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Price to win under interest-rate liberalization at China's banks

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The central bank has eased interest-rate regulations. To take advantage of the change, institutions must adopt smarter pricing strategies.

With a single regulatory change in 2015, the People's Bank of China put pricing at the forefront of strategic concerns for the country's financial sector. Traditional profit and revenue models were threatened as the central bank took one of the final steps in reforming interest rates—eliminating the ceiling on interest rates for deposits—and opened up the industry to more intense competition based on price. The People's Bank itself called this step the riskiest move in the whole reform effort.

Under China's previous regulatory regime, banks generally neglected pricing capabilities and strategies. Small and midsize institutions usually based interest rates mechanically on bands published by the central bank or on the rates offered by China's largest state-owned banks. The way institutions respond to a liberalized pricing environment will play a significant role in their growth prospects, especially in light of the industry's other disruptions, such as slower macroeconomic growth and higher levels of nonperforming loans.

Banks that adapt to the new regime quickly and decisively could capture huge benefits: for example, McKinsey analysis suggests that revenues could increase by 6 to 15 percent under modern pricing strategies (exhibit). Much of this improvement would come from better lending practices and the optimization of fees; benefits would accrue as well from reducing price leakages and adjusting deposit list prices. Modern pricing strategies can also create closer relationships with core customers—a critical advantage in a more competitive environment—and improve performance throughout the organization.

But adapting to greater interest-rate competition will not be easy for most of China's banks, which carry significant burdens from their legacy business models. Pricing traditionally has been a perfunctory, isolated activity, and most banks in the country have very little experience using it in their overall business strategies—for instance, by offering targeted discounts to support business-acquisition goals. Ambitious banks must quickly build capabilities in critical areas, such as governance, pricing models, and tracking the performance of individuals and the organization as a whole. In addition, they will have to invest in an appropriate IT infrastructure and the skills to power the new pricing strategy and deliver its full range of benefits.

Exhibit

A pricing transformation in the Chinese banking sector could lift revenues by 6 to 15 percent.

Potential contribution to banking revenues, %



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The transformation must be carefully planned to avoid as much disruption to ongoing business as possible, even as sophisticated practices and approaches replace more traditional ones. It will be necessary to cover the full range of banking: deposits, lending, and fee-based businesses. The transformation must move the overall business model to a customer-centric one that addresses the needs of individual customers and gives them seamless value. Governance systems and IT infrastructures have to be modernized. Finally, to generate enthusiasm and momentum for change, banks should design initiatives to deliver quick wins and stop price leakages as soon as possible.

Just as important, a pricing transformation requires patience. Experience shows that a program often requires 18 to 24 months as it moves from design through pilots and then to full implementation. Each of these stages must be planned carefully, but tensions along the way are inevitable and should be anticipated. Often, banks must push their management capabilities higher to accommodate a more modern pricing system. Frontline relationship managers may resist change, especially if they don't understand its benefits clearly. Fatigue can set in among even the most enthusiastic teams. Organizations can combat these and other common implementation challenges by clearly communicating the need for and advantages of the program, showing obvious high-level support, and demonstrating success at each stage.

Disruptions are creating severe challenges for China's banks, which must fight to safeguard their revenues and profits in a starkly different landscape. In the new regulatory regime, pricing strategy will take center stage in a much more competitive industry. Additional factors, such as slower macroeconomic growth and a higher level of nonperforming loans, are pressuring banks to abandon their traditional approaches and adopt more modern ones.

To survive—and indeed thrive—in the changed market, banks must fix many aspects of their organization and practices. These changes will affect all banks in China but strengthen only those that respond to them actively. [□](#)

[Download the full report on which this article is based, *Price to win: Create value through smarter pricing in a competitive interest rate environment*, on McKinsey.com.](#)

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