PROFESSIONAL PPS PRICING SOCIETY™

The PRICING ADVISOR

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Saudi Arabia's vast landscape might soon be ruled by challenger banks that can provide a strong digital offering, as this article explains. Dr. Jan Engelke, based in Switzerland, is Partner in Simon-Kucher's Banking Competence Centre. He can be reached at jan.engelke@simon-kucher.com. Matthew Jackson is a Director at Simon-Kucher's New York office. He can be reached at matthew.jackson@simon-kucher.com.

In This Issue:

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Water in the Desert

With its reputation for traditional relationship-based, face-to-face banking and its dispersed population, the Saudi Arabian market presents a distinct challenge to smaller banks without sufficient branch presence. Studies of attitudes towards online banking have probed the reasons behind slower uptake of digital alternatives in Saudi Arabia.

The leading inhibitors are related to psychology (attitudes and fears) and awareness (general digital literacy), but are not likely to remain an obstacle as the generational shift towards an online society moves forward. The YouGov BrandIndex BestBrand Rankings for 2015 show that six out of the ten most positively perceived brands in Saudi Arabia are digital – with newcomer WhatsApp at second place.

While society changes, the traditional branch-based banking model is under pressure.

The kingdom's branch coverage and shortage of human capital is a growing problem. Furthermore, an emerging tech-savvy customer base has higher standards than the customers of yesterday. Where will this lead?

A new survey, conducted last year by Simon-Kucher & Partners in association with Lightspeed Research, reveals that the future may be not so very far away.

Although many Saudi Arabian customers (38%) identify 'branch network' as their main reason for choosing a 'main bank,' an almost equal number (34%) selects 'ease of online banking' as their main reason (see Figure 1).

Similarly, although the branch is the most widely-used channel, 46% of customers in Saudi Arabia say that they do most of their banking online (see Figure 2). The majority of these users are in the age range of 35 to 54, and branch usage is lowest in this range, indicating that users lack time, and value convenience

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PPS Happenings

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Upcoming Events

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- Hilton Miami Downtown Hotel – Miami, Florida / May 2-5, 2017
- Full-Day Workshops and Special Programs / May 2-3, 2017
- Conference Keynotes and Breakouts / May 4-5, 2017

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(see Figure 3).

Customers who favor the branch do not do so out of love for the branch *per se*, but for the security and assurance of a personal relationship. Until now, the personal dimension has been a missing factor in the 'remote' bank. However, technology is helping the remote experience to become increasingly personal. One example is the virtual assistant, already in use in the Middle East: 'Sara' assists customers of the Commercial Bank of Dubai.

Surely online customers are less sticky? Not so, according to the survey. On average, these online users purchase more products with their main bank than branch users, signifying that convenience breeds loyalty. What's more, they tend to be higher earners, meaning higher revenue per product as well. (See Figure 4)

The target is a consumer base that is predominantly concerned with getting a fair deal and avoiding inconvenience. **The seemingly daunting banking landscape in Saudi Arabia is open to an innovative bank that provides an optimal omni-channel experience.**

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Figure 1: Relative importance of factors for choosing a main bank

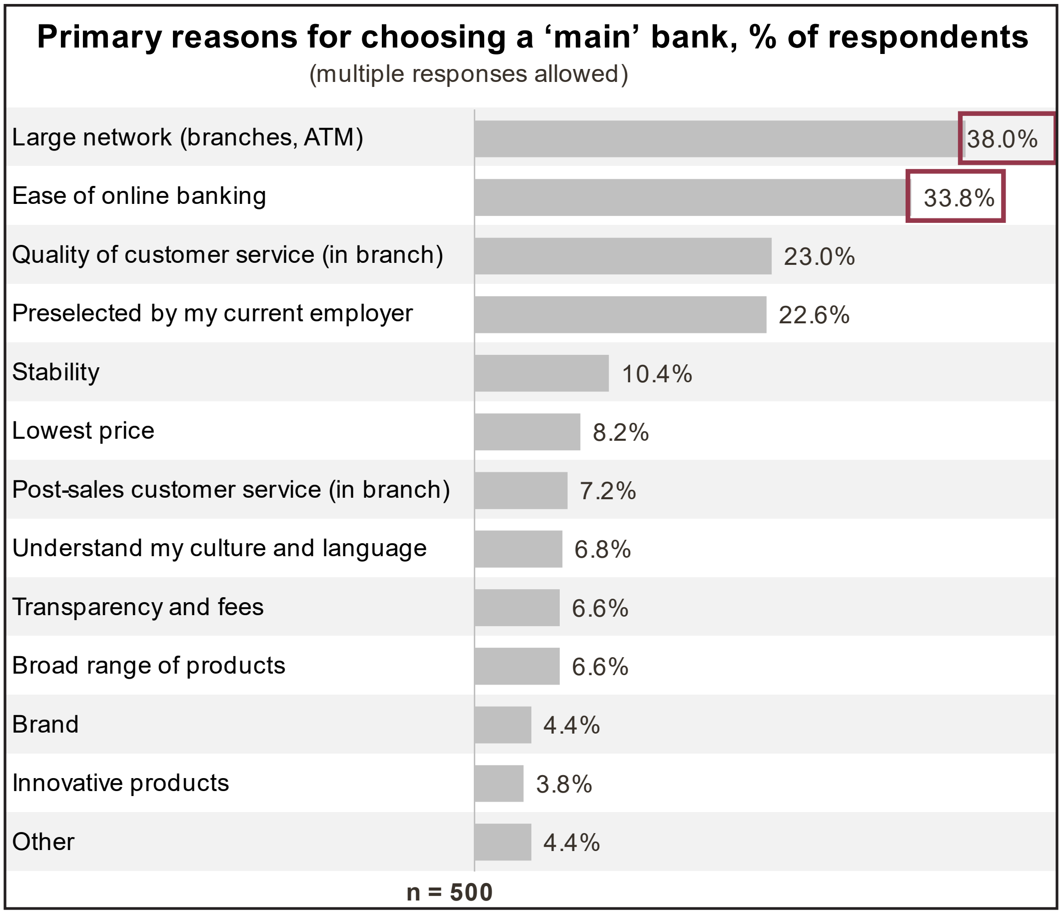

Figure 2: Banking channel use in Saudi Arabia

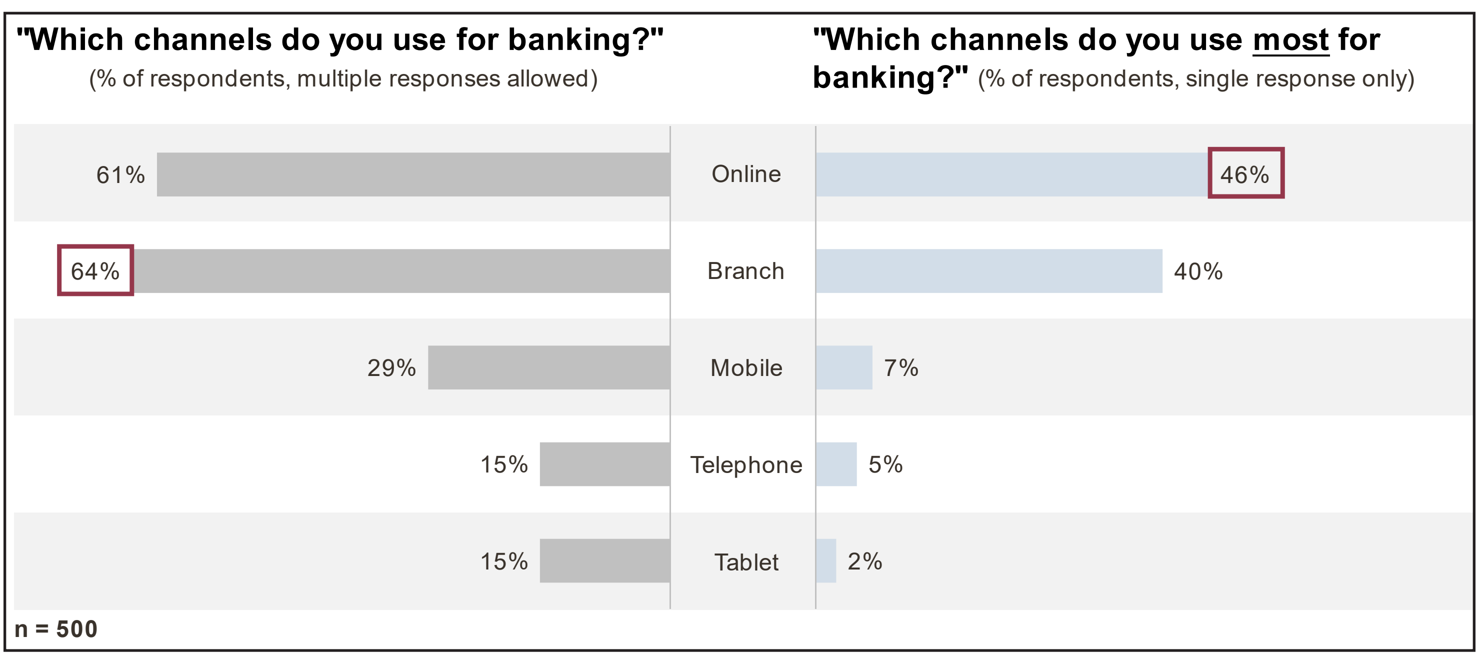

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Figure 3: Banking channel usage by age bracket

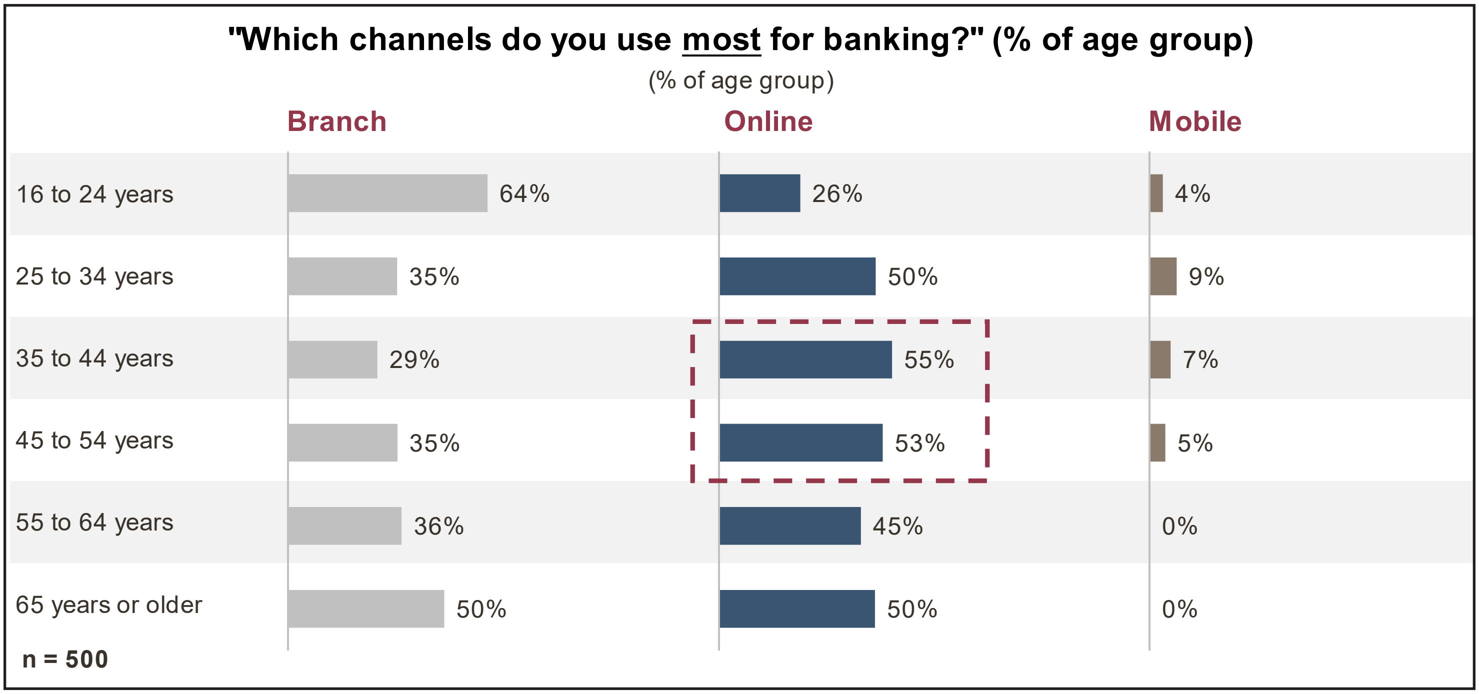
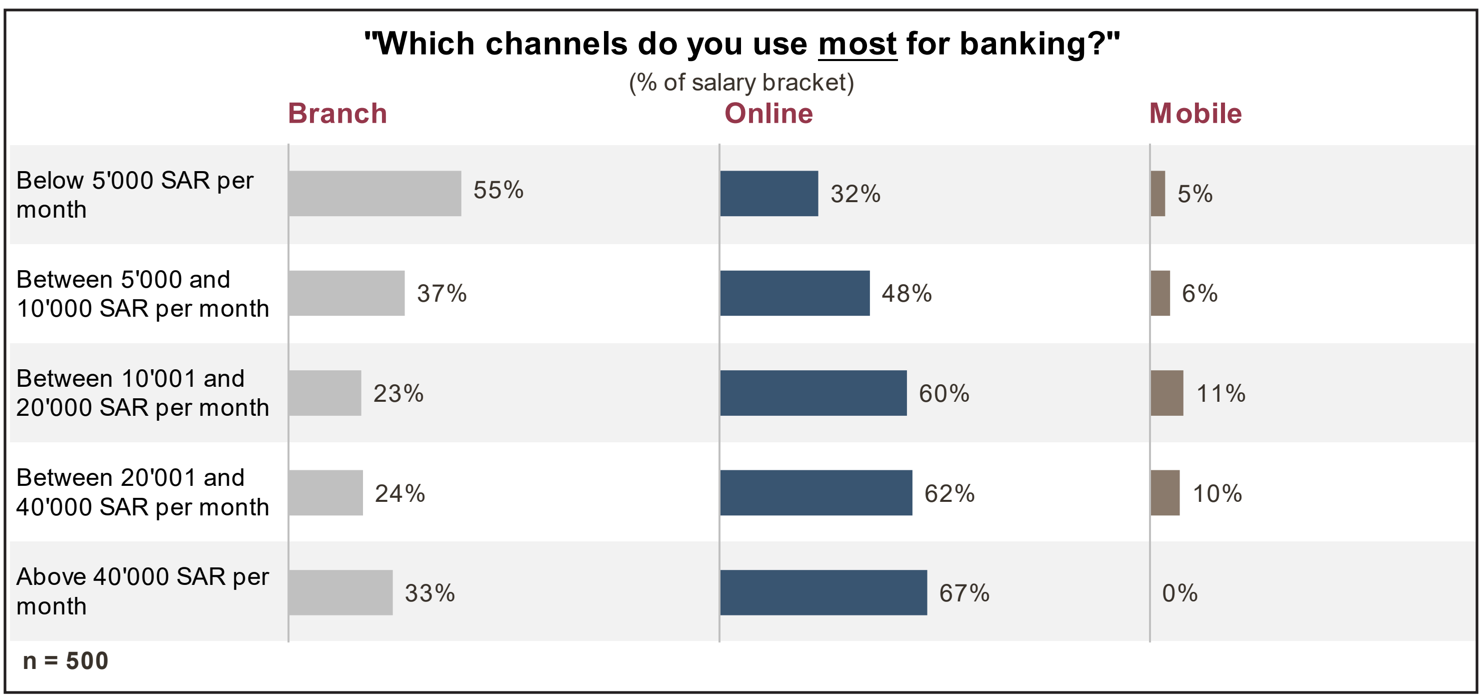


Figure 4: Banking channel usage by salary bracket



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Airlines' New Basic Economy Fares Show the Power of No-Frills Pricing

Several large airlines have recently begun to offer customers a lower-priced, basic economy fare option. At first blush, it's difficult to see how a further degradation of airline service can enhance profits and attract customers. However, as the author reveals, this is actually a powerful pricing strategy. Rafi Mohammed is the founder of Culture of Profit LLC, and author of The 1% Windfall: How Successful Companies Use Profit to Profit and Grow. *He can be reached at rafi@cultureofprofit.com. This article originally appeared on the Harvard Business Review (HBR.org).*

American Airlines and United Airlines recently joined Delta in offering passengers a lower-priced option to fly: **basic economy**. Want to save a couple of bucks on your next flight? Consider making a few sacrifices, which vary by carrier, such as paying fees for checked and carry-on luggage, having the airline (instead of you) select your seat, boarding last, or surrendering the opportunity to make flight changes.

On many Delta domestic flights, passengers can now choose from four different fare classes, each with unique amenities: basic economy, main cabin economy, comfort+, and first class.

At first blush, it's difficult to see how a further degradation of airline service can enhance profits and attract customers. But in fact, rolling out a lower-priced, no-frills version is a powerful strategy that can deliver benefits to both companies and consumers in the following four ways:

Defensive Precision Discounting

A lesson all companies can learn from basic economy is that employing a stripped-down version can combat discount rivals. It's common for discount upstarts to enter well-established markets. Their value proposition is typically along the lines of, "We don't have all of the frills of incumbents, but we'll save you money." This has been occurring in the airline industry for decades (Southwest was founded in 1967), but the discount segment has increased recently, as Spirit and Frontier have been siphoning price-sensitive customers from established carriers.

To fend off discount rivals, higher-frill companies often cut prices to remain competitive. While this retains price-sensitive customers, the downside is that it extends discounts to those who don't need them. Losing, say, 15% of your customer base to a discount rival sounds painful, but it's important to remember that 85% of your customers continued purchasing at full price. These loyalists decided the fewer-frills-for-a-discount trade-off isn't worth it for them. So, really, only 15%, the "at risk" customers, need discounts.

The beauty of employing a stripped-down version is that it allows budget-conscious customers to raise their hands to credibly say, "Price is important to me." The reduction of frills serves as a hurdle to screen out the posers ("Sure, I wouldn't mind a discount") from the truly price sensitive ("I'm not going to buy unless the price is lowered"). I mean no disrespect to the posers, because I'm one myself. While I love saving money, basic economy's stipulation of boarding last ("Final call for Zone Z") is a deal breaker for me.

Offensive Precision Discounting

The aim of discount companies is to both steal customers from incumbents and serve new customers by growing the market. Airlines with rock-bottom prices, for instance, have grown the air travel market by attracting travelers who would not have taken a trip as well as those who would have driven.

In a similar fashion, a no-frills discount option by an established carrier cultivates growth by targeting a new price-sensitive market while not cannibalizing profits from existing customers who prefer ample amenities.

Airlines with rock-bottom prices, for instance, have grown the air travel market by attracting travelers who would not have taken a trip as well as those who would have driven.

What makes a no-frills version so powerful is its versatility. It can be used defensively to retain price-sensitive customers as well as offensively to grow by being

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more affordable to new patrons. Another key benefit is that no-frills versions often can be turned on and off based on demand. During popular travel periods, for instance, basic economy tickets can be turned off ("sold out," "not available") since there's no need for companies to offer a discount option during those times.

During popular travel periods, for instance, basic economy tickets can be turned off ("sold out," "not available") since there's no need for companies to offer a discount option during those times.

Supporting a Price Increase

Rolling out a price increase is stressful; there's always concern over potential customer backlash. Offering a stripped-down version reduces this risk in two ways. First, it provides a cheaper alternative for price-sensitive customers to purchase. It's also more consumer friendly. Providing customers with the choice to pay higher or lower prices is preferable to a "take it or leave it" price hike ultimatum.

Spotlighting Value

Many companies only offer one option — the best — which includes a wide gamut of services or products. Often, so many attributes are packaged with a product that consumers become overwhelmed. As a result, they can't fully value all of the included benefits, which means companies aren't able to charge their product's true worth.

A stripped-down version sets a "base" from which to upsell. The distinctions between versions make it easier for consumers to understand and determine their value of additional attributes. After this scrutiny, they select the option that provides the best value to them. This doesn't automatically mean the lowest price. **Delta reports that roughly half of its customers** who look at the restrictions of basic economy opt to pay more.

Both businesses and consumers benefit from a no-frills, lower-priced option. Businesses gain the powerful ability to target discounts to only the price sensitive. Just as important, the options garnered from unbundling a product enable consumers to select the price or product combination that works best for them.

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Netflix: Streaming $800M of Price

In this article, the author explores the revenue management case study of Netflix, and presents how the company was able to issue a 17% price increase within 18 months and still grow subscriptions and top line revenues. Marc Carias is Consultant at Revenue Management Labs, a consultancy which helps clients solve problems around Pricing, Discounts, Product and Channel strategies. Carias is a revenue management professional with more than five years of experience in the aviation and healthcare sectors. He can be reached at mcarias@revenueml.com.

Throughout 2013 Netflix saw significant issues with their domestic streaming service, including:

- **Increased Competition** – Hulu and Amazon had begun to gain market share and offer differentiated services.
- **High Content Costs** – Consumers in video streaming want content, and lots of it. Content can retain customers and differentiate service. The problem is that content is expensive, and in 2013 content costs were more than 50% of streaming revenue for Netflix.
- **Average Price Decreasing** – In 2013, Netflix began offering a premium or family service for $11.99 ($4 more than their standard service). Consumers were not attracted to the premium service and opted for the standard service instead as the average price per user began to quickly decrease to $7.74 from a peak of $7.81 shortly after the service was introduced. This represents a $20M decrease annual revenue.
- **Slowing Growth in Subscriptions (Volume)** – Quarter over quarter growth subscription had plateaued.

To grow profitability Netflix had to cut costs or increase their top line. To retain customers Netflix had to invest in content. The only card Netflix had to grow profitably was to increase their price, a risky move given the circumstances.

Netflix used two revenue management techniques to increase price:

- **More Tiers** – Netflix took a page from Airlines and offered a "No Frills" tier. This allowed customers to segment themselves and pick the offer they wanted. The majority opted for the increase in price since the value offering matched their willingness to pay.
- **Phased Approach** – Netflix used different phases for current and new subscriptions:

  • Current – Netflix introduced a "grandfathered" system where current users' price increases would be delayed. This was meant to create and sustain loyalty. The decision also gave current customers time to become accustomed to the new tiered product offering before having to pay more.

  • New – Instead of a one-time increase, Netflix opted for two small-

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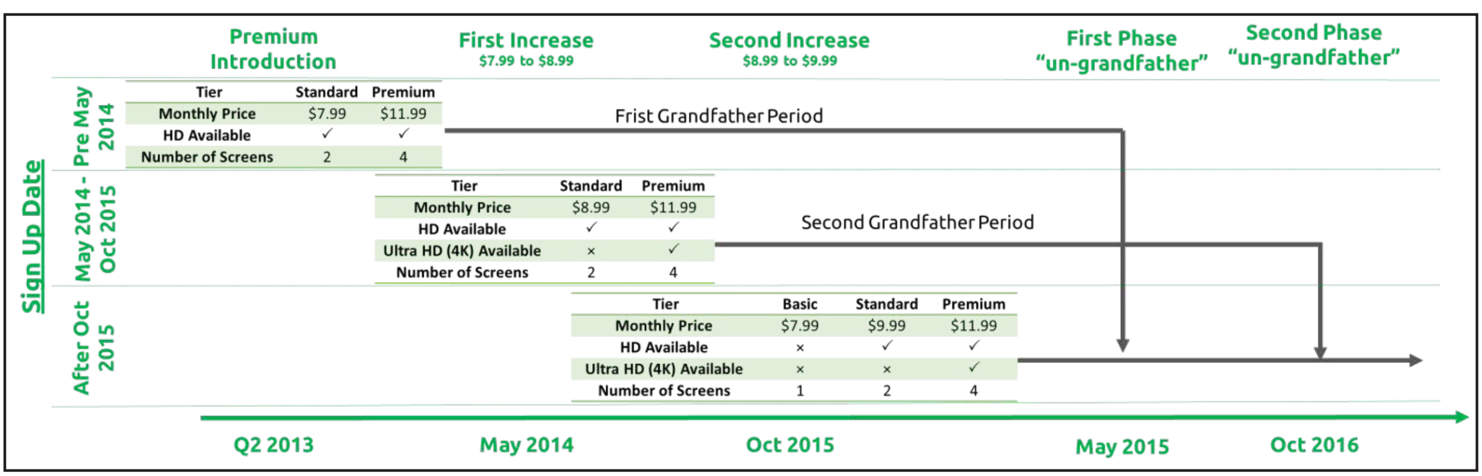
Figure 1: Netflix's implementation increasing their domestic standard price, i) two instances of $1 increase and ii) followed by two "un-grandfathering" periods.



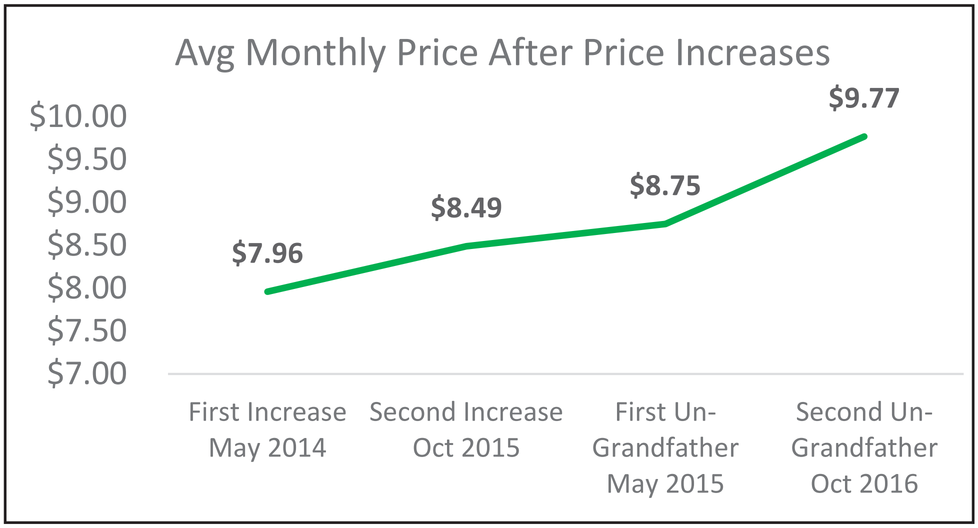
er one-dollar price increases. This had two positive effects:

i) One dollar seemed marginal to customers, meaning they would be more likely to accept the increase

ii) Small increments allowed Netflix to gauge and monitor reaction to their price increase

Throughout implementation, from May 2014 to October 2016, the average price increased by **17% or $1.39 per user**. The results of the increase became very visible in the fourth quarter of 2016 where revenue growth hit a three-year high. Price increases allowed Netflix **to increase domestic annual revenue by $800M or 44% of their domestic margin**.

Figure 2: Results of Netflix's domestic standard price increase



Netflix's price increase was undoubtedly a success. However, did they leave money on the table? There are a handful of additional revenue opportunities that were overlooked:

The fact that a company can issue a 17% price increase within 18 months and still grow subscriptions and top line is what revenue management is all about.

- **Continued Tier Differentiation**: Currently, the value propositions between the three tiers are minimal. Netflix could add more features to the premium offering (i.e. current weekly content) or add revenue generating activities (advertisements) to the basic package to motivate upselling.
- **Add-ons:** If customers are not inclined to take the leap to the next tier, add-ons allow customers to choose upgrades on an ad hoc basis. For Netflix, this could entail having add-ons to each of the tiers (e.g. add a screen or increase stream quality for one dollar). This must be done carefully as to not cannibalize current offerings (i.e. maximum number of users).
- **Mix**: This involves understanding how the Netflix offerings interact with one another and how that impacts the bottom line. Netflix can focus on moving users "up the premium ladder" into higher margin offerings by offering free tier upgrades for a limited time.

Although many people despise Netflix for their price increases over the past few years, only three percent of customers canceled their subscription, and many of them came back!

The fact that a company can issue a 17% price increase within 18 months and still grow subscriptions and top line is what revenue management is all about. There is a very good possibly that Netflix is aware of the money left on the table and have decided against capturing it until their next price increase. Watch out!

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Why IoT Nerds Need Pricing Nerds

In this article, the author explains the critical role that pricing professionals play in the Industrial IoT (Internet of Things) space. In the world of IoT, the pricing nerd is not simply the person who slaps a price tag to cover costs, he explains, but is the choreographer of value. This industry specific example provides insight into how pricing practices can influence profits in multiple business models. Author Roberto Rivera is the Regional Director at SPMG USA and has more than 16 years of pricing experience. He can be reached at rrivera@spmgglobal.com.

The industrial IoT (Internet of Things) space is quickly becoming the next great land rush. There will be winners and losers. Who will be the most resourceful and agile pioneers to stake their claims?

Creating Value Through Partners

Creating powerful IoT solutions requires some serious integration between machines, sensors, networks, mobile apps, cloud-based software, routers, IoT platforms, and more. This means lots of solution architecting, code engineering, system integrating, data extracting and testing. Today, there is no single player that can provide an end to end solution that delivers the full value potential of the "Industrial Internet." Vendors pushing the boundaries of IoT recognize the need to establish strong partnerships with multiple technology partners to bring their vision to life.

The role of the pricing nerd is to develop a solid understanding of the value that each partner brings to the table, then piece together product offerings utilizing a range of solutions that provide varying levels of value. The goal is to align your offering capabilities with customer value, budget and willingness to pay.

Delivering Value Through Co-creation

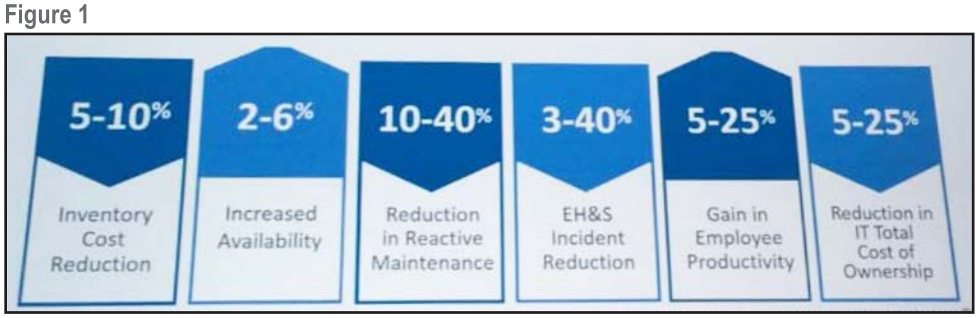
Another critical success factor for IoT pioneers is their ability to establish strong collaboration with customers. Technology is changing fast and both suppliers and customers must work together to uncover value and bring successful solutions to market.

Customers clearly are looking for solutions to their challenges and look to strong suppliers that can meet their needs. In fact, for most customers, the speed of technology adoption is largely dependent on the level of trust they have in their strategic suppliers. This trust is created by having a common vision of the benefits and value that technology will deliver to their business. Increasingly, customers are open to sharing their specific needs or goals for the business and expect vendors to provide whatever technology is necessary to accomplish it.

The role of the pricing nerd is to quantify the value of achieving improved customer outcomes. In the new wave of IoT technology, vendors must be able to prove their value through pilots and results-driven case studies.

On the other hand, customers must have the confidence that you can deliver on your value promise. Capturing value numbers on paper and having constructive conversations on value assumptions, dollars and outcomes with your customers is, in a word, priceless.

Figure 1



Capturing Value Through Price

Coordinating between partners and customers and managing the complexity of implementing breakthrough technology is never easy. With so many moving pieces it is hard to strategically think about how to capture a fair portion of the massive value that IoT technology can deliver.

The role of the pricing nerd is to set and manage prices that result in a win, win, win for partners, suppliers and customers. Nothing more and nothing less.

The Challenges Ahead

The IoT transformation requires new ways of thinking about pricing models that seamlessly align with customer value. In some cases, it could mean charging a monthly subscription fee per output produced, or per cost avoided. Tying your pricing to customer outcomes is critical but also adds complexity. It is the role of suppliers and partners to simplify the buying process for customers. I ran into an interesting statistic from a major research organization that claimed there is a "62% greater chance of closing the deal when the purchase process is easy." Vendors make the buying process easier for customers when there is clear communication upfront on value, ability to execute, a clear implementation plan and the investment (price) to turn vision into reality. Managing customer communications requires finesse and confidence. In the world of IoT, the pricing nerd is not simply the person who slaps a price tag to cover costs, the pricing nerd is the **choreographer of value**. Who is your pricing nerd?