



# the \$4T credit card disruption

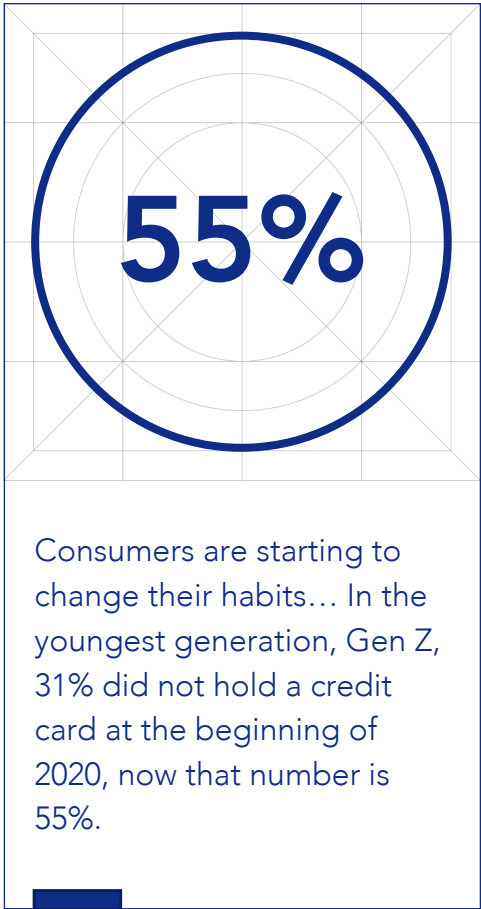
MOTIVE ——— INSIGHTS

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Embedded finance is set to create infinite opportunities in the consumer credit industry. The rise of embedded finance, which encompasses the integration of traditional financial products into non-financial business models, is underpinned by the innovation in how consumers and retail brands transact with each other. Since the introduction of magnetic stripes on credit cards in the 1960s, the fundamental premise behind a credit card has remained the same: A credit card is a method to buy now and pay later. Although leading consumer credit companies such as Klarna have defined a new transaction trend, traditional credit card incumbents still dominate the credit industry. With a \$9.6 trillion market opportunity in 2030, we continue last week's deep dive into the credit industry by looking at how financial technology and embedded finance can play an instrumental role in the new era ahead for the consumer credit industry.





At first glance, the credit card market looks healthy. Credit cards comprised 23.6% of US consumers’ total transactions on average in 2019, up 8.7% from the previous year. The US credit card industry processed close to \$4 trillion in 2020, where the eight largest credit card issuers accounted for 80% of those transactions. With a high market concentration, a handful of credit card issuers such as JP Morgan Chase and American Express continue to dominate the market with a magnetic stripe product that has not changed radically since 1991 with the launch of loyalty programs. In contrast, Klarna, the world’s largest buy-now-pay-later provider, reported \$53 billion in payment transactions in 2020 which is less than 10% of JP Morgan Chase and American Express, the two largest credit card issuers, separately. Buy-now-pay-later (BNPL) is a way of spreading out payments when consumers buy something, similar to an instalment plan. If Affirm, Afterpay and Klarna, the three leading players in the BNPL industry, with north of 100 million customers are

not able to disrupt the credit card market, will it ever happen?

While the market has not fundamentally changed, consumers are starting to change their habits. Outstanding credit as a proportion of total credit card spending has been steadily declining over the past 15 years and COVID-19 has only accelerated this trend. In the youngest generation, Gen Z, 31% did not hold a credit card at the beginning of 2020, now that number is 55%. Several reasons support that development, but one key driver is the increased skepticism about taking on debt and using traditional credit cards from young adults. That further adds to the fact that nearly half of all credit cardholders prefer their debit card as a primary means of payment.

Nevertheless, the industry barriers remain high. While some new companies have come to market offering credit card products directly to end-users, building a credit card product is complex, time-consuming, and costly. As creating the actual physical credit card can be too



costly, new financial technology companies can unlock the value in building the infrastructure to support it.

Historically, issuers have built their own in-house infrastructure to support the processing of credit card transactions, but with other industries venturing into the consumer credit space, an opportunity is opening for financial technology. By embedding credit issuing into non-financial brands, financial technology can enable brands to distribute credit products directly to their customers. In this emerging technology—sometimes referred to as credit card as a service (CCaaS)—providers develop application programming interfaces that allow clients to integrate processes related to underwriting, physical and virtual card issuance, credit line, risk management, and bank partnerships. Today, the CCaaS represents a \$1 trillion revenue opportunity for brands. CCaaS allows brands to have more control over their credit card programs and gives more access to consumers. Several consumer brands, including Instacart, DoorDash

and Apple, are said to be exploring fully integrated credit card programs.

Over the past decade, retail financial services disruption has occurred across deposit accounts, savings, investment management, financial advice, retirement services, but the consumer credit industry remains the last incumbent bastion. Inevitably, with a shift in demand and new technological advances, a change will happen. No matter in what direction the industry moves towards, there is an opportunity for financial technology in building the embedded financial services to connect consumers with brands. Credit card issuers may hold a position of strength, but new entrants will embrace the challenge by continuing to elevate their roles in customers' day-to-day lives. Increasing the existing value proposition and investing in transforming business models, will be the two central driving forces behind the new era for the consumer credit industry.

Today, the Credit Card as a Service represents a \$1 trillion revenue opportunity for brands

