Tip Sheet

experian

Find your sweet spot in the pricing game

Understanding a customer's price elasticity

In golf, the sweet spot is the area of the clubface the ball should connect with to produce optimal results. Highly skilled golfers not only know where their sweet spot is, but they also consistently hit it and outperform their competitors.

When it comes to pricing, businesses are looking for their own sweet spot with customers. Until recently, finding this prized area was based on risk instead of focusing on profit-based analytics. Now, by reviewing and interpreting available data, lenders can assess tradeoffs and optimize pricing decisions — this helps generate increased takeup rates and profitability — not just reduce risk.

Consumer price elasticity is the degree to which pricing affects purchasing behavior. For your business, it answers this question: What is the maximum amount the customer is willing to pay?

Upgrading your clubs

Technology is great. From lighter materials — like titanium — to balls engineered to soar with the eagles, our golf performance is reaching new heights. It's this new technology that provides previously unattainable advantages.

Similarly, today we have strategy and analytics to help you fully consider each customer's price elasticity and risk. With this holistic customer view, you can avoid overcharging low-risk borrowers and underpricing those who are high-risk. Or, you could say, locate and hit that sweet spot over and over again.

Playing to win

Competitive golfers are serious about their game. When they come to the course, they bring everything they've got. They intend to win. Lenders often don't play to win; they play not to lose.

Optimization maximizes a business goal by considering every combination of actions, understanding the tradeoffs among them and choosing the best set of actions to fit within the business's restrictions.

When lenders offer the same interest rate and terms to every customer for the same loan product, low-risk customers can secure better rates elsewhere and high-risk customers can't. The end result? Only the high-risk customers will select your product, which increases losses and reduces profitability.

For this reason, the lending industry established risk-based pricing. This pricing method addresses the above issue by offering customers with different risk profiles different rates. But the strategy is limited. It's like focusing on not having the highest golf score instead of having the lowest. Like the highly skilled golfer, more advanced lenders consider all available factors, such as the price elasticity of customer demand.

Historically, dynamic pricing of models for consumer financial products has been especially difficult. Lenders must consider these challenges:

- A complex regulatory environment
- Fair lending concerns
- The potential for adverse selection by risky consumers and fraudster
- The direct impact a loan's affordability may have on both the consumer's ability to pay it and the likelihood it will be repaid

Resolving these concerns is challenging but not impossible.

Lenders that have implemented our pricing optimization solution have increased profitability by 33% to 100% while reducing bad rates by 8% to 18%.

Find your sweet spot

How a business prices its products is a dynamic process that drives customer satisfaction and loyalty, as well as business success. In the digital age, pricing is becoming even more complex. For example, companies like Amazon may revise the price of a hot item several times a day.

Since customers have different needs and risk profiles, they react to a loan offer in different ways. Many factors determine a customer's propensity to accept an offer — the competitive environment and availability of other lenders, how time-critical the decision is and the loan terms. Understanding a customer's price elasticity allows your business to offer the ideal price to each customer to maximize profitability.

Personal loans grew to $273 billion at the end of Q2 2018, an 11.4% increase over the previous year and the largest outstanding balance in more than a decade. Are you taking advantage of these market conditions?

Pricing optimization is the superior method of finding your lending sweet spot. It applies a scientific, data-driven approach to predicting how different customers will respond to different prices. This allows you to determine the best offer for each customer to meet your business objectives while adhering to financial and operational constraints such as volume, margin and credit risk.

You can assess tradeoffs between competing objectives, such as maximizing revenue and optimizing volume, and determine the best decision for each customer to best meet both objectives.

Sorry. No mulligans.

Competition and demand for your limited resources are increasing in today's marketplace. Using clubs from 1989 just won't cut it when competing today. An effective loan pricing optimization strategy requires robust analytics, proven software and industry expertise to help you tie it all together.

As you contemplate upgrading your strategies, consider these advantages of price optimization:

- **Profitable growth** — Increase loan volumes and ROI while controlling risk.
- **Competitive edge** — Compete more effectively with lenders that use only risk-based pricing.
- **Improved customer experience** — When you understand your customers better, you can offer more relevant and personalized pricing.
- **Smarter decisioning** — Use data at a more granular level and based on an individual's specific characteristics, not on a group of customers within a segment.
- **Flexibility** — Dynamically respond to different economic, operational and competitive environments.
- **Efficiency** — Decrease manual effort needed for rate reviews and price exceptions.
- **Compliance** — Reduce the fair lending risk inherent in manual price exceptions and comply with state and federal regulations.

Optimized pricing can't guarantee you a hole in one, but it can help improve your game. By optimizing your pricing through predictive analytics, such as risk and price elasticity — along with industry consulting — you can better design

Do you know where your pricing sweet spot is?

Let's talk.

Experian
475 Anton Blvd.
Costa Mesa, CA 92626
T: 1 888 414 1120
www.experian.com

© 2016 Experian Information Solutions, Inc. • All rights reserved
Experian and the Experian marks used herein are trademarks or registered trademarks of Experian Information Solutions, Inc.Other product and company names mentioned herein are the property of their respective owners.
xx/16 • [xxxx/xxxx • xxxx-CS]