

ELECTRONIC PAYMENTS COALITION

# The Value of Rewards

**August 2023**

**EPC**

**Electronic Payments Coalition**

**ELECTRONICPAYMENTSCOALITION.ORG**

## The Value of Rewards

Consumers' resilient spending activity despite inflationary pressures is a reminder of the numerous benefits that credit and debit card rewards programs offer to retailers and to consumers of all income levels. For cardholders, rewards programs are a way to earn cash, airline miles, hotel stays, or other rewards through their everyday spending. For merchants, accepting rewards cards leads to a larger customer base and higher sales volumes. In this way, rewards cards are an important part of a well-functioning electronic payments market, and they provide tangible benefits to all stakeholders.

### THE ROLE OF REWARDS IN THE ELECTRONIC PAYMENTS MARKET

The electronic payments system is a classic example of a two-sided market in which a platform or service serves multiple end-users (in this case, cardholders and merchants). The value that each end-user group derives from using the platform depends on the extent to which the other group participates. Due to this interdependency, market forces exerted by both cardholders and merchants jointly determine the price to participate in the electronic payments system. The resulting price balances the need to attract merchants (by providing the benefits outlined below) with the need to increase the number of cardholders (by offering incentives like frequent flier miles and cash-back rewards).

Importantly, the dynamics of a two-sided market may result in the two end-user groups paying a different price. In the electronic payments market, card issuers typically offer incentives directly to consumers via rewards that are funded in part by merchant interchange fees — all for the purpose of increasing the overall use of electronic payments, which benefits all parties. In other two-sided markets, the price disparity is even larger: for example, the online restaurant reservation platform operated by Open Table charges one end-user group (restaurants) the entire cost while offering services to the other group (consumers) at no cost, effectively charging them a negative price to use the platform.<sup>1</sup>

However, government intervention on behalf of one side of the market carries a high risk of negative consequences for the other side, as well as the overall system. A good example of this dynamic is the Durbin amendment, which imposes interchange fee caps for debit card transactions. As detailed in a [2022 EPC report](#), the Durbin amendment has negatively affected consumers in several ways, including a sharp decline in the availability of debit card rewards.<sup>2</sup> A 2017 Federal Reserve study found that due to the Durbin amendment, consumers experienced decreased availability in free checking accounts, higher minimum balance requirements, and higher banking fees.<sup>3</sup> More recently, a 2022 study conducted by economists at Georgetown University and the University of Pennsylvania reached a similar conclusion, finding that as a result of the Durbin amendment, the share of free checking accounts fell from 61% to 28%, checking account fees rose from \$3.07 per month to \$5.92 per month, monthly minimums to avoid fees rose by 21%, and monthly fees on interest-bearing checking accounts rose by 14%.<sup>4</sup> These higher fees are disproportionately borne by low-income consumers whose account balances do not meet the monthly minimum required for fee waivers.<sup>5,6</sup> If price caps were also instituted on credit interchange fees as they are on debit interchange — or if retailers were allowed to reject certain rewards credit cards at the point of sale — the scales of the two-sided market would be tipped away from consumers and toward retailers.

## VALUE TO CONSUMERS

The vast majority of consumers have access to electronic payments, with survey data showing that 95% of consumers earning less than \$20,000 per year have access to a credit or debit card.<sup>7</sup> Moreover, most consumers own at least one credit card, including nearly two-thirds of adults earning less than \$40,000 per year.<sup>8</sup>

Most of these cardholders own and enjoy rewards cards. For example, according to a recent LendingTree survey, 87% of credit cardholders own at least one rewards card.<sup>9</sup> Other data comes to a similar conclusion: Verisk Financial finds that 86% of credit cardholders have at least one rewards card (including 77% of credit cardholders earning less than \$50,000 annually),<sup>10</sup> while the Federal Reserve estimates that 92% of cardholders have a rewards card.<sup>11</sup>

Unsurprisingly, consumers put these rewards cards to good use and prefer to use them over non-rewards options. According to data from Phoenix Marketing International, 97% of total credit card spending is charged to rewards accounts,<sup>12</sup> and more than three-fourths of rewards credit cardholders redeemed their resulting rewards within the past year.<sup>13</sup> Moreover, the preference for spending on rewards cards vs. non-rewards cards holds true across income groups: low-income cardholders use their rewards cards for more than 90% of their card spending.<sup>14</sup>

There is also little geographical difference among rewards card users, rebutting any assumptions about urban or coastal elites being the only beneficiaries of rewards. About 79% of active cardholders in New England have a rewards card, compared to 76% in the Southeast and 77% in the rural Plains states.<sup>15</sup> These data leave little doubt that consumers want and value their rewards cards. In fact, 96% of rewards cardholders consider their card-based rewards programs “very or somewhat valuable,” and the majority report that their card rewards deliver value on every purchase.<sup>16</sup>

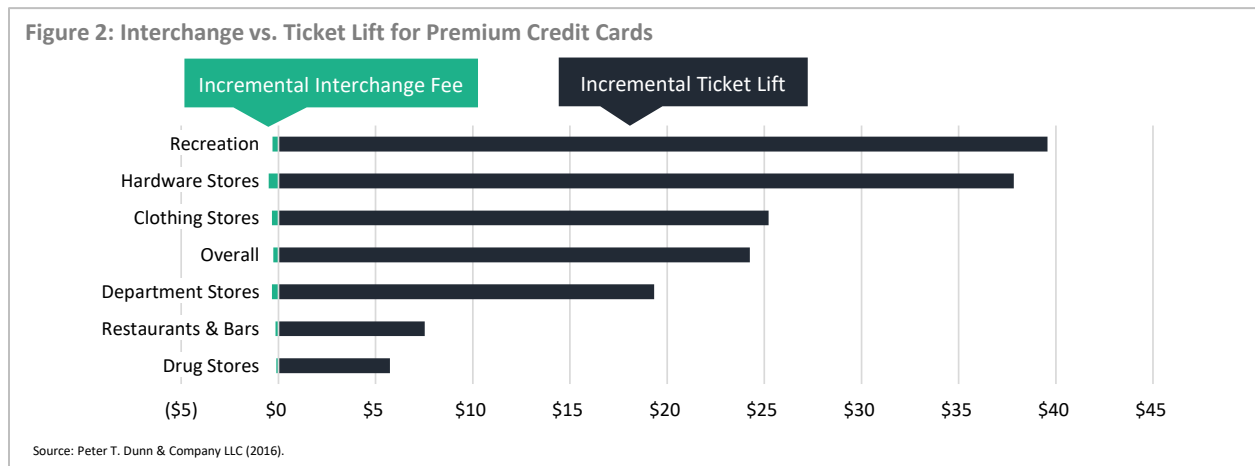
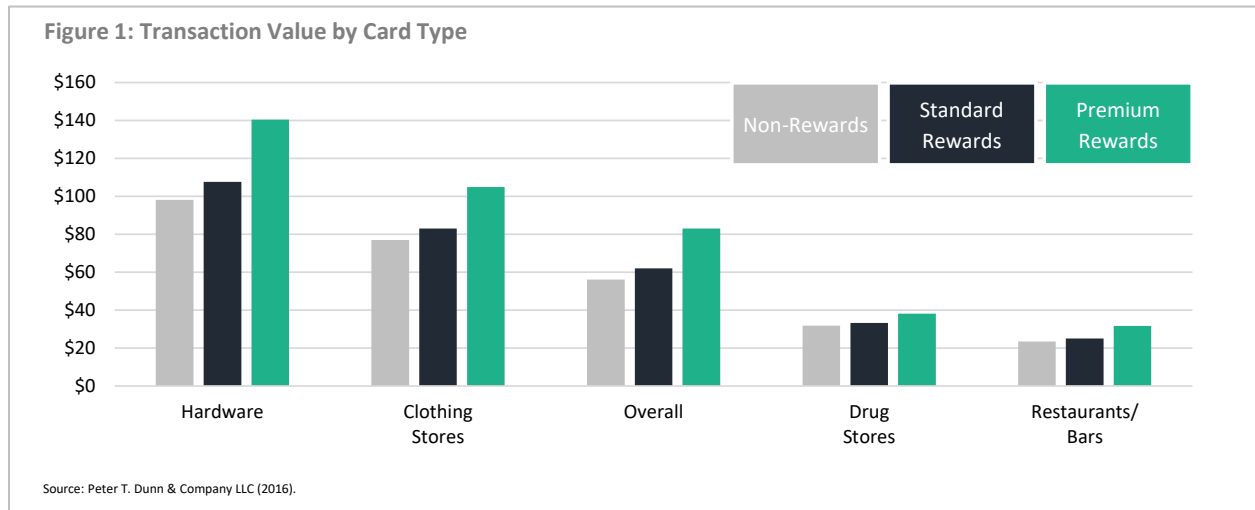
Over the last three years, credit card issuers have introduced new types of rewards, including those for on-time card payments, using credit cards to pay off student loans, and planting trees to reduce carbon footprints.<sup>17</sup> They also adapted rewards cards programs during the COVID-19 pandemic. As described in a 2021 CFPB report, to support cardholders during the pandemic, issuers extended sign-on bonus periods and increased points for groceries, streaming services, and home delivery.<sup>18</sup>

## VALUE TO MERCHANTS

While rewards cards are intended for consumers, they also provide a host of benefits for merchants. For example, it has long been established that consumers who pay with cards tend to spend more than those who pay with cash. This phenomenon, known as “ticket lift,” is significant: debit and credit card transactions are 2 to 4 times larger than cash transactions,<sup>19</sup> and when a merchant first begins accepting card payments, they experience a 10% to 15% increase in average transaction size.<sup>20</sup>

A closer look at consumer spending habits shows that the ticket lift effect is even more pronounced for rewards cards. Relative to a non-rewards consumer credit card, a rewards card is associated with an average transaction size that is 25% to 60% higher.<sup>21</sup> Premium rewards cards generate even greater ticket lift: as shown in Figure 1, the average transaction size of a premium rewards card (\$83) is more than 30%

higher than the average transaction size of a standard rewards card (\$62).<sup>22</sup> Moreover, the additional spending generated by a premium rewards card more than offsets the higher interchange fees associated with these cards, resulting in a net benefit to both merchants and cardholders. As Figure 2 illustrates, on average merchants pay an additional 26 cents in interchange fees for each transaction paid for with a premium rewards card but earn an additional \$24.25 in revenue for these transactions compared to purchases made with a non-rewards or standard rewards card.<sup>23</sup>



Although large retailers sometimes neglect to consider all the facts as they lobby for government intervention to lower interchange costs (and, by extension, curb consumer rewards programs) most small businesses recognize the value derived from accepting rewards cards. In a recently conducted survey of small business operators, approximately three-fourths of respondents reported that accepting credit cards brings in additional businesses, and half reported that accepting rewards credit cards in particular boosts sales.<sup>24</sup>

Beyond ticket lift, merchants who accept rewards credit cards also enjoy the myriad benefits associated with accepting electronic payments in general, including:

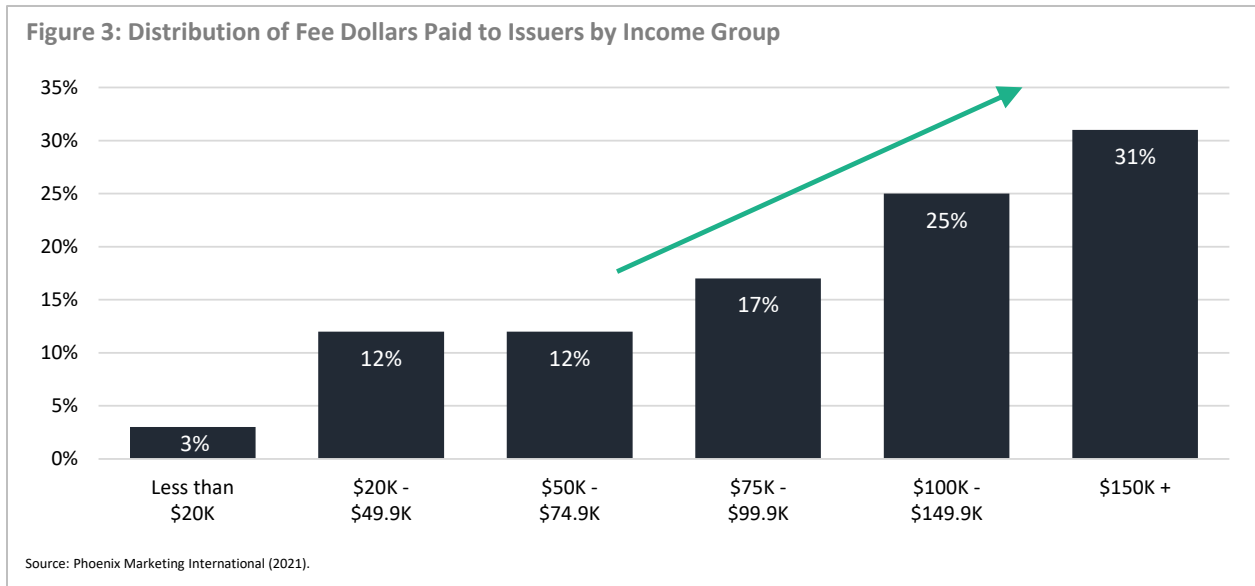
- **Additional retail channels.** Electronic payments also allow merchants to take advantage of other sales channels via e-commerce and mobile commerce avenues, which are growing rapidly.<sup>25</sup>
- **Faster transaction time.** Electronic payments cut down on checkout times and are processed twice as fast as cash and several times faster than checks, allowing retailers to move customers quickly through the checkout process.<sup>26</sup>
- **Reduced cost of cash.** Card acceptance reduces costs associated with counting, storing, safeguarding, and transporting cash, and limits losses from mislaid or stolen cash — all of which are significant expenses that retailers often overlook. A recent study conducted by a retail industry research firm found that the average retailer spends more than 9% of the value of their cash transactions counting, auditing, and depositing cash.<sup>27</sup>
- **Prompt, guaranteed payments.** Beyond helping merchants avoid the costs of cash, electronic payments reduce the risks to retailers associated with credit loss. Electronic payments are deposited directly into the merchant’s account, and issuers, not merchants, take responsibility for losses if a customer who uses a credit card is ultimately unable to pay.<sup>28</sup>

## WHAT CRITICS GET WRONG ABOUT REWARDS PROGRAMS

Some observers of the card market believe that lower-income consumers subsidize high-income cardholders through rewards cards (sometimes referred to as the “Reverse Robin Hood” theory), but this argument relies on simplistic, incorrect assumptions about cardholders with low incomes, as well as a misunderstanding of the myriad benefits merchants derive from accepting electronic payments. In reality, cardholders of all incomes draw benefits from rewards cards, and lower-income consumers are not subsidizing rewards for the wealthy.

- First, contrary to common narratives, there is not a strong relationship between income and credit score. According to Verisk Financial data, the correlation between income and credit score is only 0.16 among cardholders — positive, but far weaker than is often assumed.<sup>29</sup>
- Second, while average net rewards (i.e., dollar value received in rewards minus interest and fee payments) from credit cards increase with income, they remain positive in the bottom tercile of the income distribution (\$1.90). This finding confirms that lower-income consumers do not subsidize the rewards accrued by higher-income consumers. On average, higher-income consumers with high FICO scores benefit from reward credit cards largely at the expense of higher-income consumers with low FICO scores, who tend to pay more in interest.<sup>30</sup>
- Third, lower-income cardholders do not face higher interest rates than higher-income cardholders. Per 2020 data from Verisk Financial, among consumers with super-prime (780+) credit scores, the average APR of the lowest-income cardholders (18.04%) is similar to that of the highest-income cardholders (17.41%).<sup>31</sup>
- Fourth, credit cardholders with higher incomes pay significantly more in fees and interest than those with lower incomes. For example, 31% of annual fee revenue to issuers is generated by credit

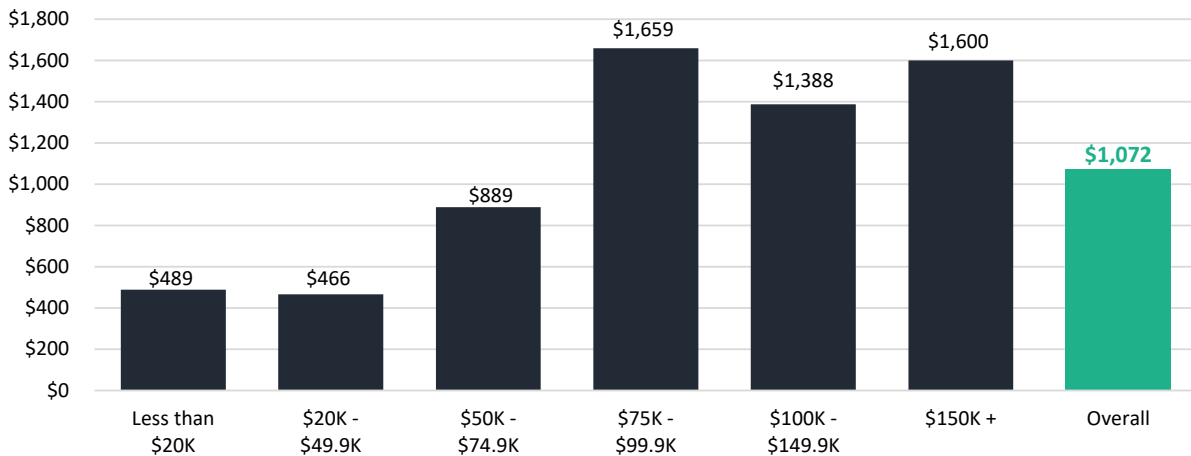
cardholders in the highest income bracket, compared to only 3% by those in the lowest income bracket (see Figure 3).<sup>32</sup> Similarly, though they comprised 67% of the Verisk Financial sample, cardholders earning more than \$75,000 per year pay 70% of total monthly interest.<sup>33</sup>



- Fifth, issuers do not profit from interchange fees. In 2022, a study published by the Federal Reserve found that, on average, banks' revenue earned from credit functions (interest income) generate approximately 80% of credit card profitability, whereas the contribution of transaction revenue (interchange) to profitability is slightly *negative* due to the cost of rewards programs.<sup>34</sup>
- Finally, as Figure 4 shows, cardholders with higher incomes deliver substantially more in value to credit card issuers (as determined by interest payments, annual fees, and interchange revenue generated by purchase volume) than those with lower incomes. Specifically, cardholders with annual incomes under \$50,000 generate less than \$500 per year in value to card issuers, whereas cardholders earning more than \$75,000 generated roughly three times more value.

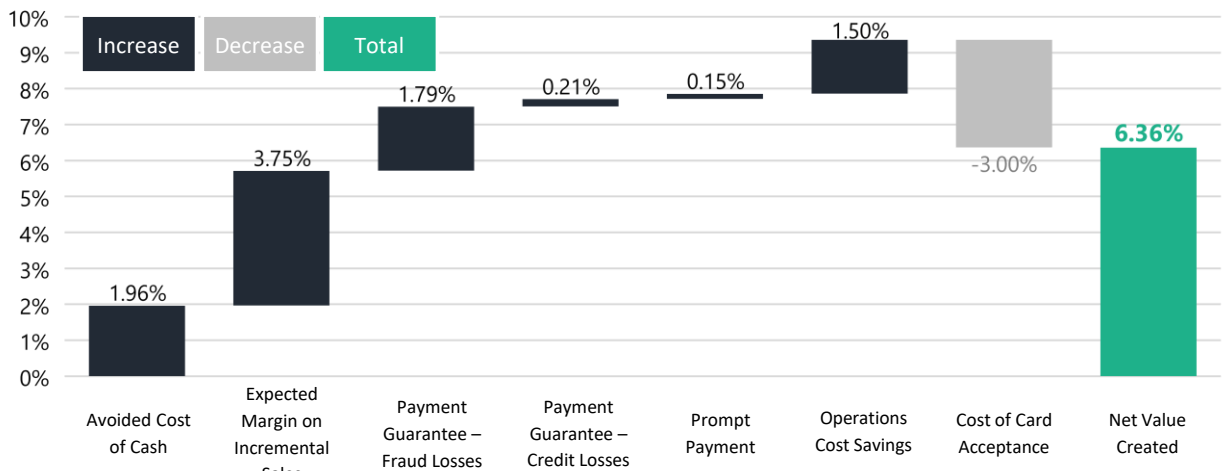
Some critics of rewards also claim that merchants pass through the costs of card acceptance (including interchange) through to consumers. These critics argue that merchants must raise prices on all consumers in order to pay for interchange on lucrative rewards cards – and thus low-income cash and debit users end up paying higher prices without receiving rewards. In reality, there is little evidence for such a pass-through, because merchants gain far more from accepting rewards cards than they pay in interchange and other fees.<sup>35</sup> In fact, data shows that the value that U.S. merchants receive from accepting credit cards (+9.36% of transaction value, on average) far exceeds what they pay, resulting in a net value of more than 6% of the card transaction (see Figure 5).<sup>36</sup>

**Figure 4: Relative Customer Value to Issuers**



Source: Phoenix Marketing International (2021).

**Figure 5: Net Value of Credit Cards to Merchants (Share of Transaction Value)**



Source: Peter T. Dunn & Company LLC (2020).

## CONCLUSION

When the benefits of accepting electronic payments are weighed against the costs, the data clearly demonstrate that the interchange fees that merchants pay are easily outweighed by the value they receive in return, including increased sales, lower costs, faster transactions, prompt and guaranteed payments, and the expansion and sustenance of an inclusive and secure payment system for all.

While it is understandable that merchants aim to minimize costs, calls for regulations that would curtail rewards programs, whether by capping interchange rates directly or allowing retailers to refuse to accept rewards cards at the point of sale, are misguided and would harm consumers. Such a position fails to consider the important role of rewards in balancing the credit card market or the value that rewards cards deliver to consumers and merchants alike.

## ENDNOTES

---

- <sup>1</sup> Evans and Schmalensee (2008), "Markets with Two-Sided Platforms," as cited in the U.S. Supreme Court's July 2018 decision in Ohio v. American Express.
- <sup>2</sup> Weisbaum, H. (2011), "Farewell Debit Reward Cards: Banks, Credit Unions Ax Programs in Anticipation of New "Swipe-fee" Rules," *NBCNews*, and Ellis, B. (2011). "Wells Fargo, Chase, SunTrust Cancel Debit Rewards Program," *CNN*, cited in McGinnis, P. (2013). *Misguided Regulation of Interchange Fees: The Consumer Impact of the Durbin Amendment*. Loyola Consumer Law Review Vol. 25 Issue 2-3, 299.
- <sup>3</sup> Manuszak and Wozniak (2017), "The Impact of Price Controls in Two-Sided Markets: Evidence from US Debit Card Interchange Fee Regulation."
- <sup>4</sup> Mukharlyamov, V., and Sarin, N. (2019), "Price Regulation in Two-Sided Markets: Empirical Evidence from Debit Cards."
- <sup>5</sup> *ibid*
- <sup>6</sup> Federal Reserve Board (2017), "The Impact of Price Controls in Two-Sided Markets: Evidence from US Debit Card Interchange Fee Regulation."
- <sup>7</sup> Phoenix Marketing International (2020).
- <sup>8</sup> Federal Reserve Board (2020), "Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020."
- <sup>9</sup> LendingTree (2022), "Nearly 7 in 10 Rewards Credit Cardholders Sitting on Unused Cash Back, Points or Miles."
- <sup>10</sup> Verisk Financial (2020).
- <sup>11</sup> Federal Reserve Bank of San Francisco (2023), "2023 Findings from the Diary of Consumer Payment Choice."
- <sup>12</sup> Phoenix Marketing International (2021).
- <sup>13</sup> CreditCards.com (2023), "Poll: 23 percent of Cardholders Have Unused Credit Card Rewards."
- <sup>14</sup> Phoenix Marketing International (2021). Low-income cardholders are defined as those earning less than \$20,000 per year.
- <sup>15</sup> Verisk Financial (2020). The share of cardholders with rewards cards is 79% in the Far West, 78% in the Rocky Mountain states, 77% in the Southwest, 77% in the Plains, 77% in the Great Lakes states, 76% in the Southeast, 79% in the Mideast, and 79% in New England. The geographical analysis is based on cardholders with open accounts, rather than those with balance-active accounts. The share of balance-active cardholders with rewards cards is even higher.
- <sup>16</sup> Phoenix Marketing International (2016), "2016 Credit Card Monitor Report."
- <sup>17</sup> Consumer Financial Protection Bureau (2021), "The Consumer Credit Card Market."
- <sup>18</sup> *ibid*
- <sup>19</sup> Peter T. Dunn & Company LLC (2018), "Illustrating the Value Provided by Electronic Payments." Peter Dunn is a founder of the management consulting firm Edgar, Dunn & Company and presently provides global advisory services through Peter T. Dunn & Company. He has over 40 years of experience in strategic consulting in payments.
- <sup>20</sup> Mastercard (2017), "Measuring the Value of Electronic Payments to Merchants."
- <sup>21</sup> Peter T. Dunn & Company LLC (2016).
- <sup>22</sup> Capital Policy Analytics (2019), "Both Consumers and Merchants Benefit from Rewards Cards." Based on data from Peter T. Dunn & Company LLC (2016).
- <sup>23</sup> *ibid*.
- <sup>24</sup> Policy & Economic Research Council (2012), "PERC Small Business Survey of 2012" quoted in Turner (2013), "Credit Card Rewards: Context, History, and Value."
- <sup>25</sup> Federal Reserve Bank of San Francisco (2023), "2023 Findings from the Diary of Consumer Payment Choice."
- <sup>26</sup> Digital Transactions (2018), "Many Merchants Expected to Erase Signature Requirements From Their Checkout Counters."
- <sup>27</sup> IHL Group (2018), "Cash Multipliers: How Reducing the Costs of Cash Handling Can Enable Retail Sales and Profit Growth."
- <sup>28</sup> Peter T. Dunn & Company LLC (2018), "Illustrating the Value Provided by Electronic Payments."
- <sup>29</sup> Verisk Financial (2020). Researchers from the Federal Reserve also found a weak correlation between income and credit score among a broader population of U.S. consumers (0.27). See Rachael Beer, Felicia Ionescu, and Geng Li (2018), "Are Income and Credit Scores Highly Correlated?" Board of Governors of the Federal Reserve, FEDS Notes.
- <sup>30</sup> Agarwal, Presbitero, Silva, and Wix (2023), "Who Pays for Your Rewards? Redistribution in the Credit Card Market."
- <sup>31</sup> Verisk Financial (2020). Similarly, there are only small differences between the APRs of the lowest- and highest-income prime and subprime cardholders. Among those with prime scores, the lowest-income cardholders have an average APR of 21.29%, while the highest-income have an

---

average APR of 19.10%. Lower-income (23.88%) and higher-income (21.77%) APRs are also similar among cardholders with subprime credit scores. Excludes promotional APRs. The lowest-income cardholders in the sample have annual household incomes below \$50,000, while the highest-income have incomes above \$250,000. Data from Phoenix Marketing International (2021) confirm the lack of discrepancy among average APRs for different income groups.

<sup>32</sup> Phoenix Marketing International (2021).

<sup>33</sup> Verisk Financial (2020).

<sup>34</sup> Adams, Bord, and Katcher (2022), "Credit Card Profitability."

<sup>35</sup> If merchants kept prices elevated to pay for interchange fees, prices should have fallen in response to the cap on debit interchange instituted by the Durbin Amendment. In fact, several academic studies have found that the law had little effect on prices. (See Zhu Wang, Scarlett Schwartz, and Neil Mitchell (2014), "The Impact of the Durbin Amendment on Merchants: A Survey Study." Federal Reserve Bank of Richmond Economic Quarterly, Volume 100, Number 3; and Todd J. Zywicki, Geoffrey A. Manne, and Julian Morris (2017), "Unreasonable and Disproportionate: How the Durbin Amendment Harms Poorer Americans and Small Businesses Unreasonable and Disproportionate: How the Durbin Amendment Harms Poorer Americans and Small Businesses." International Center for Law and Economics.) Other studies similarly found that the net effects of the price cap on consumers were negative. (See Vladimir Mukharlyamov and Natasha Sarin (2019), "The Impact of the Durbin Amendment on Banks, Merchants, and Consumers." Faculty Scholarship at Penn Law. 2046; and David S. Evans, Howard H. Chang, and Steven Joyce (2013). "The Impact of the U.S. Debit Card Interchange Fee Caps on Consumer Welfare: An Event Study Analysis." Coase-Sandor Institute for Law & Economics Working Paper No. 658.)

<sup>36</sup> Peter T. Dunn & Company LLC (2020).