Credit Card Offerings Still Offer the Best Profits, If Done Right

By Gaylon Jowers

While credit card programs present a more complicated business endeavor than debit offerings, they offer financial institutions a chance to make much bigger profits - if done right. This is especially true with credit cards, given their universal acceptance and flexible repayment terms.

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In fact, fintech has learned recently that it's exceedingly hard to generate a profit without effective lending of some sort. Neobanks have scooped up legions of new customers with prepaid cards and savings accounts, yet most of them have failed to turn a profit.

No doubt, credit card lending is a tough business to be in. It's one reason we have seen so many startups enter the buy now/pay later (BNPL) market. This type of lending is not currently subject to the rigorous regulatory review banks must go through. Yet even so, with rising inflation and strained household budgets, we are reminded of the importance of good underwriting. BNPL providers Affirm and Klarna are now struggling with their portfolios, facing challenges to credit quality and pressure on loan funding. A closer look also shows that the BNPL model actually does more for promoting the business of merchants than it does for building lucrative receivables.

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In fact, it's the digital banks that have pursued traditional lending from the start that have managed to turn a profit. For example, Virgin Money UK has built sizable portfolios of mortgages and business lending, while making a strong push into personal credit, adding 335,000 card accounts in the second and third quarters for its fiscal year ended Sept. 30, according to financial statements. London-based Starling Bank has been profitable for about the last two years, deriving roughly two thirds of its revenue from interest income, according to its 2021 annual report.

Simply put, consumer credit is a highway of sorts to profitability—if it's managed well. And in an environment where customers are looking for the ability to manage their budgets by spreading out their repayments, it pays to give credit card programs a second look. This goes for neobanks looking to turn a profit, or traditional financial institutions with underperforming credit card offerings.

For successful credit issuers, the wind seems to be at their backs. For example, the average credit card balance in the United Kingdom increased 5.5% to £1,555 for the 12 months ended May 31, according to FICO, a company that provides credit scoring. That means more revenues generated for issuers.

The case for revamping your credit card program

To be sure, mastering the credit card business is still no easy task. Even many traditional banks have struggled to get the most out of their credit card programs. What's the secret formula for success? Data tops the list, according to PROFIT INSIGHT, a global consulting firm in the payments space. PROFIT INSIGHT has worked with issuers for more than 45 years, helping them generate greater profits from their portfolios. The firm works with financial institutions, stressing that when they segment their data, profit potential is the most important metric.

We at TSYS couldn't agree more. Companies need to know their customers and understand them at the transactional level. This helps issuers maximize revenue streams by profiling what type of borrower their most profitable customers are, then going out and finding them. Surprisingly, as PROFIT INSIGHT affirms, that's not always the customers who spend the most. Lenders may be missing a trick by rolling out the red carpet for those with the highest credit limits, while ignoring their most profitable customers. At the same time, issuers must also pay a close eye to marketing costs, which can eat quickly into revenues.

In this journey, choosing the right processor is key, because it will allow you to have a strong understanding of your customer base, while maximizing the potential of your portfolio. We recommend giving a close look at the following criteria when evaluating a provider:

- **Security.** The provider and its platform should have a robust system that can help you maximize approval rates by combining real-time customer interaction and transaction data with machine learning and predictive risk modeling.
- **Scale.** This is critical for issuers to be able to quickly grow their account base without having to invest in additional infrastructure. You don't want to run out of capacity after a promotional offer floods your website with applications. The provider should be able to ramp up to whatever volume of account openings you need, and do so quickly.
- **Thought leadership.** A provider needs to have an evolving roadmap that will keep you at the forefront of the payments space. What kind of innovation has the vendor introduced over time, and how quickly does it pivot to offer best-of-breed solutions?
- **Technology.** The last thing you want is to be sitting on a legacy technology stack that will hold you back. Cloud-native architecture, driven by application programming interfaces (APIs), allows more flexibility in terms of delivering tailored solutions.
- **Speed to development.** APIs also greatly speed up the time to make changes to an app or web interface, from months to weeks. APIs allow developers at the issuer to pick and choose what services—or "microservices"—to offer through their product.
- **Flexible credit card platform.** You need a provider with a tried-and-tested track record of being able to issue multiple credit products. Many processors may be able to offer debit and prepaid solutions, but credit card platforms with the flexibility to easily accommodate changes to parameter settings are few and far between.
- **Financial stability.** You don't just want a processor that's growing accounts, but also one that has a solid track history. For instance, how stable is its management? Newer entrants to the market claiming to offer digital solutions might be missing the regulatory expertise, leadership and financial longevity needed to provide effective services in the long term.

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For financial institutions, especially fintechs, the challenging economy has exposed some weaknesses in generating sustainable revenue growth. That makes it a good time to reevaluate your business strategy and change adversity into opportunity. With the right processor, debit-only providers—or banks themselves—can embark on a new beginning with a robust, cloud-native credit card program. Despite the challenging economic environment around the world, with a strong focus on segmentation and growing revolving balances, the profits are still there for those issuers who can manage their credit card programs effectively.

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