

Understanding Credit Card Profitability



“Outstanding professional experience in the area of banking and payment systems”

The European Commission

rbr

TABLE OF CONTENTS

ACKNOWLEDGEMENTS	I
About the author: David J Cavell FCIB	I
About the publisher: RBR	I
Confidentiality	I
Disclaimer	I
TABLE OF CONTENTS	3
TABLE OF FIGURES	8
EXECUTIVE SUMMARY	9
Section A: The case studies	9
Section B: Marketing and Marques	9
Section C: Credit risk management	10
Section D: Operational overview	11
Section E: Credit card profitability	12
Conclusions	12
INTRODUCTION	14
Objectives	14
Why credit cards?	14
Four (and three) party payment systems	15
Card issuing business models	16
Co-branded schemes	16
Affinity schemes	17
Private label schemes	18
Conclusions	19
SECTION A: CASE STUDIES	21
1. American Express (Amex), USA	23
1.1 Background	23
1.2 Strategic diversification	23
1.3 The small business sector	24
1.4 Conclusions	25
2. Australia & New Zealand Banking Group (ANZ), Australia	27
2.1 Background	27
2.2 Consumer credit cards	27
2.3 Small business credit cards	29
2.4 Conclusions	29
3. Chase Bank (JPMorgan Chase Group), USA	31
3.1 Background	31
3.2 The Chase credit card business	31
3.3 Consumer products	32

3.4	Small business products	32
3.5	The Ultimate Rewards programme	33
3.6	Conclusions	34
4.	Dubai Islamic Bank (DIB), UAE	35
4.1	Background	35
4.2	Strategic repositioning	35
4.3	Committing to the Islamic credit card	35
4.4	The DIB Islamic credit card portfolio	36
4.5	Conclusions	37
5.	MBNA, UK (Bank of America Group)	39
5.1	Background	39
5.2	MBNA	39
5.3	The affinity proposition	40
5.4	Conclusions	42
6.	UniCredit Bulbank, Bulgaria	43
6.1	Background	43
6.2	Retail banking and the women's sector	43
6.3	The 'Donna' concept	44
6.4	The Donna classic Visa credit card	45
6.5	Conclusions	46
7.	Vanquis Bank, UK	49
7.1	Background	49
7.2	The target segments	49
7.3	The product	50
7.4	Conclusions	51
8.	Wells Fargo and Company, USA	53
8.1	Background	53
8.2	The consumer card products	54
8.3	The business credit card products	55
8.4	Other consumer and business card issues	57
8.5	Conclusions	58

SECTION B: MARKETING AND MARQUES 59

9.	The credit card portfolio	61
9.1	The consumer credit card portfolio	61
9.2	The 'electronic' or online credit card	61
9.3	The standard card	61
9.4	The Gold card	61
9.5	The Platinum card	62
9.6	The exclusive credit card	62
9.7	The private label credit card	62
9.8	The SME credit card portfolio	63
10.	Product development issues	65
10.1	Key drivers of customer take-up	66
10.2	New card concepts	67
10.3	Core card features	68

11. The product launch project	71
11.1 Product validation	71
11.2 Customising the package	71
11.3 Card design and production principles	72
11.4 Going to market	74
11.5 Conclusions	74
12. MasterCard Europe	75
12.1 Background	75
12.2 MasterCard and the small business sector	76
12.3 Understanding the SME sector	77
12.4 Segmenting the market	77
12.5 The new card proposition	78
12.6 Go to market	79
12.7 Staff and channels	80
12.8 Conclusions	81
13. Visa Europe	83
13.1 Background	83
13.2 The credit card products	84
13.3 The 'Classic' card:	84
13.4 The 'Gold' card:	84
13.5 The 'Platinum' card:	85
13.6 The 'Infinite' and 'Signature' cards:	85
13.7 Other issues	86
13.8 Conclusions	86
SECTION C: CREDIT RISK STRATEGY	89
14. The credit strategy function	91
14.1 The scope of scoring	91
14.2 Application scoring and related techniques	92
14.3 Limit management	94
14.4 Authorisations	95
14.5 Collections strategies	96
14.6 Scorecard monitoring and strategy analysis	98
14.7 Provisioning	99
14.8 Infrastructure requirements for credit strategy	99
14.9 Conclusions	100
15. Scoring and analytics for consumer cards	103
15.1 Background	103
15.2 Identifying and evaluating prospects and customers	103
15.3 Managing ongoing relationships	104
15.4 Fighting fraud	106
15.5 Conclusions	108
16. Risk management for the SME sector	109
16.1 Background	109
16.2 Defining SMEs	109
16.3 The use of scoring	109
16.4 Credit reference agency data	110
16.5 Summary	113

17. Advanta, USA	115
17.1 SMEs and the credit cycle	115
17.2 Introducing Advanta	115
17.3 Business development	116
17.4 2006 – the turning point!	118
17.5 Risk management strategy	118
17.6 Conclusions	119
18. Critical management functions	121
18.1 The steering committee	121
18.2 The programme manager	122
18.3 Conclusions	124
SECTION D: OPERATIONAL OVERVIEW	125
19. Risk management operations	127
19.1 Application processing	127
19.2 Authorisations	128
19.3 The collections function	129
19.4 Fraud administration	131
20. Other operational areas	135
20.1 Background	135
20.2 The customer service function	135
20.3 The customer dialogue	136
20.4 Managing the call centre	137
20.5 The payment systems organisation (PSO) – ongoing relationships	138
20.6 Operational accounting	138
20.7 Mailing and plastic card production	139
20.8 Premises issues	141
20.9 Contingency planning!	142
21. Outsourcing – the rationale	143
21.1 Comprehensive capabilities	143
21.2 Third party processing – who is using it?	144
21.3 Why use a service provider?	148
21.4 Conclusions	149
22. The outsourcing partnership	151
22.1 Defining the service requirements	151
22.2 Contracts and service level agreements	153
22.3 Getting started	155
22.4 Managing the service provider	157
22.5 Conclusions	158
23. External debt collection agents	159
23.1 Background	159
23.2 Collection operations	160
23.3 Engaging with the debtor	162
23.4 The cost of collection	163
23.5 Conclusions	163

SECTION E: CREDIT CARD PROFITABILITY	165
24. Account base development	167
24.1 Applications received	167
24.2 Decline rate	167
24.3 Accounts opened and closed	168
24.4 Total number of accounts (year end and average)	169
24.5 Active accounts	169
24.6 Key metrics	170
25. Income from lending and other sources	170
2.1 Aggregate outstandings	170
2.2 Percentage of balances revolving (earning interest)	171
25.3 Yield, funding cost and net margin	172
25.4 Income from sales turnover	172
25.5 Cash advance income	173
25.6 Creditor protection insurance income	173
25.7 Card fees	173
25.8 Other income	174
26. The cost base	175
26.1 Background	175
26.2 Marketing costs	175
26.3 Operating costs – in-house and outsourced	176
26.4 The payment systems organisations (PSO)	177
26.5 Other business costs	178
26.6 Bad debt and fraud costs	178
26.7 The bottom line	179
CONCLUSIONS	181
Credit cards for all	181
Credit risk management and operations	181
Profitability	182
APPENDIX: CONTRIBUTORS	184

TABLE OF FIGURES

Figure 1: Reward points by product and scheme (Amex and Visa)	28
Figure 2: Qantas points by product and scheme (Amex and Visa)	28
Figure 3: Dubai Islamic Bank card rewards	37
Figure 4: The dedicated Donna branch in Sofia, and its attractively restyled interior.	44
Figure 5: The new Donna logo, developed in-house.....	45
Figure 6: The EU's SME Enterprise Definitions	109
Figure 7: Advanta corporate and business credit cards	117
Figure 8: Percentage of receivables and their FICO score at origination	119
Figure 9: Breakdown of TSYS accounts by type (end-2013)	147
Figure 10: Debt collection agent tranche analysis	161
Figure 11: Time to first payment analysis	161
Figure 12: Pro forma profit and loss account.....	166