The future of credit card distribution

The Smiths, a retiree couple, live in Chicago. For the past 20 years or so they have enjoyed the benefits of cash back and mileage bonuses, and 0 percent credit card balance transfer offers received through direct mail. They have great credit and don't really need to use a credit card but have found it pays to watch the mailbox for great offers. They have never felt any loyalty to a particular card or company, and because they don't really interact with them except when redeeming or closing an account, customer service doesn't matter much either.

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Recently, in the midst of planning a trip to Europe, a 50,000-mile bonus offer landed in the Smiths' mail box and got them thinking about switching from their cash-back card. This time, the Smiths go on-line to research the best offers and then to an aggregator site that compares rewards, fees and rates for all cards to see if the deal offered in the mailing really is the best option. While browsing they live chat with a few issuer representatives and learn about foreign transactions fees and EMV issues they might encounter abroad, and realize they need more than just good rewards, they need a better card. They end up selecting a card from an issuer with no local presence in Chicago but with a highly recommended iPhone app and no foreign transaction fees. They aren't comfortable sharing their personal information online so they call the issuer to do an application over the phone. In the end, they don't pick the card with the highest bonus miles, but one that is going to work the best for them now and while on vacation.

The details will vary, but this fictitious example of how one family in the U.S. has chosen their credit card illustrates how the journey has changed for millions of cardholders and issuers worldwide. Consumers are using all of the channels at their disposal to shop for the best deals and finalize transactions. For card issuers, this multichannel environment presents both new opportunities for distribution innovation, and potential threats in the form of emerging models that leverage alternative distribution networks to acquire customers and provide superior customer experience (e.g., American Express's Bluebird debit card, distributed through Walmart stores, Simple.com, Mint.com debit card).

The journey to a new distribution model that meets the demands of evolving customers is founded on three imperatives: shifting from direct mail to multichannel customer acquisition; increasing marketing sophistication to meet customers' emotional needs; and optimizing digital conversion.

Embrace multichannel acquisition

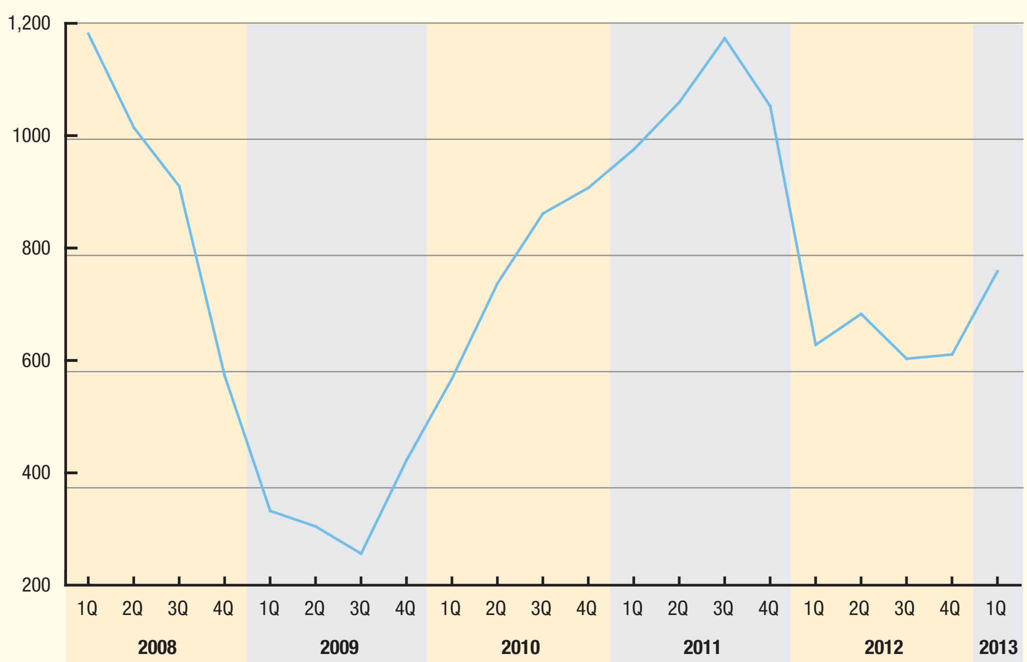
Direct mail volumes have declined 35 percent from pre-crisis levels (Exhibit 1), but this is not the result simply of a direct shift to online acquisition; the retail bank branch is also experiencing a resurgence as an acquisition channel. Online acquisition can be up to 60 percent cheaper than direct mail, and costs are even lower for bank branch acquisitions. In a 2011 investor presentation Chase noted that branch origination was the cheapest channel, with online costing 4 times that amount and direct mail costing a whopping 11 times more. In their most recent investor presentation, Chase revealed that direct mail had shrunk to account for just 11 percent of new accounts while online and branch has grown to 71 percent.

A successful multichannel approach to distribution in credit cards depends in part on taking a customer-centric view of each channel. This "customer-back" view – new to many banks – can deliver increases in acquisition of up to 5 percent per campaign.

Exhibit 1

U.S. credit card issuers' mailing volume has declined

Estimated mailing volume, top 6 issuers, 1Q-2008 to 1Q-2013
Millions mail pieces



Source: Mintel Comperemedia

The approach entails capabilities including:

- **Big data analytical methodologies.** Big data analytics can help map and quantify customer pathways that lead to specific positive (e.g., successful cross-sell) and negative (e.g., silent attrition, customer complaint) outcomes. The data can also be leveraged to make the business case for customer experience efforts, and to prioritize those efforts.
- **Design-to-value economic approach.** Banks' (and other issuers') P&Ls are typically highly disaggregated into functional areas: they know how much they spend by channel and on technology, and have methodologies for cost allocation to the household level. However, when designing customer experiences, banks rarely design to an economic goal. They must be able to measure the all-in economics of pathways and design target end states that meet economic objectives.
- **Cross-functional, rapid prototyping.** Issuers often take a pilot approach, where one element of an ecosystem (e.g., a product, or a technology) is well-built, but the rest is neglected. Using the first two approaches in this list, issuers can develop rapid, cross-functional processes to create "minimum viable experiences" across the entire product feature spectrum.
- **Treat change as a design exercise.** Few issuers designate an "owner" of the customer experience. Most typically have functional owners: head of acquisitions, head of call centers, head of online, head of products, head of marketing. As a result, customer experience tends to be highly inconsistent but should be crafted and designed from end to end.

Engage customers emotionally

To capture the attention of customers, issuers need to understand the true drivers of a winning value proposition. Over the last few years, the percentage of reward offerings with incentives or sign-up bonuses has risen from 50 percent to 86 percent (Exhibit 2), suggesting that issuers are focused on the purely rational side of customer acquisition. Incentives have been as high as $395 or 50,000 points after the first purchase. Competing on this price basis is leading to commoditization of credit card offers. Issuers are paying less attention to the emotional side of the equation. (See also, "Making loyalty pay: Lessons from the innovators," *McKinsey on Payments,* July 2013.)

Ethnographic consumer research reveals that saving and spending have emotional contexts. They cause happiness and anxiety; they empower and deflate. As the securers of customers' hard-earned assets, banks have to handle emotion in ways that few other retailers must contend with. Now, however, some financial services firms are learning to emotionally engage through direct channels. There are three major archetypes for this level of customer engagement:

- Belonging: USAA orients its value proposition around "integrity" (e.g., highest-ranked bank in response to "My financial provider does what's best for me, not just its own bottom line") and a strong community focus (e.g., active-duty military receive reduced fees), which have engendered a feeling of belongingness in customers that has led to disproportionate success. From a single branch in Texas, USAA has increased its deposits more than five-fold over the past decade, and achieved industry-leading rates of cross-sell.

- Autonomy and empowerment: American Express has always been heavily reliant on direct channels (phone and online) for customer acquisition. Through decades of effective marketing, the company has created a brand of empowerment, helping their customers achieve what they aspire to and experience life. Through recent digital initiatives like "Link, Like, Love," "Sync, Tweet, Save" and "Mobile Offers," American Express provides customers with access to unique, personalized offers and convenient tools for making purchases (e.g., tweeting the name of the item).

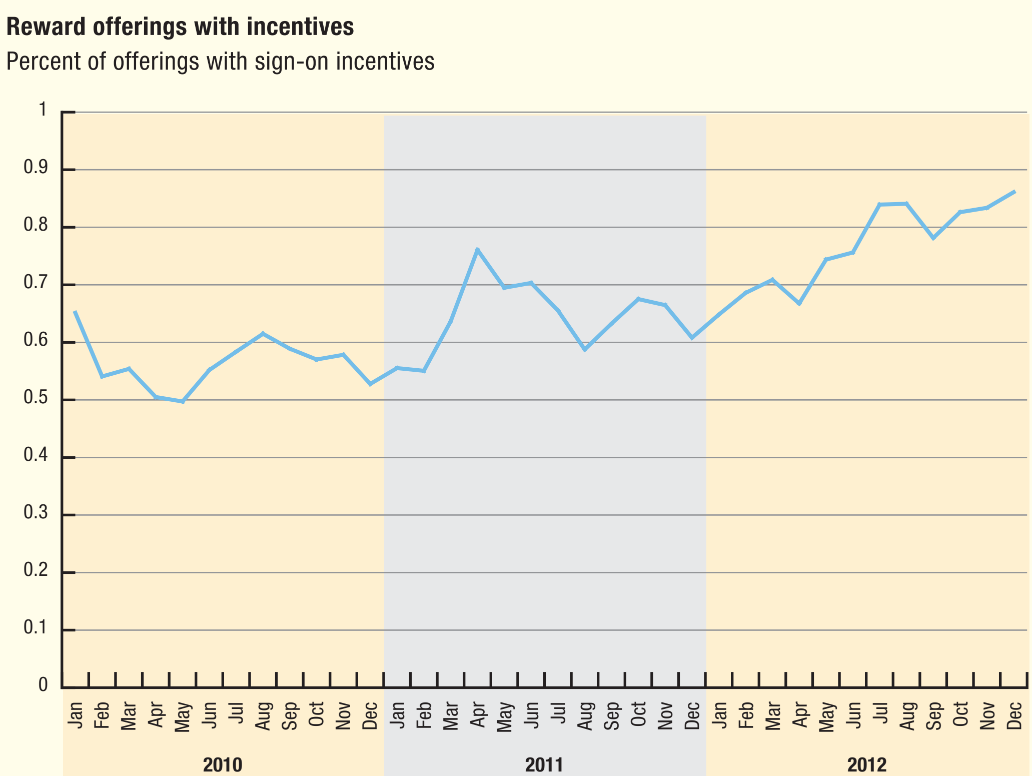
- Trust and security: Charles Schwab's value proposition focuses around "Ask Chuck," combining personalized investment advice largely by phone and a full-service online channel, while maintaining premium pricing. This personalized, high-quality service level has built deep trust among customers, in some cases leading to lower price elasticity in even high commodity products such as mortgage.

Optimize the digital conversation

When customers start using a mobile app for service they dramatically increase the frequency with which they connect to an issuer; however, this increased engagement has gone

Exhibit 2

Reward offerings with incentives continue to rise



Source: Mintel Comperemedia

largely untapped. Improvements to servicing channels are the third imperative for a new approach to credit card distribution, and can be an effective way to deepen the overall relationship across many products.

The bank created a cross-functional, front-line-led rapid prototyping design lab to build a unified customer experience across channels, targeting the most common journeys taken by customers during the first 90 days of their banking relationship.

One large retail bank, realizing that customers were acquired and served through streams of activity across channels, shifted from its classical "funnel" approach to acquisition to one focused on cross-channel "journeys" that follow customers across multiple interactions. Upon embarking on this change, the bank saw that inconsistencies across channels were making them difficult to work with and increasing operational cost and risk. So the bank created a cross-functional, front-line-led rapid prototyping design lab to build a unified customer experience across channels, targeting the most common journeys taken by customers during the first 90 days of their banking relationship. The result was a 40 percent increase in products per new account and a 30 percent drop in time to open new accounts.

Best practices for optimizing service channels are well-established across a number of customer-facing industries, and include:

- Connect data across channels. In order to reap the full benefit of the multichannel model, issuers must be able to track customer behavior across interactions on all channels. For instance, knowing that a cardholder recently researched a home equity loan on a bank's Web site can be an important piece of information for a call center rep the next time that customer dials in to discuss a problem with their card. Seamless collection of data across channels can be a powerful tool both for improving customer experience and expanding wallet share.
- Integrate the message across channels. By the same token, communications with customers should be consistent across channels. Too frequently, consumers see one offer in the mail, another online and a third in the branch. In some cases, banks will explicitly aim to customize offers based on channel because they can, but it is more important to have the capability to identify target customers with a consistent message. Don't assume that hipsters shop online and retirees don't.
- Service on the customer's terms. Customers have been conditioned to expect a high level of service, capabilities and efficiency in their interactions with companies in the digital space: through the Internet, on their smart phones, through apps. There is an expectation not only for high-quality digital experience, but a frequent rate of improvement. Card issuers must meet these new expectations for digital access with seamless and intuitive tools and service. Simply put, if a bank is not currently updating its app, then it is probably already behind the curve.

Optimization of service approach to align with customer needs and usage not only helps in individual customer interactions and drives usage and customer satisfaction, but also helps generate positive brand sentiment and word-of-mouth. In turn, those could lead to a lower cost per acquisition.

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Cards customers are changing their behavior, making more use of multiple channels and moving almost en masse to digital or direct access. As always, behavior is more complex than at first it appears. The challenge for cards issuers is to first understand what their valued customers really want, and to build the distribution model of the future based on those needs.

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