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# Strategy in payments

## How to improve profit in existing retail card partnerships

# What are the key levers that issuers and their retail partners can pull to reinvigorate existing partnership card programs?

## The historic win-win proposition

Historically, private label and co-branded, credit cards were a win-win proposition. Partnerships provided attractive margins for issuers, drove purchase volumes, and increased loyalty for retailers. With an estimated retail spend of more than $350B,[1] partnership programs comprise approximately 10 percent of the overall credit card market.

While the overall market continues to grow at about 6 percent year-over-year, our analysis shows that many partnership card portfolios are stagnant.[2]

General-purpose card purchase volume (issuer-branded cards) has grown at an average of 6.7 percent from 2000 to 2016 ($1.1T to $3.1T). Private label credit cards, a key part of the broader partnership market, have seen average purchase growth of only 3.4 percent ($120B to $206B) over the same time frame.[3]

The main reasons for lagging performance of partnership programs are generally:

- Customers shifting purchase habits away from "traditional" retail toward mobile and online marketplaces
- A saturated market where most retail chains have loyalty programs—and where individual programs don't stand out
- Aging issuer infrastructure that can lead to negative customer experiences

As retail has moved toward omnichannel, partnership programs need a refresh with an emphasis on creating a seamless, cross-channel payment experience using real-time underwriting, issuance, notifications, and support. Issuers should consider how to move beyond plastic and how their customers think about the moment of payment in the broader context of their shopping journeys.
The ability to improve profit in the retail partnership space lies in addressing four key levers:

- Reinforcing the retail ecosystem and omnichannel experience with a contextual value proposition
- Owning the physical and digital points of sale (POS) seamlessly
- Upgrading the channel strategy to include sophisticated performance marketing and influencers
- Developing best-in-class risk management that can be leveraged across multiple portfolios

### A contextual value proposition

Retailers focus on enabling omnichannel experiences and building retail ecosystems that enable commerce at every point of inspiration.[4] Card value propositions, however, have historically been less engaging for customers. They continue to focus on immediate discounts or added credit at the point of sale (for larger purchases).[5] Issuers should strategically focus their value propositions to support a recurring retail shopping experience. This can mean driving spend via a growing channel (such as video, or chat) or reinforcing a retail ecosystem (for example by creating a seamless purchase and redemption experience across that ecosystem).

Let's not forget: Many customers value the largest discount they can get on either an up-front purchase, or on specific purchases if they're loyal to a brand. Unfortunately, those same customers often don't use the card again after the first purchase, resulting in a high inactive cardholder rate, a limited ability to drive continued transaction volume, and lower revolving balances. In response, retailers have shifted to cash back as a better option to drive continued spend.

But experience shows that cash-back deals risk a race to the bottom among the competition. Given that retailers usually pay for all or most of the rewards, this could eliminate the margins that make partnership cards so appealing to issuers and negate the volume increases and customer stickiness that make them important to retailers.[6]

Cash back or acquisition discounts reinforce the commoditized nature of many retail products, rather than focusing on how to create a personalized experience. Loyalty programs have become ubiquitous, with increasing consumer enrollment but flat consumer engagement (The average consumer is engaged in 14.3 programs, but only active in 6.7[7]).

It's important for partnerships to think about their mutual goals and invest jointly to ensure their customer experiences, redemption strategies, and visions are aligned and measured. The ability to contextualize and personalize redemption options while promoting a retailer's channel strategy is critical for modern partnership programs.

In addition to driving strategic channel spend, issuers can also strategically drive category spend this way. If a retailer would like to increase sales in higher-margin categories or toward products or partners that drive store traffic, rewards and redemption options can be offered just in time to nudge customers toward the desired behavior. While some companies are experimenting with these types of nudges (such as using in-store beacons and push alerts), efforts are relatively immature.

As security becomes a concern for customers, virtual cards or text alerts can provide visibility and control over (irregular) spend. As speed and convenience become ever more important, a "walk-in/walk-out" experience using facial recognition can be a differentiator—albeit an expensive one to add to existing stores.

Likewise, partnerships need to think broadly to include ecosystem participants. As retailers build retail ecosystems to increase revenue and service beyond their own capabilities, issuers must keep up and get infrastructure and data ready.

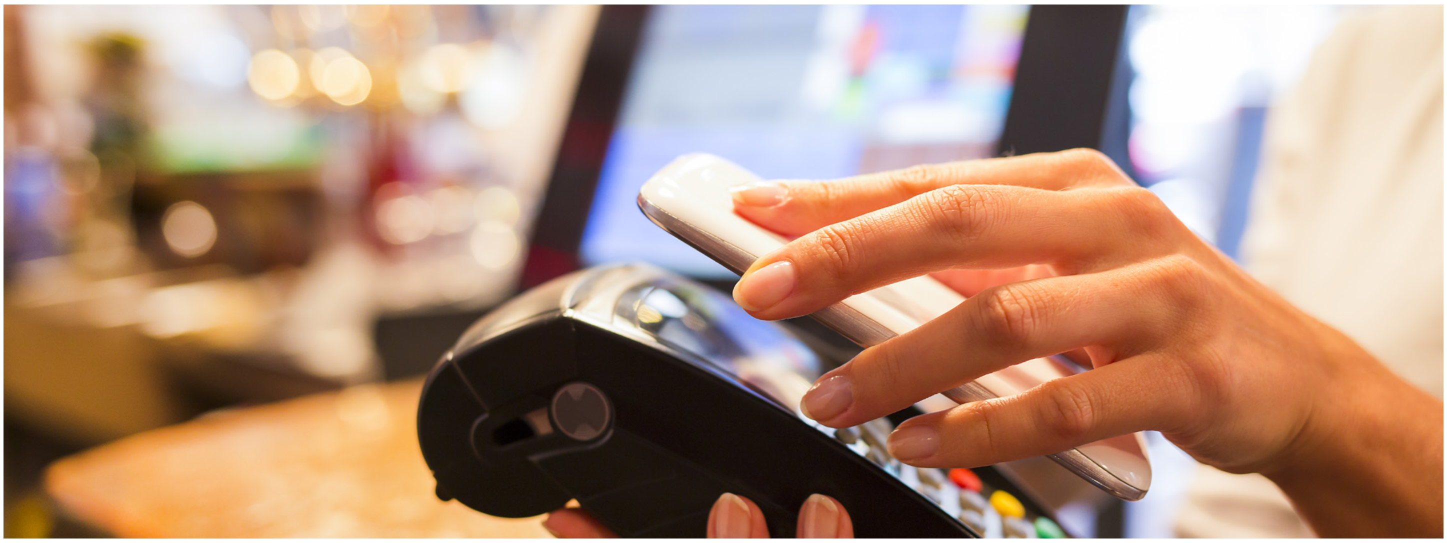
## Own the digital and physical POS

Owning the physical and digital POS is critical for partnership programs. For customer acquisition, this is the ground on which they can have true competitive advantage against general-purpose cards.

A key differentiator for partnership cards is their access to captive customers at the retail POS, a moment when customers have already indicated their interest in making a purchase. Switching customers in-store from shoppers to owners has historically had a significantly higher conversion rate than online. Estimates place in-store purchase conversion rates at seven times higher than online.[8] In addition to higher acquisition rates, owning the POS allows partnership cards to build a deeper, more personal customer relationship from the outset.

For example, issuers can offer immediate incentives to reuse the card or underwrite specific purchases made with instant financing (for example. new furniture or a large electronics purchase). However, one of the challenges with offers at POS is that the customer experience must be near-frictionless due to the extreme focus most retailers place on a rapid, seamless checkout.

In addition, in-store conversion from application to cardholder can be twice as high due to lower fraud risks.[9] Conversion rates for in-app and web purchases aren't as high as they



are in-store. But the same logic applies, as a customer is already deeply engaged in the shopping experience and has displayed some brand loyalty to a retailer.

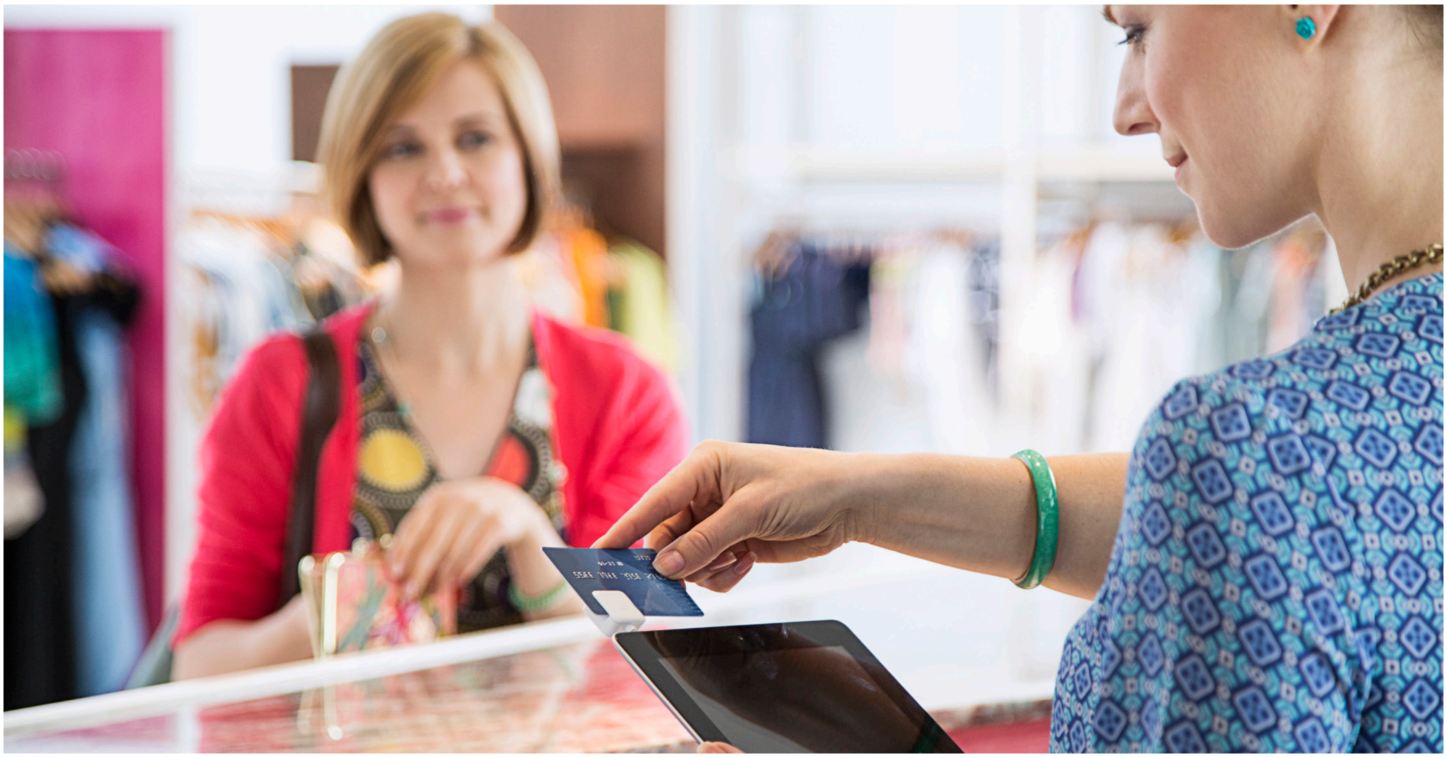
Developing the technology and messaging to own the POS is critical. Arguably, the largest key to success lies in turning retail employees into evangelists. It's no secret that motivated employees drive significantly higher conversion rates. Motivation doesn't need to come from direct, financial incentives. Instead, partners should create employee training that supports employee product evangelism, because owning and using the card is in the best interests of their customers. If the value proposition is clearly communicated and structured to employees, employees will drive acquisition volume.

This evangelism becomes even more important as the transaction becomes part of a seamless shopping experience.[10] Associates who previously spent their time at the register helping with customer checkout will become trusted advisers to help better meet customer needs. The program should provide a value that customers need. The application must be effortless. And upon approval, the card needs to be immediately available and ready for use, in both physical and digital form.

## Upgrade the channel strategy

That said, many competitors to partnership cards have larger marketing budgets and sophisticated channel strategies. With changing customer preferences and increasing market options, owning the POS isn't enough to win against competitors. Partnership programs need to complement their in-store advantage with robust channel strategies to drive awareness and affinity.

While partnership cards may not have similarly large marketing budgets, they can focus on creating rich content and raising awareness via personalized outreach that drives brand affinity. Specifically, in the content-rich world of online advertising, partnerships may want to shift spend away from channels that drive general awareness and toward those that will resonate deeply with their key customer segments.



At the individual level, they should focus on direct marketing (such as paid online marketing) in niche segments. For example, an issuer that has a portfolio from a leading electronics retailer could drive channel spend via paid reviews on gaming influencer sites or vlogs (video blogs).

### Develop best-in-class risk management

Competition has increased. Digital acquisition is on the rise. Partnership portfolios should consider leveraging non-traditional data and investing in cloud-enabled underwriting engines to more rapidly and accurately manage risk at the customer level.

Despite often having riskier pools of cardholders, underwriting for partnership cards historically enjoyed three key advantages:

- Lines were typically smaller.
- Spend was more concentrated.
- Almost all applications were in-store at POS, where fraud could be more easily managed.

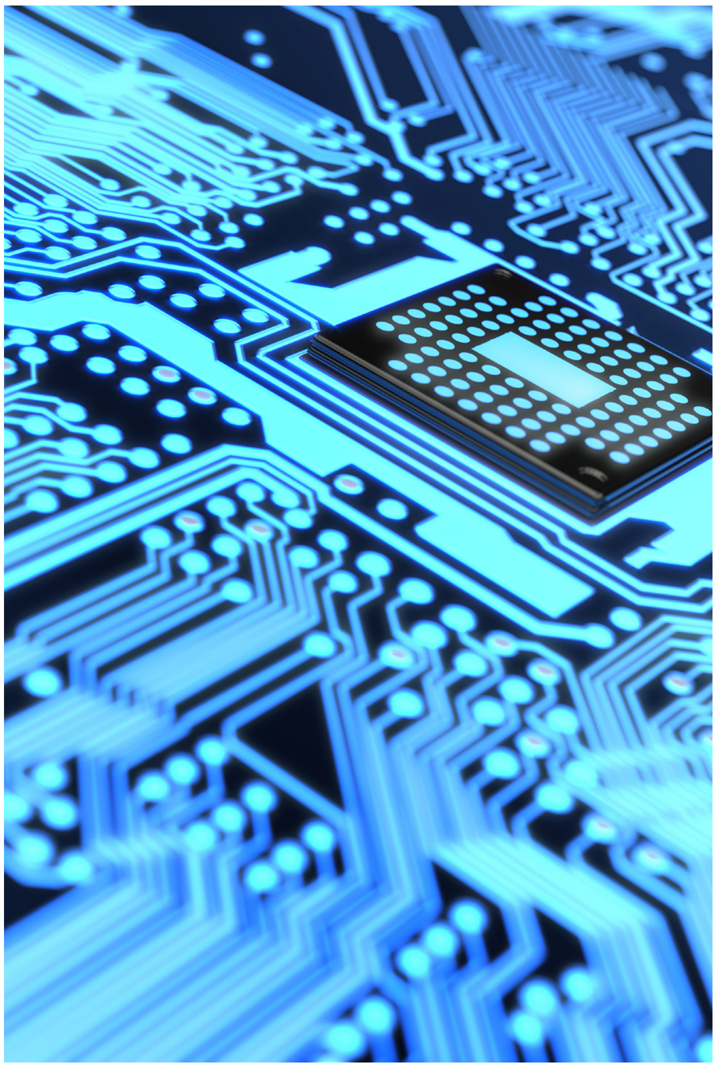
Given slower growth in acquisition, partnership portfolios must ensure they maximize the incremental margin they get from each applicant with more rapid and accurate underwriting engines that are both cloud-native and leverage nontraditional data sources.

While many issuers are beginning to leverage behavioral data in underwriting, partnerships have a unique opportunity to leverage retailer data as a key differentiator. The additional information on customer shopping patterns can help rapidly and accurately extend lines of credit at application while driving down fraud rates.

But to effectively integrate purchase and behavioral data into fraud models for retail customers, issuers will need to invest in cloud-based underwriting engines that can handle massive amounts of near-real-time data from retailers and that have secure connections for the mutual exchange of retailer and issuer data. While the cost of technology and talent investment is high, partnering with flagship cards or other retail portfolios is a powerful way to manage cost while still building a case for modernizing underwriting.

In addition, once the secure connections are in place, this data can support the development of more customized products and services based on a better understanding of customers through their behavior (who they are, what they value, and how they shop). This need not be a one-way street. Financial data can help retailers better educate their customers on how to smartly manage their credit, track spend with dashboards, and proactively drive savings opportunities in line with the card's value proposition.

While it may seem to be a secondary concern, when financial firms, like card issuers, are seen as customer advocates, they directly drive customer loyalty and future purchase intent.[11]



# Enabling capabilities are table stakes

To execute effectively on each key lever, partnership portfolios need to ensure that they have:

**A true partnership and shared vision.** Both the retailer and issuer need to be aligned on the vision for the card, where the card will play, and how it will both win on its own and complement the retailer's go-forward customer strategy. This is one of the most important building blocks, and it's often reflected in the culture of the relationship, as well as the contract language.

One way to incentivize a shared vision is to share both the upside and downside in the partnership. By exposing both parties to losses, the partnership creates shared responsibility for the future of the product. The card no longer risks being a bolt-on or cross-sale where retailers stand only to gain.

**Fintech collaboration.** As retailers focus on enhancing their customer experience, the ability to work well with fintechs that are supporting enhanced security, convenience, and control in a retail environment becomes critical. Fintechs focused on virtual cards, micro-installment loans, prepaid debit cards to manage teen spending, for example, can provide important expertise to support this shift.

**Digitally enabled, top-tier talent.** Retail partnerships may lag flagship cards in talent,[12] but a changing market makes that untenable. Recruiting younger, digitally savvy talent in marketing, product, tech, design, and underwriting, as well as working with flagship portfolios, e-commerce players, and retailers to exchange talent, are the first and second steps in developing stronger talent.

A third step is to become a talent incubator for the issuer's broader card business. This increases buy-in and connectivity with the rest of the business and builds a portfolio's internal brand as a desirable rung on the career ladder.

**Flexible, cloud-enabled technology.** As retail moves toward hyper-customization, issuers must be ready to succeed in an environment where customers want rapid change and retailers shift to meet them just as quickly.[13] Flexible, cloud-enabled technology creates an environment in which an issuer can constantly flex to meet retail partner and customer needs.

Again, building coordination with a flagship portfolio may be one way to find efficiencies in investment. Another is to build a business case across multiple portfolios for the resources required to build a broader microservice ecosystem. Once in place, the added flexibility should allow for easier customization across partnership portfolios.

# What's next

While partnership portfolios often have many challenges, they can also be an attractive product for both issuers and retailers, and there are clear ways to create sustained, differentiated advantage. To start on this journey, issuers should first assess the four strategic levers and key enablers mentioned previously, jointly work on an action plan to swiftly close the gap with their competition, and ask themselves the following questions.

- When you assess the differences between your and the retailer's value proposition, how is that contextualized across channels and ecosystem?
- How can you work with your partner to maximize customer engagement and drive recurring spend most effectively?
- What is the engagement that the retailer is using across its salesforce to drive the product to market at the point of sale?
- How efficient is the marketing funnel, and is it driven by automation?
- Is the underlying data infrastructure in place to enable the use of behavioral and retailer data?
- Based on the responses above, what solutions can be quickly prototyped and tested in the market to get real, actionable data?

The answers to these questions could determine who wins and who loses in the partnership market.

# Endnotes

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