

LESSON 8:**CREDIT CARDS****8.0 Objective:**

After reading this lesson, you will be able to understand .

- Concept of credit cards
- Types of credit cards
- Benefits, limitations of credit cards

Structure:

- 8.1 Introduction
- 8.2. Origin and History
- 8.3 Features
- 8.4 Types of Credit Cards
- 8.5 Benefits and Limitations
- 8.6 Conclusion
- 8.7. Self Examination Questions
- 8.8. Reference Books

8.1 Introduction: -

Economic, social, cultural and technological development of society led to the growth of the service industry. Society exhibited increasing affluence combined with growing complexity of life. All these factors have contributed to the phenomenon of credit cards. Credit cards enable the individuals to purchase certain products / services without paying immediately. The buyer only needs to present the credit card at the cash counter and to sign on the bill. Credit cards can therefore be considered as a good substitute for cash and cheques. However these credit cards are accepted only by those establishments, which have consented to entertain them, these establishments are known as merchant establishments.

During the past decade, plastic cards have become increasingly popular in India. The reason for their popularity has now shifted focus from being a status symbol to offering convenience and security with worldwide acceptance of late, bankers have been permitted into the credit card business without every the prior approval of the RBI. Banks have been given the freedom to start the card division either by themselves or in association with other card issuing banks. As a result, many Indian banks including state Bank of India have entered the credit card business in a big way during the last few years.

8.2 Origin and History:-

Credit cards were introduced as viable means of selling goods on credit with maximum of expanding sales and building a strong customer base.

8.2.1 Non Bank Cards:-

The use of credit cards originated in USA in the 1920's, when individual firms, such as oil companies, hotel chains, began issuing them to customers for purchase made at their outlets.

Mobil oil issued the world's first credit card in the year 1940. Initially, the company in order to give specialised services to its regular customers issued the card. This helped boost sales and increase customer base following the success of the Mobil card, various organizations such as the Diners club, American Express and carte blanche standard issuing cards, for different purposes like travel, leisure, etc.

8.2.2 Visa and Master Card:-

Fraklin National Bank, USA issued the first ever-general purpose credit card in the year 1952, and it was widely accepted by local merchants. The sales slip which was generated using the card, was presented to the bank, which would then credit the merchants account. The limitation of these cards was the card-holders could shop only in their geographical area and only with those merchants who had agreements with their banks.

In 1960, Bank of America developed the present credit card operating system. This system was subsequently licensed to some other banks, which led to the establishment of an international bankcard system called Visa international. Competition amongst the U.S. banks resulted in mother international bankcard system being introduced, known by Master card.

8.2.3 Electronic Cards:-

Most banks became members of the two organizations and started to issue both super of cards. The seventies witnessed the evolution of electronic card authorization systems, electronic clearing and settlement systems and electronic data capture (EDC) at the point of sale (POS) terminals. This virtue6 eliminated paper work and significantly speeded up the process. The card industry is presently witnessing a technological, revolution and is fast moving towards the introduction of "Smart" cards, which user computer ships, biometrics etc.

8.3 Features of Modern Credit Card:-

Any card that is used as a payment device to access customers financial resources is referred to as a credit card. The card. The card may be used during travel, at home, for purchaser or at the Automatic Teller Machines (ATM's) for credit or debit transactions. It is also known as plastic money and it can be used for the purchase of all kinds of goods and services. Following all the salient features of the modern credit card.

8.3.1 Owner identification:-

A Credit card identifies its owners at one who is entitled to purchase goods and services with out physical money and is eligible for credit from establishments. For this purpose, the card issuer enters into tie-up with various merchant establishments.

8.3.2 Wide usage:-

Bank credit is the most widely used payment device issued by bank of. It is based on the system of revolving credit where by a credit limit is sectioned to the customer and can be availed impart or in full. The credit card holders can use the credit cards at merchant locations to buy goods and services.

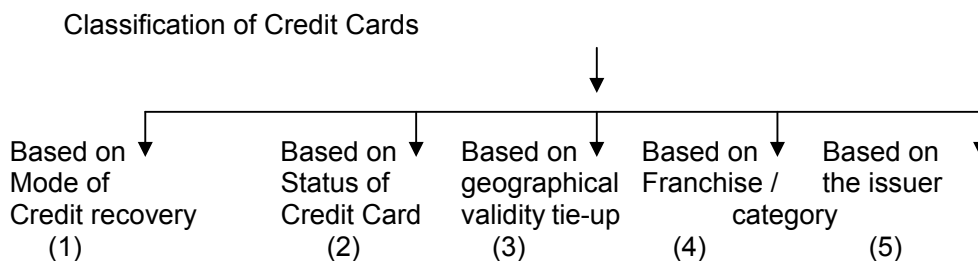
8.3.3 Credit Limit:-

The issues for the purpose of convenience and scrutinising set up a credit card limit for its card holders and a floor limit for its merchant establishments. The convenience and safety factors add value to these cards.

The credit card business is typically a high volume low value business, with the potential to break-even only beyond a certain volume of cards issued. The dependence on technology is inevitable to keep the operating costs to the minimum.

8.4 Types of Credit Cards (or) Classification of Credit Cards:-

The credit cards system can provide a wide range of products and services to the user. Depending on the necessity of the customer and trade competition, banks issue different types of credit cards.



8.4.1 Based on mode of credit recovery:-

This classification includes two types.

8.4.8.1 Revolving Credit Card:-

This type of credit card follows revolving credit principle. A limit is set on the amount of money one can spend on the card for a particular period. The card holder has to pay a minimum percentage of outstanding credit which may vary from 5 to 10 percent at the end of a particular period. Interest varying from 30 to 36 percent per annum is charged on the outstanding amount.

8.4.8.2 Charge Card:-

A charge card is not a credit instrument. This facility given a consolidated bill for a specific period and bills are payable in full on presentation. There is no interest liability and no pre-set spending limits either.

8.4.2 Based on the status of Credit Card:-

Based on the status of credit card the credit cards can be classified into three types as under.

8.4.2.1 Standard Card:-

Credit cards that are regularly issued by all card-issuing banks are called standard cards, with these cards it is possible for a card holder to make purchases without having to pay cash immediately. Some banks issue standard cards under the brand name "Classic" cards.

8.4.2.2 Business Card:-

It is also known as "Executive" cards are issued to small partnership firms, firms of chartered accountants, tax consultants and others for use by executives on their business trips.

8.4.2.3 Gold Card:-

The gold card offers high value credit for the elite. It offers many additional benefits and facilities such as higher credit limits more cash advance limits etc., that are not available with standard or executive cards.

8.4.3 Based on Geographical Validity:-

Based on geographical validity the cards can be classified into two categories.

8.4.3.1 Domestic Card:-

Cards that are valid only in India and Nepal are called "Domestic Cards". All transactions will be in rupees. These cards are issued by most of the banks in India.

8.4.3.2 International Card:-

Credit cards that have international validity are called "international cards". These cards are honored in every part of the world except India and Nepal. The card holder can make purchases in foreign currencies subject to RBI sanction and FEMA rules and regulations.

8.4.4 Based on Franchise Tie-up:-

According to this category, the cards can be classified into four categories. Those are.

8.4.4.1 Proprietary Card:-

Cards that are issued by banks themselves, without any tie-up are called proprietary cards. A bank issues such cards under its own brand.

8.4.4.2 Master Card:-

This is a type of credit card issued under the umbrella of "Master Card International". The issuing bank has to obtain a franchise from the MasterCard Corporation of USA.

8.4.4.3 Visa Card:-

This is a type of credit card, which can be issued by bank having tie-up with VISA international corporation, USA. The banks that issue VISA cards are said to have a franchise of VISA international.

8.4.4.4 Domestic tie-up card:-

These are cards issued by a bank having tie-up with domestic credit card brands such as Can-card and Ind-card etc.

8.4.5 Based on the issuer category:-

According to this category the credit cards can be divided into 2 types.

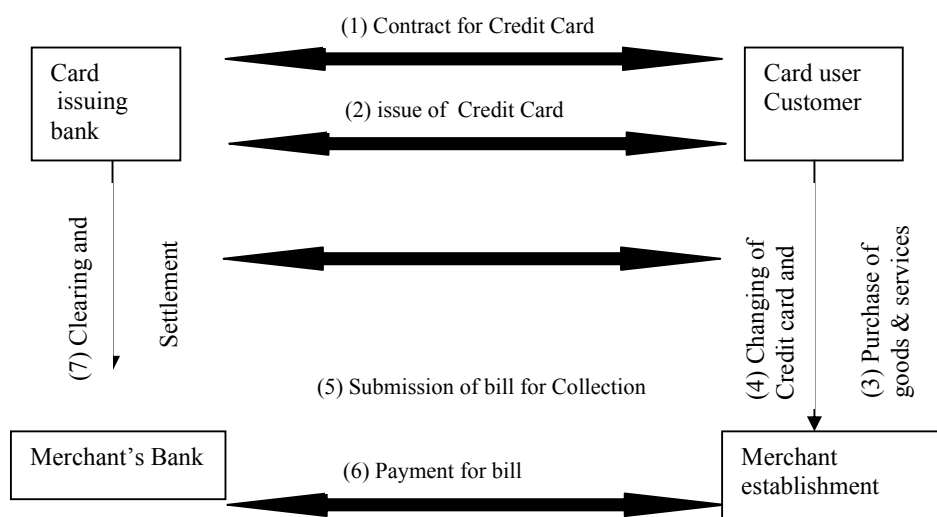
8.4.5.1 Individual Cards:-

These are the non-corporate credit cards that are issued to individuals.

8.4.5.2 Corporate Cards:-

These are the credit cards that are issued to corporate and business firms. The executives and top officials of the firms use these cards. The card bears the name of the firm and the bills are paid by them.

Mechanics Of Credit Card Operation (or Process of Credit Card):-



8.5 Benefits of Credit Cards:-

The benefits of credit cards can be classified into three types as under.

- (a) Benefits to card holders
- (b) Benefits to Merchants and

(c) Benefits to issuer banks.

8.5.1 Benefits to card holders:-

8.5.8.1 Shopping convenience:

Credit cards are convenient to use. Shopping is made more comfortable and joy us and purchasing poses no difficulty, since cards have wide acceptance.

8.5.8.2 Credit facility:-

The credit card enables the card holders avail the credit facility sanctioned by the card issuing company. The customer can either repay the amount of credit in full, or can up to for repaying it in flexible monthly installments. Card holders usually get a period of 30 to 45 days to clear the dues.

8.5.8.3 Safety:-

Credit cards allow for a safe means of conducting transactions. Credit card holders need not carry large amount of cash, they avoiding the risk of theft.

8.5.8.4 Acceptability:-

Merchant establishments widely accept VISA and Master card. This makes it vary convenient for holding a credit card.

8.5.8.5 Cash withdrawals:-

In times of need, card holders are also given the facility of withdrawing cash up to the sanctioned limits, from the banks or other tie-up ATMs.

8.5.8.6 Offers:-

Card issuing institutions, service organizations like Railways and Airlines, Merchant establishments are giving attractive bargains and offers to encourage purchase transactions by credit cards.

8.5.2 Benefits to Merchants: -

8.5.2.1 Guaranteed Payment: -

The merchant has guarantee of payment and in his account if created immediately on the submitting the charge slip into his bank. No bad debt arises in credit card transaction.

8.5.2.2. Proper Cash Flows: -

A good cash flow is established because of the speedy settlement of bills by banks.

(i) Reduction in Security Risk: -

The acceptance of credit card in lieu of cash reduces security risk.

(ii) Availability Credit Facility: -

The member establishments are able to offer credit facility to their customers without setting up their own credit arrangement.

(iii) Increase in volume of business: -

More and more people accept the practical advantage of credit cards and turn to suppliers who accept the cards in settlement. This helps in increasing the volume of business to member establishments.

8.5.3 Benefits to issuer banks: -**(i) High Profit: -**

Credit card holders offer high profit for the banks. They commission or discount usually @ 2.5% on sale through credit cards. As more and more take advantage of credit facility the credit card service becomes more profitable.

(ii) New Customers: -

If the card is issued to non-account holders it may help to generation of new customers.

(iii) Cost control: -

The credit card system helps to control the bank cost as it reduces the number of cheques issued by the cumtomers

Credit Card limitations: -

The rapid growth of the payment card industry has lead to a dramatic rise in credit card frauds. A significant amount of money is lost because of frauds. The credit card is not risk free and all payers associated with it have to face an element of risk associated with it.

1. The card holders are burdened with service charge, annual fee, membership fee, etc. A high rate interest is charged for delayed payment. Credit card tempt the holders for more purchases beyond their repayment capacity.
2. The cost involved in the credit card business is high which includes the cost of plastic card to be imported, cost of information and the cost on staff to monitor processing of applications, etc. Unless the number of cards are high and the volume of business is more, the credit card business will not be profitable one.
3. The frauds perpetuated by the holders of bogus cards and some times in collusion with the member establishments is the major problem for the issuers.
4. The average utilisation of credit card is only 20% to 30% in India. The under utilisation this facility erodes the profitability of the banks.
5. More commission is to be paid to the issuing bank or credit card organisation. Due to the lack of effective system and prominent personnel some banks make delay in payment, which affect the cash flow of the member establishment.

Drawbacks of Credit Cards:-

Credit have many drawbacks for the user, issuer and the merchant establishments alike. Some of these are.

1. Waste of Money:-

It would be a waste of money to subscribe to a credit card if the card was not utilised.

2. Thought less buying:-

Credit cards invariably encourage impulsive purchases. Since the user need not pay instantly it may tempt the purchase of product / services that are not genuinely required.

3. Financial problem:-

Use of credit cards may drag the user into financial problems including overdraft. This happen where repayment on the credit card account is not done promptly.

4. Mental agony:-

The pressure tactics used by recovery agents appointed by some card issuers to collect outstanding dues may cause mental agony to the user.

8.6 Conclusion: -

According to top banking professionals the credit card business will grow over 100% every year for the next 5 years. To realise the potential in the credit card market the following suggestions are made.

- Reduce the membership and annual subscription fees.
- Encourage member establishments to accept credit cards for routine items also.
- Make the features of cards convenient to middle class people.
- Enhance the cash withdrawal limits.
- Workout the strategies to popularise the credit card among people in semi urban and rural areas.

8.7 Self Examination Questions: -

1. Explain the features of credit cards issued by various banks?
2. Explain various types of credit cards?
3. Describe the facilities offered to the credit card holders?
4. Discuss the advantages and disadvantages of credit cards?

8.8 Reference Books: -

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