Creating value through credit card partnerships in Latin America

Over the past decade, credit cards have become an increasingly important source of profits for a wide range of Latin American companies, including grocery chains, airlines, telecom providers and department stores. Banks and other financial institutions in the region are also adding to their bottom lines by providing alliance-based cards in partnership with merchants. For their part, consumers are drawn to these products by special offers and exclusive benefits that are bundled with card membership.

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In Latin America, credit card partnerships are a high-growth opportunity, as they connect banks with large numbers of new customers at a relatively low cost. Compared to other direct channels, a customer acquired via a partnership with an airline, for example, costs 60 to 70 percent less. By partnering with a telecom provider, and leveraging its inbound call centers for sales efforts, banks can slash acquisition costs by as much as 80 to 90 percent. When factoring in all other lines of the income statement, such as credit losses and operational costs, our analysis shows the contribution margin on a credit card business partnership, at steady state, is frequently over 10 percent, and as much as double that in some cases – substantially higher than in traditional bank credit cards.

More than half of new cards issued by some of the leading financial institutions in Latin America last year came via card partnerships. At present these partnerships account for one-third of the total card portfolio held by financial institutions. This trend will likely accelerate over the next two years, to the point where alliance-based cards account for more than half of these portfolios.

Merchants gain from these partnerships as well. To start, the merchant credit card offers an additional credit line to the customer. This benefit alone is a strong reason to offer credit cards, since in Latin American markets there is still a strong demand for credit. The combination of credit with offers of exclusive benefits such as promotions and rewards, added to the convenience of shopping with a credit card, increases the frequency of cardholders' visits and spending in the merchant's stores.

In terms of financial impact, major retailers across Latin America are deriving substantial shares of their overall profits from sales of financial products. In 2009 merchants in

Brazil earned up to 60 percent of their domestic profit from partnerships. In the same year, Chilean merchants garnered 15 to 25 percent of their profits from financial services (Exhibit 1).

The opportunities for credit card partnerships across Latin America remain robust.
To tap this potential, financial players should first understand how the markets differ in their development, and then apply partnership best practices in six specific areas.

One region, multiple approaches

Latin American markets vary widely in size and financial sophistication. There is no single strategy that banks should apply. The opportunity is substantial: consumer-to-business payment volumes in the region grew approximately 15 percent per year between 2006 and 2008, to $2.2 trillion. Credit cards account for 10 to 15 percent of this total, and revenues from credit cards totaled $30 billion to $35 billion in 2008.

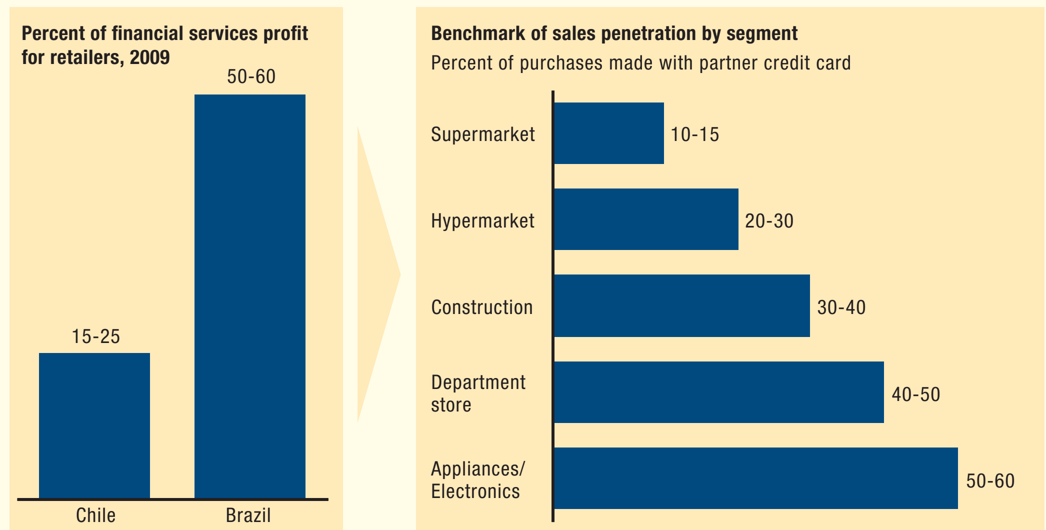
As a first step in planning a strategy, it is important to define the market segments. A formal scan of economies across Latin America reveals two distinct groups: In one, card partnerships are more sophisticated and widespread; in the other, partnerships are still incipient (Exhibit 2, page 26).

The first group includes the more developed markets of Brazil, Mexico and Chile. In these countries, financial institutions already have significant partnerships with major airlines, car manufacturers, mobile operators and retailers. Examples of financial institutions leading the way include Itaú-Unibanco in Brazil, Santander in Chile and Banamex and Bancomer in Mexico. In Chile, retailers such as Falabella, Almacenes Paris and Ripley offer financial services products.

Banks operating in the developed markets should focus primarily on achieving the full potential of current partnerships, developing a “standard” model for partnerships with mid-sized merchants, and capturing any remain-

Exhibit 1

For some retailers in Latin America, financial services represent a significant portion of their profit



Source: Economática; annual reports; press clippings; McKinsey analysis

ing opportunities to partner with large merchants that either have stand-alone financial services businesses or are willing to switch to a new bank partner.

In terms of credit card partnerships, the rest of Latin America would fall into the developing market group. In Colombia, Argentina and Peru, for example, card partnerships do exist, but many relevant companies in significant sectors remain unpartnered.

The strategic challenge for financial institutions in these markets involves locking up partnerships with remaining large-scale partners such as telecom providers (e.g., Telefonica de España-Movistar in Peru), gas station groups (e.g., Terpel in Colombia) and large retailers.

Six points where partnerships excel

To capture the benefits of partnerships, financial institutions need to tailor their strategies closely to local conditions, considering the different levels of sophistication across Latin American markets. We have identified six areas where successful card partnerships have distinguished themselves across the region, maximizing value creation for both the issuing financial institution and its merchant partner (Exhibit 3).

1. Product offering

In general, partnerships in the region are moving gradually from private-label cards, which are only valid in the merchant's stores, to general purpose, cobranded credit cards that can be used anywhere. In some situations, such as at gas stations and other businesses where close control of spending by type of purchase is valued by customers, private-label cards will still be the preferred product offering.

Partnerships are also migrating from offers focused on credit and installment payment options to those that offer benefits such as reward programs and discounts that promote frequency of use. Successful partnerships in

Exhibit 2

Strategic focus for credit card partnerships should be determined by the market's development stage

Countries		Situation	Strategic focus
Developed	Brazil Chile Mexico	Most relevant merchants have partnerships or have developed their own financial services operation Some mid-sized companies could be potential partners Issuers looking to non-traditional sectors for partnerships Existing partnership contracts may expire	Extract value from existing partnerships Adapt business processes to different partnership situations (mid-sized merchants, non-traditional sectors) Gain share by competing for expiring partnership contracts
Developing	Colombia Peru Venezuela	Several partnerships already established Some relevant sectors and companies (e.g., gas stations) still do not have partnerships	Approach remaining large-scale merchants for partnerships Extract value from existing big partnerships
	Argentina Paraguay Uruguay	Most relevant merchants are not involved in partnerships with banks In some cases, credit card market dynamics create additional challenges for partnerships (e.g., Argentina's banks already offer discounts in most sectors, but lack retailers with significant critical mass)	Approach large-scale merchants for partnerships Identify if critical elements of successful partnerships are in place (critical mass, distinctive value proposition, etc.)

Source: McKinsey analysis

Brazil, for example, offer prize-based reward programs featuring discounted sports and movie tickets and the ability to earn minutes for mobile phones (Exhibit 4, page 28).

As partnerships between merchants and financial players grow in sophistication and scale, the products on offer go beyond credit cards to include insurance, personal loans and savings products. In these cases, the benefits are communicated to consumers through all marketing channels – in-store, online, advertising and customer service call centers.

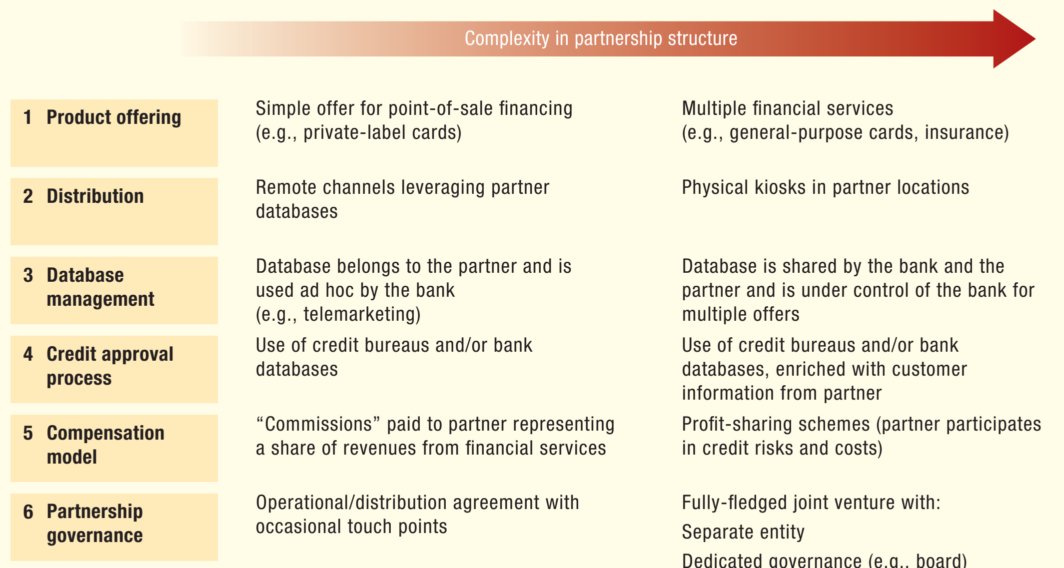
2. Distribution

Unlike their peers in markets such as the United States and Europe, successful retail financial services operations in Latin America rely on a strong physical presence in store locations. A number of factors explain this contrast, including lower labor costs in Latin America, lower credit card penetration and the frequent use of credit cards to pay in installments. The viability of this distribution strategy depends on a diffuse physical presence with well-located stores, supported by sufficient business activity in terms of frequency of purchase, average cost and total spending.

Financial services kiosks allow for face-to-face customer interaction and – when embossing machines are present – the issuance of cards on the spot. The use of such machines in store kiosks is a growing trend in Brazil; it makes sense where scale is sufficient. The rapid approval kiosks offer is highly appealing to consumers. For one partnership, store-card sales where the bank had kiosks with on-the-spot embossing were four times higher than those for stores with no physical presence (20 percent versus 5 percent). Kiosks, however, are not a strategy in and of themselves. In most markets, other low-cost sales channels such as call centers and Web sites also play important roles in distribution.

Exhibit 3

Successful financial services partnerships excel in six areas



Complexity in partnership structure →

1 Product offering	Simple offer for point-of-sale financing (e.g., private-label cards)	Multiple financial services (e.g., general-purpose cards, insurance)
2 Distribution	Remote channels leveraging partner databases	Physical kiosks in partner locations
3 Database management	Database belongs to the partner and is used ad hoc by the bank (e.g., telemarketing)	Database is shared by the bank and the partner and is under control of the bank for multiple offers
4 Credit approval process	Use of credit bureaus and/or bank databases	Use of credit bureaus and/or bank databases, enriched with customer information from partner
5 Compensation model	"Commissions" paid to partner representing a share of revenues from financial services	Profit-sharing schemes (partner participates in credit risks and costs)
6 Partnership governance	Operational/distribution agreement with occasional touch points	Fully-fledged joint venture with: Separate entity Dedicated governance (e.g., board)

Source: McKinsey analysis

3. Database management

Customer data is a valuable asset in a financial service business. Control over this data, as well as access, must be carefully defined in advance by partnering merchants and banks.

Database-sharing is the means by which partners will understand customer behavior and tailor strategy to different customer segments. Usually, the financial institution has a myopic view of customers, because it lacks data on the contents of their shopping baskets. Merchants, for their part, are usually unable to consolidate transactions by customer due to the lack of customer identification. Nor do they know what customers are buying outside their stores.

By combining both databases, the bank-merchant partnership opens up a whole new world in terms of customer lifecycle management. With the knowledge of what is inside the consumer basket, for example, partnerships can offer incentives for purchases in selected categories. One major retailer in Latin America segments its customers by shopping behavior and demographics, and then analyzes the shopping basket of each segment to offer specific coupons with discounts for 10 to 15 items in four categories: basic products, items most purchased by this segment, seasonal goods and items not purchased currently by this segment. Taking this a step further, retailers can see what consumers are purchasing elsewhere and target promotions to shift those purchases to their own stores.

Use of shared data should be closely coordinated to make these tactics work. Each incremental offer to customers, including the cross-selling of other banking products, should be carefully discussed by the partners to ensure that all interests are aligned and, importantly, that customers are not saturated with offers.

4. Credit approval process and analytics

By working together closely, financial institutions and merchants can improve the credit

Exhibit 4

Partnerships offer exclusive benefits to cardholders - Brazil examples

Car manufacturers	Mobile operators	Retailers	Airlines	Gas stations
Discount vouchers Percent of spending is accumulated in U.S. dollars and can be redeemed in car purchases, spare parts purchases and car-related services	**Extra credit for prepaid mobiles** Customer gets extra credit equivalent to his purchase of minutes **Double points for postpaid mobiles**	**Exclusive discounts** For purchases at stores and Web site **Better financing conditions** Additional "zero interest rate" installments **Rewards program** Purchases accumulate points that can be exchanged for prizes	**Extra miles versus other cards** Customer earns more miles per U.S.$ versus regular cards **Access to VIP lounges** **Free parking in selected airports**	**Cash back** 3 percent for purchases within own stores and 1 percent elsewhere **Points** Can be exchanged for prizes, miles or discounts (e.g., 2 points for U.S.$ purchase in partner stores and 1 point elsewhere) **Purchase of prepaid mobile credits** Purchases converted into credits for mobile phones

Source: Company Web sites; McKinsey analysis

analysis process to enhance the benefits of the partnership. There have been a number of innovative approaches to credit analysis. As part of its credit application process, one retailer gathered information about consumers' automobiles, enabling it to significantly improve its estimates of customers' income. In low-income segments, the estimates improved by almost 60 percent and benefited the partnership's bottom line.

One online merchant leveraged real-time access to the partner bank's customer database to offer a pre-approved credit card and discounts at check-out. The offer also allowed the customer to include the transaction on the brand new card.

In another case, a home improvement retailer adjusted credit scores by analyzing the contents of the customer basket. Customers who buy items such as door locks or fire alarms, for example, could be more careful financially, leading the partner financial institution to consider lifting their credit scores.

By integrating nontraditional data, such as automobile information, into credit screening models, both merchants and banks can raise the approval process to a new level. Furthermore, this information can also provide insights that power marketing decisions and even inform the strategic direction of the partnership.

5. Compensation model

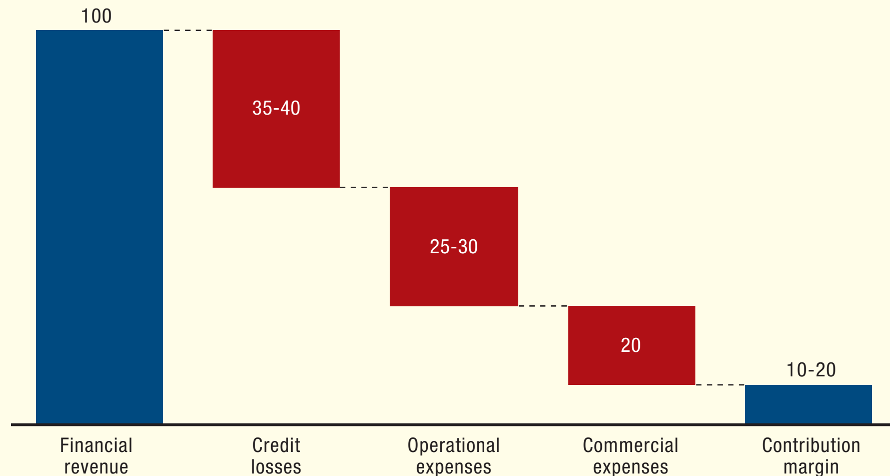
There are three typical compensation structures for financial services partnerships in Latin America: *merchant discount rates*, wherein the merchant gets a reduced interchange rate on partner card purchases in its own stores; *sales commissions*, which pay the merchant an amount tied to card sales or to overall revenue and transaction volumes; and *profit sharing*, wherein the merchant gets a percentage of the profits (or, rarely, the losses) generated by the financial services business.

The last two models tend to be more effective in driving overall card penetration and profitability, as they can be structured to track a set of metrics aimed at stimulating card sales (commissions for each activated card, volume of in-store purchases made by card, etc.), improving customer quality, and increasing the overall share of purchases made with store cards. Commission-based models tend to work best for mid-sized merchants, as they are often seeking immediate results and could be seriously harmed by a loss in the partnership. Profit sharing, on the other hand, is best for larger players willing to invest during the ramp-up phase to capture higher upside once the financial business is operating at steady state.

6. Partnership governance

The final ingredient in a successful card partnership is proper governance. There are two typical structures: one involves the creation of a full-fledged joint venture, and the other a simpler operational agreement. Partnerships will of course have to make tradeoffs in terms of organizational complexity, speed of decision-making and operational costs; but our research indicates that successful large-scale partnerships involving profit-sharing agreements generally use joint-venture structures. While this structure is inherently more complex, it better enables both partners to extract the full value of the business. Under either structure, clear division of responsibilities is required, with the bank typically handling risk analysis,

Exhibit 5
Economics for partnership cards



Source: McKinsey analysis

card issuance, payment processing, credit-line management and statement processing, and the merchant controlling marketing, promotions and discounts.

The best-performing financial services partnerships excel in the six areas we detail here. Of course, other factors remain integral to success (as they do in any financial services business), including credit and collections models, fraud management procedures and IT systems.

Putting the pieces together

With a deliberate focus on the hallmarks of successful partnerships, and a robust strategy, fine-tuned to the level of sophistication of the local market, financial institutions and their partners can expect significant returns. Our analysis of typical partnership economics shows that these cards generate contribution margins of between 10 and 20 percent (Exhibit 5). Card partnerships offer financial institutions profitable access to a customer base that they might not otherwise be able to reach in an economically viable way. As a result, it constitutes an attractive growth opportunity.

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With a significant share of the Latin American market in the early phases of a multi-year partnership-expansion trend, there is great untapped opportunity in this vital segment. A strong foundation and careful monitoring can allow credit card partnerships to offer non-financial players an important revenue stream and give banks the chance to reach more customers at low cost. The benefits for both parties, and the discounts and special offers provided to consumers, create that rarest of events – a win-win-win proposition.

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