*Second Case Study:*

Case example: Analyzing an affinity credit card (ex . special card only available to members of a specific group)

Facts: 1) average card balance is $1000

2) each card has a rate of 15%

3) membership fee is $20 per card

4) loss rate is 3%

5) $25 operating cost per card

6) $10 affiliation fee per card (cost to the group for access to members)

7) 6.5% cost of funds

Q1: How much profit % is generated in 1 year?

A1: Total Revenue = ($1000 \* 15%) + $20 = $170

Total Expense = (3% \* 1000) + $25 + $10 + ($1000 \* 6.5%) = $130

Total Profit = $40

Q2: The 3% loss rate can either mean either 3% of the outstanding balance defaults or 3% of the borrowers default on their entire balance. If the average balance is increased to $2000, what happens to the loss?

A2: The loss doubles either way you calculate it.

Q3: Is a borrower with a low balance more or less likely to default then a borrower with a high balance?

A3: Less likely. Borrowers tend to charge up a balance before they default.

Q4: Would the affilated group ever want to puchase the accounts from the financial institution?

A4: The most likely scenario is that they want to purchase the accounts in order to turn around and sell them to another financial institution.

Q5: If the affilated group offered $20 per account to purchase from the financial institution, what would thier profit be? (assume that we are only talking about 1 year)

A5: Current profit per account is $40 minus the cost of $20 per account to purchase and eliminate the affiliation fee of $10 per account. Profit after the purchase woul be $30.

Q6: What could the financial institution do to convince the affiliated group not to want to purchase?

A6: Increase the affiliation fee

Q7: What is the most the financial institution would be willing to increase the affiliation fee to?

A7: Max profit is the current level of $40 and minimum is the profit if sold to the affiliation at $20. $40 - $20 = $20. They could only increase the fee by $20 for new affiliation fee of $30.