



# Informed Loan Pricing Decisions



## Introduction

Right pricing benefits both the customer as well as the bank. Analytically derived loan pricing offers a competitive and attractive rate to customers, consequently ensuring steady increase in portfolio volume through addition of good customers. Whilst, identifying sources of profitability (and losses) for loan issuers.

In the face of shrinking profit margins informed pricing is an important lever for profitability and a key ingredient for design of incentive schemes/offerings.

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## Segmenting Loan Product Portfolio Individually

Each loan product portfolio is unique and requires individual attention. Pricing decisions formulated at loan product level prove to more robust than those developed for the entire customer portfolio irrespective of the loan products held.

To develop customized pricing strategies it is important to segment the loan product portfolio into manageable fractions. Such customer segments allow swift development of pricing strategies as well as their implementation.

Defining right pricing segments involves choosing the right segmentation schema for each product portfolio. These segmentation schemas can be demographic, risk based, value based or profit based etc based on business vision for the product. Demographic segmentation can be done on dimensions like salaried/non-salaried. It can also go in-depth by segmenting customers into sub categories of a dimension salaried like self employed, business category 1, business category 2 etc.

This cross of products and segmentation schema provides actionable insights into the portfolio.

## Loan Pricing

The interest rate for the loan is a function of diverse factors ranging from domains of cost, risk and market.

For each cell, pricing simulations are done base on factors like, cost of funds, delinquency and recoverable, tenure, target yield for next year, competitive benchmark etc.

A pricing decision can be arrived at through running optimal number of simulations.

## Implementation Framework

Once the profitable interest rate for the loans is predicted it is further fine tuned during implementation through test and learn framework for best results.

Champion-challenger interest rate campaigns are designed using design of experiments. Here the predicted interest rate is deemed the champion and the next most likely to be profitable interest rate is called the challenger. These two interest rates are rolled out simultaneously. Depending upon the campaign results either the previously predicted champion still remains the champion or the previous challenger becomes the new champion and the process repeats.



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### Making Loan Product Price More Attractive

Other factors to be considered while developing a holistic pricing mechanism are:-

➤ **Relationship Pricing**

It requires understanding the needs of a customer and evaluating the value of potential customer-issuer relationship. It is often used to offer a slightly better rate to customers that have a substantial business relationship with the issuer. This is often a price improvement offered on top of the otherwise computed rate using risk based pricing.

For example:-

- Provide incentive to the customer to buy more products by reducing the APR with every purchase.
- Structure the loan along with other products and services and price this package at a reduced rate.

This methodology requires prediction of the customer acceptance likelihood of the range of products available to be bundled. Identification of the price threshold which ensures customer acceptance as well as maximum realizable profit is vital for success of relationship pricing. When coupled with accurate estimates of customer's lifetime value this approach leads to a long term and highly profitable customer-issuer relationship.

➤ **Regional Pricing**

- Customize loan prices for different regions based on market research

## The Adventivity Advantage

Adventivity is an end-2-end service provider converting your thoughts into reality by combining – research, analytics, processes and operations. We specialize in predictive analytics, database management and decision support solutions.

Adventivity offers targeted and seamless services and solutions for credit card space. We possess the capability to implement the retention and renewal strategies through running single/multi wave campaigns.

Building upon a foundation of people, processes and technology, Adventivity can manage the complete design, global delivery and deployment of analytical solutions

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