McKinsey&Company

Volume 9 Number 24

September 2016

McKinsey on Payments

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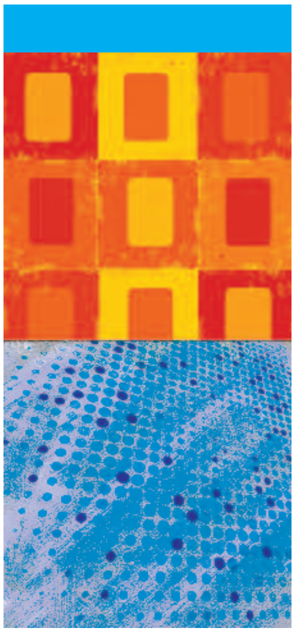

From plastic to pixels: Digitizing the credit card

Competition is fierce in card issuing, and many of the traditional approaches to differentiation are losing effectiveness. Once persuasive rewards such as acquisition bonuses and cashback payouts have become table stakes. Interest rates have evened out across cards. Large issuers continue to capture a bigger share of transactions, but smaller issuers are gaining market share in outstandings by bringing portfolios back in house and developing highly targeted customer-management campaigns within their existing deposit customer base.

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Meanwhile, some alternative lenders are competing at the point of sale (POS) by offering instant credit for larger purchases (e.g., home-improvement financing company GreenSky partners with retailers to offer POS loans for items such as TVs and furniture). Alternative lenders are also offering consumers easy ways to consolidate their debts at more attractive rates than they are currently paying.

More fundamentally, the future for cards is in flux as younger people show less enthusiasm than their parents for using credit cards as a means of payment.

In this environment, where merely maintaining market share is a challenge, card issuers must develop their digital capabilities to keep pace. From customer acquisition to onboarding to payments to servicing, the digital channel is becoming the most effective way to engage cardholders. It enables issuers not only to enhance the customer experience, but also to set the stage for the use of big data and advanced analytics techniques to improve decision making.

Diminishing returns?

Although volumes are growing as cardholders spend more on their cards—with global transactions increasing by 8 percent a year according to the 2015 McKinsey Global Payments Map—card issuers are finding it harder to win new cardholders and compete for market share. Consumers are holding fewer cards and expecting more from them. The average U.S. consumer reported owning 3.3 credit cards in 2002, 2.9 in 2008, and just 2.6 by 2014, for example. At the same time, issuers are handing back nearly all the transaction revenues they generate in the form of rewards and offers. Reward cards have become so entrenched that they made up nearly 80 percent of all new card volumes in the first quarter of 2014, while reward earn rates continue their upward trend (Exhibit 1).

The difficulties card issuers face in the U.S. are mirrored in high-interchange regions such as Canada, Latin America and pockets of Asia. Interestingly, in regions that have dramatically cut interchange rates, such as Europe, issuers find it even more difficult to differentiate themselves. Worldwide, the credit card is becoming a commodity, despite the many and various forms and revenue models that exist.

Digital tools can help card issuers get more value out of their business by enhancing their customer interface and offering a superior customer experience.

Digitization and the customer

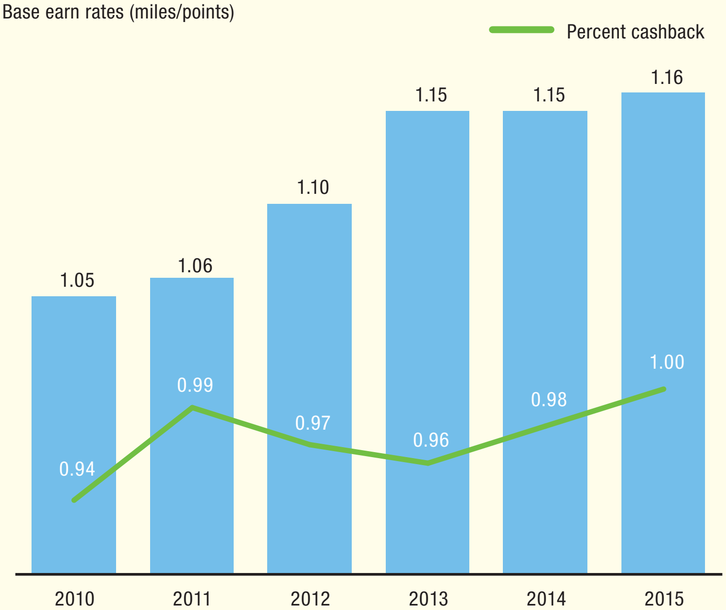
McKinsey research shows that customers are ready to engage digitally, and often start their journey via digital channels. More than 80 percent of U.S. customers research credit cards online before purchase. More than a quarter of customers get personal recommendations via social networks to inform their purchasing decisions. For the average large issuer, 28 percent of credit card sales are made through digital channels, and two-thirds of customers activate their new cards online.

Exhibit 1

Customers are holding fewer cards but expecting more from them

Cashback and other rewards have been increasing over the past few years

Base earn rates (miles/points)



In 2014, the average American owned 2.6 cards, compared with 2.9 in 2008 and 3.3 in 2002

83% of all credit card holders have at least one reward card

52% of new card holders say they chose their card because of better rewards

40% of card users say they would stop using their card if rewards were removed

Source: CardHub; Gallup; NerdWallet; J.D. Power; McKinsey Consumer Financial Life Survey

Example: U.S. market

As competition intensifies, issuers can turn to digitization as a differentiator. Indeed, several issuers have already taken steps to ensure their digital capabilities place them at the top of the "search, shop, buy" value chain with consumers looking for a new card. (See "The new rules for growth through customer engagement," *McKinsey on Payments,* October 2015.) Credit card issuers occupy different points along the digital maturity curve, but almost all have gaps in their digital offering when it comes to interacting with customers. Some of the biggest gaps are in:

Banks should reach beyond the payment and compete for share of total marketing revenue. This means expanding the value proposition to include both payments and marketing along the full shopping continuum.

- **Customer acquisition**, and in particular, converting customers from consideration to application and getting them through the approval process in a real-time digital environment.
- **Customer onboarding** after an application for a credit card is approved. From the customer's point of view, the days that follow are either full of pain points or lacking in any kind of contact with the issuer that might help cement the new relationship.
- **Customer servicing** to ensure customers continue to use digital channels for self-service. The challenge is to make the mobile channel easier to use, more engaging, and more robust than any other channel.
- **Card usage—**making the card itself easy to use in a mobile and online context and using alerts and texts to provide protection and reinforcement against fraud.
- **Deals, offers, and redemption—**providing a simple customer experience to deliver something that a points system or competing card cannot match. For example, BankAmeriDeals uses purchase data to develop personalized offers that benefit customers and merchants alike. Similarly, seamless point redemption—as in American Express's link-up with Uber to allow instant point redemption to pay for a ride—is an often neglected opportunity for issuers to provide value for their customers at a critical point in the cardholder relationship.

Customer acquisition

Issuers should ask tough questions about their digital marketing and acquisition strategy. Are they effective at driving traffic through SEO strategy? Do they optimize paid traffic strategy? They need to understand what happens when a potential customer lands on their homepage, and where the biggest leaks in the funnel are. Are they different for desktop and mobile users? How does their funnel compare with those of competitors? The user interface and experience must be optimized to drive conversion.

Issuers need to look at how their campaigns perform for each segment, and how their digital products and prices align with the needs of their target segments. They need to know if—and how—they are differentiated from their competitors. Do they offer a breadth of shopping features—product comparisons, deal of the day, recommendations—that cater to diverse customer preferences? What do they know about the people who visit their site? Should they be using cookies and click behavior to predict which products or messaging will work best?

Customer onboarding

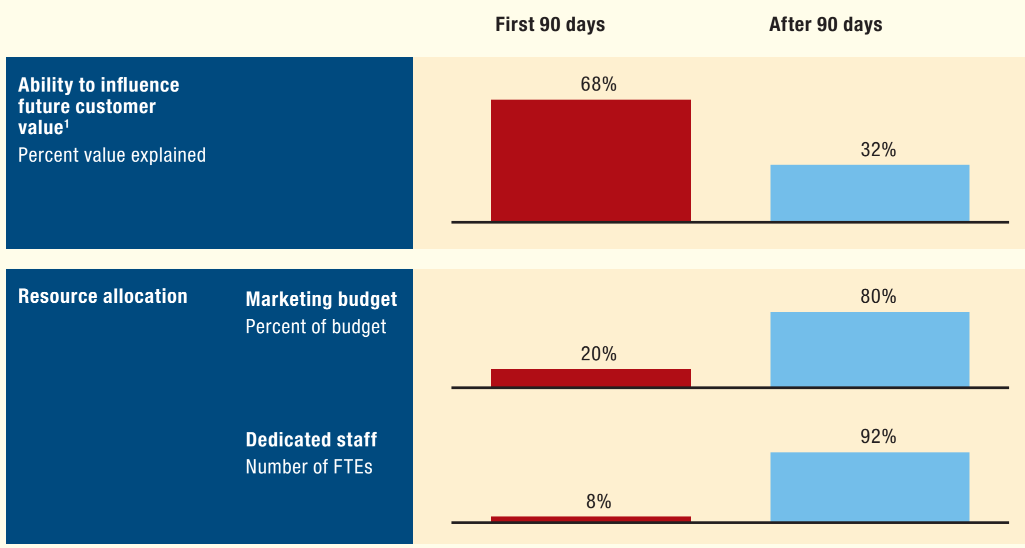
The first step in building a relationship with a new customer is to make the application process simple, seamless and quick. The fewer the fields to complete, the faster the application. If online forms are customer-centric and user-friendly, they are less likely to be abandoned. Applicants, for example, can provide their name and address via their smartphone camera and a photo for verification through facial recognition software. Some issuers have managed to cut completion times by up to a third, raise completion rates by more than a quarter, and increase digital applications by 40 percent by simplifying the application process.

The second step in engaging new customers is to ensure they use their card early and often, rather than for one big purchase, so that usage becomes a habit. In India, for instance, most travel cards require holders to spend a specific amount in the first 90 days to qualify for reward miles. Axis Bank refines this approach by asking new holders of its Privilege card to swipe their cards three times in the first 60 days as a way to encourage regular use. McKinsey analysis indicates that the long-term value of a customer is up to three times greater when they are engaged frequently in the first 90 days, yet many issuers routinely allocate only about a fifth of their marketing budget to this critical period (Exhibit 2).

Issuers looking to capture full impact from active cardholders need to make sure their card is the first choice for all transactions. McKin-

Exhibit 2

The first 90 days are critical in shaping cardholder behavior, yet they receive few resources



[1] Coefficient of determination of the predictive model, using high-value actions in the first 90 days to predict the future value of customer

Source: McKinsey & Company

sey research has shown that cardholders are more likely to make a card their preferred form of payment if they do five things: make their second transaction within a week of their first; use their card for purchases in more than one category; make at least one transaction of more than $100; buy from a mass retailer; and use a specialized product, such as bill payment. Issuers should focus on encouraging and reinforcing these activities, and conduct regression analysis to identify and address any hidden differences in cardholder behavior across markets and products.

Once the card is in the hands of the cardholder, they need to select and use it regularly in preference to other payment options if the issuer is to extract maximum value.

Customer servicing

Card issuers need to understand where to invest to deliver the best customer service. The opportunities are abundant, so no issuer has the resources to address them all. Digital business models are often built with cost savings in mind, which is a good start. Issuers need to balance capturing these easily quantified savings against meeting their strategic need to appeal to target segments such as millennials and optimize their customer satisfaction scores.

Improving customer engagement can be as simple as providing a real-time alert every time a card is used. Some issuers are now using artificial intelligence and natural-language processing to offer customers real-time responses to phone and online queries.

Card usage

Once the card is in the hands of the cardholder, they need to select and use it regularly in preference to other payment options if the issuer is to extract maximum value. From incentivizing spend (as with Capital One's "every tenth ride free" promotion with Uber) to card replacement (as with American Express's automatic provisioning in Apple Pay), digital plays an important role. Experience indicates that simply by introducing smart recommendations—such as sending restaurant recommendations via an app or an email when a cardholder is near a merchant partner—an issuer can boost cardholder spending by 5 to 10 percent.

Deals, offers and redemption

An early example of a digitally enabled offers engine is BankAmeriDeals, which allows Bank of America customers to choose restaurant and store deals from a range of options on its web site and mobile banking app. When cardholders pay for these deals using their credit or debit card, cash is automatically credited back to their account. This kind of offering takes considerable time and IT capacity to orchestrate, and requires issuers to strike individual deals with retailers to connect the customer offer with the point of sale.

But issuers can go much further. For instance, they could provide real-time offers based on where the cardholder is, what they have just bought and where they might go next. When a cardholder checks into a hotel, the issuer could text them dinner discounts to restaurants within walking distance. Features like these can work without requiring the customer to log in and select offers.

Often overlooked, redemption is a key moment when an issuer's relationship with the customer is at risk. After a cardholder has cashed in all the points or miles they have accrued, they have little to hold them to the issuer. Issuers should take advantage of redemption as an opportunity to offer the customer attractive new benefits and experiences. For instance, some issuers allow cardholders to cash in small amounts via digital wallets that offer the option of paying for a purchase with accumulated points rather than a standard card transaction.

Getting started

Delivering a compelling customer experience in a digital environment requires a set of competencies that most card issuers do not yet have, and which will need to be built or brought in from the outside. Issuers should first reflect on the current state of the organization by asking questions such as: Where are the gaps in our digital marketing? How good is our tagging and our digital performance reporting? How digitally savvy is our marketing organization? What tools and services should we build first, and on what platform? How do we capture and make the best use of the data afforded by our digital channels?

Issuers embarking on a digital program in credit cards can adopt a three-stage approach:

- **Discover.** Identify opportunities to develop compelling digital experiences and offerings for customers, diagnose gaps in the organization's ability to provide them, and work out how much value can be created by addressing these challenges. Start small and always keep customer needs in sharp focus.
- **Design.** Develop operational building blocks that can easily be scaled into a transformative program, including governance structure, capability-building programs, technology requirements and implementation roadmap. Build for the future in ways that create flexibility so that the organization can change course as markets shift.
- **Deliver.** Capture value through implementation, performance monitoring (often through a war room in the early stages) and cultural change. It is important to deliver early and often, so credit card providers should aim for small wins and build fast rather than taking a year to develop a comprehensive program that could be outdated before it hits the market.

* * *

If an issuer is not leading the digital charge, it is likely falling behind. As smartphone penetration soars, two-thirds of the global population now has access to the internet. Issuers in all regions should be developing digital capabilities to engage with their cardholders. Not only do they reap immediate rewards in the form of higher loyalty and usage; they also make a start on gathering digital data they can use to supercharge their business in new ways, including enhancing credit scoring, risk management, product cross-selling, line management, deals engines and collections.

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