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J.P. MORGAN CHASE & CO.: THE CREDIT CARD SEGMENT OF THE FINANCIAL SERVICES INDUSTRY

I-Executive Summary

Consumers are increasingly using "plastic cards" and electronic vehicles while they are moving away from cash and checks as means to purchase the things they need and/or want. The use of credit and debit cards and electronic methods (smart cards) is rapidly replacing the traditional paper (cash and checks), even as the dollar volume of payments and the number of transactions expand. The outstanding credit card debt grew to $675 billion by the end of 2000, an increase from $242 billion a decade ago. This incremental increase in the usage of card-based payment methods are due to the high convenience, enhanced services and reward programs that they offer, as well as due to the inevitable effect of the Internet.

While the market of credit card grows steadily to saturation levels, the competition among the players of the financial market becomes extremely fierce. Industry modernization activities made it possible for large banks, taking to create new financial holding entities by doing profitable mergers and acquisitions. Chase Cardmember Services (CCS), the menace child of the merger of two large banks, is a highly leveraged credit card player in this almost saturated domestic credit card market. CCS also has the advantage of being a child of J.P. Morgan Chase; a highly reputable and internationally known investment bank.

The competition is cut throat. Although CCS has several competitive advantages such as having capital support and industry leading technology platform; the saturated domestic market and the exponential growth in the internet usage bring the need to make strategical management decisions. CCS should either focus on domestic market competition, in which there are too many substitutes such as other credit cards and/or monolines (American Express) or it should prepare a strategic plan to compete in the international arena by being the only competitor of Citibank.

II- Strategic Issues

New Payment Methods (Smart Cards, Secure Internet Platforms)

Technological advances like smart card and electronic payment options have dramatically affected the industry. The growth of purchasing on the internet is exponential, which means a huge opportunity to obtain new customers. Partnering with highly trafficked web sites is a good move to attract new customers. On the other hand even though the online purchase increased exponentially, people were still hesitant to shop online for fear of security breach when placing personal information over the internet. Creating a secure internet environment by developing high secure systems for credit card use over the internet is very critical issue to have a competitive advantage.

Co-branded cards (Reconsideration of existing partnership with large brands)

The main purpose of co-branding is creating brand loyalty by offering discounts and promotions on products and services. CCS has a strong position within co-branded cards area with several offerings including airlines, gasoline and retailing. However some of them are no longer profitable and must be re-considered, such as Wal-Mart card. The card does not offer any value enhancement but carries a low interest rate. In a fierce competition where the interest rates going lower and lower, Wal-Mart card has to make other offers to keep the brand loyalty and attract new customers, however because of the nature of the relationship with Wal-Mart, CCS is prohibited from making similar offers.

Corporate Credit Cards & Business Credit Cards

This is a profitable and growing segment which CCS must be active. A larger growth is expected from corporate card market, where the leader is American Express. CCS recently acquired corporate card business of Paymentech, the biggest competitor of American Express in the area. Paymentech has a more flexible technology platform for servicing corporate clients than does American Express. CCS must have an aggressive sales force to attract new corporations to the system by emphasizing the competitive advantages of its more flexible system.

Domestic or International Growth

The technological advancement made it highly convenient for customers to shop online, while making a growth opportunity in highly saturated domestic market. On the other hand, the credit card segment worldwide is likely to consolidate faster than one firm alone could absorb. Citibank, as being the only commercial bank targeting international growth is a big competitor for CCS. However, with the capital required to buy all international portfolios on sale, CCS also has strength to compete with Citibank. J.P. Morgan Chase has an advanced technology together with a good reputation as an investment bank but it lacks international presence as a commercial bank.

Uncertainty about management

The slower growth of the commercial banking business may cause CCS to exit the credit card segment since its parent company has more experience and a good reputation in the expanding investment banking business. Strategic decisions would be strengthened with the clarification of the situation. Otherwise, this indication will be a weakness point for the company.

III- Factors Contributing to Strategic Issues

(a) Industry Analysis

Buyers – (Very High Bargaining Power)

The potential buyers of credit cards are individuals, businesses and corporations. The individual consumer market is the largest among these three segments. The buyers are threats when they are able to force prices down and quality. Since there are many other alternative products with low switching costs, in this case, buyers have a high bargaining power which may result an increase in the operating cost and a decrease in the profits.

Substitute – (Intense Threat)

There are several substitutes which increase the tension of the threat. Other banks' credit cards with different features (lower interest rate, better value-addition…etc); debit cards and smart cards are the physical ones. On the other hand, with the introduction of banks that exist solely on the Internet, this technology threatens banks that have a physical existence where consumers interact with the institution. And last but not least, using "*cash*" instead of any other payment method is always a strong substitute which brings another perspective of threat.

Supplier – (High Bargaining Power)

In financial service industry, credit card companies are supplied by commercial banks. However, mergers and acquisitions also made it possible for an investment bank to supply a credit card, as it happens in this case. Chase Cardmember Services made up 29% of the cash operating earnings of J.P. Morgan Chase's commercial banking sector, where J.P. Morgan Chase is an investment bank. Even though credit card sector is almost saturated and there are a few players in the industry, it is still a growing market and there are many opportunities, especially in the international platform. Suppliers have a high bargaining power due to their capital power and built customer database.

Rivalry – (Intense competition)

The credit card industry is consolidated by largest issuers controlling an increasing percentage of the market. Large banks with deep pockets are also buying up smaller banks, making the consolidation stronger. As a result of this consolidation, the introductory interest rates, value propositions and retaining current card holders are becoming most important issues that make the rivalry even more intense.

Entry – (Possible with mergers and acquisitions only)

The Financial Services Modernization Act (1999) allowed cross-section affiliation between the banking and securities industries and the union between the banking and insurance industries. The legislation established a new financial holding company and thus spurred a flood of mergers and acquisitions.

The result of antitrust suit from Department of Justice against Visa and MasterCard recommended that major credit card issuing-banks commit their credit and debit cards exclusively to either Visa or MasterCard. So a new entrant should consider committing to either Visa or MasterCard or it has to be a monoline issuer like American Express, without a bank account.

(b) Firm's Competitive Strengths

- Chase Cardmember Services (CCS) has a strong domestic presence. It became one of the few remaining large issuers in the credit card segment as a result of two large bank mergers.

- CCS also benefited from exiting commercial banks trend. It acquired the entire credit card portfolio of the Bank of New York, which created a huge opportunity for the increased sales of mid-sized and large portfolios.

- CCS is competing strongly in co-branded credit cards area. It has offerings in various industries including gasoline, airlines and retailing.

- J.P. Morgan Chase (parent company) has a strong international presence and a good reputation in investment banking sector.

- CCS also has the capital required to purchase portfolios anywhere in the world as an aggressive acquirer, which makes its international expansion even more possible.

- CCS also developed an Internet presence as part of the www.chase.com site. The site allowed cardholders to check their current and previous statements online, and if they had a Chase checking account, pay their bills online.

- CCS has the industry leading technology platform that could be applied to corporate card portfolios domestically and internationally.

IV- Alternatives & Analysis

Leveraging competitive position by using technological advancements

In an industry where the bargaining power of buyers is very high, a company must be capable of creativity/innovation to meet the growing needs of buyers. The biggest portion if buyers in credit card market are the individuals. Individuals have a very high bargaining power due to many substitute alternatives and low switching costs. Even though the individual credit card segment is almost saturated, the increasing internet usage creates a huge opportunity of growth. However, it also creates new needs, new requirements and new payment methods. The worst case scenario for the credit card companies would be the increasing cash preference among customers, when they think that it is not safe enough to use credit cards online. Since the growth on the internet usage is an opportunity, then CCS must develop a secure internet platform to attract new customers and to retain the existing ones by adding value to its services.

Together with individual credit card users, corporate credit card is also another unsaturated segment. Corporate credit card segment requires intra-net networking type features to be convenient to corporate employees. CCS has the industry leading technology and it should apply the technology to build a convenient intra-net networking in the corporate.

Exiting credit card business and being a leader in investment bank business

The growth in credit card business is slower than the growth in investment bank business. Also, the lack of a commercial bank part wouldn't hurt an investment bank since it has different financial perspectives. J.P. Morgan Chase could chose to exit credit card business and hence it may focus on developing an industry leading position in investment banking business. By doing so, it will prevent further expenses to open international branches and to retain the current customers by lowering interest rates. It will also gain capital by selling the customer portfolio. On the other hand, in case of exiting the credit card business, J.P. Morgan Chase will lose a competitive advantage in growing international segment. It might leverage its competitive position in domestic and international market by relying on the internet and its industry leading technology to lower the costs of doing business. It can also use its investment bank reputation to attract new businesses and customers in profitable international segment.

International Co-branding

In almost saturated domestic credit card market, one of the critical issues for success is to retain the existing customers by creating value additions. CCS has several co-branded credit cards with large sectors such as airlines, gasoline and retailing. However, it is also important to have co-brandings with international brands in order to increase worldwide customer loyalty. It would also create a competitive advantage against Citibank in terms of added value. If the international co-branding is inevitable in competition then it would be better to make the commitments with large international businesses.

V-Recommendations

The bargaining power of buyers…….Very high

The bargaining power of suppliers….High

The rivalry…………………………..Intense

New entry……………………………Possible through mergers and acquisitions

The substitutes………………………Intense threat

The assessment of the industry reveals that one must be very strong and must have several competitive advantages to survive in this almost saturated domestic industry. However, the assessment of Chase Cardmember Services also reveals strong competitive advantages and capabilities that could be leveraged through industry leadership.

I would recommend CCS to stay in the credit card business by strengthening its position in domestic market through several more acquisitions and using its agent bank experiences. By holding portfolios in various sizes, it could also increase its accounts receivables and thus decreases the charge-off rates. To prevent its customers to convert to "transactors", CCS should decrease the interest rates. Also in order to increase the loyalty among existing customers, it should focus on value addition by offering discounts and rebates together with powerful co-brandings.

Since CCS has more threats in domestic market, especially from monolines due to their reduced operating costs, I would also recommend CCS to go international as being the only competitor of Citibank. Its only disadvantage against Citibank is its lower international commercial bank presence but it can overcome this problem with the capital support of J.P. Morgan Chase. It also has another competitive advantage of having a reputable parent company in investment bank industry. So it can leverage this advantage through getting new customers from J.P. Morgan Chase customers.

In a market where the internet usage and online shopping are incrementally growing, technological advancement and internet become the most critical and the most powerful weapons in the war of credit cards. CCS has the industry leading technology platform for now but I would recommend CCS to invest in developing better technologies to prevent imitation and to set higher entry barriers.