Doing Business The Digital Way:
How Capital One Fundamentally Disrupted the Financial Services Industry
Here’s a quick exercise. What links these different outfits: online bank ING Direct; Bankons, a mobile startup that creates geo-located offers; Bundle, a Citibank spin-off that specializes in analysis of spend data; Sail, a mobile point-of-sale card-swiping device? Here’s a hint – all of these companies were acquired to bolster the digital services of a leading financial services organization. We are talking about Capital One. Since its founding as a credit card company in 1988, Capital One Financial Corp. has grown into a diversified bank with more than 65 million customer accounts worldwide. It is not hard to see why Capital One is investing heavily in digital technologies. It conducts over 80,000 big data experiments a year. Currently, 75% of customer interactions with Capital One are digital, and this number is only expected to grow. In Q4 2013, Capital One was one of the most visited websites, with 40 million unique online visitors.

Capital One has fundamentally altered traditional industry ways of working through digital technology and has an unflinching focus on digital. Chairman and CEO Richard Fairbank has reiterated that philosophy in a number of statements, saying that “Digital is who we are and how we do business.” He is very clear that digital is not about cost reduction, saying “I think it’s a bit of a fool’s errand and really off the bull’s eye to chase digital for the sake of cost reduction”, and emphasizes how deep digital goes at Capital One – “We need to make digital how we do business not only with our customers, but also how we operate the company.”

“Digital is who we are and how we do business.”

- Richard Fairbank, CEO

This unrelenting focus on digital has underpinned Capital One’s strong performance. Despite the global recession, Capital One has maintained sector-leading growth and steady profits. For instance, from 2005 to 2013, Capital One achieved a CAGR in profit-before-tax of 10.78%, significantly outperforming the CAGR of the top three leading banks in the US (see Figure 1).

Despite this strong performance, the bank is not resting on its laurels and continues to innovate. In 2013, Capital One introduced new digital enrollment and card activation experiences to migrate customers to digital services. It also introduced pattern tracing, where customers can trace a pattern on their mobile phone instead of entering a password. This makes it easier to use their mobile application and to shop and buy with a mobile phone. The bank’s digital service culture is supported by rapid prototyping capability, which helps deliver new tech-based features faster, as well as real-time analytical tools. These digital capabilities are the deliberate result of a long-term strategy that Capital One has had in play over a number of years, and which we look at in the following section.

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Figure 1: Profit-Before-Tax and Comparative CAGR Analysis of Capital One and Peers

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<td>2005 $2.8bn</td>
<td>CapitalOne vs Top 3 US Banks</td>
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<td>2006 $3.6bn</td>
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<td>2007 $3.8bn</td>
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<td>2008 $582mn</td>
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<td>2009 $1.3bn</td>
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<td>2010 $4.3bn</td>
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<tr>
<td>2011 $4.5bn</td>
<td>Capital One</td>
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<tr>
<td>2012 $5bn</td>
<td>9.80%</td>
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<tr>
<td>2013 $6.4bn</td>
<td>10.78%</td>
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Source: Capital One, Citigroup, JP Morgan Annual Reports
As early as the ‘90s, Capital One was quick to identify that there was little differentiation in the credit card industry, with its CIO, Robert M. Alexander, noting that “It was a one-size-fits-all pricing approach.” This belief led to the creation of an “Information-Based Strategy”. The strategy combined the power of information, technology and testing to bring customized solutions to consumers and help deliver “the right product to the right customer, at the right time and at the right price.” As the CIO explains, “Essentially, what we were doing in the ‘90s was leveraging the power of data to custom-tailor products to our customers. We ran thousands of tests to learn about what customers wanted.”

Capital One formulated its digital strategy on three key pillars – the use of analytics, investment in digital talent and restructuring the company’s IT workforce to enable rapid development and deployment of new innovative services (see Figure 2).

**Using Analytics to Target Profitable Customers with Personalized Offers**

Analytics has always been the cornerstone of Capital One’s business. Since its inception, the bank has been using sophisticated data collection methods to tailor products and services to individual customer needs. In the 1990s, when most of the credit card industry was characterized by uniform pricing, Capital One’s founders used statistical models based on publicly available credit and demographic data. The objective was to determine the best combination of product, price and credit limit that could be offered to its customers. For example, as early as 1999, Capital One received over a million calls per week at its call centers. Before the call was answered by an employee, high-speed computers, which contained information on one in seven US households, swung into action. The analytics system reviewed over 50 options to determine whom to notify and analyzed a range of information about the person who is calling. The system even predicted what the caller might want to buy with greater than 70% accuracy. All these steps happened in under 100 milliseconds.

This pioneering approach to analytics was one of the cornerstones of Capital One’s approach as it made strong inroads into the market. The bank achieved growth in both earnings per share and total customers at a compounded annual rate of 28% in the period 1994-2003. From 2000 through 2003, Capital One’s share of the U.S. credit card market rose from 3.3% to 7.2%.

Capital One used analytics not just for predictive sales; it also used it effectively to drive an increase in the customer retention rate and a reduction in cost of customer acquisitions. For instance, the use of data on interest rates, rollover incentives, special promotions and so on has helped Capital One increase its customer retention by 87%. It has also lowered the cost of acquiring a new customer by 83% over a period of 2-3 years.

By using analytics to drive product customization, Capital One has been able to create several innovative service offerings crafted to customer needs (see Figure 3). For instance, the bank was the first to introduce an innovative balance-transfer credit card. The card allows customers of other banks to transfer what they owed on higher-interest cards to a Capital One card with a lower introductory rate.

Capital One also introduced a rewards redemption program called “Purchase Eraser”. The program allowed consumers to repay the cost of previous travel expenses using their reward miles. The “Purchase Eraser” offer could be redeemed across a variety of travel expenses that include flights, cruises, hotel stays and car rentals. The benefit of the program was that it allowed customers to take advantage of deals not offered through in-house travel-booking channels. For example, customers have the dual benefit of combining discounts offered through third-party websites while also redeeming their miles through the “Purchase Eraser” program. Capital One also offered digital coupons through a mobile app – “Mobile Deals” – which...
could be accessed via a smartphone or email. The coupons provided targeted money-saving deals to card holders based on their spending habits.

**Driving Partnership between IT and Business to Deliver Products with Increased Speed and Efficiency**

Early on, Capital One realized that IT was a key determinant of success in a digital world. Its CIO goes as far as to say, “For financial services, our product is IT, in a way. It’s an intangible product that we deliver through IT solutions.” However, in delivering this intangible product, the company understood that traditional approaches to software development could be a hindrance. In 2011, to achieve greater business engagement – and ensure their involvement with developers through the lifecycle of the project – the bank started to move 70% to 75% of outsourced IT development work in-house. Having the business team involved with the IT development team allowed the bank to monitor a product along several metrics that include quality, delivery time, cost and meeting expectations on the first deployment.

**Building a Digital Talent Base to Drive In-House Development**

Its focus on analytics meant Capital One needed to recruit analysts with quantitative skills to assess complex numbers and derive actionable insights. While that skill set is scarce and difficult to find, securing it formed a key element of the Capital One IBS strategy. As early as 2006 the bank was seeking to hire three times as many analysts than operations people.

Moving development capabilities in-house meant the bank needed to recruit more engineering talent equipped with mobile and software skills. As CIO Rob Alexander said, “If digital is so central to our strategy, we really need an IT organization that is able to deliver like a technology company, and not like a traditional bank.” To equip itself with this talent, the bank acquired several banking technology start-ups while also recruiting new associates directly from college and graduate school. In 2012 it acquired Bankons, a mobile start-up that creates geo-located offers. The acquisition allowed the bank to offer tools that reward users based on their geo-location and their purchase history. The bank also acquired data aggregator firm Bundle Corp. The acquisition helped the bank capitalize on Bundle’s proprietary analytics technology powered by data from more than 20 million Visa and MasterCard branded cards.

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While acquisitions certainly helped Capital One gain access to digital talent, that was not its only route to talent acquisition. Capital One has an 18-month Information Technology Development Program that gives new associates the opportunity to work on global-scale technology projects. The exposure allows them to develop skills needed to build new Internet, social media and smartphone capabilities.

A key element of getting the right talent was the hiring process itself. And here, as well, Capital One’s focus on analytics is clear. The company administers mathematical cases, a variety of behavioral and attitudinal tests, and multiple rounds of interviewing to ensure it gets the people with the right fit. And such an approach is followed across all levels, right up to senior vice presidents who head business functions.
Capital One’s digital leadership is not just confined to operations. It has also successfully utilized various digital platforms and technologies to transform the customer experience.

Creating Brand Awareness and Customer Engagement Through Social Media

Capital One is a strong proponent of using social media and video to engage with its customers. For instance, in 2012, the company sponsored the US college football Capital One Bowl, with the promotional hashtag trending on Twitter throughout the matchup. The initiative had around 120,000 people vote via Twitter in a contest to name the 2012 college Mascot of the Year[22]. It also launched a humour-driven web video series to drive awareness for its mobile banking offering.

Focusing on the Mobile Channel to Exploit Future Opportunities

Capital One has progressively extended the capabilities of its mobile applications. Its app, for example, allows customers to make check deposits using their smartphones. The bank’s digital brand manager has said, “Mobile is really blurring the lines between traditional and digital channels and the bank is really looking at how to use mobile as an interactive piece[23].” To achieve this, Capital One is making a foray into mobile payments. It is testing new user experiences in the payments space, such as paying with rewards at the point of sale. It is participating in multiple payments technology trials, such as the NFC pilot and the QR code pilot programs. And it recently introduced a peer-to-peer payment service that allow customers to exchange money with one another using a bank-owned platform, ClearXchange[24].

Capital One has come a long way in its digital journey. The company has set several fundamental benchmarks that its peers in the financial services industry are now compelled to meet. And this journey has only just started, as its CEO states, “I think there is a lot of work and a lot of challenging of our own conventional wisdom to actually truly now build a digital company[25].” With its radical digital approach, Capital One is not just challenging its own wisdom, but that of the entire financial services industry.

Accelerating Innovation with Capital One Labs

Launched in 2011, the objective of the Capital One Labs is to develop digital products in collaboration with venture capitalists, entrepreneurs and academics. The Labs launched a mobile card reader in 2013 called Spark Pay that lets merchants accept payments on mobile devices. The Spark Pay reader integrated with a mobile and web app and is designed to help business merchants execute tasks rapidly and access associated analytics. The platform's current services include custom receipts, offers, inventory management tools and sales report analysis.

The bank also holds regular meetings and competitions for young designers to encourage the creation of new products in less than 24 hours. For example, in 2012, the bank held MoDevUX Hackathon, a competition for developers of mobile banking applications.

There are three innovation labs, operating out of three tech hubs of New York, Washington D.C. and San Francisco. The labs are intended to allow its team of developers to test new ideas without hampering other ongoing projects. In order to encourage innovation across the wider enterprise, Capital One rotates developers through the labs.

The labs use an integrated set-up with teams of three people consisting of a business analyst, an engineer and a designer. This combination is designed to ensure that concepts become tangible and real in about two to three weeks. As CTO Monique Shivanandan says, “We combine technology people, data analysts, marketing people, brand managers and product managers in the labs to be sure we’re focused not just on cool technology but innovative products and services to delight the customer.”

Source: Computer World, “How enterprise IT gets creative”, June 2013
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