



enhance

In association with Priority Collection

for people involved in payment card marketing and product development

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Issue Two, September 2006

In The News

What's the 400lb gorilla in the card issuer board room?

It goes by the clumsy name of alternative payment media: more simply, it's the fast-growing tendency for customers to make electronic financial transactions which side-step payment cards.

Are we seeing the beginning of a second revolution in payment processing? Just as customers started to use cards because they were so much more convenient than cheques or cash, could alternative payment media pose a similar threat to plastic? Early signs are that it's possible.

Consider some facts. Let's look first of all at PayPal:



- At the end of Q2 2006, PayPal had 113.7 million accounts, a 44% increase from one year ago.
- Total payment volume rose 37% to a record \$8.9 billion.
- During the quarter, PayPal handled 143.3 million payments, up 27% from 1Q/05. ¹
- In April, the company launched a mobile payment service.
- In May, a turnkey loyalty programme for merchants was added.
- The future? PayPal's management team said in May that Merchant Services remains its strategic priority for this year: the company is expanding its focus from sole proprietors and small and mid-sized businesses to include large merchants. ²

Are PayPal alone in their ambitions? Not at all.



Here's what the official Google blog says: "Looking ahead, we want to continue building payment services that meet the needs of Google users and advertisers. We expect to add payment functionality to Google services where our users need a way to buy online. For us, it's all about bringing our users a better online experience whether they're searching or buying." ³

Of course, it's easy to dismiss these new competitors as being Internet-only. But take into account the hugely accelerating proportion of retail sales which go through the web rather than the High Street, and suddenly the Internet limitation doesn't look so confining. And listen to PayPal again: in their May statement, executives also said they plan to expand the company's reach beyond online payments into areas such as financial products, including "PayPal Credit."

New players are coming in from other directions, too. Contactless technology is rapidly gaining traction: research suggests that manufacturers will ship over 40 million contactless cards, mini-cards, and fobs globally in 2006, compared with some 10 million contactless payment cards last year. The point to note is that this powerful and versatile new technology is by no means limited to cards: in fact, by 2010, ABI Research predicts that more than 50% of cellular handsets, or about 500 million units, will incorporate near-field capabilities that will be used not only for payments at points of sale and remotely, but also to access information from smart objects. ⁴

Think it's too far away to worry about? Think again – it's happening today. One of the largest issuers in Taiwan is offering wristwatches featuring MasterCard PayPass technology on an embedded chip: Chinatrust Commercial Bank is the first bank in the world to offer contactless payment capabilities in a watch. ⁵

Let's sum up: card issuers can no longer afford the comfortable assumption that their product is unassailable. In an

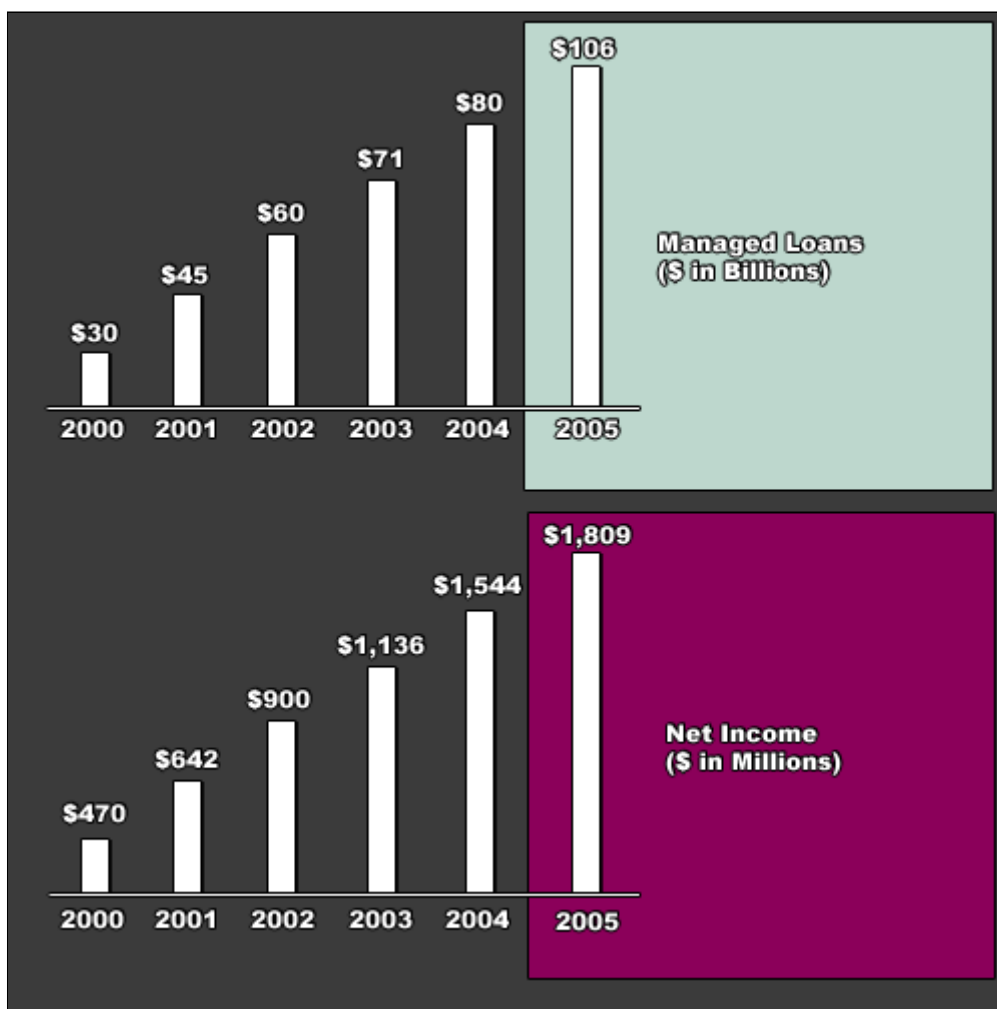
electronic age, agile new technologies are emerging which have serious potential to damage the reign of the card. The lesson? Still more pressure on issuers to identify and retain their best customers.



"The philosophy of using intelligence to drive marketing is still the gold standard."

The Power of Data-Driven Marketing: Using information to build profitability

The charts below tell a story of huge success: in five years, this issuer's managed loans have more than tripled, and net income more than quadrupled. It's a performance record that any business would envy, let alone a card issuer operating in a fiercely competitive, supposedly saturated market.



Source: Capital One

Capital One | what's in your wallet?*

The business? Capital One. Their secret? Well, let them tell the story: "Capital One's success is powered by our unique information-based strategy. Using scientific testing on a massive scale, we gather huge amounts of information to help us tailor products and services to the individual consumer, rather than simply offering one product to broad socio-economic groups. We don't believe that 'one size fits all.'"

The history is fascinating: in the late 1980s, two consultants are convinced that the future of marketing lies in using

data intelligently. Rejected by banks across the US when they try to sell their ideas, they eventually find a taker in a small regional institution in Virginia. Repeated experiments in acquisition mailings fail, time is running out on them, when suddenly there comes a Eureka moment: a campaign featuring low introductory APRs on transferred card balances is a winner. The business is transformed – and so is the industry.

That philosophy – of using intelligence rather than guesswork to drive marketing – is still the gold standard. It lies behind the Champion and Challenger protocol for communications, it exploits multivariate analysis to assess complex product offerings, it powers sophisticated prospect targeting. Properly deployed, it affects every facet of the business:

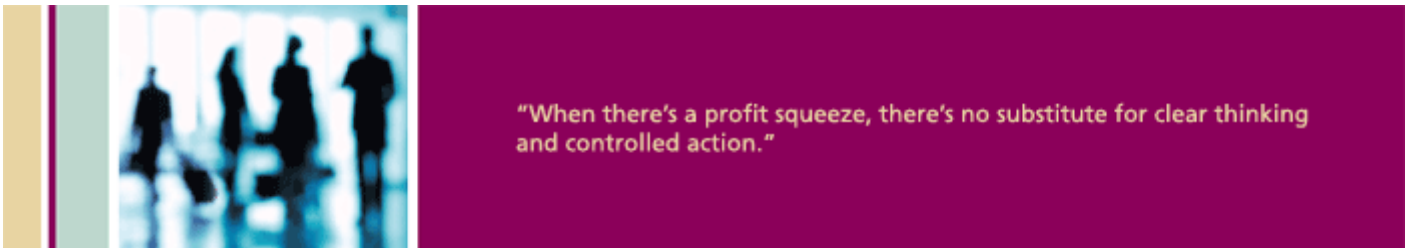
THE CHANGING APPROACH TO FINANCIAL SERVICES MARKETING

	Traditional	Information-led
Products	One size fits all	Targetted, segmented
Organisation	Hierarchical	Modelling and analysis-led
Objective	One product at a time	Maximise cross sell
Management policy	Cautious – driven by risk reduction, not opportunity	Profitability driven, based on flexible pricing
Customer relationship	Static: defined by product held today	Dynamic: defined by potential product holding and profitability
Testing discipline	Minimal	Iterative, continuous testing
Measures	Maximise market share	Maximise Net Present Value at account level
Tracking & analysis	Product level	Test cell level

Source: Adapted from Slawsky and Hall, "European Card Review"

The impact of data-driven marketing ranges from the micro – the valuable finding that simply adding a recipient's name to a communication increases response rates by 44%⁶ - right through to the macro: one of the reasons HSBC bought Household Finance was to tap into the latter's data analytics skills for both marketing and credit control.⁷

Let's go back to Capital One for the final proof of the power of data: one customer offer in one quarter generated \$3 billion of new business.⁸



Maximise The Returns From Your Marketing Budget: What effective card marketing programmes all have in common

It's likely that many card marketers will look back on the industry a few years ago as The Golden Age.

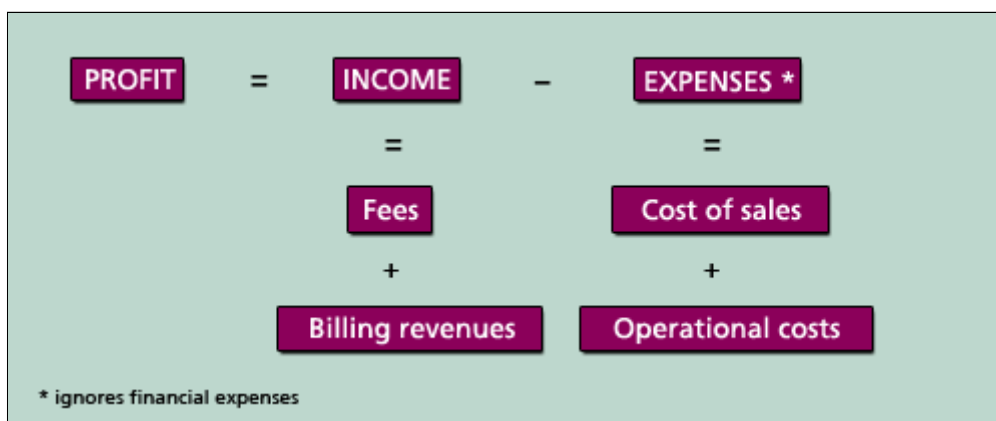
Creditworthy customers scrambled to get cards, revenues burgeoned, charge-offs were low, and budgets were generous. What a change from today, where incomes are being slashed, costs are under huge pressure, and profitability is sagging.



But when the going gets tough, the toughest marketers get going. Today's best-in-class card managers are focussing relentlessly on three key questions:

- How do I cut my acquisition costs?
- How do I find my most profitable customers – and keep them?
- How can I increase spend to compensate for falling fees and interchange?

To strengthen profit performance, it's helpful to remind ourselves of the main streams of income and expenses. For a credit card, they look something like this:



The check list which follows breaks out these streams – fees, billing revenues, cost of sales and operational costs – into their main elements, identifies the key drivers for each element, and proposes practical strategies to improve performance on every one of them:

CHECK LIST FOR BUILDING CARD PROFITABILITY

INCOME	Component	Key drivers	Goal	Strategy suggestions
Fees	Annual	Fee level	Maximise pricing level	Monitor competition charges Understand cost base
		# of plastics	Maximise sales	Careful list selection Train branches in prospecting and selling Establish "Champion and Challenger" DM strategy Consider Balance Transfer offers Consider APR offers Consider annual fee waiver Maximise # of additional cards
		Renewals	Minimise attrition A: Voluntary attrition	Monitor monthly Identify precursor behaviours and mail

accordingly
 Consider profitability-related pricing
 Create Retention Strategy
 Create Welcome Back offers for profitable attritors
 Evaluate line of credit strategy*
 Feedback into list selection criteria

Additional services	# of services offered	B: Involuntary attrition Maximise take up
	Fee level	Maximise pricing level
	Renewals	Minimise non-renewals
ATM	Availability to CHs	Maximise # of authorised CHs
	# of transactions	
FX	Charging regime	Affected by Euro billing
	# of transactions	Maximise number
Interest*		Maximise APR
		Maximise interest bearing balances
Late Payment*		Optimise income
Overlimit*		

Billing

Billing volume	# of transactions	Maximise number
	Average transaction value	Maximise value
	Interchange %	Maximise average level

Offer insurance protection
 Build share of wallet
 Encourage recurring payments
 Manage credit lines pro-actively
 Promote high value T&E and business purchase usage
 Stimulate use in restaurants, hotels, high value retail, etc.

EXPENSES

Cost of sales

Component	Key drivers	Goal
Cost per approved card	# of applications	Maximise number
	Approval rate	Maximise in light of risk

Strategy suggestions
 Careful prospect targeting
 Establish Champion and Challenger DM strategy
 Train branches and manage performance
 Evaluate channel performance and allocate resource accordingly
 Feed portfolio performance back into list selection
 Review score card performance regularly
 Incentivise electronic MIS, billing and

Operational

costs**payment****Notes**

* These aspects must be developed in consultation with Risk Management
Ignores financial costs - funding, debt management, and fraud

Source: Marketing Planning for Financial Services, Roy Stephenson, Gower, 2005

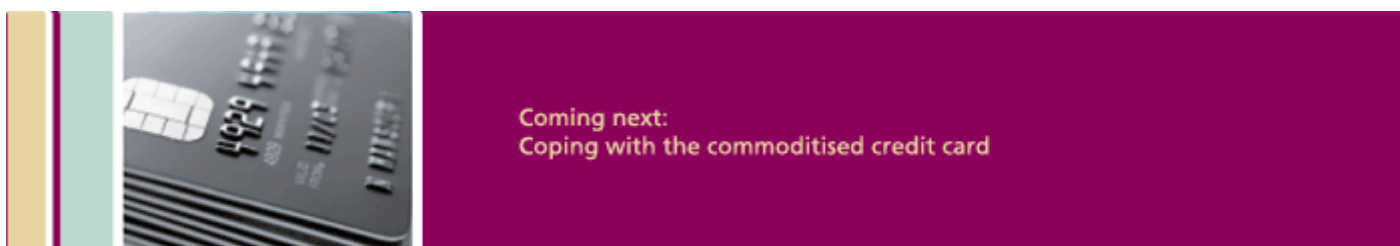
Let's take a couple of examples of how this might work out in practice: leaders in anti-attribution strategies know that customers are much less likely to defect if their card gives them access to services which they see as valuable, or a nuisance to change. Valued services might include privileges at golf clubs, preferred access to airport lounges, or competitive rates on travel insurance. Services that would take time and effort to change might include recurring payments such as internet or magazine subscriptions. (It's worth noting that, as well as increasing product "stickiness", many of these features also make a useful contribution to account spend levels.)

Data-driven issuers have gone a step further than across-the-board offers: they've analysed past defector behaviour to predict accounts at risk in the future. For credit cards, one powerful example of precursor behaviour is paydown of balances owed without corresponding purchase debits. Profitable customers exhibiting these patterns are contacted with offers directly related to a resumption of activity ("Keep your account balance over £1000 for 12 months, and win this MP3 player") or simply a Thank You on an account anniversary or client birthday. One Brazilian bank sends its most valuable customers a gift with a personally signed letter from the Division President on their birthdays. Other issuers organise special shopping nights at favoured stores, or tickets to special concerts and sporting events.

If all these efforts fail, win-back programmes target the most valuable defectors.

What is the common factor? Focus and discipline: focus to determine where the priorities lie, and discipline to implement strategies, measure performance, adjust, and execute again. When there's a profit squeeze, there's no substitute for clear thinking and controlled action.

1. www.carddata.com, 2. <http://www.cardweb.com/cardflash/2006/may/5e.xcml>, 3. http://googleblog.blogspot.com/2006/02/update-on-payments_24.html, 4. <http://www.cardweb.com/cardflash/2006/may/24c.xcml>, 5. The Nilson Report, 6 August 2006, and MasterCard International, 6. Rochester Institute of Technology, 7. Wall Street Journal, 23 October 2005, 8. http://customer.corante.com/archives/2004/03/30/capital_ones_80000_tests.php



Message From The Editor

Around the world, the payment card industry is facing unprecedented competitive and regulatory challenges. Now as never before managers need to find marketing responses that are innovative and effective. Enhance is Priority Collection's contribution to the debate: every two months, we'll share our global experience and success with card marketers everywhere.

In the first issue of Enhance we covered:

Your best customers: How to find and influence them

The search for the Holy Grail: How do I make more profit from the customers I already have?

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Roy Stephenson, Consulting Editor

Consulting editor bio note

Roy Stephenson, a former VP and General Manager with American Express, is a banking and payment card

consultant and a member of the MasterCard Advisors pool. He is the author of Marketing Planning for Financial Services (Gower Publishing).

Please contact me, Roy Stephenson, Editor at roy.stephenson@prioritycollection.com

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comes out first.



email:enquiries@prioritycollection.com tel:+44 (0)20 8253 5086 www.prioritycollection.com