improve our understanding of customer attitudes and reactions to price changes.

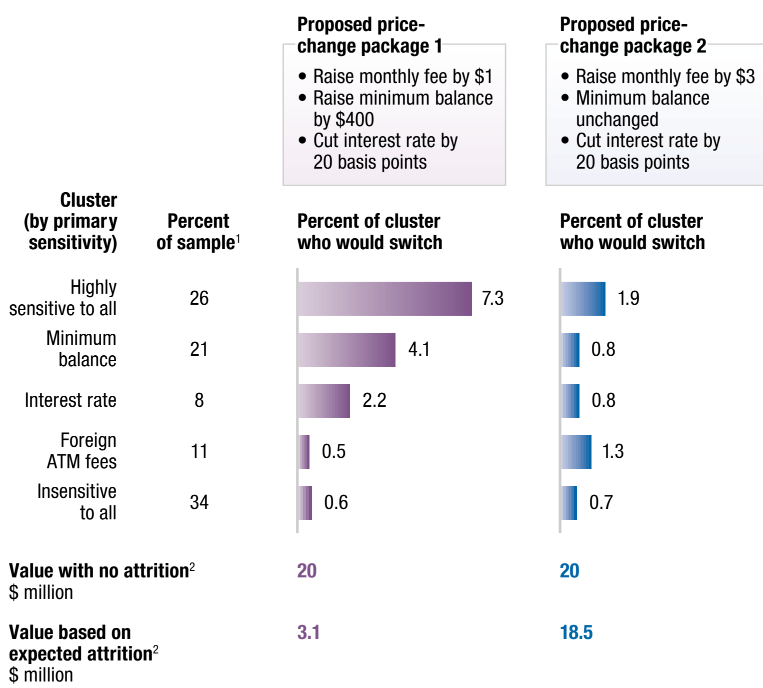
change to their checking accounts, and only 13 percent of those who do remember troubled themselves to shop around for a better deal. In the end, just 2 percent of all customers moved their accounts (Exhibit 1).

Customers are also willing to trade off certain pricing features for others. Some customers are very sensitive to changes in the minimum monthly balance, for example, but far less so to changes in the monthly fee. By designing price changes that accommodate these sensitivities, banks can significantly increase their revenues while managing their overall rate of attrition sufficiently to affect the bottom line. When customers were presented with two comparable checking-account price changes—one emphasizing a higher fee, the other a higher minimum-balance requirement—for example, their switching behavior was so different that one package would have generated six times more revenue than the other (Exhibit 2).

In selecting a bank for CDs, customers said that interest rates accounted for 45 percent of their decision. Yet at renewal time, only a third of CD

EXHIBIT **2**

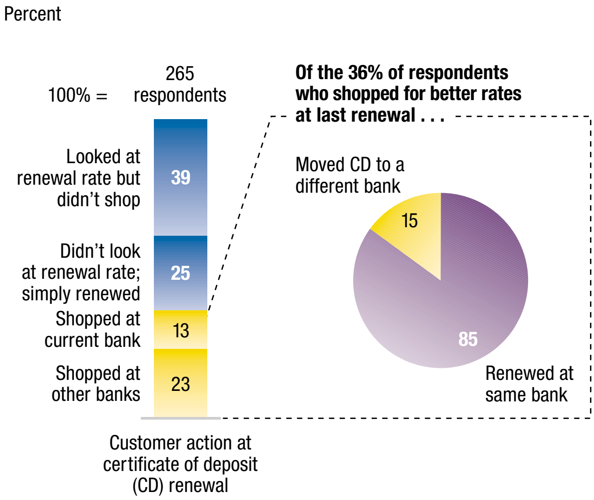
Comparable packages, contrasting results



[1]Distribution of customers for typical interest-bearing checking account.
[2]Assumes bank with 1 million accounts and $4 billion in outstanding checking-account balances.
Source: 2001 McKinsey survey of >500 retail-banking customers

EXHIBIT 3

Sticky savers: Customer behavior at CD renewal



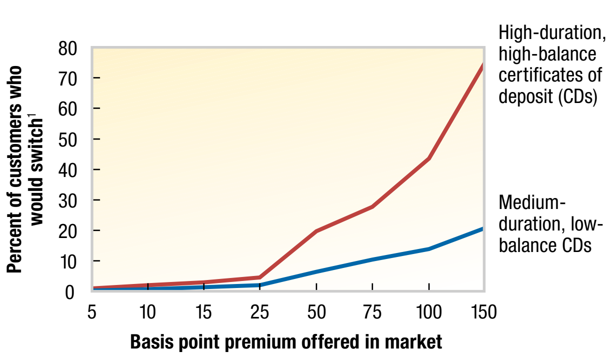
Source: 2001 McKinsey survey of >500 retail-banking customers

customers shopped around at all for a better rate, and 85 percent of them renewed at the same banks. In the end, no more than 5 percent of all the CD customers moved their assets to a different one (Exhibit 3).

For checking accounts, the willingness of customers to switch reflected their preferences for different fee structures (for instance, a high minimum balance as opposed to a high maintenance fee). But for CDs, these customers' willingness to change their banks reflected, more than anything else, the value and duration of their CDs. For a small decrease in the interest rate (0.25 percent) at renewal and a small premium from a local competing bank (0.25 percent higher than the renewal rate), very few (2 to 3 percent) of the respondents would have switched. But as the premium increased, customers with high-amount, high-duration CDs did so four times more often than did customers whose CDs were of medium duration and for low amounts (Exhibit 4). Clearly, the sensitivity of customers to interest rates has heightened in the current environment. Such shifts emphasize the need to conduct research on a regular basis to anticipate customer reactions to price changes.

EXHIBIT 4

CD customers favor duration and balance



[1]Given 25-basis-point decrease in interest rate for renewal.
Source: 2001 McKinsey survey of >500 retail-banking customers

Of course, as banks price their products, they must balance their customers' sensitivity to price changes against many other considerations, including their objectives in the local market, the pricing of competitors, the value proposition of each product, the profitability of serving different customers, and the relationship value of various customer segments. While some banks consider several of these elements in their pricing programs, consumer research often isn't pursued aggressively. Many banks view it as difficult and time-consuming, but in our experience a pricing program that includes consumer research can be completed in just three to four months. If banks get a clearer understanding of the pricing trade-offs customers are willing to make and their sensitivity to prices, those banks will be better equipped to determine the optimal combination of price changes. Q

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