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Author 1	Quah, Boon Huat
Author 2	NA
Author 3	NA
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Credit Card Wars and Credit Risks

By Quah Boon Huat

The growth in the use of credit cards as a transactional medium in Malaysia over the last two decades is a notable change in consumer financial services.

Credit cards now serve as a payment device in lieu of cash for many routine purchases. It has become widely used and accepted because not only does it offer a revolving credit line without the need for collateral, it also provides convenient access to other banking services.

For foreign banks operating in Malaysia, credit cards are an excellent way to overcome distribution limitations imposed on them. Hence the aggressive efforts by large local subsidiaries of foreign banks in marketing credit cards.

The credit card business can be profitable, provided that there is adequate risk management. Unlike corporate loans where margins can be razor thin and a single big bad loan can cripple the unfortunate lender, banks are able to charge 18% per annum on credit card debt, way above the rates they charge for other types of consumer lending.

High fixed overhead expenses imply that card issuers need to issue a large volume of cards to hopefully creditworthy heavy card users to maintain profitable operations. Though a card loan amount is usually relatively small, credit card loans earn the credit card issuer about three-quarters of its revenues in the form of interest earnings. The balance of one-quarter comes from interchange fees charged on the merchant.

Competition among credit card issuers is therefore intense and most prospective account holders receive many credit offers. Hawker sales tactics are commonplace, and often escalate into a blitz of "can-you-top-this?" gimmicks.

One of the greatest challenges credit card issuers face is generating a sufficient volume of profitable accounts while at the same time being selective in granting accounts and credit lines to maintain an acceptable level of credit risk.

The issuing bank manages these risks by issuing cards only to those with a risk profile it is comfortable with and then setting reasonable account limits. Banks are more likely to issue credit cards to relatively high-income individuals as there is greater likelihood that they will

promptly repay their debts and have low default rates, besides having greater prospects of extensive card use.

However, in their bid to boost market share in the face of intense competition, credit card issuing banks are increasingly making easy the availability of credit, possibly to ever-riskier customers. This increases the risk that some borrowers will become overextended, especially during periods of financial stress. In addition, increased competition can often lead to account management practices that increase the risk profile of the credit card portfolio.

As a percentage of total loans outstanding, the current level of credit card non-performing loans (NPLs) – RM740.5 million at end-Dec 2006 – may seem relatively small. But when analyzed within the context of an environment where there is double digit growth in:

- annual total credit card spending; and,
- amount of credit line extended (as at end-Dec., on a year-on-year basis),

intuition tells us that the credit card NPL problem is unlikely to stay small.

It should also be noted that credit NPLs, as a percentage of total consumption credit NPLs, have been rising – up from 23% as at end-Dec 2004 to 29% as at end-Dec 2006. Overdue credit card balances (less than 3 months) as a percentage of total current balances due from cardholders average around 11%. But, if all overdue outstanding balances are included, the percentage goes up to about 15%.

Malaysia's credit card NPL problem could deteriorate if not tackled adequately, and early enough. Rules on credit card business should be tightened to prevent over-indebtedness. For example, the minimum monthly payments could be lifted from the present "5% of the outstanding balance or a minimum of RM50" to "10% of the outstanding balance or a minimum of RM100."

In the long run, both the financial sector and the consumer should benefit from new regulations to control credit card businesses, as the risk of credit default will be minimized.

The writer is a research fellow with the Malaysian Institute of Economic Research (MIER).

One-liner summary: The credit card wars are increasingly making easy the availability of credit to ever-riskier customers.