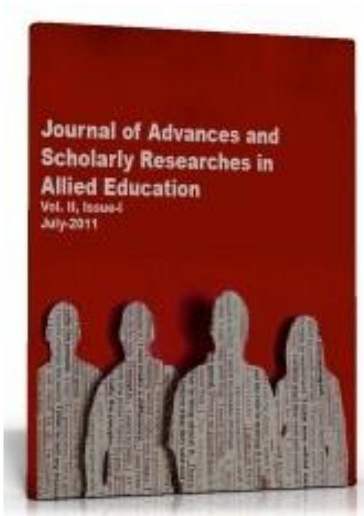
ISSN-2230-7540

A Study of Financial Services Marketing



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ABSTRECT:-

The traditional notion of the retail bank clerk who is intimately knowledgeable about a customer's banking needs and who personally knows the customer may no longer be a typical part of the banking experience. In such an environment, it is imperative that financial services marketers find innovative ways to create loyalty and trust among their customer base and provide the personal touch that may be needed to retain customers.

INTRODUCTION:-

The objective of this book is to help the reader develop a thorough understanding of the marketing practice in financial services. With that in mind, one has to take into account the underlying cognitive processes which guide consumers' financial decisions. We will therefore study how consumers decide to purchase financial services and contrast this pro- cess with how non- financial services and goods are purchased. The differentiating aspects of marketing

ISSN-2230-7540

financial services versus other marketing contexts are also highlighted throughout the book. The book will also detail the elements of what constitutes successful marketing practice, as it relates to pricing, advertising, and selling of financial services.

UNIQUE ASPECTS OF FINANCIAL SERVICES

Subjective Perceptions of Quality: A unique aspect of financial services marketing which differentiates it from other marketing practices is the illusive notion of quality. In the tradi- tional context of marketing manufactured goods, quality is typically objectively measured utilizing standard quality assessment methods and by assessing product defect rates on the production line. However, in the context of financial services, the notion of quality is a highly subjective phenomenon. For example, while the objective quality of an insurance company might be reflected by the willingness of the company to pay out customer claims, this measure is rarely known by the average customer. In the insurance business, the majority of policyholders do not utilize their policy benefits since the events being insured typically have low probabilities of occurrence. As a result, most policyholders never experience the process of filing a claim, and for those that do, the outcome of their experience may not be captured or recorded anywhere for others to examine and learn from.

The net effect is that the most objective aspect of the quality of an insurance company, which is the protection it offers its policyholders in case of losses, may never be determined by the majority of consumers. Quality assessments in such a context are therefore not objective and largely based on subjective factors such as the customer's recognition of the name of the company or suggestions and advice provided by friends or insurance brokers. Similarly, in the context of securities brokerage services, customers may not necessarily be able to determine whether the broker is providing them with the most objective and informed advice. The objective quality of a broker-recommended investment portfolio may not be evident for many years until the securities within that portfolio have exhibited their long- term characteristics. A similar issue can be identified in the context of tax

ISSN-2230-7540

returns. While a tax accountant's ability to secure the highest tax refund is probably the most objective aspect of quality, a client may never be certain of having received the highest possible refund. Such an inquiry would require one to file taxes with multiple accountants as a means of "testing," which is a highly impractical exercise. In all these contexts, despite the important role that the financial services provider plays in securing the financial well-being of the customer, quality assessments by the customer may be driven by highly subjective aspects of the service experience such as the friendliness of the service providers or perceptions of the level of expertise portrayed in the service process. This topic will be extensively discussed in Chapters 2 and 3 where the consumer's decision process in financial services is examined. In addition, which focus on financial service quality will shed additional light on the topic.

Price Complexity: The prices of financial services are intrinsically complex. For example, the lease price of an automobile might consist of monthly payments, the number of payments and a down payment, rather than the single sticker price used when purchasing the vehicle with cash.

Often the price consists of multiple numbers, some of which the consumer may not even completely understand. This not only makes the task of under- standing the various prices available in the marketplace difficult for the consumer, but it also creates scenarios that may lead to deceptive and, in some cases, unethical practices by marketers.

Regulations: The practice of marketing financial services is distinctly different from other marketing practices due to the dozens of regulations that rule the industry. For example, the type of content included in a financial service advertisement is controlled and closely monitored by regulatory bodies, such as the Securities and Exchange Commission, the Federal Trade Commission, and the departments of insurance in individual states. In Chapter 10, we will therefore provide an overview of regulations which influence the vari- ous aspects of marketing financial services.

Market Clustering: One of the other unique aspects of financial services marketing is the fact that consumers' needs for financial services vary significantly from one customer to the other. As a

ISSN-2230-7540

result, the types of services that a financial services organization introduces to the marketplace may be best suited for specific groups of consumers rather than for the mass markets. Recognizing and identifying individuals that a particular financial service is best suited for is the task of the financial services marketer. Therefore, it is important to not only understand the underlying technology that is used for segmenting and grouping customers based on their needs (Chapter 8), but also to have an accurate understanding of consumer segments that are most relevant to a given financial service. This is especially true in light of the abundance of customer data available for segmentation analysis. For example, most financially active individuals in the United States have credit history records that can be purchased and used as the basis for understanding each person's credit behavior and financial needs. Financial institutions also possess large amounts of transaction-based data on their existing customers that can be effectively used to target them with relevant financial services.

Consumer Protection: Any informed discussion of financial services marketing must also include issues related to consumer protection and conflicts of interest, which have historically characterized the industry. The human inability to make rational financial decisions has fascinated researchers in psychology, economics, finance and marketing for decades. Consumers can often make catastrophic decisions related to financial services. Research in psychology has for example established an array of human judgment errors that are persistent and highly influential in consumers' financial decisions (Chapters 2 and 3). It appears that the human brain is simply not hardwired to respond rationally to financial stimuli. This issue is further complicated by the fact that most financial service offers are so complex that by making minor changes in the presentation of the offer, one could make many otherwise unattractive products look highly attractive. This can be a highly problematic concern from both an ethical and regulatory perspective.

PRICING

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Pricing is one of the most important decisions in the marketing of financial services. Price serves multiple roles for the financial services organization as well as for the individuals who use those services. To the financial services organization, price represents the sole source of revenues. Most activities that an organization undertakes represent costs and an outflow of funds. When advertising, for example, one has to spend money purchasing advertising space in a newspaper or media time on radio or TV. When employing staff in a sales department salaries and benefits need to be paid. All of these activities represent an outflow of funds, and the only way to recover these expenditures is through revenues obtained by charging prices for the financial services provided. It is critical not only to appreciate the importance of price, but also to be certain that one's prices are at optimal levels. Pricing too low or too high can have detrimental effects on profitability of financial services organizations.

In addition, price is the most visible component of the marketing strategy of a financial services organization. Unlike advertising style, product strategy, or sales force incentives, which might be difficult to quantify precisely, price is always presented numerically, and can be observed and compared by consumers, regulators, and competitors. Therefore, a second function of price is to communicate to the marketplace the identity, market positioning, and intentions of a financial services organization. Lowering of prices or an upward movement of premiums might signal a shift in marketing strategy to competitors and may provoke reactions from them. This fact raises the strategic importance of price and highlights the great impact that price has been found to have in shifting the balance of power among competing financial services providers.

A third function of price is to serve as a signal of quality to customers. As mentioned in earlier chapters, the quality of a financial service may be highly elusive and vague.

Determining whether one insurance policy is better than another or if an investment advisor will provide recommendations that generate high returns on one's investment portfolio, is difficult if not impossible for many.

ISSN-2230-7540

It has been well established in consumer research that in such situations where quality is not clearly evident, consumers tend to rely on price as a proxy for quality. They might therefore assume that higher-priced financial services are of better quality, and the lowering of prices may not necessarily be associated with more positive consumer impressions of the financial service. The potential for this 95 unexpected relationship between price and consumer demand in specific markets further highlights the critical importance of setting prices correctly in financial services.

We will discuss methods for pricing financial services. The complexity of financial services prices and the cost structure of financial services organizations have a great impact on how financial services pricing is practiced. We will discuss the unique aspects of pricing in financial services and how it differs from the practice of pricing in other contexts. We will then discuss common approaches used for pricing specific types of financial services commonly used by consumers. The chapter will conclude with a discussion of strategic and tactical aspects of pricing financial services.

CHALLENGES IN PRICING FINANCIAL SERVICES

Financial services prices are unique in several ways. The unique aspects of price in financial services are important to recognize when developing marketing strategies and analyzing consumers' decision dynamics. Some of these unique aspects are listed below:

Financial Services Prices are often Multi-Dimensional: One of the most notable characteristics of financial services prices is that they are complex and often consist of multiple numeric attributes. For example, an automobile lease is often communicated in terms of the combination of a monthly payment, number of payments, a down payment, the final balloon payment, wear-and-tear penalties, and mileage charges for driving over the allowed number of miles. Therefore, unlike the sticker price for the cash purchase of a car, which is a single number, the lease price consists of many different numbers. As a result, to evaluate an offered lease accurately, the consumer will have to conduct considerable amounts of arithmetic. To calculate the total dollar layout

ISSN-2230-7540

for an automobile lease, for example, the monthly payments and the number of payments have to be multiplied and added to the down payment. The complex numeric nature of financial services prices and the requirement of a minimal number of numeric computations make financial services prices among the most complex items that consumers have to evaluate in their purchase decisions. Research has established that conducting arithmetic tasks associated with the evaluation of a financial service price can be highly stressful, and consumers have a tendency to simplify such tasks by finding mental short-cut strategies that would allow them to avoid carrying out the demanding arithmetic. These simplification strategies, some of which were discussed earlier in Chapter 2, may result in poor consumer decisions.

Elusive Measures of Quality: A second challenge in the pricing of financial services is the elusive and intangible nature of the quality of a financial service. In contrast to manufactured goods, which can be scientifically tested in laboratories and are often rated by well-established third party organizations such as Consumer Reports, J.D. Power and Associates, and the Insurance Institute for Highway Safety, the quality of financial services is far more difficult to determine. Objective levels of service quality as determined for example by the likelihood that a mutual fund will have good returns, the transaction processing accuracy and efficiency of a commercial bank, and the ability of a tax accountant to secure the highest possible tax returns, are difficult to assess. The fact that these measures of quality are difficult if not impossible to quantify often forces consumers to examine other pieces of information, in particular price, as an indicator of service quality.3 Therefore, while a high price may discourage some consumers from purchasing a financial service, it may also serve as a positive signal for others and may increase their desire to use the service.

Economic Forces: The pricing of financial services is further complicated by the fact that the attractiveness of a financial service may be affected by the general economic environment. For example, in order to appreciate the value of an investment option a consumer must compare the expected rate of return with the rates of return experienced in the financial markets. A change in the prime rate or U.S. Treasury rates might make an investment option look more or less attractive to the consumer. As a result, financial services providers need to take relevant economic indicators such as interest rates and stock market returns into account when setting prices for specific financial products and services.

Poor Consumer Price Knowledge: The pricing of financial services needs to take into account the fact that consumer memory for financial services prices is quite weak.

The unexciting and complicated nature of financial services often results in poor recall of the prices of financial services. For example, many consumers have a difficult time remembering the cost of their banking services, such as the monthly maintenance fees for checking account services and ATM transaction charges, or what yearly premiums they are paying for their automobile insurance. As a result, the general level of price knowledge with which consumers interact with financial services providers might be quite limited.

Difficulty in Determining Customer Profitability: An additional challenge presented in the pricing of financial services is that the profitability associated with a given customer may be difficult to assess. This is because a single customer may purchase multiple services from a financial services provider, some of which are highly profit- able and others that represent losses. For example, a bank customer might use the bank's checking and savings account services, which may not be highly profitable to the bank. However, she may also conduct her investment and retirement planning, which are typically higher margin services, at the same bank. Therefore, while certain transactions with this customer may be perceived to be unprofitable, other transactions may compensate for this shortfall making the individual a highly valuable customer to the bank overall.

Indeterminable Costs: Determining the costs associated with a specific financial product or service might be a numerically challenging task given the fact that various elements of a financial services organization contribute to the service experience that is delivered to the customer. The

ISSN-2230-7540

limited ability to pinpoint costs accurately can therefore complicate the task of pricing a financial service.

Conflicts of Interest: The pricing of financial services is further complicated by the significant conflicts of interest that may exist in the selling process. For example, brokers may use different components of price, such as trading fees or commissions earned on the sale of specific financial products, as the means for their earnings. Therefore, the link between price and the incentive mechanism used to compensate the broker might influence the types of products that the broker would be inclined to recommend to the client. The expected broker behavior would be to recommend products with a price structure that provides her with higher commission earnings. This further complicates the pricing decision by introducing issues of trust and ethics to the already complex pricing process.

COMMON APPROACHES TO PRICING FINANCIAL SERVICES

The general approach to pricing can be visualized as a process of determining where on a continuous line one chooses to set the price charged to customers. The range of these possibilities is shown in Exhibit 4.1 as a spectrum of pricing possibilities. At the one extreme, one could choose to freely provide services to consumers by charging nothing (point A). While such an approach may result in a significant growth in one's customer base, it is typically financially unwise, as it will result in loss of significant amounts of profits. Such a pricing approach is only associated with short-term promotional objectives in which new customer acquisition is the primary objective. For example, an automobile road-side assistance policy might be freely offered to customers for a three-month time period in hopes that some of these customers will decide to continue the service by subscribing to it after the free trial period has ended. Alternatively, one could choose to price a financial service below cost (point B) or at cost (point C).

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These price points may also serve the general objective of new customer acquisition, but may be catastrophic in the long-term due to their harmful impact on profitability.

Furthermore, prices that are below cost often trigger competitors to engage in intensive price competition and may raise the attention of regulators who may consider the prices to be predatory and anti-competitive. This may result in legal actions against the company

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