

Credit Union News

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Credit Card Profitability:

Why is breaking even so challenging and what can you do about it?

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- Credit Card Break-Even Guidelines
- Steps for Improving Card Profitability
- Scorecard Analysis

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Credit card profitability is a tricky business. The off-the-cuff thinking is that with high rates (particularly in this low rate environment) and good interchange income, credit unions should be seeing the money come flying in from this product. And many credit unions have worked hard at introducing and establishing credit card products and portfolios.

Yet, the money isn't flying in, and many credit unions are seeing *negative* profitability for their credit card product. At the same time, we're seeing that many of the large, national credit card providers continue to produce quality earnings. Why isn't this happening among many credit unions? Why are we not sharing in the good times? Why can't we get our piece of the pie? How can that be?

To begin with, profitability is not just determined by the revenues. There is a lot more to assessing profitability. Remember, revenue and profitability are not the same. Profitability refers to the bottom line earnings, *after all of the expenses*, and it can be negative even if the revenue stream is significant and increasing.

Instead, profitability is a combination of many factors that produce net earnings. For credit cards, these factors include: usage, interchange income, processing costs, card production costs, collections, reserves and losses, salaries/benefits, marketing, other overhead, training, premises/furnishings, equipment, telecom, printing, postage, supplies, of course – rates, annual fees, late payment fees, processing fees, cash advance fees and other fees, and many other income and expense items. And, of course, the rate has value only in relation to the cost of

"Every day your credit union is fighting with other card providers in your members' wallets. Each day, your members make a choice about which card to use."

funds, which requires additional funding factors to be taken into account when assessing profitability. When all of these factors are accounted for and fully allocated, then you can begin to see the real picture.

Most critical, these factors are impacted by scale and by utilization. Revenues are important, but many of the costs are fixed, many members do not have or use the card with your credit union, and many members revolve with your credit union in such small amounts. What happens is that the interest and non-interest income

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Credit Card Break-Evens *(continued)*

generated can be insufficient to cover the costs of the credit card operations and all of the costs associated with the product. In a nutshell — not a big enough base, not enough outstandings. And the costs tend to be big, and if a sizable portion of the base doesn't revolve, then even getting an APR of 18% (or more!) of zero balances is still only zero, then there just isn't enough transaction revenue to cover the costs of credit cards that need to be incurred in order to provide, service and market the product.

“Profitability of the credit card product is most impacted by scale and by utilization. This means that you must achieve critical mass in penetration and break-even outstandings in order to produce a profitable credit card product.”

to which I have penetrated my own base with credit cards. This is calculated by dividing the total number of credit card members with credit cards, divided by the total number of members at your credit union.

- What is the break-even point for balances at my credit union? This refers to the dollar outstandings on a per account basis that are needed to break even at that balance range.

Remember, this is not the average balance per account, but the balance range at which profitability moves from a negative to a positive number. (It is much higher than the average balance per account.)

WHAT QUESTIONS SHOULD I BE ASKING?

What key measures that you typically haven't looked at in the past should you be looking at in order to determine how best to improve the profitability of your credit card base? There are two key measures that can tell a critical part of the profitability story: The first is the *penetration* level of credit cards among your entire credit union member base; and the second is the *break-even point* for outstandings on a per account basis. These two critical measures typically correlate with credit card profitability, and help you understand what you need to do to increase profitability (or to take alternate strategies, such as selling the portfolio).

Here are the two new questions you should be asking yourself:

- What credit card penetration do I have among my total member base? This refers to the degree

WHY ARE CREDIT CARDS DIFFERENT FROM OTHER PRODUCTS WE SELL AT THE CREDIT UNION?

Unlike so many other credit union products, members have multiple credit cards, and they walk around with them every day. Sure members do business with multiple financial service providers, and they may have a time deposit or two elsewhere, but they don't have lots of mortgages, lots of home equity loans, or lots of auto loans on the same car. Credit cards are different. This means that your credit union is fighting with other card providers every day in your members' wallets. Each day, your members make a choice about which card to use. This kind of activity is unlike other credit union products.

Rules of Thumb

- Penetration should be at a minimum of 30 to 40%
- Penetration should optimally be closer to 50%
- Break-even point for balances should be below \$3,000
- Break-even point for balances should optimally be below \$1,500

ARE THERE RULES OF THUMB I SHOULD FOLLOW?

Here are some basic and general “rules of thumb” for ensuring profitable credit card products for credit unions:

- Penetration should be at a minimum of **30 to 40%** of your member base, and should optimally be closer to **50%** penetration. If you are lower than these thresholds, then you have serious work to do to reach break-even penetration.
- The break-even point for balances should be below **\$3,000**, and should optimally be below **\$1,500**. If you are higher than these thresholds for average outstanding break-evens, then you have serious work to do to reach break-even average balances.

WHAT CAN I DO ABOUT THIS?

There are a number of steps your credit union can take.

- First, you can understand the complete profitability picture for credit cards, including far more than just the interest income and non-interest income. You need to ensure that you have a full allocation of costs (this is critical), so that you can clearly see the revenue the product generates relative to the all-in costs. It is important to include all costs, including critical costs such as loan losses, reserves, funding costs, marketing and sales costs, as well as the others.
- Second, you need to examine how likely your credit union is to reach minimum penetration levels. Reaching these levels usually requires serious marketing and sales efforts. Your credit union’s card must be able to provide real value to your members relative to their alternatives. This is not a one-time campaign, but an on-going and continuous effort of providing real value that members can quickly understand and quickly respond to.
- Develop utilization programs to significantly increase outstandings. This requires serious product positioning and enhancement efforts (and keep in mind that these kinds of programs add to your costs!), so that your credit union’s card is the card of choice. These are not easy programs to develop or maintain, but you need to implement them regularly if you are going to get the utilization levels you need.
- Finally, with low penetration levels and high break-even levels, you might consider a portfolio sales strategy. For many credit unions, the costs are just too high, and they would prefer to act as the intermediary, and not process or keep the outstandings on their books. You need to look at your penetration levels and break-evens, and determine the feasibility of reaching optimal levels. Otherwise, you may find it more prudent to sell the portfolio.

Rich is President and CEO of The Database Marketing Agency Inc. (DMA), Portland, Oregon, a premier service provider specializing in innovate systems and support that integrate marketing, sales and finance to deliver profitable solutions to credit unions and community banks throughout the U.S. DMA is an award-winning company, dedicated to increasing profitability to the financial service community. To contact DMA:

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Free Card Assessments

AssetExchange provides free credit card portfolio assessments and market valuations.

Your custom credit card portfolio assessment includes a full KPI analysis, plus:

- ROA & NPV analysis
- Detailed illustrations of performance
- Unbiased financial analysis of “keep versus sell” scenarios
- Best practices guidelines
- Peer group analysis.

AssetExchange Advantage

Our brokerage services ensure you get the best partnership available.

*AssetExchange is the credit union community’s leading credit card portfolio brokerage firm. Should you choose to sell your portfolio, our process is unique because we bring **all interested buyers** to compete for your portfolio. You get the highest premiums, best terms, and most partnerships from which to choose. Plus, we never pressure you to sell.*

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- Credit Card Portfolio Break-Even Guidelines
- Steps for Improving Card Profitability
- Analysis of 2003 Credit Card Scorecards

Presented by **AssetExchange**

Your 2003 Credit Card Portfolio Scorecard

Recently, you may have received a 2003 Credit Card Portfolio Scorecard from AssetExchange, which included rankings for your credit union's card portfolio performance. If you did not receive a scorecard or would like more information, please call us at 503-220-0007 x202.

Each Key Performance Indicator (KPI) was grouped into one of three categories: **Focus**, **Value**, or **Risk**. Those that fall into the "Focus" category, Account and Balance Growth and Cards as a Percentage of Total Loans, reflect the focus you place on your card program.

The KPIs that fall under "Value," (i.e., Percentage of Members with Your Card, Average Balance per Account, and Credit Line Utilization) provide insight into the value of your card product, relative to other cards your members may carry. Charge-Off Rates

and Delinquencies, or "Risk," reflect your underwriting criteria and collections efforts, and ultimately impact your bottom line.

