



for people involved in payment card marketing and product development

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Issue Eight, November 2007

In The News

How generous do you want to be?

The UK card industry has been thrown into turmoil by the massive cashback offers now available from some issuers: Abbey and Barclaycard were first off the mark in the current race to offer new customers money for their business, but Capital One has comfortably outstripped all other competitors with a massive 4% on all purchases for the first three months, reverting to 1% thereafter. No caps, no fees, no need to apply for the money – it's credited straight to your account at year end.



Cap One positions the heavily-promoted product as a move into the mass affluent market away from the controversial sub-prime segment. On the other hand, minimum income requirement is a very modest £10,000 annually – though of course there may be a lot of declines through rigorous scoring at the approval stage: applications are invited only from those with an "Excellent" credit history. Interestingly,

Cap One offers a parallel product with higher APR at an £18 annual fee for those with only a "Good" credit rating. But basic arithmetic will tell cute consumers that they only have to spend £1800 at 1% to get their money back: after that, it's all profit.

All in all, industry observers are puzzled to know how the issuer has done its sums: even writing off the 4% offer as an acquisition cost, the ongoing 1% will still be tough to afford.



The world is changing – and banking is changing with it

Consider some statistics:

- In Brazil, between 2000 and 2005 the number of households with annual income of \$5,900-\$22,000 grew by half, from 14.5 million to 22.3 million¹
- In Mexico, the number of households with annual income of \$7,200-\$19,200 has increased from 5.5 million in 1996 to 10.7 million in 2006¹
- In Argentina, the number of households with incomes of \$12,000 (the level to be categorised as middle class) has doubled from 20% in 2003 to 40% in 2007¹

In Latin America as a whole, 15 million households ceased to be poor between 2002-6. If the trend continues, Banco Santander forecasts that by 2010 a small majority in the region will have joined the middle class.

And it's a global development, too: on the other side of the world, the same pattern is emerging. According to McKinsey, India, with an economy growing at 8% pa and a population rising to 1 billion, has the potential to overtake Germany as the world's 5th biggest consumer market by 2025. As part of this take-off to wealth, the middle class will expand from 50 million to 583 million.

So what's the implication for bankers?

First and foremost, it means more money in more people's pockets. That will lead to a move from holding cash to checking/current accounts and, in time, savings products. It will also create more spending, and therefore growing volumes in the payments area. Finally, greater discretionary spending power means that consumers' aspirations grow, and that they're better prospects for loans. For example, in Brazil, credit as a proportion of GDP has risen from 21% in 2002 to 32% today. There's a similar pattern in the growth of new mortgages in Mexico, which are soaring at a rate of 35% a year¹.

That's the opportunity: how should banks respond to it?

Well, let's take a look at a country which has gone through that process of economic take-off. Less than a generation ago, Spain was a business backwater. Now, it's a star of the European economy, with firms among the global leaders in growth industries:

- Telefónica is the world's 5th biggest telecoms firm and Europe's largest provider of both fixed and mobile connections
- Banco Santander is the biggest bank in the Euro zone by market capitalisation, and the leader in Latin

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There are huge prizes out there, if you're fast and flexible enough

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How to stop customers walking out of the door when the interest rate changes

[We have ways of making you pay](#)

Who said that fees were a thing of the past?

America²

And those stellar performances are feeding right through into customers' pay-packets.

How are Spain's bankers responding to this new opportunity? Effectively, they're re-thinking the business. Here's Francisco González, who chairs BBVA, one of Spain's leading banks which has a big operation in Latin America, and also has substantial presence in the US and Asia.

Sr. González says he runs "An industrial financial company" not a bank. "The bank of the future," he believes, "will be a distribution-services company." He argues that the bank will make money from knowledge it gains about customers to sell them products such as health care, education and even funerals. And he's putting that strategy into practice: using the bank's enormous buying power, selected BBVA branches sell houses, cars and health care. Spain's leadership position in customer data management also allows pre-approved clients to withdraw loans direct from a BBVA ATM without ever speaking to a loans officer³.

It certainly isn't banking as we knew it twenty – even ten – years ago.

The picture is of new customers, enjoying their financial empowerment, eager for banking services, qualified for credit, and beginning to understand that they have a choice of provider. How will you make sure that they select your bank to do business with?

¹ *The Economist*, Aug 18, 2007

² *The Economist*, May 5, 2007

³ *The Economist*, June 16, 2007



Is there life beyond balance transfers?

Enhance has often drawn attention to the changing face of credit card economics. Not to prolong the agony, but the deterioration in net interest margins, the squeeze on fees and charges, and the increasing savviness of pick-up-and-go customers have made many issuers' reliance on 0% balance transfers increasingly unrealistic. Question is, what to do with customer segments – and in many cases, whole portfolios – which have been built on the back of beggar-my-neighbour balance transfer offers.

Product managers for these customer groups wince when re-price comes around: they know that expensively-acquired customers, who have been busily paying down transferred balances, will cheerfully move on to the next issuer who offers them a cut price deal. Worst of all, it's not as if these customers are low value: many of them are well-heeled, carry other cards – and use them extensively for purchases and balance building. Too often, the 0% balance transfer card is used only to finance existing balances and for no other purpose. Result? Tenure of these customers may run as low as two years or fewer, during which they are a dead loss to the issuer. How to break out of this trap?

"The main challenge is to change the way the card is used, so as to make it attractive to the customer, not just as a low or zero cost financing tool, but as a valuable payment instrument."

Enter rewards.

Let's take a portfolio of the sort we've just described. The main challenge is to change the way the card is used, so as to make it attractive to the customer, not just as a low or zero cost financing tool, but as a valuable payment instrument. And if you can get the spending habit going, experience suggests that revolved balances will build also. Unfortunately, issuers commonly find that average spend on these cards is very low – but these results will likely be affected by:

- High propensity not to use the card for purchase transactions at all
- Very high dormancy rates after re-price



But closer examination of account performance often suggests that there is a wide variation of behaviours:

- Never purchase
- Go dormant or attrite after re-price
- Low purchase
- Higher purchase

The solution may be to use a rewards solution to provide benefits calibrated to meet the needs of each behaviour

segment. These customers have proven they're financially alert, so rewards which respond to that are likely to be attractive. The table shows some possible options:

Segment	Goal	Constraints	Solution
<ul style="list-style-type: none"> • Never purchase • Go dormant or attrite after re-price 	<ul style="list-style-type: none"> • Motivate spend • Provide reason for use after re-price 	No/low spend means that awards have to be low value/easily attained	<p>Earn reward points</p> <p>Bonus points for:</p> <ul style="list-style-type: none"> • First use • Qualifying spend (possibly with threshold) • Recurring payments <p>Burn reward points</p> <ul style="list-style-type: none"> • Prepaid gift cards • Mobile minutes • Downloads (ring tones, music...)
Low purchase	Increase stickiness		<p>Lottery/sweepstakes against purchase transactions</p> <p>Earn reward points</p> <ul style="list-style-type: none"> • As above, but also spend related • Tiered spend/points levels
Higher purchase	<ul style="list-style-type: none"> • Cut attrition • Build spend (and balances as a result) 	Need to build share of wallet	<p>Burn reward points</p> <ul style="list-style-type: none"> • Lifestyle • Experiences • Travel • "Choose your own" • Green options

So, returning to the question in the headline – Is there life beyond balance transfers? Yes, there is: and it doesn't need a miracle to create it.



We have ways of making you pay

Since the Office of Fair Trading's 2006 ruling on card charges, UK issuers have increased numerous charges for card usage, according to UK consumer association Which? It says that since the lowering of default fees, there have been ten changes to the way that card issuers implement charges, including the introduction of low use fees.

1. Annual fees – some cards charge up to £24 a year
2. Low use fees – customers who don't regularly use their card may be charged penalties of up to £35
3. Balance transfer fees – the cost of switching a balance is rising, from a typical 2 percent to 2.5 or 3 percent
4. Lower minimum payments – so borrowers who only pay the minimum will pay more interest
5. Order of payments – some providers have changed the way they allocate repayments, so they start paying off the cheapest debt first
6. Interest calculation – the lowest APR does not necessarily mean the lowest interest, as there's no standard interest calculation method
7. Impromptu charges – some card providers penalise customers who don't tell them they've moved house, by up to £12
8. Credit card cheques – the interest rate is often more than 20 percent, there's a handling fee and usually no interest-free period
9. Withdrawing cash – some providers have increased interest rates and fees for cash withdrawals
10. Gift vouchers – some cards treat gift voucher purchases as cash withdrawals, which attract a higher interest rate

The result? When one issuer recently issued revised Terms and Conditions for its mainstream cards portfolio, each change disadvantaged the customer in one way or another.

Absolutely nothing wrong with building profitability, of course. But there is another way: how about offering your

customers better value?

And finally...

Does size matter?

There's a growing trend out there for card product names to get ever longer. Here's one we recently noticed:

GE Money Earth Rewards Platinum MasterCard comes in at a lengthy six words. Have any readers come across a longer name?



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Consulting editor bio note

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In previous issues 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?

The power of data-driven marketing: Using information to build profitability

Maximise the returns from your marketing budget: What effective card marketing programmes all have in common

Coping with the commoditised credit card: Using relationships to build profitability

Business card marketing: Is there a case for product enhancement?

Conflicting signals from co-brand cards: The rules that successful issuers are following

Emerging markets: How different are they really?

Channel optimisation: 6 rules for getting the most value out of your card acquisition budget

What happened to all the good ideas?: Maximising profit the right way

Green cards: From Zero to Hero?

Vive la différence: Lose the cookie cutter!

The language of rewards: What does it all mean?

Price-led or product-led?: The dangers of focussing on price-cutting

Let's hear it for rewards programmes: How savvy issuers get value from loyalty

Make sure your card
comes out first.



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