**LBG Background Research**

# Digital transformation and card payments in the UK

There are 39.2 million card payments occurring daily in the UK, and this is forecasted to increase to 60 million by 2026 [1]. Half of all these payments in the UK are carried out using debit cards, with the number of contactless payments increasing by 30% to 17 billion annually (compared to 13.1 billion in 2021) [2]. With every transaction, banks collect a host of other data including amount, frequency, type, location, origin and beneficiary information **[ref]**. This is alongside information the customer has already declared to the bank such as personal contact details, addresses and personal finance information. Clearly, transactional data is a vast source of information for banking institutions that is readily available and abundant and that can provide immeasurable insight into the bank’s customer spending behaviours.

The impact of COVID, lockdowns and public health regulations remaining in flux for an extended period has had a significant and irreversible impact on consumer spending and purchasing behaviour. In particular, there has been a massive increase in online spending and contactless/digital payments for consumer items. Even after or between the lockdown period, this consumer spending behaviour hasn’t wavered. As a result in this new banking environment has become critically important for banks as digital marketing strategies to cater to this new segment of digital customers [3].

# Background of banking sector in the UK

Commercial banks, are for-profit organisations that open accounts for customers to deposit money, lend money and offer other personal banking services. They play a critical role in the UK and global economies by providing a critical service to customers that allows them to store and deposit their money as well as creating liquidity by aggregating the deposits of their many customers. Primary sources of revenue for commercial banks are interest earned on loans that are lent using money deposited in accounts from customers or businesses however this is limited as banks cannot freely do so indefinitely [4].

*Market forces* affect how much banks can lend as they must maintain profitability to preserve business outcomes. Banks have liabilities, overheads and operational costs that they must pay utilising the profit from capital that is lent. Many banks also offer interest on personal savings/current/select accounts that they must pay out. The rate of interest banks can offer in the UK is ultimately constrained by the Bank of England. Furthermore, banks attempting to offer more loans doesn’t necessarily fix this issue, as when banks increase lending, their average profits from each loan reduce as they often must reduce the interest rates to stay competitive in the market.

Furthermore, banks need to do extensive risk management with loans – as loans are made over long-periods of time, the banks require ideally stable deposits from customers in order to maintain sufficient liquidity in order to manage any unexpected defaults on loans that may be extremely costly. Credit risk analysis is a key factor in this.

Therefore, not only is it important for commercial banks to acquire as many customers as possible that have stable deposits but it is equally important for banks to profile customers correctly to minimise losses from defaulted loans and prevent any liquidity risks.

This highlights how acquiring new customers is the central driver of revenues for commercial banks directly and indirectly. Therefore, banks need to develop advanced methods to target and encourage customers to join the bank.

# Alternative sources of income for banks

Other than debt securities and loan/mortgage interest payments, banks offer other services and charge fees to provide additional revenue streams.

Credit cards offer a lucrative source of income for banks such as interchange fees charged to merchants for accepting the credit transactions as well as interest fees and late-payment fees on the client/user.

Many banks also offer premium accounts that provide other services such as travel and device insurance, shopping vouchers and cashback schemes. Selling these products requires a deep understanding of the psychology and spending behaviour of customers in order for targeted marketing to be effective in selling these products.

# References

[1] “Card payments per day UK | Statista.” Accessed: Feb. 16, 2024. [Online]. Available: https://www.statista.com/statistics/719708/card-payments-per-day-forecast-united-kingdom/#statisticContainer

[2] “Half of all payments now made using debit cards | Insights | UK Finance.” Accessed: Feb. 18, 2024. [Online]. Available: https://www.ukfinance.org.uk/news-and-insight/press-release/half-all-payments-now-made-using-debit-cards

[3] “Consumer spending trends and COVID-19 | Growth | Barclays.” Accessed: Feb. 18, 2024. [Online]. Available: https://home.barclays/news/2021/02/Insights--COVID-19-and-the-rise-of-the-contactless-consumer/

[4] M. Mcleay, A. Radia, and R. Thomas, “Money creation in the modern economy.” [Online]. Available: www.youtube.com/watch?v=CvRAqR2pAgw.