Retailers’ Entry into Banking and Payments: Much Ado about Nothing?

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Panel Questions

• What factors contribute to the success or failure of retail banking venture?

• What are the advantages and disadvantages of a retail firm offering payment products to its customers?

• Are alternative providers filling new niches or competing directly with banks for retail banking customers?
Reasons Retailers Want Entry to Banking

• Process store payments made by their customers
  – Reduce costs of accepting payments

• Offer customers additional products & services
  – Credit cards
  – Home mortgages and home equity lines of credit
  – Investment products
  – Transaction accounts
Reasons Banks Do Not Want Retailers in Banking

• Reduces their revenues from payments processing
  – Merchant processing fees

• Challenges the bank franchise (charter)
  – Its value lies in its exclusive right (ability) of final settlement of payment
  – Yet, is currently being encroached by third party payment providers

• Large retailers (especially those with market power) pose additional threat to both
Reasonable Motivation By Both Parties?

• Banks offer a comparative advantage in payments in many respects
  – Access to Federal Reserve operated payment systems
  – Trusted third-party guarantee
  – Expertise in financial risk taking
  – Soft-information collection (know your customer) and hard-information collection (know income and spending patterns)
Reasonable Motivation
By Both Parties?

• But banks also “outsource” or “offshore” a number of functions
  – Customer service (call centers)
  – Account servicing (lockbox, account reconciliation)
  – Loan production (mortgage processing)
  – Information technology (networks, software)
  – Credit history (credit scoring)
  – Currency (armored car carriers)
  – Check Processing (adjustments and exceptions)

Retailers in the US

- In the U.S., retailers have had to find creative alternatives to outright owning a commercial bank
  - Due to separation of banking and commerce activities, which has existed since 1787

- Solutions:
  - Cooperate with a payments provider
    - Open a bank branch in a retail outlet
    - Offer niche or limited payment services
  - Establish an Industrial Loan Corporation (ILC) or a Credit Card Bank (CCB)
U.S. Solutions:

Industrial Loan Corp (ILC)

- Only a small number of retailers own ILCs
  - Target
- Or are awaiting approval
  - Home Depot
- Wal-mart’s application brought issue to forefront
  - Current moratorium on ILC applications

U.S. Solutions:
Industrial Loan Corp (ILC)

• Significant size differences between ILCs and Commercial Banks (CBs)
  • $213B in assets in ILCs
  • $8.9T in CBs ($11T in all banks)
  • Largest Commercial Banks: Bank of America ($1,084B), JP Morgan Chase ($653B), Citibank ($538B)
  • Largest ILCs: Merrill Lynch ($67B), UBS ($22B), American Express ($21B)
  • 52% of ILC assets in top 3, all financial firms
  • All ILCs account for < 2% of banking industry assets
U.S. Solutions:
Credit Card Bank (CCB)

• Retailers with CCBs: Sears, Circuit City, Harley-Davidson, Nordstrom, May Department Stores

• Potential benefits to owning CCB:
  – Increase revenue with private-label cards (interest income)
  – Improve targeted sales efforts (direct mail campaigns)
  – Reduce cost of financing CC receivables (move to CCB)

• No evidence of improved performance of retailers with CCBs, some negative results (longer collection periods, more receivables)

Retailer solutions in the US

• Retailers could have competitive advantage in:
  – Distributing goods (services) to a wide customer base (both demographically and geographically)
  – Providing new products
  – Offering competitive prices
  – But it is not obvious that these advantages would make retailers skilled at banking
Much ado about nothing?

- Debate regarding retailers entry into payments
- Would it result in:
  - Competition?
    - by competing in the same payments space, but without the potential regulatory oversight and without the experience and foundation in payments/banking activities
  - Cooperation?
    - by bringing new business/customers to banks, driving innovation and/or creating efficiencies by passing on their knowledge and advantages (i.e., running electronic networks, creating expansive distribution networks, branding and advertising)
- Let’s ask our panelists…
Panelists

• **Steve Worthington**
  – Professor of Marketing, Monash University, Faculty of Business and Economics
  – Retailer experience in the UK

• **Dave Martin**
  – Executive Vice President and Chief Training Consultant, NCBS
  – In-Store branching

• **Hamed Shahbazi**
  – Chairman & CEO, TIO Networks Corp.
  – Offering payment solutions to niche market