Plastic surgery: Are credit cards being reinvented?

An analysis of how the credit card sector is evolving in the face of competition from buy now, pay later and other digital-only challengers.

Introduction

There was a time when competition within the traditional credit card market was rife, with companies vying to offer the longest interest-free deal and attract new customers.

But in recent years, the biggest challenges have come from outside the traditional market. New payment methods such as buy now, pay later (BNPL), as well as digital, virtual credit cards that offer a suite of innovative features, have delivered speed and convenience.

Currently, physical cards are still a popular method of payment, with a new Finder survey of 2,000 consumers showing that 46% would most likely use either a physical debit (25%) or credit (21%) card to pay for an expensive item (£100+). Paypal was the third most popular option (11%).

But figures from UK Finance show that although the total amount spent on credit cards is up this year, the number of cards is down: there were 59 million credit cards in issue in February 2022, down from 63 million in 2021 and 66 million in 2020. What's more, our survey found that, although the average cardholder believes they'll continue to use a physical card for 9.5 more years, more than a third expect to stop using a physical card within 5 years and more than 1 in 10 already has stopped (see p4).

So are physical credit cards starting to fall out of favour with consumers, specifically younger generations? And will traditional card providers struggle to keep up with an increasingly innovative payments world? There's no doubt that digital-only payments are growing, and providers that can't offer a slick and fast acceptance process will suffer. The bar will only continue to be raised, as digital leaders such as Apple turn their sights on credit through BNPL, and challenger banks keep evolving their digital insight and tracking tools for customers. Meanwhile, Open Banking is changing the way decisions are made behind the scenes.

To stay ahead, some traditional players are looking to partner with upstarts rather than try to compete with them, as our report mentions on p5, but what else are they doing?

To explore this evolution, we asked 6 experts for their views on what's driving the changes in the market and what to expect next. We've published their views and our exclusive research in this report.

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Daniel Dawson, senior associate, RBR

RBR provides strategic research and consulting services to organisations in banking and retail technology, cards and payments. Daniel leads RBR's annual study of the global card and payments markets.

David Parker, founder and CEO, Polymath Consulting

Polymath Consulting advises organisations across the cards and payments industry. David is an active mentor, NED and advisor to boards including: 3S Money, Lifetidy, Nymcard, Cinnte, Swiipr, Edfundo, Cinnte, and others.

Hannah Elderfield, associate insight director, Canvas8

Canvas8 is a consumer insights agency that works with brands to improve their strategies, products and businesses. It was launched in 2008.

James Shepherd, head of credit products, Cashplus Bank

Cashplus Bank is a digital-only UK challenger bank that was founded in 2005. It provides current accounts, credit cards and other lending services to small businesses and consumers.

Martin Magnone, CEO, Tymit

Tymit is a fintech startup that was founded in 2017. Its stated mission is to reinvent credit and it offers 2 credit cards - one for building credit and one for those with a medium-to-high score.

Richard Whatmough, director of customer engagement, consumer finance at Lloyds Banking Group

Lloyds Banking Group is the largest UK retail and commercial financial services provider, with 26 million customers. It was formed through the acquisition of HBOS by Lloyds TSB in 2009.

Daniel Dawson, RBR

The younger generations, in particular, are turning more to alternative forms of payment. To some extent they use debit cards instead of credit cards. There is also increasing uptake of BNPL for which application tends to be less stringent than for credit cards.

Martin Magnone, Tymit

Old school plastic is without a doubt falling out of favour with consumers. The customer experience with the traditional end of the industry just hasn't evolved. When you think about the lack of control and transparency it offers, you immediately understand why so many people are afraid of using a credit card.

Hannah Elderfield, Canvas8

What's changing now is how people obtain credit. With digital banks making credit more accessible - be that through BNPL or lower barriers to entry - it will become easier for people to spend and move their money.

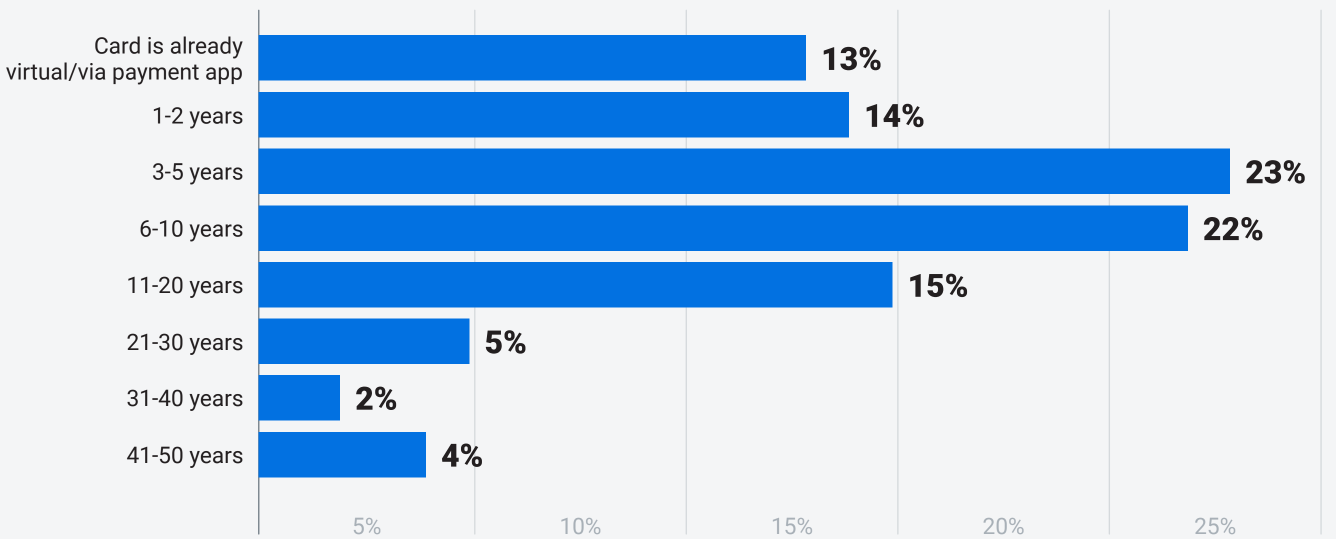
David Parker, Polymath Consulting

Credit cards have a bad reputation as they have become misused and are misunderstood by consumers. Credit cards were designed to provide short-term credit, not to be a long-term loan. But people…are using credit cards for the long-term, and…paying a high interest rate. BNPL is just the new version of short-term credit cards.

James Shepherd, Cashplus Bank

There are signs that customers and providers are thinking about these products less as cards and more as a flexible, digitally-enabled credit line…Digital enablement is also allowing customers to access payment options outside of the traditional card schemes…and other in-app functionality…encourages them to think of the product as more than a card.

How much longer card users expect to have a physical card



Source: Finder survey, May 2022. Base:1,627 consumers with a credit card

What are traditional card companies doing to innovate?

Richard Whatmough, Lloyds Banking Group

Traditional…providers [are] investing in online services for credit cards. For example…we've added payments controls, spending alerts, gambling blocks, virtual PIN view, free credit score checks, merchant discounts and more. What we think is important…is customer choice and competition…there is space for a whole host of credit card options – some people will prefer cashback, others linked loyalty programmes, perhaps travel perks.

James Shepherd, Cashplus Bank

What many of the new challengers have done very well is to find under-served customer segments which the established lenders have overlooked, and then wrapped their products with slick digital servicing options. In response, the traditional card brands are having to invest more into their legacy card and servicing platforms just to keep up. We've also seen…larger banks launch digital-only brands, but with limited success, and they are also being forced to compete on price and product features such as cashback and other rewards.

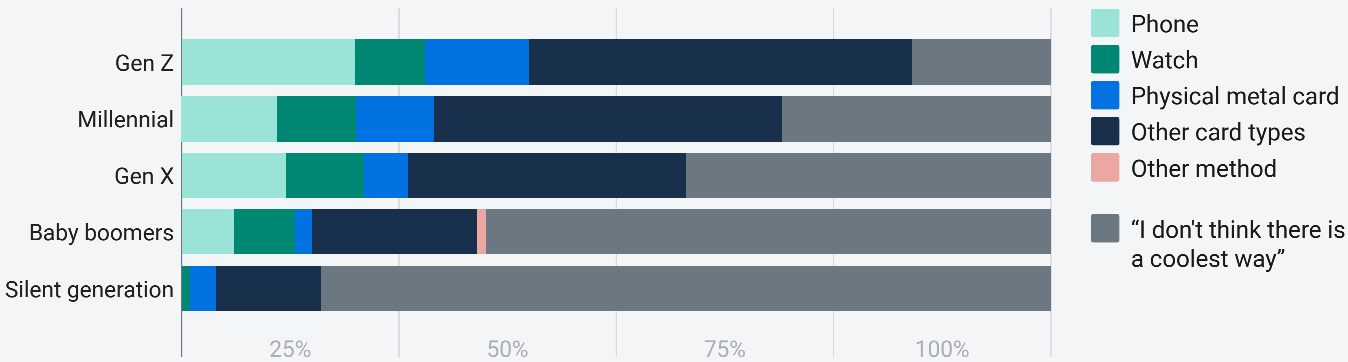
Hannah Elderfield, Canvas8

To secure the benefits, interest rates, and features they want, people are taking a hybrid approach to banking with fiscal promiscuity now fast becoming the norm. …Every brand…is having to work harder to engage consumers. We're seeing traditional banks play catch-up with digital disruptors. Whether that means launching digital offshoots themselves - something NatWest did in 2018 with Mettle, which saw a 5-fold increase in customers in 2021 - or competing with "market-leading" interest rates, rewards, or cold hard cash.

Martin Magnone, Tymit

For the most part, the traditional players are struggling. In many ways the deck is stacked in their favour – they have deep pockets to fund their portfolios, their cost of capital is low, and they can pay higher customer acquisition costs. But they have zero capacity to innovate. True, there are exceptions, and some banks are open to partnering with startups. At Tymit we're speaking to a few banks and lenders who see the opportunity around what we've built and want to tap into our capabilities.

The "coolest ways to pay" with a credit card



Source: Finder survey, May 2022

How can credit cards distinguish themselves in a virtual world?

Martin Magnone, Tymit

By putting the experience first and relentlessly sticking to this principle. Credit cards can't expect consumers to sacrifice on experience just to access credit. They expect all the features they get at a neobank, from real-time notifications and spend categorisation to budgeting tools.

David Parker, Polymath Consulting

Credit cards need to position themselves as the true BNPL solution, but the flexible one. [The credit cards market] needs to reposition itself as the best short-term flexible credit solution.

James Shepherd, Cashplus Bank

Customers expect seamless digital customer journeys from start to finish, so the speed and ease of both opening a credit card and then managing it are of paramount importance when it comes to differentiating your brand. For new customers, the expectation is not only to see the likelihood of approval upfront, but also the credit limit and interest rate they'll receive. Gone are the days of "indicative offers", and lenders need to react to this change if they want to compete.

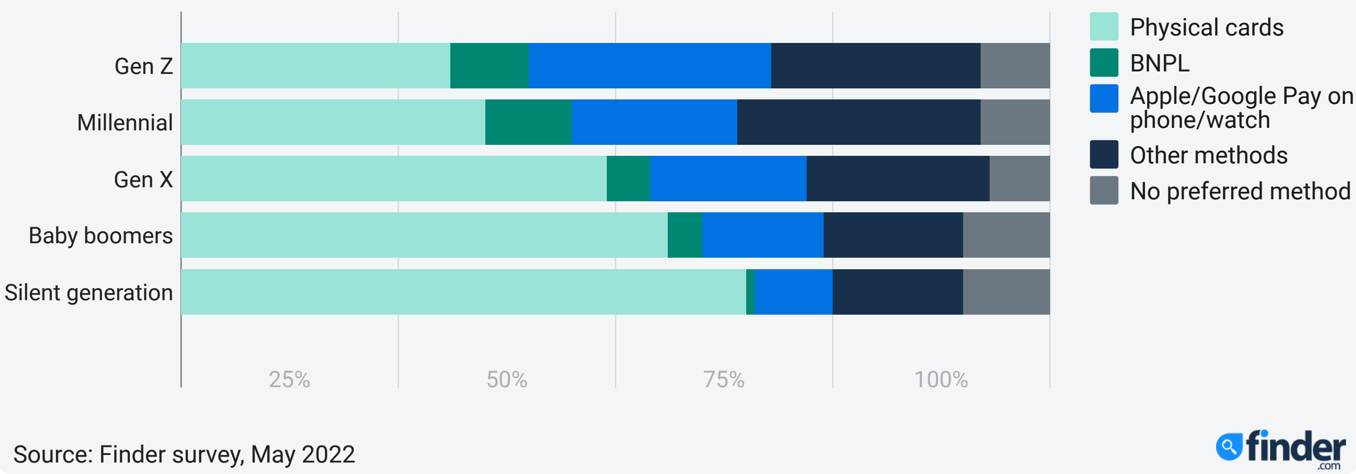
Hannah Elderfield, Canvas8

In recent years, we've seen a huge uptick in the adoption of digital wallets, contactless payments and digital banking. As people grow increasingly comfortable spending without a physical card, the opportunities for credit cards to become a more compelling way to spend and move money is huge - from the flexibility of payments to the expansion of rewards.

Daniel Dawson, RBR

In the commercial cards sector, virtual cards are becoming more widespread because of the security benefits (eg single-use virtual cards may be provided to settle a specific invoice). Although up to recently, virtual commercial cards could only be used for e-commerce payments, it will become increasingly common for them to be embedded in mobile wallets to allow them to be used for face-to-face transactions...This will reduce the need for companies to issue plastic cards to travelling employees.

Preferred ways to pay for items costing more than £100



Source: Finder survey, May 2022

What are the key drivers of change in the sector?

James Shepherd, Cashplus Bank

The rise of buy now, pay later (BNPL) and other instant lending products is undoubtedly driving mainstream lenders to innovate and move beyond the traditional credit card model. I expect to see more instalment loans and 0% purchase promotions in the market to compete, but at the same time most card providers have also realised that they need to up their game with promoting the benefits of credit cards over other short-term, non-regulated products.

The availability of Open Banking data, as well as a number of other data sources, will certainly drive a level of change in the industry, however it'll probably be a couple more years before we see the real benefit from the current levels of customer engagement.

Ultimately, Open Banking should be a powerful tool for driving competition as it will allow lenders to offer, where possible, guaranteed saving by having visibility of the customer's current pricing.

Martin Magnone, Tymit

Open Banking is obviously a huge driver, offering benefits to both consumers and credit providers, but another promising development is greater connectivity with merchants. Bringing the merchant and credit card closer together, directly and through affiliate networks, creates opportunities to add value to users in new and exciting ways.

David Parker, Polymath Consulting

No credit card firm is yet using Open Banking data as far as I am aware to fully assess consumers for credit card approval and set limits. They could do it, of course - Apple just bought Credit Kudos [a challenger credit reference agency specialising in Open Banking] to enable BNPL on ApplePay - but the credit card companies are just not using Open Banking to its full potential today.

“Ultimately, Open Banking should be a powerful tool for driving competition as it will allow lenders to offer, where possible, guaranteed saving by having visibility of the customer's current pricing.”

James Shepherd, Cashplus Bank

David Parker, Polymath Consulting

Traditional credit card firms will come under increasing pressure as we enter a tough economic period when bad debts are likely to rise, but also because most of them are not yet embracing the new ways to check creditworthiness using Open Banking. BNPL will become more regulated, but credit card firms will continue to lose business to this type of instalment payment method, particularly amongst the younger generations as they do not perceive BNPL as going into debt.

Martin Magnone, Tymit

The traditional revolving card is on the way out. How fast its decline will be, I can't say, but its descent looks unstoppable. I also see a new credit solution, with flexibility, transparency, and control at its core, emerging to take its place.

James Shepherd, Cashplus Bank

Historically low funding costs, combined with high liquidity, have enabled a range of new, digitally-focused credit card providers to enter the market, and this has been one of the biggest drivers of change in the last decade. However, changes in the current macro environment now represent a challenge to new entrants and may limit their capacity for funding and growth. It's possible we'll see some further consolidation in the market either through acquisitions or asset sales.

Daniel Dawson, RBR

We expect credit card spending to continue to increase over the coming years, albeit at a slower rate than debit cards after 2022 (there will be continued recovery in credit card spending in 2022 after the travel restrictions associated with COVID-19 in 2020 and 2021). Some payments will move from credit cards to other forms of payment in the next few years, but this will not be sufficient to lead to a decline in credit card spending in the short term.

Richard Whatmough, Lloyds Banking Group

It remains true that a credit card continues to be a useful choice for many in borrowing, spending and budgeting – they can help spread costs, earn rewards, build credit history, alongside other perks related to things like travel. Looking to the future, and the continued growth in different payment options, credit cards will likely remain a solid option but will sit alongside a wider range of choices – which can only be a good thing for consumers.

Conclusion

Demand for more flexible short-term credit is growing and as consumers become more comfortable spending without a physical card, and fast acceptance for credit becomes their expectation, competition is likely to focus on which brands can offer the most innovative features and benefits and the slickest experience. The entry of tech giants such as Apple into the BNPL market can only speed up that evolution.

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 launched in the UK in February 2017 and was founded in 2006 by 3 Australians. Finder.com/uk is the UK's fastest-growing comparison site, while 10 million people use finder.com each month around the world and over 400,000 rely on the Finder app to manage their money better (Source: *Similarweb*).

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About the author

Rachel Wait is a freelance journalist and has been writing about personal finance for more than a decade. She studied at the University of Exeter and has written for a wide range of websites and national newspapers, including *The Mail on Sunday*, *The Observer*, *The Sun and Forbes*.