BUSINESS INSIDER

JPMorgan uses its might to cut costs in credit card market

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A view of the exterior of the JP Morgan Chase & Co. Corporate headquarters in the Manhattan borough of New York

By David Henry

NEW YORK (Reuters) - JPMorgan Chase & Co. is cutting prices for a group of its credit card customers and getting Visa Inc to shoulder at least some of the burden of the lost revenue, underscoring how the largest U.S. bank's size can help it hang onto business in fiercely competitive markets.

At stake are the billions of dollars that banks receive annually from consumer use of a credit card to pay a retailer. Chase, which generated roughly $3.6 billion of revenue last year from those fees, is increasingly occupied with fending off banking rivals like Citigroup Inc , as well as Silicon Valley companies such as Paypal Inc and Square Inc.

Chase's revenue from those fees is showing signs of eroding. In the first half of 2015, fee income in the bank's credit and debit card business fell 2 percent from the same period a year earlier, even as the bank processed a higher volume of transactions. A person familiar with the matter said lower processing fees were a critical part of that decline.

JPMorgan CEO Jamie Dimon pledged in an April letter to shareholders "to be very aggressive in growing this business." At a conference with securities analysts in February, he cited the credit card operation as an example of how JPMorgan has to cut prices and upgrade products to keep from falling behind competitors.

"In a capitalist world," Dimon said, "you've got to be giving the client more, better, faster, quicker, or you lose."

Credit card fees generated about 4 percent of the bank's revenue in 2014, but analysts said that much of that money has historically fallen to the bottom line, making it a critical support for the bank's $22 billion of annual profits.

To stem the decline, Chase is assembling a vast array of parts into what will become either a brilliant machine or a makeshift disappointment. A key part of the strategy came in 2013, when Chase inked a deal with Visa that allowed the bank to essentially lease Visa's network for 10 years at what industry sources said is a fixed rate.

There are some signs that the Visa deal is starting to pay off for Chase. This year, the bank won the right to process credit card transactions for customers of Marriott International at some 3,700 hotels in the U.S. and Canada and for Chevron USA at nearly 8,000 gas stations.

Steve Mott, an independent payments consultant said, "Fizzle was the watchword until they got the Chevron deal."

Some wonder if the bank is wasting its time.

"So far, there is no evidence that it has mattered in a way that changes market share," said veteran card company analyst Craig Maurer of Autonomous Research.

BRAINCHILD

Chase's efforts are the brainchild of Gordon Smith, the head of JPMorgan's consumer business, who joined Chase in 2007 after 26 years at American Express. He is trying to recreate large parts of American Express inside of JPMorgan Chase, the largest U.S. bank by assets.

An American Express spokeswoman declined to comment.

To imitate American Express, Smith needed a few components. When a consumer pays for a sweater at a department store with a credit card, three parties usually get involved: money moves from the bank that issues the consumer's credit card through a network like Visa or MasterCard to the bank that processes transactions for the retailer. Each of those three, the two banks and the network, collects a fee for its role.

American Express usually occupies all three links of the chain. But Chase, without borrowing Visa's network, was only able to be two of the three: the bank for retailers and the bank that issued the credit card to the consumer.

The deal that Chase signed with Visa allows the bank to essentially serve as all three links, which in the near term gives it more leeway to cut costs.

Longer term, the deal with Visa will allow Chase to corral more information about what its customers are up to, said Mike Passilla, the Chase executive running this effort, in an interview.

When a retailer uses Chase to process its credit card transactions, it can now sign up for a service known as ChaseNet, which means that when a consumer buys something with a credit card issued by Chase, the bank will process the transaction from start to finish, essentially serving as all three links in the chain.

When that happens, Chase can charge the retailers lower fees for processing partly because of terms it negotiated with Visa, although the details of how much lower the charges can be have not been disclosed.

Consumers may never know that ChaseNet exists. Their cards feature a Visa brand, and they can use them wherever Visa cards are accepted.

ChaseNet works only when Chase is both the consumer's bank and the retailer's bank. That could happen fairly often, because Chase is second only to American Express among U.S. issuers in spending on cards, with market share of 19.4 percent last year, according to the Nilson Report. Chase is the biggest U.S. card issuer by outstanding balances, according to Nilson.

Having the chance to cut fees for retailers is important now because many merchants are pressing on every front for lower processing costs. Retailers have won court cases against card companies over pricing in recent years. Mark Horwedel, CEO of the Merchants Advisory Group, said merchants expect more concessions because they have seen regulators in Europe move to cap fees on credit cards at about 15 percent of U.S. levels.

Costco Wholesale Corp is widely believed to have chiseled lower fees out of Citigroup and Visa when it decided to stop using American Express as its transaction processing bank, and to stop putting its brand on American Express cards. Costco declined to comment on the specific terms of its agreement with Citi and Visa.

Neither Visa, nor Chase, which is the biggest issuer of its cards, have disclosed the terms of their deal, but payments experts believe both sides had reasons to sign on the dotted line.

For Visa, it was the chance to lock in 10 years of business from the biggest issuer on their network, without the fear of their fleeing for rival MasterCard Inc .

For Chase, the deal gives it the chance to run as much additional volume over the network as it can gather for no extra cost, which gives it more leeway to cut rates to retailers, two people in the industry said.

The bank's sales pitch has worked on at least some companies.

Michael Cullen, a finance executive for Marriott International, said that Chase's deal with his hotel company will yield "significant" cost savings. He added that the bank's history of investments in its credit card business gives him confidence that Chase will keep up with technology and customer demand for advanced payment devices and spending information.

"Payment processing is such an important part of the business," Cullen said. "You're going to go with the provider that has the technology and the customer base and is investing."

(Reporting by David Henry; Editing by Dan Wilchins and John Pickering)

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