Capital One: Exploiting an Information-Based Strategy

Eric K. Clemons1
Matt E. Thatcher2

Abstract: Capital One has exploited an innovative approach to targeted marketing, based on customer profitability analysis, to achieve impressive performance as a leading credit card issuer. It is sustaining its advantage through investment in infrastructure and personnel, and through constantly improving its expertise through a practice known as test-and-learn. Moreover, it is attempting to generalize this information-based strategy to other industries.

1. Introduction

After soliciting 16 banks in 1988 as consulting clients for a radical transformation of their credit card businesses and after having been turned down by each, Rich Fairbank and Nigel Morris now enjoy their positions as Chairman / Chief Executive and President / Chief Operating Officer of Capital One, one of the world's most profitable credit card issuers. As a result of its rapid growth and its ability to retain profitable accounts, Capital One was named credit card issuer of the year in 1995 by Credit Card Management [7].

Since 1992, the dollar value of loans managed by Capital One has increased from $1.7 billion to $12.8 billion and the customer base has grown by over 500% [6]. With total growth in outstanding balances of 880% between 1992 and 1996, among the highest in the industry, and bad loan chargeoffs consistently among the lowest in the industry, the stock's price soared between 1991 and 1996. Nigel Morris smiles when he adds, "Sometimes I pinch myself. I've been very lucky... helping manage this fabulous company. Sometimes I think I'll wake up and find myself working in a woolen mill near my family in Wales."

The lessons of Capital One's success in the banking industry can be extended to a large number of other companies in a wide range of other industries.

The company relies heavily on what it terms its Information-Based Strategy (IBS). The use of an IBS allows Capital One to develop new and different strategies by exploiting fundamental differences between itself and its competitors in organizational structure, corporate culture, and use of information. Rich and Nigel define an information-based strategy as the use of scientific testing to drive mass customization, enabling them to deliver "the right product to the right customer, at the right time and at the right price."

As its credit card business matures and as competition increases, the company is prepared to diversify into a wide range of industries where it believes that its IBS approach will provide competitive advantage. Indeed, marketing efforts and spending increasingly are committed to ventures outside traditional banking, and the senior officers believe that it is critical that they "not remain loyal to any industry." Their key strengths are in IBS, and not in banking or the credit card industry.

We will seek to address the following questions in this case study:

- Does Capital One enjoy a competitive advantage?
- How was competitive advantage achieved?
- Why were the opportunities identified by Signet / Capital One first exploited by a relative outsider — a small regional bank under the guidance of consultants rather than bankers?
- Is the advantage sustainable? Can other banks erode the advantage?
- What are some other applications of Capital One's information-based strategy?

2. Newly Vulnerable Markets

2.1. Introduction

A large number of industries exhibit characteristics that change the relative balance of power between large incumbents and nimble new entrants. We use the term newly vulnerable markets to characterize those conditions that enable new entrants to threaten previously dominant incumbents, even where those incumbents enjoy dominant market share and resulting superior cost structures.

The following conditions generate vulnerable markets:

- Ease of entry — It must be possible for new entrants to enter the market and attack estab-
lished firms. Potential barriers to entry, including regulatory restrictions and costs associated with acquiring distribution or production facilities, must be low enough to provide new entrants with the ability to attack.

- **Attractive to attack** — New entrants must perceive that it will be profitable for them to attack. That is, they must believe that there are market segments where the difference between the costs associated with serving those segments and the prices that they can charge those segments will be sufficient to provide favorable profits.

- **Difficult to defend** — There must be some obstacles that prevent incumbents from immediately duplicating the strategies of new entrants, and thus that allow new entrants sufficient time to realize the benefits from their entry.

2.2. Differing Customer Costs and Uniform Pricing

In many industries there are enormous differences between the costs of providing service to different customers:

- In telecommunications, costs of providing customers with local service will often depend upon their distance from the central office, and thus the length of the dedicated local loop that connects their home to the communications network.

- And in banking, some customers use their credit cards largely as charge cards, paying off their balances in full each month; these customers enjoy the free float, but provide only limited revenues and even smaller profits for their issuers.

And yet, historically, in many industries dominant players have continued to follow a uniform pricing strategy, charging customers prices based upon average costs, rather than differential prices that reflect the costs associated with serving these individual accounts:

- In telecommunications, state regulators largely determine prices and typically over-charge customers in cities and suburbs in order to subsidize higher cost customers in rural communities.

- And in banking, most banks have historically not performed customer profitability analyses, and instead have charged all accounts prices that do not reflect their profitability.

Conditions such as those described above make markets attractive for new entrants to attack, as they suggest that some customers are being dramatically over-charged under average cost pricing strategies, and that they are in fact subsidizing other higher cost customers.

Retail banking provides a clear example of how a new entrant can enter an “attractive” market and acquire profitable market share at the expense of a previously dominant incumbent firm [3,4]. In many industries, firms can distinguish between those customers that account for their profits (i.e., love 'ems) and those customers that represent loss making accounts (i.e., kill yous). In retail banking, for example, the best 20\% of consumers may account for more than 100\% of a bank's profits, while the bottom 20\% may account for all the off-setting losses.

Most retail banks in 1988 charged uniform prices across consumers for banking services despite the presence of significant differences in customer costs (i.e., love 'em and kill you accounts). This situation provides an opportunity for competitors to target the love 'ems, charging them less for the provision of banking services than they are charged by their current bank but at prices that still generate profits for the attacker. Such targeted marketing and opportunistic cream skimming will leave the incumbent serving a larger proportion of higher cost, kill yous and will cause the incumbent's average costs to rise and profits to fall. In response, the incumbent will be tempted to raise its prices to compensate for declining profits, resulting in even more customers becoming vulnerable to the new entrants' attack. As the new entrant continues to target customers being overcharged by the incumbent, as the incumbent continues to raise its prices to compensate for its losses, and as the new entrant continues to acquire profitable market share at the expense of the incumbent, the defender may begin to enter “death spiral” [3]. That is, for the defender, “the worse it gets the worse it gets!”

There is a literature and supporting theory on how to perform targeted marketing and to provide differential offerings (e.g., [2]) and on why differential pricing is important (e.g., [9]). However, there is very little evidence to suggest that this was followed in banking prior to Fairbank's and Morris's implementation of
targeted marketing strategies in the credit card business of Signet Bank in the late 1980s.

Competitors’ reliance upon uniform pricing in the presence of extreme differences among customers set the stage for Rich and Nigel’s information-based strategy, and is no doubt the most important reason for Capital One’s success. “This strategy of mass customization represents a quantum breakthrough in marketing effectiveness and has led to tremendous success competing against traditional banking industry with its one-size-fits all approach to marketing.” [5]

3. Capital One and Competitive Advantage
3.1. The Early Days
In the late 1980s, Rich and Nigel developed an idea, or a vision, for radically transforming the credit card businesses within banks. The Great Idea was to enable a bank, through a radical transformation of their credit card business, to acquire profitable market share and develop competitive advantage by implementing targeted, information-based marketing strategies (or IBS). At that time, they might have articulated this vision as follows:

- Not all banking customers are equally profitable to serve
- Banks do not know who their most profitable accounts are, so these accounts are vulnerable to competitors who could identify them
- Direct marketing techniques, allowing banks to solicit many consumers at relatively low cost, has turned some banking products, like credit cards, into a national, rather than a local or regional business.
- When using targeted direct marketing, it will be necessary to test different targeted offerings, in order to learn the combination of characteristics that make different products desirable to customers and profitable for credit card issuers.
- Since most combinations of product offerings may be unprofitable for most customers, it will be necessary to start with small tests, but when learning is complete larger rollouts can be made.

Nigel also stresses that implementing their idea was made easier because it was not necessary to create a new product or a new brand — that is, improving the profitability of a bank’s existing MasterCard or Visa portfolio had far fewer entry barriers than attempting to create a new brand.

Rich and Nigel acquired these insights by observing the credit card businesses of many of their major banking consulting clients at the time. Once the insight was developed, they solicited numerous banks as consulting clients to radically transform the credit card business by exploiting their insights. However, most banks were not interested in what became known as their information-based strategy. In fact, it was not until after the first 16 banks rejected their solicitations that they found a home at Signet Bank.

By 1988, the credit card industry was characterized by competition among banks for scale and market share; as a result, the credit card business had made the transition to consolidation in the hands of large players. By increasing their customer base, banks were able to spread the high fixed costs associated with credit card operations over a large number of accounts, enabling them to lower prices through economies of scale.

In addition, during this period banks commonly engaged in uniform pricing strategies, creating attractive opportunities for attack. In addition, the average cost associated with acquiring new accounts in this competitive environment (cost per solicitation divided by hit rate) was quite high. This too suggests that incumbent banks were vulnerable to an opportunistic marketing strategy that improved hit rates by selectively offering lower annual interest rates to certain potential “love ‘em” customers.

As Rich and Nigel note, while competitors in this market appear vulnerable to opportunistic targeting strategies, executing these strategies is not easy. Or, as Nigel Morris has said, “Anyone can find customers who want your money! Anyone can find customers who will take it and not pay you back! The trick is to find customers who will take a lot of your money fast and pay you back slowly.”

It was in this competitive environment that Rich and Nigel attempted to pitch The Great Idea. Rich and Nigel began to shop their idea to major banks, including New York and West Coast money center banks and super-regionals. Although many of the major banks were willing to work with Rich and Nigel in other areas, their Great Idea was rejected by five of the top six (Citibank, Chase, Bank of America, Bank of New York, and Chemical Banking) and fourteen of the top twenty banks in the U.S. Reactions were remarkably similar across institutions:
“It can’t be done!” — it’s too expensive, and the data that you need on individual consumers to make the strategy succeed is simply not available to the bank.

“And we don’t need your help; we already do it!”

Finally, Signet Bank, a small bank looking for opportunities to grow, accepted The Great Idea. However, Signet wanted Rich and Nigel to come into the company not as consultants but as salaried bank employees with long-term bank contracts. Surprised by the offer, Rich and Nigel agreed to come into the company as heads of credit card marketing and strategy, but only under certain conditions: Rich and Nigel were to be given real bank titles, they were to have real control over systems, and they were to be accepted within Signet as line bankers. However, unlike main-stream employees of the bank Rich and Nigel would retain significant profit-sharing potential. They believed that these conditions were necessary to allow their IBS to flourish.

David Hunt, Executive Vice President of Signet Bank, played a major role in the transition. Rich and Nigel also received support from Bob Freeman, then CEO of Signet. Perhaps most importantly, David listened to Rich and Nigel, had the vision to recognize the potential of their ideas, and helped to generate buy-in within the firm. As he stated, “You think that you can make IBS work? Then go do it!”

3.2. Initial Performance

The initial period for Rich and Nigel at Signet ran from October 1988 when they entered Signet to December 1991. Nigel stresses that the first year entailed a large commitment to “infrastructure build: building databases, learning the trade of account management, and figuring out how to implement this very difficult strategy.” In August 1989 they rolled out their test and learn solicitations in significant scale.

The initial implementation of their IBS was based on a “test and learn” methodology. In brief, test and learn consists of the following:

- Running some test marketing activities (e.g., sending out a small, yet carefully selected, sample of direct marketing solicitations)
- Determining which tests make money and which ones do not; this takes some time, and most of the tests will be unprofitable. However, unprofitable tests are not unsuccessful, if they enable you to determine the basis of profitable tests going forward.
- Then running more programs, more and more like the ones that proved successful in the initial test stage.

Unfortunately, there is a significant and expensive lag between the stage of initial “testing” and the stage where “learning” is realized and profits are earned. In fact, by December of 1991 chargeoffs from Rich and Nigel’s 1989 solicitations had soared to 9.5%, more than doubling the chargeoffs of the bank’s total portfolio from 2.6% in August 1989 to 5.9% at the end of 1991. As Rich notes, “Signet stock price was in free fall!” The stock price plummeted from over $20.00 in late 1989 to less than $5.00 in early 1991 (prices adjusted for a split in 7/93). According to Nigel, “We hit bottom in late 1991.” From bank card profits of $27 million in 1988 and $25 million in 1989, forecast profits for 1992 had dropped to zero by late 1991. The fall in stock price was a result of bad real estate loans. Had the credit card portfolio profits actually dropped to zero the results for the stock price would of course been far worse; fortunately, the IBS began to produce profits at just this time.

Rich and Nigel, however, never lost faith in their basic conception of strategy for the bank; equally important, neither did David. They continued their focus on testing, nearly doubling the number of tests conducted from 335 in 1989 to 617 in 1991.

3.3. The Middle Period

Late 1991 began a period of triumph for Rich, Nigel, and those associated with implementing The Great Idea, which continued through the spin-off of Signet’s credit card business to Capital One in 1994.

During this period (1992-1994), growth in receivables and in number of accounts soared [see Table 1], especially when compared to its competitors. At the same time, percentage chargeoffs improved and were consistently better than industry averages [see Figure 1]. Not surprisingly, the stock price of Signet Bank surged, allowing the bank to grow faster than 996 of the Fortune 1000! In fact, Signet’s stock appreciated 537% between January 1991 and the end of 1994.

The credit card operation at Signet was doomed by its own success — it could not continue as part of the bank. The credit card business came to account
for roughly 2/3 of the profits of the bank. This threatened the stability of the bank's governance, when relatively young and relatively new additions to the bank were accounting for such a large portion of the bank's profits. Moreover, as Rich and Nigel began to envision new lines of business, many outside traditional banking, it was clear that they would require more freedom of action than would be possible within the structure of Signet. As a solution, Signet CEO Bob Freeman made the audacious decision to spin off the credit card business as a wholly independent company, not associated with Signet.

3.4. The Current Period

The current period can be considered the time from the spin-off in 1994 through the present. During this period, Capital One has continued to enjoy considerable success. They have achieved success as measured in terms of growth in number of accounts and total outstandings [see Table 1], as well as in low loan losses when compared to its competitors [see Figure 1]. In addition, stock performance has been strong.

Clearly, Capital One has experienced tremendous success. "By any measure, Capital One has more than tripled in the past three years." [5]

Capital One continues to rely upon Information-Based Strategies to acquire profitable market share and continues to rely upon Test and Learn methodology for developing and implementing those strategies. Indeed, testing continues at Capital One, as demonstrated by the exponential growth of its R&D efforts [see table 2].

3.5. Assessment of Capital One's Strategy

It is clear that Capital One has achieved competitive advantage. The bank has been outperforming most of its competitors in terms both of market share and of margins. Consequently, Capital One's stock price has more than doubled since its 1994 IPO, significantly outperforming both the market as a whole and the banking sector.

4. How: Steps towards Achieving Competitive Advantage

There is little secret about either the extent of Capital One's advantage or the source of this advantage. The entire management team believes that the organization's success comes from its Information-Based Strategy and its reliance upon implementation of IBS via Test and Learn.

"The success of Capital One has been the direct result of the proprietary information-based strategy that we have pursued since 1988. The strategy leverages information technology, scientific testing and a highly flexible operating infrastructure to deliver the right product, to the right customer, at the right time and at the right price." [5]

The core of this strategy is based upon the realization that customers differ widely in their profitability, and that information from a variety of sources can be synthesized to exploit this "customer profitability gradient." IBS represents the commitment to exploit this customer profitability gradient, and test and learn is the mechanism for doing so.

4.1. Implementation of Test and Learn

Rich Fairbank explains that in the late 1980s, when he and Nigel were attempting to interest bankers in a test and learn strategy, banks relied upon "black box" credit scoring models that were used to determine whether or not to offer an account to an applicant. These black box models were usually procured from a vendor, and were "sealed" in the sense that the algorithms could neither be examined nor altered. While parameters could be updated based on experience, allowing the models to be tuned, algorithms could not be changed. These models were definitely not designed to learn which customers could profitably be offered accounts at different rates. Rich and Nigel thus advocated turning the credit scoring models off for test offerings, and developing and tuning their own models to determine which combination of product, price, and credit limit could be profitably offered to customers who could be characterized by a wide range of publicly available credit and demographic data. After a lengthy incubation period, it would be possible to determine which tests were profitable, and to rollout large profitable offerings corresponding to these smaller profitable tests.

The structure of this process explains the initial period of extremely unprofitable operations after the introduction of test and learn. The degree of trust needed to turn off the banks' credit scoring models likewise probably explains a great deal of the resistance that Rich and Nigel encountered when they attempted to create interest in their IBS approach.

4.2. The Balance Transfer Product

The first breakthrough offering discovered
through this process of test and learn was the “balance transfer” product. This product offers customers a lower initial APR for applicants who transfer their balances from a competitor’s credit card. It turns out that this transfer of balances by customers from higher APR credit cards to a lower one provides the card issuer with an important signal. Customers that do not carry balances find no value in a lower APR and will not take the time and effort to switch cards. More importantly, the customers that the balance transfer product will attract are those customers who have a balance they cannot presently payoff but which they will eventually payoff slowly. Therefore, they care about the lower APR.

Clearly, these customers meet Nigel Morris’s characterization of great accounts: They borrow money, they pay it off, and they pay it off slowly. Or, as Rich Fairbank more flamboyantly says, “We found the elusive low-risk revolver” and “we hit the jackpot!” People who borrow more, and who approach the borrowing limits of their cards, tend to be riskier. A graph of percentage of loans more than 60 days delinquent, plotted against percentage of credit line utilized, clearly illustrates this trend. However, customers who accepted the balance transfer product exhibit much more attractive risk-utilization profiles, as shown in Figure 2.

The graph in Figure 2 can be summarized differently by noting that marketing expenses for the balance transfer product represents an investment in an annuity. Each dollar of expense invested results in an annuity stream of more than $2.25 in the first year, close to $4.00 in the second, close to $2.50 in the third year, more than $1.50 in the fourth year, and over $1.00 thereafter. Nigel summarizes the graph simply by saying “We found the sweet spot”.

4.3. Other Products and Services

Capital One offers a whole range of products to credit consumers, including offers to students and to applicants without previous credit history. In fact, presently there are over 3,000 price points in Capital One’s current offerings. Capital One has the ability to “customize everything”. On account acquisition, they can customize on customer segmentation, market channels, products, pricing, credit lines, and credit approval policies. On account management, they can customize on repricing and retention, credit line increases and decreases, collections and recoveries policies, and cross-selling.

5. Sustaining Competitive Advantage

Why did so many powerful banks reject the strategic recommendations offered by Rich and Nigel? Why were they not understood and adopted by the banks and used as the basis of their strategies, even before The Great Idea?

Unlike other examples of our newly vulnerable markets paradigm, there was no rapid change in technology or regulatory discontinuity that suddenly made differential pricing possible. A steady decrease in cost of computing for analysis, and of costs of storage and classification for the creation of targeted mailing lists, had made information-based marketing and pricing strategies possible well before 1988.

The principal problems faced by banks in responding to opportunities in the market include their: 1.) organizational structure; 2.) information infrastructure; 3.) organizational skill set; and 4.) organizational culture.

5.1. Bank Structure

Most competitors have, or used to have, two very separate organizations responsible for credit cards. The marketing department is responsible for selling; it is their responsibility to maximize the number of cards issued and the total balances outstanding. In contrast, there is also a credit department, and it is their responsibility to minimize exposure to bad loan losses, by limiting who has access to cards and what balances they are allowed. These two groups are in constant tension, but they are frequently poorly coordinated or not integrated at all.

Rich and Nigel employed an integrated, risk managed, approach to sales and marketing that attempted to compute the expected NPV or annuity value of each new account, providing first Signet Bank, and now Capital One, with the ability to respond appropriately to situations like that described above.

5.2. Information Infrastructure

To support its IBS, Rich and Nigel believed that they had to invest heavily in information technology. At Signet they developed what was considered at the time to be the largest Oracle database in the world. The database not only contained detailed data on customers (i.e., their demographics, purchases, activities, etc.), but also supported regressions and other analytics, and stored the results. The generation, storage and analysis of such data enabled Signet to
identify profitable marketing opportunities; the systems continue to support Capital One's marketing efforts.

This is in sharp contrast with the actions of competitors, some of whom have outsourced all non-branch customer contact, and do not maintain their own databases or do their own servicing. As Nigel has said, "This is like trying to do planning after you've put your planning department through a guillotine!"

This view that infrastructure provides critical value is shared throughout the organization, where it is widely believed that the necessary flexibility cannot be achieved in organizations that outsource their data processing. Indeed, in 1994, the year of the spin-off, Capital One was willing to incur the expense of $49 million to break its long term outsourcing contract with EDS, since it was seen as necessary to do so in order to achieve maximum flexibility for the new company [1].

5.3. Organizational Skill Set, Culture, and Commitment

Bank structure and information infrastructure would not achieve advantage without the skill set to exploit them and the commitment to hire and train the right people.

At Capital One, successful implementation of their more complex strategy begins with hiring the right people. According to Nigel, "We compete with McKinsey for the best graduate students; we're not competing with commercial banks... Above all, we know that the key to our success has been and will continue to be our commitment to hiring and developing incredibly talented and motivated associates." This appears in the Letter to Stockholders, in the company's Annual Report for 1995 [5], and similar thoughts are unlikely to be seen in any form in the annual reports of more traditional banking companies.

In addition, the success experienced at Signet and Capital One requires commitment to a long term strategy of identifying and solving problems. Nigel claims that "if none of your initial tests lose money, you're probably too conservative for us. If you can't figure out why they lose money and solve the problems, you're also probably not right for us; we need people with tenacity and superb problem solving skills." Nigel also notes that "We truly believe that we have put in place a better mousetrap. Duplication of the strategy by the competition is very difficult, and would take them years of patient investment."

While it may be clear what changes competitors need to make to respond to Capital One, it is also clear how very difficult it is for most organizations to accommodate such profound change.

In summary, Capital One senior management believes that their advantage has been sustainable because it is based on a complex combination of structure, information, skills, culture, and commitment.

6. Future Opportunities

That said, senior management also believes that it will become more and more difficult to sustain this advantage. As other banks begin to follow similar strategies and as competition increases it will become more difficult to maintain margins. Therefore, it will be necessary for Capital One to continue to refine its offerings.

When AT&T offered all accounts the same service and the same price, Signet had 23 price points. When AT&T had over 20 price points, Signet had over 300. Now that AT&T has over 300 price points, Capital One has over 4,000. Indeed, a senior officer at AT&T UCS believes that all competitors will be forced to adopt similar strategies, noting that "When one of your competitors begins down this slippery slope, you have no alternative but to follow."

Scott Barton, Director of New Business Development (or the Growth Opportunities Team), believes that ultimately, all accounts will be priced efficiently to reflect their risk adjusted expected return, a complex way of saying that in credit card issuing, as it is presently structured, it will become increasingly difficult to be profitable for any issuer.5

However, profitable opportunities are likely to continue as long as competitors are less able than the bank to assess the profitability of their accounts. Capital One employs retention specialists, whose job is to keep customers who call to cancel their accounts. Retention specialists are supported by screens and computer models that indicate the effects on profitability of changing a customer's APR. While they are empowered to lower a customer's APR down to just above the break-even level, their compensation system rewards them not only for retaining profitable accounts, but for retaining them at the highest possible APR.
Further evidence of increased competition is the fact that the balance transfer product has come under assault. According to Nigel, "The balance transfer product, which we pioneered in 1991, has enjoyed such spectacular success that the market has become increasingly competitive. While we will continue to pursue profitable balance transfer opportunities, we have begun to roll out the next wave of market-tested credit card innovations."

The Growth Opportunities (GO) Team originates from the belief of senior management that the skill set, personnel, culture, and infrastructure of Capital One can be used in other settings, to develop and market different products in different, perhaps unrelated industries. "In the long run, we see our destiny not merely as a credit card company, but as an information-based marketing company offering a variety of products in information-rich industries." [5]. Rich augments this as follows, "We have never viewed ourselves as just a credit card company. We're an information-based marketing company. The credit card just happens to be a product which has been transformed by the information revolution."

There are other newly vulnerable markets, and hence other opportunities for a new entrant like Capital One to use information-based strategies to target an established competitors' most profitable customers. Capital One wants to focus the core team on areas where Capital One's core strengths can provide advantage, and yet to avoid having too focused or too restrictive a view of what these strengths might be. As Peter Schnall, Vice President of New Business Development, says, "We want to make certain that we are not being too narrow in our view of future opportunities. Is our core strength in information-based strategies for test and learn targeting of profitable new accounts or in the use of information more generally for relationship management?"

The GO Team is presently assessing opportunities in a wide range of industries. The company is making increasing investments in non-card targeted marketing; expenditures in 1997 are estimated to be split among balance transfer, other card products, and non-card products, with GO and other card products expenditures roughly equal and both substantially greater than balance transfer product expenditures. The team is, however, all too aware that unfortunately there will once again be a considerable lag between initial tests and profitable rollouts, especially in areas where they must first create a legal operating entity, gain new industry expertise, develop systems and operating infrastructure, create their tests, allow them to incubate and then tune their models, all before profitable rollout can be attempted. The senior management team also believes that there are enormous opportunities to exploit similar strategies in markets outside the U.S.

7. Conclusions

It appears clear that the history of Capital One and Signet Bank provides considerable support for our theory of newly vulnerable markets. The erosion of profitability however suggests that without fundamental differences in resources, innovations like differential pricing and effective market segmentation will become strategic necessities rather than continuing as sources of competitive advantage. If the skills required for information-based strategies are sufficiently difficult to acquire, and if they are sufficiently general in their applicability, then Capital One should enjoy a prolonged period of profitability, exploiting a sequence of opportunities in newly vulnerable markets in other industries. Rich believes that this, indeed, will be the long term source of Capital One's competitive advantage, rather than its positioning in any specific product, industry, or market segment:

"Capital One’s competitive advantage is that the entire company is built around the information-based strategy — the people, organizational structure, systems, operations, accounting systems, human resources, policies, and, most importantly, the culture. We are building a machine that can identify opportunities, adapt infrastructure, and roll out products at full speed. While those opportunities grow, we work in parallel to plan for their eventual obsolescence. This company can turn on a dime. We’re built for change."

While in hindsight test and learn strategies applied to newly vulnerable markets may appear to be obvious, clearly at the time they were not. The Capital One team sums up their beliefs in the sources of their advantage:

"Our growth is the result of opportunistic origination and account management. The strategy was the easy part. Making it work was the challenge! We also continue to test the application of information-based strategy to other products, both financial and non-financial, with positive results."
8. References


Acknowledgements

The assistance of Nigel Morris, President and Chief Operating Officer of Capital One, of Rich Fairbank, Chairman and Chief Executive, of Scott Barton, Director of New Business Development, and of Peter Schnall, Vice President of New Business Development, is gratefully acknowledged. The support of the Reginald H. Jones Center, Project on Information: Industry Structure and Competitive Strategy likewise is acknowledged.

End Notes

1. The Wharton School, University of Pennsylvania

2. College of Business Administration, University of Arizona

3. Outstandings, or outstanding balances, represent the amount of money that a credit card issuer is owed by cardholders. It is generally considered desirable to have high outstanding balances, since this represents money that cardholders have borrowed from issuers, and on which issuers are generally paid a high annual rate of interest.

4. In previous work, we have explored these conditions and their application to a wider range of industries [4].

5. Unfortunately for banking as an industry, there is considerable evidence to support this concern. The assessment of technology in banking suggests that even as it creates value for customers it increases competition and the efficiency of pricing, destroying profits for financial intermediaries [8].

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<td>$6,197,423</td>
<td>$9,089,278</td>
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Table 1: Number of Accounts and Amount of Receivables for Capital One

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<tr>
<td>Number of Tests</td>
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<td>370</td>
<td>617</td>
<td>1,130</td>
<td>1,850</td>
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Table 2: Number of Tests run by Capital One
Several Major Competitors are Experiencing High Charge-Offs

Percent Charge-Offs

Figure 1
Percentage Chargeoffs, Capital One and Competitors

We Found the Elusive Low-Risk Revolver
Solicitation Results (1 year after booking)

Percent of Managed Loans
60+ Days Delinquent

Figure 2
Risk-Utilization Profiles, Illustrating Balance-Transfer Product