Playing for keeps: The credit card sector's fight for customers

An analysis of how consumers have been changing their use of credit cards during the pandemic, and how the industry is tackling disruptors such as buy now, pay later.

Introduction

The long-term trend for credit cards has been one of growing global card circulation and increasing consumer spend. But 2020 has not been a normal year.

The coronavirus pandemic has seen nations' economies and people's personal finances affected in ways which have upended traditional spending patterns.

Official figures from UK Finance show that in April this year, at the height of the first and most severe lockdown, the value of transactions by UK cardholders fell by half. By July, credit card spending was still a quarter down year-on-year, but signs of growth were again starting to emerge.

These green shoots of recovery have been reflected in new research by Finder which was carried out this November. It found that since the first lockdown came into effect on 23 March, 43% of cardholders used their credit cards more, while only 16% had used them less, compared with the "old normal."

However, as well as the current economic turmoil, there are other challenges for the sector. While the concept of paying for purchases in instalments has been the backbone of the credit card industry for decades, a new type of deferred payment, in the form of buy now, pay later (BNPL) schemes, has entered the market in recent years. Popular with millennials, in particular, these schemes tap into a generation of consumers who want to spread the cost of their online purchases but do not want a credit card.

This paper examines how the credit card industry has responded to the emergence of BNPL, explores consumer spending in the UK and reveals the results of Finder's latest research. It includes insights from experts and predictions for forthcoming challenges and how the sector may evolve.

Contents

Cards around the globe

There were 16.5 billion payment cards in circulation worldwide at the end of 2019, of which 12.7 billion (77%) were debit cards and 3.8 billion (23%) were credit cards, according to analytics firm RBR.

In 2014, out of a total of 12.5 billion cards, there were 9.2 billion debit cards (74%) and 3.3 billion credit cards (26%) in issue. This means the number of payment cards increased by 4 billion in just half a decade, at a time when the global population grew by just 0.4 billion.

Spending on cards is also on the up in the longer term. Global payment card expenditure rose by 13% in 2019 to reach $35 trillion (£26.7 trillion), reflecting a combination of factors. These include increasing financial inclusion, the burgeoning use of contactless payments - which will undoubtedly increase in 2020 due to the pandemic - and a growing consumer appetite to spend.

Global players

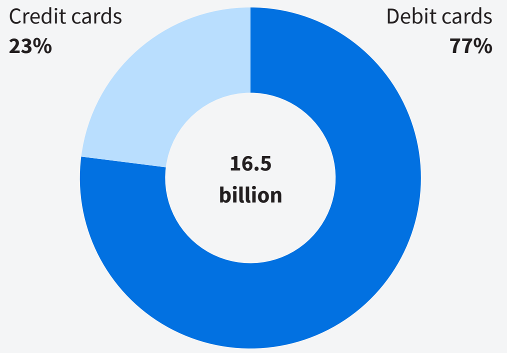
As for the major global players, RBR data also reveals that UnionPay - a name unfamiliar to many outside of China - is the world's largest card scheme, commanding 45% of global card expenditure by volume in 2019.

Visa (including its sub-brands Visa Electron, V PAY and Interlink) comes second with a 27% share, while Mastercard (including Maestro and Mastercard Electronic) follows with an 18% share.

UnionPay's dominance is due to its strong position in the world's largest market; it accounts for 93% of China's total spend, but just 1% of non-Chinese expenditure.

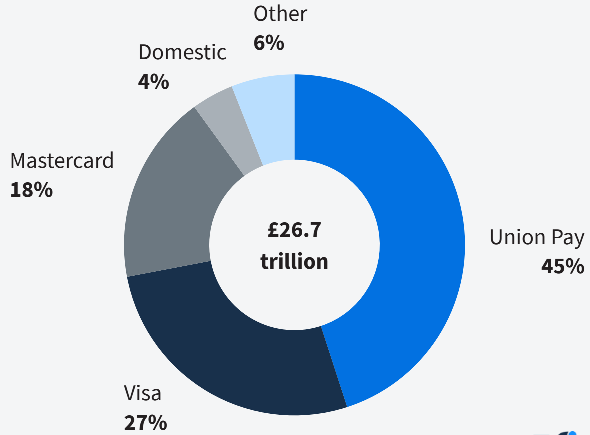
RBR's analysis shows that if China is excluded, the global picture shifts - Visa is then the largest card scheme with 39% of the market, followed by Mastercard with 32%.

Payment cards in circulation globally in 2019



Source: RBR

Share of purchase volume by card scheme in 2019



Source: RBR

In July 2020 there were 159.8 million payment cards in issue to UK residents, a slight decrease from the 163.9 million in circulation in July 2019, according to the latest figures from the industry body UK Finance. Of those 159.8 million payment cards, 95 million (59%) were debit cards and 64.8 million (or 41%) were credit cards - 52.2 million of which had contactless functionality.

Data from UK Finance also showed that while spending on credit cards by UK cardholders had been on a gradual upward trend until the end of 2019, the events of 2020 drastically altered that curve. As the UK population went into coronavirus lockdown in March, credit card use nose-dived, with the total value of transactions dropping from £15.8 billion in February to £8.7 billion in April. While debit cards also saw a drop - £47.9 billion in February vs £40 billion in April - it was not as drastic.

A slight recovery

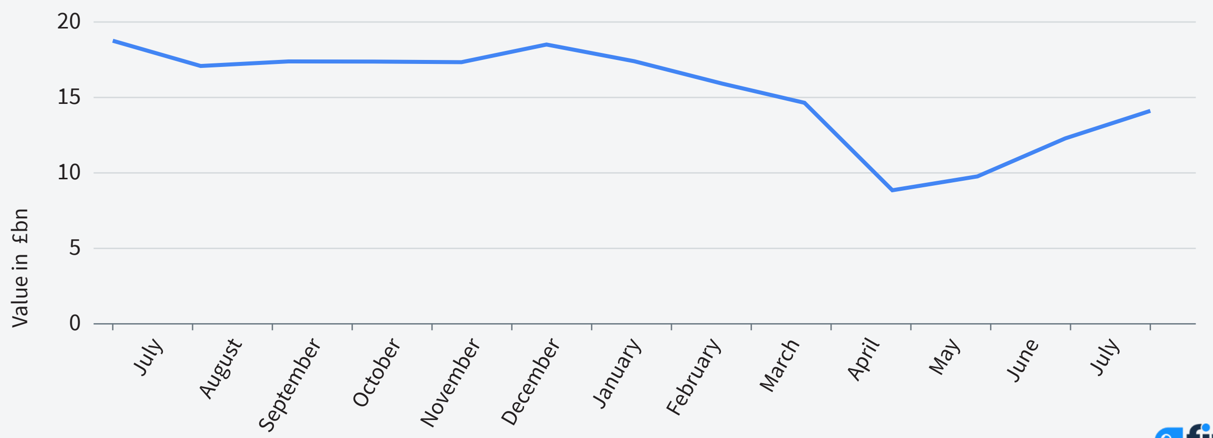
As the country began to emerge from the toughest of the restrictions, credit card spending did start to stage a recovery, rising again to £14 billion in July. However, compared to July the previous year, this was still a decrease of 24.8%.

The inability of many families to book a summer holiday has likely played a part in this fall; Barclaycard data shows that customers' combined debit and credit card travel spend was down 60.4% in July 2020, year-on-year.

Year-on-year card spend at restaurants also fell 64.2% - perhaps unsurprising, given that restaurants were only able to re-open on 4 July, and some diners were still reluctant to head back to public eateries. By contrast, the Barclaycard figures found that grocery spend was up 17.7% over the same period, while DIY and home improvement spend had increased by 27.1%.

Although the events of 2020 are disrupting traditional consumer spending patterns, in terms of the ways people choose to pay, the move away from cash and towards card payments in general is a growing longer-term trend. Card payments accounted for over half (51%) of all payments for the first time in 2019, pushing cash further towards the sidelines.

Value of UK credit card transactions, July 2019 to July 2020



Source: UK Finance

The first UK credit card was launched by Barclaycard in 1966. Since then, the credit card industry has evolved in line with technological advancements such as contactless payments, mobile wallets and digital loyalty programmes, but in terms of its core business proposition it has remained relatively unchallenged. Until now.

Over the past few years, buy now, pay later (BNPL) schemes have started to emerge both in the UK and globally. Popular with younger shoppers - who may not have a credit card but are still looking to spread the cost of their online purchases - the BNPL option is offered at the online checkouts of some of the UK's biggest retailers, such as Marks & Spencer, New Look, ASOS and boohoo.

Klarna, which was founded in Sweden and launched in the UK in 2014, is leading the BNPL pack. It was the UK's most downloaded BNPL app between 1 January and 31 July 2020, with 986,000 installs, according to statistics from Sensor Tower. Klarna's Australian rival Clearpay (known in Australia as Afterpay, the parent brand), was downloaded onto UK smartphones 298,000 times over the same period.

BNPL schemes have also started to offer different payment options to consumers who sign up. Klarna has three avenues to choose from: pay interest-free within 30 days; pay in three instalments; or pay using "Slice It", which involves finance for between 6 and 36 months with no interest if payments are on time, otherwise representative 18.9% APR (variable). The platform performs a soft credit check but charges no late fees.

Clearpay, which launched in the UK in 2019, offers to split the cost of an item into four chunks, with payments taken automatically every two weeks. This service is also interest-free but a late payment charge of £6 applies if a balance is left unpaid on or after the due date.

BNPL growth

A report released in February by payment processor Worldpay suggests that BNPL services are growing at a rate of 39% a year in the UK, and that they could double their market share of online purchases by 2023.

RBR senior associate Daniel Dawson says the trend is hitting the credit card sector already: "Buy now, pay later schemes will have a negative effect on the attractiveness of credit cards in certain markets, and Australia is one where this is starting to happen."

Top 5 most downloaded BNPL apps in the UK, 1 Jan - 31 July 2020

1. **Klarna** (986,000)
2. **My Argos Card** (435,000)
3. **Clearpay** (298,000)
4. **Laybuy** (162,000)
5. **Openpay** (44,000)

Source: Sensor Tower

finder.com

The card industry is feeling the threat from BNPL and has begun to respond. Although credit cards by their nature are already a type of pay-by-instalment product, card issuers have started to introduce BNPL-style features. Halifax, Royal Bank of Scotland and NatWest have all rolled out options called "Instalment Plans", where customers can choose to allocate a specific credit card purchase (or in the case of Halifax, a chunk of their credit card balance) to a separate payment plan.

NatWest's Instalment Plan feature launched in June 2019, with the aim of giving customers more choice over how they manage their borrowing, by providing a way to pay off an existing large credit card purchase over a set number of months, interest-free, with a fixed monthly fee instead. Customers receive an offer through their mobile app for qualifying purchases of between £300 and £3,000 and can choose between 5 repayment terms - 6, 9, 12, 18 and 24 months. They can compare the monthly payment amount and fee for each term before choosing.

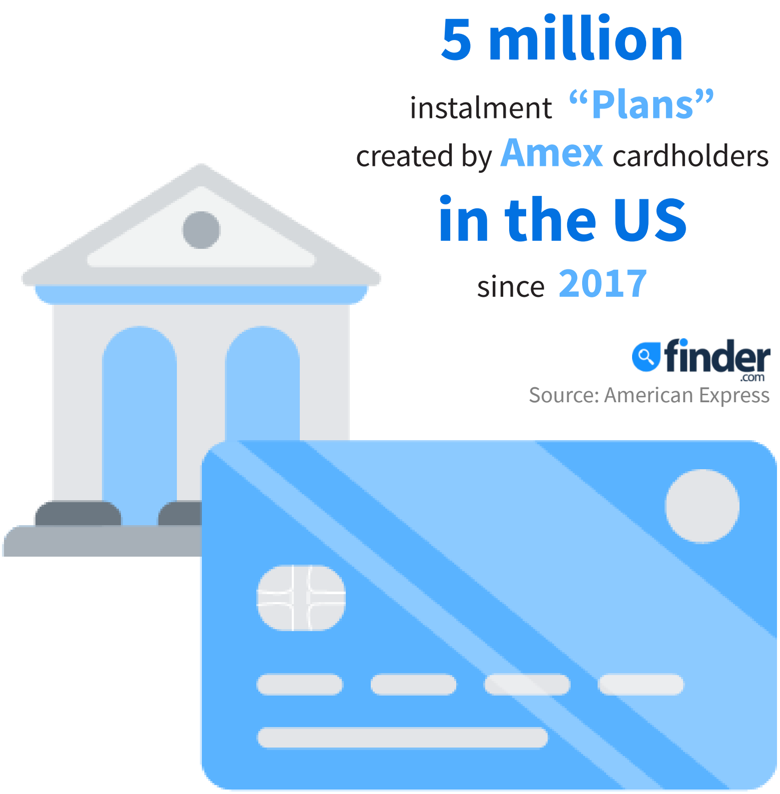
NatWest says the plan is always cheaper than if a customer pays off the transaction via their credit card over the same period. The monthly fee varies depending on the individual customer's "risk score", the purchase value and the term length, but the bank estimates that a typical APR for an Instalment Plan would be 10.9%, while a typical credit card purchase interest rate is 18.9%.

Amex Plans

In the US, American Express extended its "Pay It, Plan It" scheme to Platinum card holders this August. The "Pay It" element allows cardholders to use their Amex mobile app to pay instantly for purchases of under $100 (£76) at any point. The "Plan It" feature lets cardholders split larger purchases (of $100 or more) into equal monthly payments with a fixed fee and no interest. This can also be set up in the app, and the customer earns rewards in the same way as for other purchases.

Amex launched the "Pay It, Plan It" option to Amex Green and Gold cardholders in 2017. Amex says that so far, US cardholders have created nearly 5 million Plans, totalling almost $4 billion (around £3 billion). Millennial and gen Z customers account for 44% of the Plans that have been set up. Overall, the average Plan size is about $790 (£602), and the average number of Plans per customer is 4.

Meanwhile, the UK saw a new breed of credit card launch in December 2019. Tymit lets customers set their own repayment schedule for individual items, spreading the cost over 3 to 36 months. Users can also "simulate" purchases before they buy, to see overall costs and how it will affect their bill.



There was a dip in spending overall during the spring lockdown, UK Finance data shows, then a growing recovery over the summer - but beneath this lies a more complex picture. Data from analytics software provider FICO indicates that average spending on UK credit cards increased in August for the third consecutive month, up 6.9% to £639. But the number of account holders missing a monthly credit card repayment also rose - by 8.4% - reflecting the financial hit that many consumers had taken.

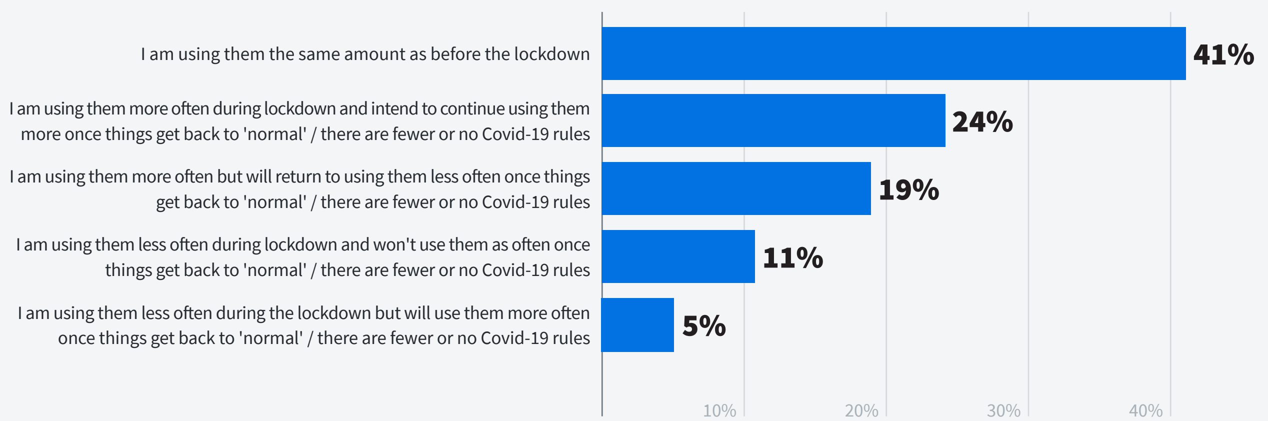
The spending trend is reflected in the results of Finder's latest survey; at the start of November, we asked 2,000 Brits how they had been using their credit cards since the first lockdown in March vs before it started. The results show that 43% of cardholders have been using their cards more, while 16% have been using them less and 41% have stayed at the same level. Of all those in the survey, 1 in 5 (19%) didn't use credit cards, which doubled to 2 in 5 (39%) among generation Z.

"COVID-19 has impacted certain larger-value purchases, such as air travel and holidays, but many people are using their credit cards to spend more on e-commerce transactions, including grocery deliveries, home improvements and streaming services," says RBR's Daniel Dawson. "In addition, there may be some people who see an uncertain economic outlook and are choosing to place transactions on credit cards as a way of deferring their liabilities and reducing the impact on their short-term finances.

"However, not everyone is using their credit card more often. There are many people who are saving money and not spending, with some choosing to reduce the balances on their credit cards."

In Finder's poll, the top reason among those using their card less - cited by 42% of this group - was not needing to buy as many consumer goods (such as clothes) since lockdown hit. Another popular reason (cited by 37%) was less socialising. And being unable to book a holiday was cited by 30%. An equal proportion simply said they couldn't afford to spend as much (respondents could choose several reasons).

Credit card usage since lockdown was first enforced (23 March)



Source: Finder research, November 2020

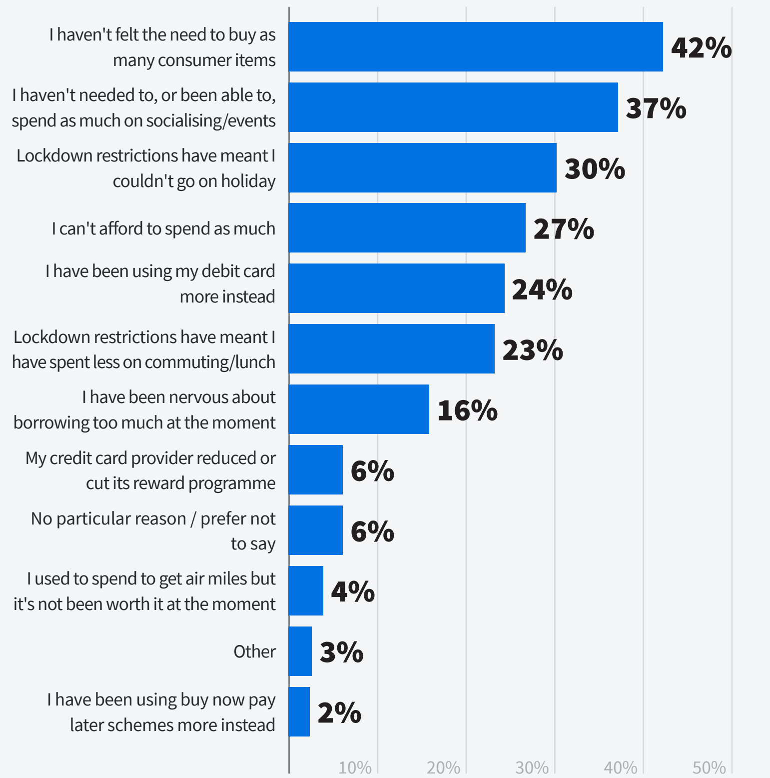
Changes in spending are evident in other parts of the credit sector, too. A Finder survey from July found that 23% of the 2,000 Brits polled had altered their use of BNPL services during lockdown: 19% had used the schemes more than usual during this period, while only 4% were using them less. We found that over a quarter (27%) of Brits who had used BNPL services recently - or planned to do so - cited not wanting to take out a credit card as the reason for choosing BNPL. The figure rose to 31% for generation Z.

The aversion to credit cards among younger generations is well documented. In a YouGov study from 2019, barely half (51%) of millennials owned a credit card vs 71% among generation X. And of those millennials who don't have a card, 93% never plan to get one.

However, younger generations' preference for another type of deferred payments is not without issues; BNPL services have drawn criticism for encouraging overspending among millennials, who don't always recognise BNPL as a form of borrowing. In Finder's July survey, 30% of respondents said one of the reasons they used BNPL was to pay for items that they otherwise wouldn't have been able to afford.

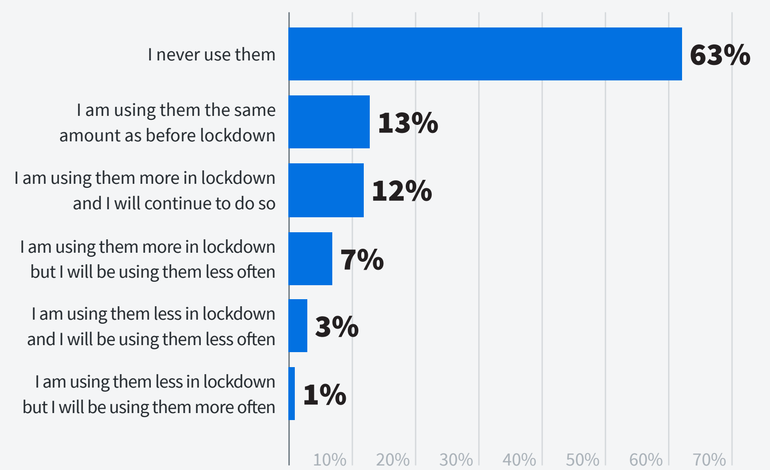
"New products that offer instalment payments should still be viewed as short-term borrowing, and there is some evidence that millennials don't recognise that buy now, pay later products are actually borrowing," reflects Andrea Dunlop, chair of the advisory board at the Emerging Payments Association (EPA).

Reasons cited by those using their card less since the first lockdown



Source: Finder research, November 2020

Shoppers' use of BNPL services in lockdown & plans for the future



Source: Finder research, July 2020

Many of the credit card industry's challenges relate to uncertainty from changes driven by COVID-19 and Brexit. But some are more predictable - disruptors like BNPL taking customers. Across the board, agility and innovation will help - and are helping - the industry meet these challenges.

Rewards programmes

For many consumers, a key influence in their choice of card (and how often they use it) is the rewards programme - cashback, air miles or loyalty points. But several factors have squeezed perks this year - including the drop in consumer spending on credit cards fed by COVID-19 disruption across the travel and entertainment industries.

A cap on interchange fees in 2015 began a shake-up of cashback perks, which were partly funded by interchange fees. And this year has seen popular cashback offers drying up across current accounts and credit cards. In fact, the finance data specialist Moneyfacts says that in 2020, the number of cashback credit cards available to consumers fell to its lowest level in 10 years.

Nationwide is the latest major provider to have announced such a cut. From 1 December, it is withdrawing the 0.25% cashback reward on its Select and Cash Reward credit cards - a move that will affect nearly 1 million of the building society's customers.

Interchange fees

The amount being spent in the UK economy is down overall this year, but some sectors are seeing a rise in customers. Finder research carried out in April showed that consumers are favouring shopping locally during the pandemic. And in a YouGov poll from August, 63% of UK consumers said they had made more card payments since the start of lockdown. This adds up to small shops paying interchange fees more often.

The trend towards card payments (now estimated to account for 80% of retail sales, having overtaken cash some time ago) has spurred the British Retail Consortium (BRC) to complain that card costs are becoming "excessive" for some retailers, particularly smaller merchants who can't benefit from the negotiating clout of large retail chains.

Jeff Moody, the commercial director of the British Independent Retailers Association, says: "The contracts available to large national chains are often not available to individual smaller independent retailers. With card transactions now the majority of their payment transactions, these costs are therefore being felt by consumers."

> Contracts available to large national chains are often not available to ...smaller independent retailers.
>
> *Jeff Moody, commercial director, British Independent Retailers Association*

The BRC expressed its concerns during the call for evidence for the government's new Payments Landscape Review, which closed in October. The Treasury will be leading the upcoming review, which will assess the UK's current payment network and identify any opportunities, gaps or risks in the overall system. Mastercard has questioned the BRC's conclusions, saying shops are paying less than they were five years ago.

Brexit

On 31 December, when the current transition period formally ends, there will be further uncertainty for the UK finance industry, although many aspects of regulation and consumer protection will remain as they are. For example, the Consumer Credit Act 1974 is UK law, so section 75 stays. But economic uncertainty will be fuelled by both Brexit and the pandemic.

"The credit card industry should be pretty resilient to the impact of Brexit," says Rob Escott, CEO of credit provider Koto. "But...when lenders perceive risk, they tighten credit underwriting standards and offer less credit to fewer customers. If lenders shut up shop to new customers, there will be a lack of affordable credit in the market, especially for people with slightly impaired credit histories or people who are new to the UK.

"Secondly, costs to service international transactions are likely to increase, and in the long run these changes will need to be passed on to customers," he continues. "That might be to the advantage of forex specialists and challenger fintechs who offer better rates for international payments than traditional banks."

Market challengers

As well as the emergence of dedicated BNPL schemes in recent years, other market players are hoping to claim their slice of the pay-by-instalments pie.

Payments giant PayPal has gone live in the UK with its own buy now, pay later shopping service, called "Pay in 3". Retailers including Crew Clothing, French Connection and Robert Dyas have signed up for the service, which launched at the end of October.

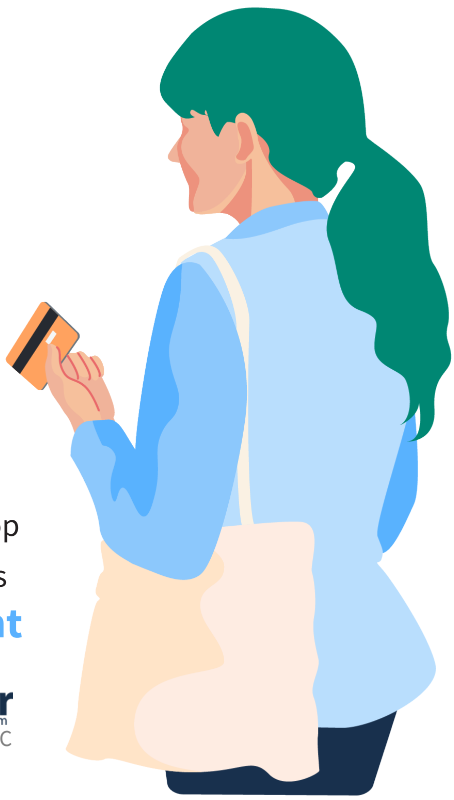
Pay in 3 allows businesses to offer their customers the option of making a purchase worth between £45 and £2,000, and then paying for it over three, interest-free instalments, taken automatically each month.

Pay in 3 will also appear in the customer's PayPal wallet, so they can manage their payments online or via the PayPal app, although any missed payments incur a charge of £12.

18.4p

The average **cost** to a shop for accepting a customer's **credit card payment**

finder.com
Source: BRC



Daniel Dawson, senior associate, RBR

“Credit cards are largely used for higher-value payments, and this is likely to continue despite the addition of contactless. COVID-19 is, of course, the main challenge facing the sector, and credit cards have been hit harder than other card types. It’s possible that we may see consumers reluctant to use credit cards as much in order to avoid going into debt, which happened to a certain extent during the global financial crisis in the late 2000s. However, we do expect to see a recovery in 2021/22, the timing of which will vary by country.”

Andrea Dunlop, chair, EPA advisory board

“I think the outlook for the credit card industry is positive, in an environment where consumer affordability is being tested. Credit cards remain a great consumer financial product, especially for emergency needs, but also for giving consumers up to 56 days to check purchases are correct before paying with their own money. Both credit and debit cards have seen the same technology innovation such as contactless and Apple Pay. The task for credit card providers is to become ‘front of wallet’, so the message about using the benefits of a credit card becomes key.”

Martin Magnone, CEO, Tymit

“The traditional ‘revolving balance’ credit card can’t match the transparency and control offered by BNPL instalments, so consumers are turning to these schemes instead. But BNPL services come with their own problems, too. They don’t provide an all-in-one-view of what their users have spent and don’t offer them any insights on affordability ... While there’s a perception that the credit card industry is too big and too important to fail, I don’t believe that. If the industry wants to stay afloat then it needs to change – or suffer the consequences.”

Chris Lily, group publisher and credit card specialist, Finder

“Credit card issuers may need to work at simplifying their interest rate and fee structures to make it easier for consumers to undertand the true cost of spreading repayments for card purchases. Established card brands can also learn from digital banks and personal finance apps, which have set new benchmarks for frictionless processes and clearer visibility for money management. While BNPL schemes are unable to compete with credit cards on several fronts, they sometimes win by being in the right place at the right time, so there’s a marketing challenge for card issuers too.”

Conclusion

With a coronavirus vaccine on the horizon, and the prospect of the travel, hospitality and entertainment sectors opening up again, the outlook for credit credit spending looks brighter for 2021. But uncertain economic conditions are only one challenge among several. The industry will also need to rethink its appeal to younger generations if it wants to tackle the threat from disruptors such as the swiftly growing BNPL operator Klarna. Card companies need to continue to innovate with different payment models and perks, and evolve their consumer appeal with the times.

About Finder

Finder is a personal finance website which helps consumers compare products online so they can make better informed decisions.

Consumers can visit the website to compare utilities, mortgages, credit cards, insurance products, shopping voucher codes, and so much more before choosing the option that best suits their needs.

finder.com/uk launched in the UK in February 2017 and is privately owned and self-funded by two Australian entrepreneurs – Fred Schebesta and Frank Restuccia – who successfully grew finder.com.au to be Australia's most visited personal finance website (Source: Experian Hitwise).

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November 2020