

Capital One can be summed up in two words: Mass customization. With information in its computer databases on over 100 million potential customers and 1 of every 7 U.S. households, Capital One has a card that's right for you.

The Falls Church Virginia based company started the jump from a regional bank leader to a credit card industry leader when cofounders Richard Fairbank and Nigel Morris began their unique "try-it-then-track" approach. They believed that using a one-size-fits-all marketing strategy was outdated and began using information to tailor specific products to specific consumers for regional Signet Bank in 1988. Fairbank and Morris believed that with pricing, fees, balance limits and other options, they could tailor a card to a specific consumer whether they were high risk or pure platinum. This new strategy became so successful that the credit card division spun off to form the corporation Capital One in 1994.

### **Marketing Environment**

Buying power - defined as total personal after-tax income available to spend on goods and services, went up for most Americans in the 1990's. (Table 1: U.S. Population by Race, Buying Power and Income) This prompted a national buying spree. But with a slower economic environment in 2000 and 2001, many people were struggling to make their monthly payments. Credit card delinquency began to rise, with an industry average of over 6.4%. However, rather than using blanket formulas when issuing cards, which most credit card issuer's were doing, Capital One kept a tight rein by offering their customers lower credit. They were also requiring well-balanced credit ratings. Maintaining this cautious fiscal policy through the years has helped Capital One achieve an annual charge-off rate of only 4.42%, the lowest rate of any major lender.

The overall conservative lending practices of Capital One prove that they are knowledgeable with how to protect the bottom line at a time when more and more consumers are concerned that credit card companies are not doing enough to protect their security. Since September 11 consumers are willing to give up some privacy for the sake of increased security. This is an opportunity for Capital One to establish increased security as a marketing tool to ease consumers' fears.

With the American public's increased debt, growing pressure on household budgets and the increase in cost of living, credit cards are obviously deemed a convenient way for consumers to acquire short-term loans. (Table 2: Average Credit Card Rates) In this country, credit card use spreads across race lines with over half of all Americans carrying some form of plastic. (Table 3: Card Ownership by Ethnicity) With expectations of low rates and flexible payments along with the convenience of being able to use their cards in conventional stores, over the phone and on-line, credit cards have become a norm when it comes to buying and purchasing all kinds of goods. Capital One is integrated in a very competitive industry. Citigroup, MBNA America, First USA/Bank One and Discover are listed as major competitors who use a variety of ways to market their credit cards. By focusing on brand strategy, affinity marketing (when a card company gives customers the opportunity to get a card from an entity that means something to them) or an information-based strategy, each takes a slightly different approach in attracting new customers. (Table 4: Estimated Credit Card Market Share—4Q01)

### **Strategy**

Capital One's business mission is founded in its core competency. Leveraging information to create the right product for the right customer at the right time is its mainstream objective. Company co-founder Richard Fairbank says the company is "really a marketing company" that happens to market credit cards.

Capital One clearly makes their marketing objectives and goals known. Through the best technology money can buy, the company continues to harness information to target specific customers with specific products. They seek customers across the credit spectrum through mass customization of products that meet people's individual needs and wants. They strive to offer divergent product lines that deliver value to a wide range of customers.

By concentrating on the latter, Capital One will test many products over and over again to make sure the right cards are offered to their customers. For example, In 1994 Capital One ran 230 product tests. Six years later, the company reportedly ran 42,000. Example tests ranged from finding out if consumers responded better to blue or white envelopes to whether a fisherman would make his payments on time if his credit card featured a fishing motif. Because of such testing dedication,

Capital One offers 6,000 kinds of credit cards and 12,000 products today, distributed through different channels with slightly different pricing, pitches and packages. Capital One's product evolution dates back to being the first credit card company ever to offer temporary low percentage balance transfer rates. However, even though this campaign was so successful with increasing its customer database and creating many imitators, customers jumped to another credit card company when the introductory rate had expired, looking to keep a standard low rate. Recognizing this as a negative impact on sales, Capital One abandoned their transfer campaign and instead appealed to the same demographic with a new locked low rate card.

### **Organization**

Capital One is constantly reinventing itself. Each year 75% of what the company markets to customers is new products. Keeping up with their competitors - Capital One is always fine tuning its products and discovering new ways to market them. The core of Capital One's organizational philosophy is Customer Service Marketing (CSM). Each product is created and tested by an internal team consisting of Operations, Information Technology and Marketing. These teams work together as cross-functional units to ensure collaboration for every product rollout. Without this "3 Man Team" - the perfect product would never be found for their customers.

Taking a more scientific approach to marketing, Capital One empowers this "3 Man Team" to develop new product ideas that are tested and potentially worked into their product line. Every idea starts with one or a series of tests. If the product passes the test - Capital One prepares it with efficiency and ease. "The flow of information between IT and the business side and the customer is constant", says Jim Donehey, Capital One's chief information officer. The feedback from constant testing allows the company to reevaluate their success and productivity along with their products. Capital One's day-to-day operations are not based on systems projects, but more business projects where everybody works together.

Capital One also divides their marketing department into three segments: building brand equity, growing the business and targeting emerging markets. These three areas are overseen by the following:

*William J. McDonald, SVP: Brand Management:* In a position created in 1998 to develop a brand identity and clear up consumer confusion over the company's name, McDonald joined the firm. His responsibilities include the marketing, advertising and global brand positioning of Capital One's businesses.

*Peter Schnall, SVP, Marketing and Analysis:* For the U.S. business, Schnall is responsible for the marketing, credit policy and portfolio management of Capital One's credit card business.

*Larry Klane, EVP, Marketing and Analysis:* In identifying overlooked demographics, Klane is responsible for Capital One's young adult business, underserved businesses, and new business development.

One of Capital One's organizational strengths is the strong configuration between marketing, sales and information technology. "Capital One is by far the best from an information-based marketing standpoint. They are world class in their ability to generate insights on consumers", according to Bob Zizka, Managing Vice President of First Manhattan Consulting Group.

### **The Bottom Line**

In 2001 Capital One reported annual profits of \$642 million on a net income of \$6.8 billion. For each of the past ten years, Capital One has exceeded earnings and predicts growth of 21.6% in 2002 and 20.2% in 2003. (Table 5: Capital One Revenue Trend, Table 6: Capital One Earning Progression) This growth can be directly attributed to its marketing strategy, with a budget of over \$1 billion. (Table 7: Capital One Financial Earning Model) Because of aggressive marketing tactics and an innovative information based strategy, Capital One's success continues with a new account growth rate of 20-30%.

### **Marketing Systems**

Capital One receives more than one million phone calls each week. Before the caller hears the first ring, high-speed computers swing into action. With meticulous data on the customer's household and their spending habits, the computer predicts the reason for the call and routes it to the correct customer service representative 70% of the time. This transaction takes place in approximately 100 milliseconds. This \$10 million system is referred to as Information Based Strategy or IBS, a

proprietary information system that enables the company to create products for appropriate customers and to ensure that their needs are being serviced efficiently. Using IBS to generate constant innovation, Capital One links its database to prize-winning information technology and highly sophisticated analytics to scientifically test ideas. The results of these tests tell Capital One how to market and tailor products to the individual customer. A FORTUNE 500 company, Capital One is one of the major financial services providers on the Internet, offering instant approval, online account decisions, online retail deposits and a growing number of customers serviced online. In fact, in 2001, the company acquired 1.4 million new accounts from their web site alone.

Many in the financial industry refer to Capital One as a "cutting edge company" for the information age. Because of its progressive efforts in informational technology, customer inquiries and information are a priority. The success of the IBS system can be seen in the fact that half of all customers buy something other than credit cards from Capital One in the first year. With call representatives empowered to sell and adjust rates and fees, Capital One's call representative are their front line sales force. The company continuously experiments with different programs and products along with reinventing telemarketing scripts to keep their sales force intuitive when on the phone with a customer. These scripts help Capital One tailor its offerings to fit a potential customer - scripts they know will make customers happy with the Capital One Credit Card. What's unique about Capital One's customer service department is that their sales force is not measured on actual sales, but are judged on their ability to meet the customer's needs. A system like this is a first in the credit card industry.

Capital One reaches out to the consumers desire to make smart decisions about credit cards and loans through scientific well-researched methods. Knowing the customer's spending habits, Capital One offers programs directed at a very specific audience. Targeting a wide range of customers across the country and with a growing international presence, Capital One has room to grow as more than a leading financial services company. Stretching to auto loans, home loans, and insurance will help increase profit and recognition.

Capital One reaches prospective customers through 300,000 million direct mail pieces each quarter. Even though it is stated that direct mail pieces generate only a .6% response, Capital One gains a

majority of new customers through this useful distribution tool. Capital One's use of mail can also be seen in their strategic business partnerships. Billing inserts promote companies such as JCPenney, Liberty Mutual and EarthLink.

Late in the fall of 2001 Capital One unveiled its now familiar television advertising campaign, "What's in Your Wallet" created by advertising agency DMB&B. This campaign was created as a brand strategy technique to build an identity for the low-profile company. There isn't a day that goes by that you don't see a Capital One advertisement, but there is more than just television to make the company stand out. Boasting 3 of the top 10 banner impressions on the Internet, they delve into a multitude of advertising outlets attracting customers through specials and deals relative to their lifestyle. (Table 8 and 9: Top 10 banners viewed from home and work) Capital One always makes a statement that meets customer's expectations.

### **Conclusion**

The \$600 Billion credit card industry is one that has been revolutionized by the use of integrated marketing. Capital One's ever-changing strategy of mass customization of products and pitches along with their continued conservative fiscal policy will be crucial for their continued success. The company continues to grow its U.S. and international credit card business and looks to broaden their product offerings with loans, insurance and potentially car sales. Capital One feels they can apply their strategy to any form of business because customers are finding what they need in a credit card company and are happy with the results. According to company co-founder Richard Fairbank, "This is not about credit cards. This is about changing the world."

## TABLES

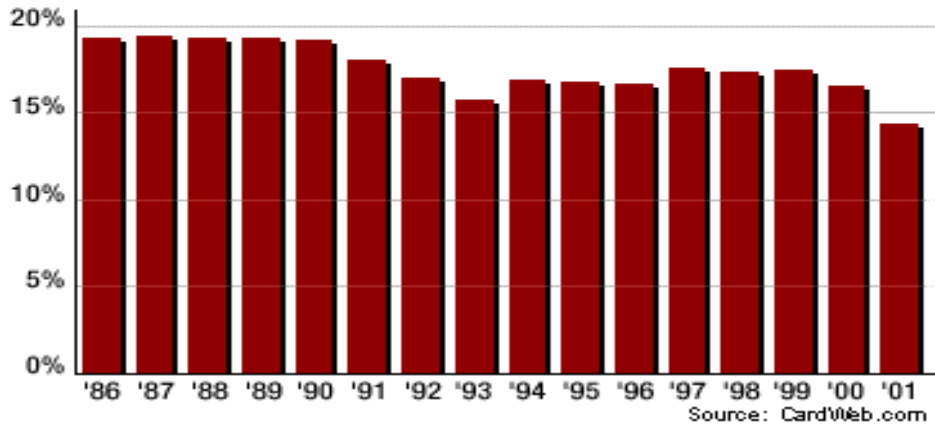
**Table 1: U.S. Population by Race, Buying Power and Income**

	Population (in millions)			Buying Power* (in billions)			Per-Capita Disposable Income, 1990	Per-Capita Disposable Income, 2001	Per-Capita Disposable Income Growth (in %)
	1990	2001**	% Change	1990	2001	% Change			
White	209.1	227.4	8.8	\$3,715.0	\$6,219.8	67.4	\$17,767	\$27,352	54.0
Black	30.6	35.8	17.0	\$307.8	\$572.0	85.8	\$10,059	\$15,978	58.8
Hispanic***	22.5	33.1	47.1	\$207.5	\$452.4	118.0	\$9,222	\$13,668	48.2
Asian	7.5	11.6	54.7	\$112.9	\$253.8	124.8	\$15,053	\$21,879	45.3
Native American	2.1	2.5	19.0	\$19.2	\$34.8	81.3	\$9,143	\$13,920	52.3

\*Total personal after-tax income available for purchase of goods and services.  
 \*\*Projection based on preliminary 1999 census figures.  
 \*\*\*Hispanic can be considered any race.  
 Source: Terry College of Business, University of Georgia

**Table2: Average Credit Card Rates**

### Cheaper Than Ever

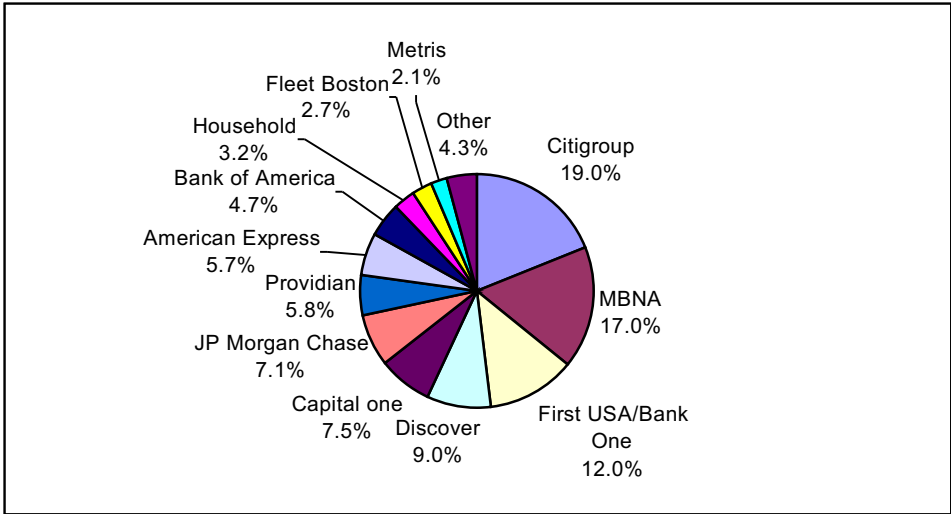


**Table 3: Card Ownership by Ethnicity**

<b>Card Ownership by Ethnicity</b>			
<b>(heads of households carrying, in %)</b>			
	<b>Hispanic</b>	<b>African American</b>	<b>Caucasian</b>
Debit/check card	35.9	36.7	55.0
ATM card	36.3	43.0	60.7
Credit/charge card total	51.0	53.0	78.0
American Express	8.2	10.0	14.7
Visa	36.9	41.7	59.0
MasterCard	26.3	26.3	44.3
Discover	10.2	7.7	17.7
Retail cards	32.5	30.7	51.3
<b>Total</b>	<b>55.8</b>	<b>60.3</b>	<b>84.0</b>

Source: Strategy Research Corp.  
 Note: Total refers to households with any credit/charge card, plus debit cards.

**Table4: Estimated Credit Card Market Share—4Q01**

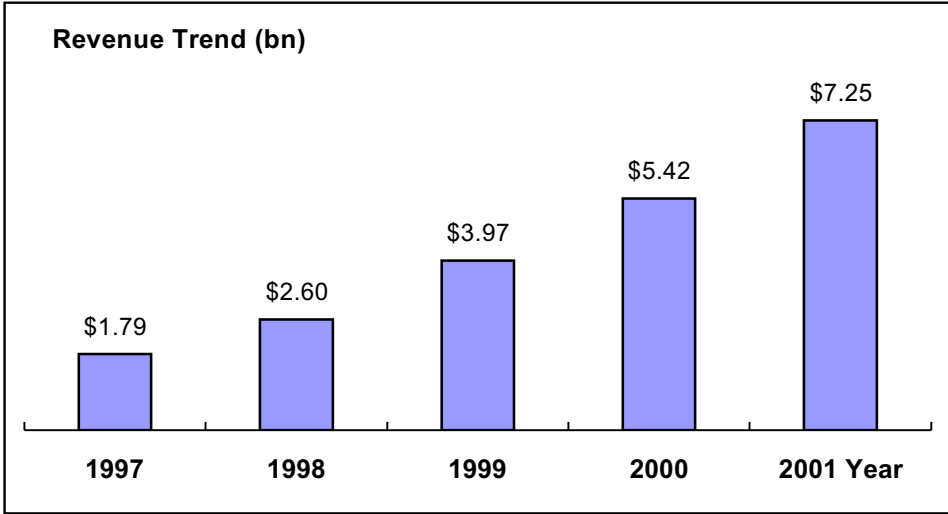


Note: Market shares based on estimated total outstanding receivables. COF and KRB market shares include all managed receivables.

Source: Banc of America Securities LCC, Nilson.

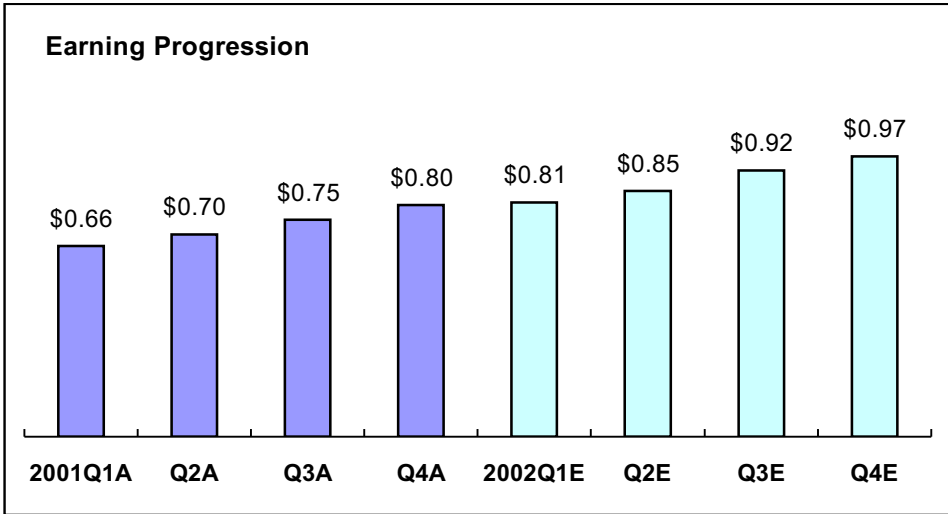


**Table 5: Capital One Revenue Trend**



Revenue for Capital One Financial Corp. grew 34% from 2000 to 2001 and has grown a total of 306% since 1997.

**Table 6: Capital One Earning Progression**



We expect Q1 2002 earning for Capital One Financial Corp. to grow 23% versus Q1 2001 and Q2 2002 earning to grow by 21% versus Q2 2001.

**Table 7: Capital One Earning Model**

Managed Asset Basis (\$ in millions)	2001				2002Estimates					
	Q1A	Q2A	Q3A	Q4A	2001	Q1	Q2	Q3	Q4	2002E
Net Interest Income	759	824	927	983	3493	1043	1083	1139	1215	4480
Non-interest Income	747	796	853	942	3337	926	999	1083	1149	4157
<b>Managed Revenues</b>	1506	1620	1779	1924	6830	1969	2083	2222	2363	8637
<b>Provision for loan losses</b>	357	379	438	563	1737	585	616	661	733	2595
Marketing Expense	231	269	282	301	1083	273	314	324	344	1255
Other Expense	687	722	793	773	2975	824	848	912	944	3528
<b>Operating Expenses</b>	918	990	1075	1075	4058	1097	1161	1236	1288	4783
<b>Pretax Operating Income</b>	232	251	267	287	1036	287	305	325	342	1259
Taxes	88	95	101	109	393	109	116	124	130	479
<b>Operating Income to Common</b>	144	155	165	178	642	178	189	202	212	781
<b>Net Income to Common</b>	144	155	165	178	642	178	189	202	212	781

(Interest income includes interest charge on credit cards as well as late fees. Non-interest income includes about everything else: annual membership fees, interchange income, overlimit fees, cash advance fees, and cross-sell revenue.)

**Table 8: Top 10 Banner Ads Viewed at Home**

Top 10 Banner Ads Viewed At Home			
Rank	Company	%Reached	Creative
1	Capital One	7	"How FAST do you want your credit decision?"
2	Bozi Software	6.9	"Warning: Your Internet Connection is Not Optimized. Download InternetBOOST"
3	Capital One	6.8	"0% Intro >>9.9% Fixed. Not just another pretty card"
4	Capital One	6.2	"Capital One VISA PLATINUM 0% Intro Rate Fixed 9.9% Thereafter"
5	ClassMates	5.6	"Do you know this person? Who could she be?"
6	PhotoAlley	5.5	"Canon, Minolta, Olympus, Kodak, Nikon & More - Click Here"
7	Bozi Software	4.6	"Internet Status: Your Internet Connection is Not Optimized"
8	Network Solutions	4.5	"Want a Web Address? Type it Here!"
9	Office Depot	4.5	"Free Delivery, low prices... your 1stop office shop!"
10	Citibank	4.5	"Credit card balances piling up? Go Platinum! Citibank Platinum"

**Table 9: Top 10 Banner Ads Viewed at Work**

Top 10 Banner Ads Viewed At Work			
Rank	Company	%Reached	Creative
1	Bozi Software	11	"Warning: Your Internet Connection is Not Optimized. Download InternetBOOST"
2	Capital One	9.7	"How FAST do you want your credit decision?"
3	PhotoAlley	9.5	"Canon, Minolta, Olympus, Kodak, Nikon & More - Click Here"
4	ClassMates	8.3	"Do you know this person? Who could she be?"
5	Plow&Health	7.9	"Must-Haves for your Garden. Order today from Gardenwork"
6	Network Solutions	7.9	"Want a Web Address? Type it Here!"
7	Office Depot	7.7	"Free Delivery, low prices... your 1stop office shop!"
8	Capital One	7.5	"0% Intro>>9.9% Fixed. Not just another pretty card!"
9	Capital One	7.4	"Capital One VISA PLATINUM 0% Intro Rate Fixed 9.9% thereafter"
10	Citibank	7.3	"Credit card balances piling up? Go Platinum! Citibank Platinum"

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