Credit Cards for Regional Banks: Aim Higher

BY JIM BRAMLETT AND ALAN SCHIFFRES

In trying to match the monoline giants at the rewards game, regional banks are forfeiting their natural edge in the battle for profitable card balances.

Hungry for consumer loan growth in a tepid post-recession market, regional banks are viewing credit cards as a key opportunity. However, while there is a growing re-commitment to the business and signs of growth, progress has fallen well short of expectations. Cross-sell penetration remains low, and many customers who do obtain bank cards fail to use them actively.

Even among active accounts with balances, banks often lose most of the potential activity to other card issuers serving the same customers. Within their core franchise of primary bank customers, regional banks will typically capture only about a 10% share of their customers’ revolving card balances, according to Novantas research. This performance pales in comparison with the deposit business, where primary bank relationships typically garner a roughly 60% share of customers’ deposit balances.

Bank issuers do not need to resign themselves to such disappointing performance. But to reach the next level, they need to re-think the basics of the card business. With a shift in strategy, winners can gain a competitive advantage against major issuers. Then it is a matter of capitalizing on those advantages more effectively.

In many cases, the main issue is clarifying which market segments to pursue. There is a powerful tendency to pursue customers who actively use their cards for monthly purchase activity, which places the regional bank in direct competition with the huge monoline issuers and their formidable rewards programs. This is not the best way to capture revolving card balances.

Contrary to popular perception, our research shows that irregular credit card users exhibit the greater borrowing potential. Though they prefer to use debit, checks and cash for regular household spending, these customers turn to their credit cards for “out of the ordinary” purchases where the revolving credit facility is especially valuable (Figure 1).

Regional banks are especially well-positioned to pursue this business, given their deep customer ties, extensive channel interaction and access to information. These relationship advantages can be harnessed to penetrate under-served segments of the core customer base, a unique banking opportunity to build revolving card balances.

**CHOOSE THE GAME YOU CAN WIN**

Regional banks have tried too hard to match monoline card giants at their own game, in which the issuer seeks to become its customers’ preferred and primary payment card and
achieve “top of wallet” status. On the surface, this strategy seems inarguable, given how the entrenched primary card becomes a major conduit for household payments.

But on closer examination this approach proves problematic for regional banks. Competing for customers’ primary payment card status typically requires an ever-expanding array of loyalty and rewards programs — cash-back, miles, points and co-brand loyalty offers. Though merchants ultimately foot most of the costs (through interchange fees), the fact remains that these rewards are offered to customers as unabashed bribes for their “loyal” spend on the card.

The problem for regional banks is that the best of such programs are typically sophisticated and complex, and they entail high fixed costs — all of which is more difficult to manage on a smaller portfolio. Thus, these programs play to the natural strengths of the national monoline issuers, with their vast economies of scale. Moreover, the dominant national players have access to the most desirable merchant partners, which are typically inaccessible to regional bank card programs.

The problem is exacerbated by the ability of the dominant card players to reach highly specific segments of customers, such as brand-loyal customers of a specific airline. In the hands of the national issuers, these programs carry a degree of precision and tailoring that a mid-sized issuer simply can’t match — particularly if the bank’s target prospect pool is confined to its own core customers, as is usually the case. It is no wonder regional banks have an activation problem with their credit card business.

The second reason why a “top of wallet” aspiration is problematic for regional banks is that it biases the strategy toward customers who prefer to use credit cards as their primary payments mechanism for day-to-day shopping. Regional banks can (and should) market to these segments. But national consumer research recently conducted by Novantas suggests that in general, such customers should be only a secondary priority, particularly if the bank’s goal is to build a portfolio of profitable, revolving balances with primary bank customers.

More specifically, our research demonstrates that customers who prefer to use credit cards for most day-to-day purchases also tend to revolve less than customers who prefer debit cards or cash as their primary payment method. Consequently, a strategy seeking “top of wallet” position tends to result in a disproportionate focus on those customers known in industry parlance as “transactors.”

While transactors like the convenience of the credit card and the rewards that go with it, they generally pay off balances in full every month. And when they do revolve, they are more likely to do so only briefly, perhaps even just accidentally. Although these transactors account for more than two-thirds of credit card purchases at the point of sale, and can be profitable, our research indicates that they carry less than a third of revolving balances across the industry, with much lower profit potential per customer.

By no means is this the end of the story, however, because regional banks have natural competitive advantages elsewhere. The opportunity lies with a different customer group that might at first seem counterintuitive to target for a credit card proposition: people who actually prefer to avoid credit cards as a primary payment method.

Deliberately opting instead for a debit card (or sometimes cash) whenever possible, these people pull out a credit card only when they need it for a particular transaction. Often they resort
to card spend because the purchase is somewhat large and/or unexpected, or just inconveniently timed, so that the liquidity (float) and credit features associated with a credit card are suddenly more valuable.

- The good news for regional banks is that such transactions are far more likely to be repaid more slowly over time and generate revolving interest revenue, and therefore these customers have the potential to be much more profitable.
- The better news is that these customers place less emphasis on rewards and points, because they are more interested in the cash management functionality.
- The even-better-still news is that in order to succeed with these customers, the bank does not need to persuade them to replace their “primary” payment card with a new credit card — a tall order indeed. The bank already owns the primary payment relationship, through its debit card for example, and is only seeking to augment that already strong relationship and extend it into new classes of spend.
- And the very best news for regional banks is that among these customers seeking liquidity and credit, the “primary bank” relationship already in place confers enormous advantages over monoline issuers.

The problem is that regional banks have not fully recognized these advantages, much less capitalized on them.

Until they do, they cannot expect to do better than the 10% or so share of wallet that they have earned to date.

**RELATIONSHIP ADVANTAGES**

In competition for irregular card users who tend to carry revolving balances, regional banks enjoy enormous advantages over monoline card issuers (Figure 2).

First, and perhaps most fundamentally, regional banks have rich information on their core customers — accurate, specific, and timely — that large monoline issuers can only dream about. Second, the core banking relationship provides frequent customer access through multiple touch points. And finally, bank issuers have an opportunity to package and bundle cards with cash management propositions that provide a natural extension of core customer relationships.

In all three of these areas, however, most regional bank issuers are only skimming the surface of what is possible:

- **Information.** Unlike monoline card issuers, banks have detailed insider views of core customers’ financial lives. This composite picture includes insights from monthly payment and purchase transactions; cues about family life events and emerging financial needs; and household profiles of loans, deposits and monthly cash flow.

One tangible benefit of this information is enhanced underwriting and risk management, using observations of the cash flow and repayment patterns of card applicants and recipients to underwrite smarter, go deeper into the base, and manage credit limits with more finesse. Another benefit is refined pricing strategy based on an understanding of customer profiles, preferences and relationship profitability. A third benefit is improved targeting based on an understanding of customer borrowing potential; the likelihood of offer response; and the customer’s preferred distribution channel.

And yet, most banks draw only superficially on the information advantage available to them. The customer databases at their disposal are typically not organized in a manner that is ideally suited for refined transaction-level multi-product insights, providing only snapshot views as opposed to longitudinal

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**Figure 2: Bank Advantages in Credit Card Competition**

*Because of their in-depth relationships with core customers, regional banks enjoy enormous advantages over monoline card issuers.*

<table>
<thead>
<tr>
<th>INFORMATION ADVANTAGE</th>
<th>Unique and detailed view of customers, including financial circumstances, account and channel activity, and overall relationship, for underwriting, targeting and pricing</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCESS ADVANTAGE</td>
<td>Regular, frequent contact with customers, presenting natural, timely and low-cost opportunities to meet the customer where he or she prefers to touch the bank</td>
</tr>
<tr>
<td>PRODUCT ADVANTAGES</td>
<td>“Cash Management” brand position, presenting natural adjacencies in liquidity and credit products, and opportunities for “comes-with” propositions that enhance cross-sell</td>
</tr>
</tbody>
</table>

Source: Novantas, Inc.
perspectives of how a customer’s needs change over time.

In addition, transaction-level data, offering the potential for some of the most compelling insights, is at best limited and is sometimes non-existent. Finally, critical analytical resources are often over-stretched across other responsibilities.

As a result, the extensive suite of predictive and economic models that potentially could be usefully applied to the business are often beyond the resource capacity — or sometimes even the capabilities — of the team assigned to develop them.

Access. Banks enjoy regular, frequent contact with their core customers, stemming both from servicing and transactional activity. And these interactions provide many customer-relevant cross-sell opportunities.

Compared with the typical mass market mail campaigns of the card monolines, bank cross-sell initiatives cost much less. Offers can be conveyed in the course of customer channel activity, so much of the expense of standalone campaigns is avoided. Channel-aligned promotions are more natural and less intrusive, moreover, reaching customers via their preferred touch points (branch, online, mobile, etc.).

Banks are also better positioned to engage customers in a timely fashion at the moment of relevance and need. And because the ongoing handling of payment and account transactions bring banks into regular contact with core customers, institutions enjoy the marketing advantages that go with being a familiar, trusted provider.

Here again, banks rarely capitalize on the advantage available to them. Even in the branch, which continues to be the primary sales channel, performance usually represents only a fraction of potential. More importantly, the bank’s channel mix has failed to keep up as customers continue to migrate away from the branch channel. In most cases, the “branch dominant” segment represents as little as 10%–20% of the total customer base.

The majority of credit card sales opportunities are best pursued through a combination of phone, online and direct mail programs. The challenge of shifting channels is not unique to credit cards. It cuts across all bank products. But the credit card lends itself to such channels more than some other products, and it deserves to be in the vanguard of channel innovation for regional banks.

Product Integration. Retail banking relationships are anchored in customers’ “cash management” needs. Monoline card issuers have peeled away a lucrative slice of the cash management pie, and one of the ways banks have allowed that to happen is by continuing with a relatively splintered silo approach to product management. In so doing, they cede yet another advantage to standalone issuers.

The reality is that banks can cover the whole waterfront of cash management and have entrée to do so. Regional issuers have significant opportunities to integrate credit card products into the primary bank relationship as a “comes-with” proposition that, properly designed, provides convenience, access to credit, and consolidated information and reporting.

To be sure, bundling credit cards and/or credit card functionality into the retail banking product line-up can backfire if not done properly. One frequently seen result is a build-up of large, relatively inactive card portfolios with high unutilized lines. These portfolios carry high expense rates. And they often pose credit management disasters, as the few accounts that do activate tend to carry high risk and cause write-offs with large balances. Such problems can be avoided however, by designing products that will appeal to specific segments and managing the assignment of credit more dynamically.

UNDERSHOOTING THE OPPORTUNITY?

Because of the historic dominance of national scale credit card issuers, regional banks have become content with the tiny corner of the market they serve today. They underestimate the magnitude of the advantage they have against larger issuers, and therefore undershoot the opportunity in front of them.

It is time for regional banks to step back and reconsider the basic customer objectives in their credit card business: who do they seek to serve; and how do they best capitalize on the advantages available to them. For many banks, this first, fundamental step will lead to a significant change in focus of their business, and a redefinition of their target customer.

Once the vision is clarified, banks need to harness the power of their retail franchises — including inherent information, access, and proposition advantages — to reach the right customers with the right propositions at the right time. This change of focus has the potential to pay off in a big way for retail banks.

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