



Focus on Your Best Customers

Resource-Constrained Issuers Are Smart to Invest in their Most Profitable Cardholders

By Patricia Foell

Portfolio optimization is suddenly on every portfolio manager's mind—and for good reason. Most issuing banks now face lower customer engagement and lower profitability due to reduced spending, high inactivity rates, and increased charge-offs. Net income for the top 11 U.S. credit card issuers fell by 66.9 percent in 2008.¹ Issuers will likely see diminished profits for some time, due not only to a challenging economy and cardholders' efforts to pay down their

account balances, but also to increased costs brought about by new legislation and regulations under consideration.

While issuers today focus on cutting costs and minimizing exposure, they must also consider the longer term. Future profits will largely grow out of successful strategies for retaining and optimizing relationships with their lowest-risk, high-value customers.

BACK TO FUNDAMENTALS

Even as many issuers are cutting credit lines, cardholders are reducing their

spending and rationalizing credit card use. This overall trend makes it all the more critical for issuers to step back and ask themselves two fundamental questions.

First, who are your target segments? The answers won't be the same for every issuer, nor will they be the same for every product within an issuer's portfolio. But with new limitations on their marketing budgets and constraints on other resources, issuers would do well to abandon the old approach of simply issuing as many cards as possible. Only by identifying the right

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target segments can you map out the strategies that will drive top-of-wallet status with them.

Second, do your card offerings resonate with your “best customers”? Issuers need to reevaluate every aspect of their products in terms of their appeal—everything from features, benefits, rewards, and service options to pricing, credit limits, and authorization criteria. A focus on products that create and sustain long-term brand preference will pay ample returns: Given consumers’ new-found conservatism, many cardholders will be reducing the number of cards they own. Now more than ever, being the primary card is critical, because cardholders put more than half (54 percent) of their credit card spending on it.²

REWARD YOUR BEST CUSTOMERS

The concept of best customer management sounds simple, yet many issuers ignore it. They spend a great deal of effort and money trying to stimulate and change behavior among transactors, low actives, balance-transfer “gamers,” and other marginal customer groups. While such tactics incrementally improve portfolio performance, they should not be executed at the expense of more desirable customers. Having conducted segmentation analysis for many issuers worldwide, we’ve found that the 80/20 rule of business—80 percent of profits come from 20 percent of customers—is even more pertinent for issuers. In fact, in one of our recent engagements,

we found that only three percent of customers actually drove profits. Yet issuers often lack differentiated strategies that recognize and protect their position with key customers—even though the most profitable, credit-worthy customers are invariably ripe for poaching by competitors.

During the current economic downturn, preemptive customer recognition and retention strategies should receive funding priority. These do not need to be expensive. Examples include prioritizing best customers in the call center queue; sending e-mail and SMS appreciation messages; providing these customers access to special offers; or even promoting basic card benefits with tailored messaging. Our experience conducting retention and service training for call center personnel indicates that many customers are unaware of basic card benefits. Once benefits are understood, customer retention and satisfaction increases—a finding that was underscored in a card satisfaction study conducted last fall by J.D. Power and Associates. The research shows that satisfaction increases by 53 percent when customers understand card benefits, particularly fraud protection.³

It’s important to maintain rewards for those who use them. Unfortunately, many cardholders now take rewards programs for granted and rarely use them. Likewise, many issuers no longer actively promote their rewards programs in an effort to avoid redemption costs. Yet the same J.D. Power study shows

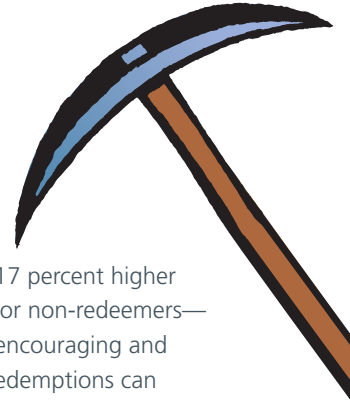
that satisfaction is 117 percent higher for redeemers than for non-redeemers—demonstrating that encouraging and managing rewards redemptions can help drive top-of-wallet status.

Issuers should look for ways to reduce rewards costs without alienating their best customers. The key is to identify unprofitable customers and scale back or eliminate the rewards being offered to them. Indeed, for the majority of cardholders, access to affordable credit may be reason enough to use their cards. By restructuring rewards programs, issuers can reduce “earn” rates, as well as discontinue underutilized, plain-vanilla programs that add to costs, but not to cardholder satisfaction. At the same time, issuers should continue to remind their best customers of the value inherent in their rewards programs.

TRIM WITH A SCALPEL, NOT AN AXE

Issuers frequently come to us saying, “We want to close accounts of customers who have been inactive for a period of time, but we don’t want to cancel those with reasonable profit potential. Can you help us identify the accounts worth saving?”

To answer this question, we carefully analyze and segment the issuer’s dormant population, based on its prior behavior and current banking relationships, as well as other data the issuer has. Account inactivity, for example, may be a sign that customers



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own cards no longer relevant to them. If so—provided that there is sufficient behavioral or other predictive data—issuers can use analytics and propensity models to migrate some of these customers to products with more compelling value propositions.

Using another set of analytical tools that assesses not just current account behavior but the likelihood of future behavior as well, issuers can identify which accounts have profit potential and which do not—and, therefore, should be closed. The findings can then be translated into communications strategies and messages that enhance or reinvigorate customer relationships.

A NEW LENS ON ISSUER PROFITABILITY

Issuers need to reassess the way they view their card portfolios. Rather than manage their credit cards as a distinct product offering with its own P&L, it is time U.S. issuers returned to a more profitable model: Measure the lifetime value of your customers across all product lines and keep your eye on relationships, not products. An example is La Caixa in Spain, which has focused its efforts on driving up sales productivity in its branches. Without increasing headcount, La Caixa offered customers a wide range of tailored product and service offerings—even non-financial ones such as tickets to theater, film, and music—through its branches, as well as the Internet, ATMs, and telephone. From 2004 to 2006, La Caixa added nearly half a million new customers and saw net business income rise 12.3 percent.⁴

With fewer resources, all issuers today need to stop investing in marginal cardholders. Closely examine your portfolio to identify those customers who deliver the greatest long-term value and invest in them. That is a much more cost-effective strategy not only now, but for the long term. If customers with the lowest risk and greatest potential make your offering their primary card, you can expect revenues, profits, and cross-sales to rise—along with loyalty. ●

- 1 *The Nilson Report*, Issue 921, March 2009.
- 2 MasterCard Advisors Payments Panel 2008 Master Survey.
- 3 J.D. Power and Associates, *2008 Credit Card Satisfaction Study*, September 2008.
- 4 Capgemini, *World Retail Banking Report*, 2008.



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