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Customer Relationship Management at Capital One (UK) - (Condensed Version)

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This case was prepared by Ulrike Wiehr, the Boston Consulting Group MBA Fellow, under the supervision of Professor Werner J. Reinartz, at INSEAD. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. I would like to thank Ana Cavalheiro for her valuable assistance in the case preparation.

Ian: "Customer Relationship Management is another buzzword to me, but what does it actually mean? It just seems like a nice concept. We don't talk about it internally – we have many buzzwords, but not this one."

Phil: "We've internalised it so much – that's why we don't talk about it."

Ian: "You're right, we don't do Customer Relationship Management – we just get on and manage Customer Relationships!"

Conversation between Phil Marsland, Director of Marketing and Analysis, and Ian Cornelius, Account Manager, Capital One, June 2002.

Introduction

Capital One's leaders, Richard Fairbank and Nigel Morris, had a vision of creating an information-based company rather than a financial services company when they worked in the consulting business in the late 1980s. They envisioned that the strategy for credit card providers should be to deliver 'the right product to the right customer at the right time, at the right price'. While sounding obvious, their statement marked a revolution that would trigger huge changes in the credit card business. However, this revolution did not happen overnight.

As consultants, Fairbank and Morris could see the potential for improving the credit card business for both customers and shareholders alike through the application of their nascent strategy ideas. The US credit card market during the 1980s was characterized by the fact that the financial institutions were offering very similar products across the whole spectrum of their customer bases, charging a standard 19.8% interest rate and a US$20 annual fee. The market lacked a customisation of offers, and one-to-one marketing was practically inexistent. The prevailing story was very much 'one size fits all'.

The journey began in late 1988, when Signet Bank, in Virginia, not only bought Fairbank and Morris' concept but also engaged them to execute the plan from within. In contrast to the prevailing attitude of the major players, Signet put a different understanding at the heart of its new strategy. According to Morris and Fairbank:

> "Credit cards are not banking, they are information. It's all about collecting information on millions of people that you've never met, and, on the basis of that information, making a series of critical decisions about lending money to them and hoping they pay you back."

Therefore, Signet Bank rebuilt its credit card operations around information technology and sophisticated analytical techniques. This new adopted strategy, named *"Information Based Strategy" (IBS)* was to compile what was ultimately to become the world's largest Oracle database, allowing the company to understand its customers and to develop mass-customised products, which would ideally suit their needs and risk profile.

By early 1994, Signet made the decision to float the credit card business separately, and hence *Capital One Financial Corporation* was born in November 1994, with Richard Fairbank as

Chairman and Chief Executive Officer, and Nigel Morris as President and Chief Operating Officer.

Since its IPO in 1994 to 2000, the stock price of the company has increased by 1,000% and the company has grown at an average annual rate of about 40%, excluding mergers and acquisitions. In December 2001, the company handled more than US$45 billion in loans and 43.8 million customers worldwide, serviced by more than 20,000 employees (see Appendix 1 for awards given to the company).

Encouraged by its success in the US, Capital One decided to launch its first overseas operations in the UK. In July 1998, Capital One opened its operations centre in Nottingham. On day one, 250 associates were employed. By 2001, this number had grown to over 2,000, and Capital One associates in Nottingham now deal with application processing, customer service, product design and marketing, card issuing, collections, business development and database management. In 2002, the company reached profitability and is now one of the UK's top six credit card issuers.

Capital One's percentage of outstanding bad debt, a key performance measure in a risk-driven business, was significantly lower than that of key competitors. This is especially significant, given that the company, unlike most of its competitors, lends to customers across the whole credit risk spectrum. At year end, 2001, Capital One posted its 18th consecutive quarter of record earnings: annual earnings grew by more than 20% and delivered a yearly return on equity of more than 20%. Reaching this goal seven times in a row put Capital One in a league with only seven other publicly held US companies. (See Appendix 2 for the growth history of Capital One's revenues).

In early 2001, Fairbank and Morris could not help wondering about its success: while all their competitors were also embracing CRM (Customer Relationship Management), and most seemed to pursue the concept with significant investments in software and reorganization, Capital One's customer base was developing at a compound annual growth rate of 40%. It seemed as if Capital One could indeed be seen as creating industry best practice in developing valuable customer relationships and managing risk based on an intimate understanding of the customer. But what exactly was it that made Capital One's approach to CRM so unique? Was the company's success down to luck or was it based on a real competitive advantage – and, if so, would this be a sustainable advantage, in the light of competitors' efforts on CRM?

Industry Background

An overview of the UK Credit Card Market

In the early 1990s, the major British banks dominated the market (such as Barclays, Lloyds, The Midland, NatWest, and The Royal Bank of Scotland) These banks would typically charge all customers interest rates of about 22% as well as an annual fee of £12. Products were barely differentiated and customers had little real choice. In the mid-1990s, the market was shaken up by the entrance of competitive US banks such as Capital One, Morgan Stanley Dean Witter and MBNA, that targeted the UK market to expand their own business. The Internet wave also prompted the emergence of new competitors such as the online banks Egg, Cahoot and IF.

The introductory offer of the new entrants revealed an aggressive pricing strategy. By offering lower interest rates and lower fees, they built sizeable customer bases. Working on the basis that around three quarters of the sums owed on credit cards are attracting interest, providers have begun to offer extremely low-cost balance transfer deals (see Appendix 3 for balance transfer rates). As a consequence, the credit card market today is highly competitive and the market share of the major UK banks (two thirds of credit cards in issue) is eroding (see Appendix 4 for market shares). It is clear that the days of the 22.9% standard interest rate are truly over.

Credit Card Revenues

Credit card issuers have many sources of income from the use of credit cards as a payment device or as a form of credit. The most frequent are: interest charge paid by customers taking extended credit, annual card fees, interchange (a service commission from the merchants accepting the card) and other fees, such as late or over-limit fees.

Another valuable source of income for credit card issuers is the revenue originated by cross-selling other financial products related to the cards, such as insurance against fraud, or personal loans and mortgages. However, the main source of profit for a card company is the Annual Percentage Rate (APR) on an outstanding balance, i.e., the use of the credit card requires that the customer pays a specific minimum proportion of their balance each month, and, in addition, an interest rate on the outstanding balance. The more outstanding balances customers have, the greater the company's revenues are, and the higher the APR, the higher the interest charges incurred.

Consumers

As mentioned, credit cards may be both a payment device and a form of revolving credit. Credit card customers can be divided into two main segments:

- ***Transactors:*** clients who regularly repay their entire balance;

- ***Revolvers:*** clients who pay less than their entire balance and usually benefit from an interest-free grace period, which may be up to 54 days.

Revolvers are the customers who provide the biggest source of revenue, since they are always revolving their credit and therefore always providing revenue as they pay their interests.

Relatively buoyant consumer confidence and low interest rates have combined to create an environment in which consumers are happy to take on extra debt. An example of this confident environment is the comparative strength of both credit and debit card markets, with charge cards in issue trailing far behind (see Appendix 5 for the evolution of card issues). The growth in the number of credit cards in issue is, in part, a result of the increased market competition but also a consequence of the changing attitude of the British towards credit. The amount of total consumer credit increased by 96.7% from 1995-2001 (£89.1bn to £175.3bn).

Credit cards represented 53.5% of this total credit in 1995, rising to 59.6% in 2001 (Source: BoE/Mintel). For many, consumer credit is simply another financial tool to be taken advantage of, in the same way as a current account or mortgage.

Also, consumers are increasingly happy to play credit card providers off against one another, switching from card to card in order to take advantage of introductory deals. While APR is clearly a key factor in customers' preferences for specific cards, there are other factors that influence their choices. These include, for example, the availability of a reward point system, the acceptance rate at stores, the size of the credit line, the card design, or the affiliation with a charitable organization.

Capital One Company Background

Business Model

The business model of Capital One is founded on the simple, yet crucial, premise that each customer requires a different product and service from its credit card provider. The company believes in the assertion that customers, if offered what they want and need, as opposed to what banks want to offer them, will choose the provider that gives them choice and individuality.

Each customer carries a specific and unique credit risk and potential revenue profile, based mainly on their previous credit history (or lack thereof). The better the company can understand and assess a customer's specific risk, the better it can manage it. And the better it understands the customer, the more it can tailor its products to his or her needs. Risk is a crucial factor in the credit card business. "We're in a risk-driven business where one bad debtor can easily wipe out the benefits from 20 average customers or 4-5 good ones – thus, it's vital to manage them carefully," explains Ian Cornelius. "It is one of our competitive advantages to understand and manage these different levels of risk."

Information-Based Strategy (IBS)

Capital One's goal is to use information to acquire the types of customers it can most profitably serve. In order to understand them, the company uses information technology to accumulate and manage large amounts of data on its customers. Alongside publicly available data on credit risk, the company supplements this with data on customer demographics and behavior collected internally during the application and account management process, where every transaction is carefully registered. None of this could be achieved without the entire company being completely aligned behind the whole process.

With the data accumulated, the company executes its proprietary "Test & Learn" strategy. Test & Learn is a scientific, hypothesis-driven approach to test any customer related activity in a controlled condition on a sample of customers before rolling it out on a large scale. Using this scientific process, Capital One's Marketing and Analysis teams develop ideas, design products, and select target customers. Real products are empirically tested with genuine customers: the number of tests run is impressive – 36,000 in 1999 and 45,000 in 2000.

(Appendix 6 summarizes the principle behind the "Test & Learn" strategy). For example, mailings with different copy and/or letter design are sent out to potential customers. Their response rates are monitored, as is their behaviour as new customers, so that Capital One can understand the relative value of different offers. All test results are then analysed and integrated into databases that can be referenced later to initiate further ideas on development and product design. Similarly, by analysing customer behaviour, the view of risk can be refined, and the credit offer can be improved accordingly. Balance-building programmes can be targeted at the low risk customer, thereby reducing the average loss rate of the portfolio.

As a consequence, the company continues to improve its portfolio of products and services, and it now offers more than 6,000 products, most of them variations of credit cards. Key products are:

- Credit cards with different conditions (APR, credit limit, fees) and designs.
- Products directly related to the credit card such as card protection plans and payment protection insurance (cross-selling).
- Other financial services such as travel insurance.

Customer Relationship Management Practices at Capital One (UK)

Managing its relationships with customers is at the heart of Capital One's strategy. CRM is not seen as a tactical or functional approach but as a key strategic process. This strategic CRM orientation expresses itself, for example, in the way the various corporate functions are interlinked. It is not only the way in which departments are structured but also the way they interact with one another. As Capital One managers usually say: "All departments work in an integrated fashion and there are no silos within the company." Internally, the company is grouped in four key activities.

1. *Marketing and Analysis (M&A):* Responsible for Capital One marketing strategy, product development, credit and risk management, pricing strategy, monitoring market trends and competition.
2. *Operations:* In charge of all front- and back-office operations and for all customer-inter processes (e.g., cross-selling, customer acquisition and retention, etc.).
3. *Information Technology (IT):* In charge of the development and maintenance of the systems infrastructure.
4. *Human Resources (HR):* Responsible for employee recruitment, training and development, the internal satisfaction survey and for nurturing the company's culture.

Marketing and Analysis (M&A)

Capital One's M&A department has, as its main functions: segmentation, testing and analysing customer data in order to elaborate the company's marketing strategy, and the development of new products and services. To segment customers, Capital One uses analytical techniques and tests to identify groups of customers and to cluster them into segments according their risk profile and behaviour.

Segmentation Strategy

Capital One's segmentation strategy focuses on a full spectrum approach, i.e., it targets all types of risk profiles, offering them different products and prices accordingly. The company's database has many types of customers, such as "transactors", with a low risk profile, and "revolvers". Capital One was able to further distinguish two sub-segments in the latter group: "high risk revolvers", with a high level of credit line utilization and high probability of default, and "low risk revolvers", who use their credit line extensively but pay back their balances. In order to identify this profitable low risk "revolvers" segment, Capital One carried out some tests that revealed that these customers could be targeted by making them a better interest rate offer. In fact, offering them a lower APR to encourage them to transfer their balances from other banks to Capital One, proves to be an attractive offer, since these customers intend to repay the balance they have already created. Many other tests were conducted to fine-tune the solicitation of these customers in terms of contact channels, credit offers and mailing preferences.

The company's other large customer segment is composed of customers for whom the Capital One card is very often the first card. This segment also includes people who have had problems obtaining or handling credit in the past, people with limited or non-existent credit records and young people. Since this segment carries a relatively higher risk, these customers are usually not well served by products offered by the main high street banks. Capital One's strategy in this case is to offer these customers an initial higher APR with an annual fee and a lower credit line. While this is clearly higher than other Capital One offers, it usually compares very favourably with alternative credit offers on the market, and represents good value to these customers.

Account Manager, Cavendish Elithorn, explains why the offer is an attractive one for this segment: "Given their credit history, the Capital One card is still a better deal than other sources of credit – store cards where interest rates are 30%, brokers who charge 40-50%, or door-to-door lenders with 100% rates." The potential volume of this segment is significant, which is why Capital One has the potential to grow this customer base alongside the low risk segment. The challenges to identify this segment are the same as those of "low risk customers": identify the customers, their risk assessment and managing attrition. To evaluate the customer risk profile on application, the company rates them based on their credit scoring, information taken from the application forms and credit bureaux data.

Retention Strategy

To attract "low risk revolvers" with balances in other banks, Capital One may offer them a card with an introductory low rate that expires after a few months, and no annual fee. However, when the introductory rate expires, Capital One may witness increasing attrition from these clients, as many price-sensitive customers tend to reduce their debt or leave Capital One, without notifying the company or closing their account. "This is a dangerous development as it's the best customers – those that are low risk – that tend to leave to get better credit deals elsewhere," explains an account manager. "Consequently, we have active strategies to keep these customers, and their balances."

Many of the account management activities seek to keep these customers from being *"dormant"* or becoming permanently inactive. These retention activities are designed to help retain customers when their introductory rate expires or when other accounts risk "dormancy". "If a customer's account is dormant for a while, there is an increasing risk of losing that customer," explains Ian Cornelius. "That's why we have a number of activities in place to guard against this – by making a range of offers to reactivate their account."

Capital One's retention strategy with this type of low risk segment is basically to grow the low credit line they received at the beginning of their relationship. Furthermore, they may also receive increased benefits, different card designs and other incentives to stay with Capital One. The key strategy with these customers is to treat them as well as any other customer segment. Just because Capital One was the best available offer on the market when they joined, it does not mean it will always be the case. Consequently, Capital One works hard to retain these customers.

At various points in time in the customer lifecycle, Capital One analyses its customer database in order to fine-tune its offers and retain customers. The behavioural and performance data allows the company to make proactive rate or credit limit offers, whenever appropriate. IBS testing is also used to help identify low- and high-risk customer profiles. By making different offers to customers, the company learns more about customer behaviour and therefore improves its targeting and retention.

Operations

In order to offer a wide variety of cards and services, Capital One aligns its Operations department with customer requirements. This strategy has proven to give Capital One a competitive advantage over other banks in the market. Rather than taking the "assembly line" approach, the company attempts to handle its customers in a personalized and flexible way.

Operations handles front-end customer relationships. There are over 1,000 people working in Capital One's call-centre, handling more than 10,000 incoming calls per day. Most call centre type operations are aligned managerially and operationally in order to achieve specific targets that often compete with one another: 1) low cost efficiency, 2) high quality customer service, 3) flexibility and 4) associate satisfaction. In fact, these four measures are the cornerstones of a model known as the "Big Yellow Square" (BYS). Each quarter, the management team rate themselves on these four "corners" to take a qualitative assessment of how "big" and "square" the BYS is at any time. This is a simple model, easy to buy into emotionally. The BYS indicates that Capital One's view on operating a call centre differs from most other organizations, particularly in the way it weights "associate satisfaction", which is equally important as "service quality" and "cost efficiency".

As mentioned, 'Flexibility' is one of the BYS corners. Because the company tests so many products in the marketplace on a regular basis, flexibility in the approach and attitude of the Operations staff is a key part of the business' success. Flexibility is also present in the way that Capital One deals with operational overloads. Many associates, even those who normally do not work with Operations, are trained in one or more disciplines. Also, when volumes exceed expectations in a particular area, managers take the decision to ask associates to temporarily move jobs to cope with the peaks. Eventually, this action is more likely to be taken when there is an unexpected surge in high value customer contacts, such as applications for new products.

Another important aspect of Capital One's strategy is the way it uses customer profitability analysis. Profitability is calculated on an individual basis to improve the product offer to each customer. However, the company does not normally differentiate customer service levels according to a customer's profitability. As Mitch Beres explains:

> "We would not be comfortable matching up high-value customers with high-level service – every customer has a choice of whether to use us or go elsewhere, and our quality of service can be a reason for them to stay. We aim to offer high-quality service to all our customers, regardless of their profitability."

However, Phil Marsland reflects on the subject of differentiating customer service: "It is a real question to me whether the lower risk customers should cross-subsidize those with higher risk, or whether everyone should get the deal they deserve." Although Capital One does not currently follow this line of thinking, Marsland's comment indicates that Capital One's management is constantly contemplating new ways of managing its business, and may even consider changing this current strategy.

Another element that differentiates Capital One's Operations department from others is its IT infrastructure. IT is used to route calls and provide associates with the necessary information to best handle specific calls. The systems are updated directly by call-centre associates. Therefore, as soon as each call is completed, associates enter information about the interaction in an encoded form into the system, which will then be available for the next contact with the customer. In some ways, this ensures a modern version of so-called 'old fashioned' personal service'.

More specifically, the Operations department is divided in four main areas:

- Operations Processing.
- Customer Relations.
- Sales.
- Collections.

Operations Processing

Operations Processing handles all back-office operations. Some examples of its key functions are: keying in credit card applications, scanning all incoming correspondence into a document management system, managing vendors such as card embossers and statement printers and handling payments from customers.

Customer Relations

Customer Relations handles incoming calls. While it is primarily devoted to providing particular service requirements and receiving customer complaints, it also attempts to cross-sell when appropriate. 400 customer service associates receive about 8,000-10,000 calls a day. These associates use the sales system SALSA (also used in the Sales department) when attempting to cross-sell. This allows them to identify suitable products to the customer who is calling and to avoid offering the same product twice.

Customer service associates, as well as sales associates, work to an incentive scheme that encourages sales and quality service. This incentive scheme is characterized by the following criteria:

1. Average handling time of the call.
2. Sales points per contact, whereby a sale is encouraged by awarding points per product sold, in order to reflect product profitability.
3. Quality, which is measured by using a system that records 10 random calls a month, per associate, to which managers listen and give feedback.

A review of their performance is received weekly and shows how associates rank against overall department targets and against their own past performance. The call listening programme, introduced two years ago by senior management, is very rigorous. As one customer relation manager explains: "This feedback from senior management has served not only as an extra quality screen, but also as a visible signal to our front-line associates that they are important". Competition between individual associates and call-centre teams is also encouraged. On the call-centre walls, colourful charts track the performance of different teams. Awards are given to the best performing teams or individuals, and their pictures are displayed on internal noticeboards or appear in in-house publications.

Sales

The Sales department is divided into the following units:

a. **Inbound:** Customers call to activate their cards or to respond to a marketing offer.
b. **Outbound**: Capital One associates call the customers to sell them a product or to provide a proactive service (e.g., customers who received a card but did not take out the payment protection insurance).
c. **Retention:** Associates try to retain customers who intend to close their accounts.
d. **New Business**: Sales are attempted with new customers.

Within all units, teams of 12-14 associates plus a supervisor and a manager are formed. While some specialization is encouraged, there is also cross-staffing and rotation to familiarize sales people with other tasks and teams, and to allow for flexibility in meeting peak demand.

Offering new products to customers is one of the key tasks of the Sales department. Given the variety of new products on offer every month, computer-based training modules are developed to familiarize sales personnel with the new offers. When cross-selling, Capital One's cross-selling system determines the likelihood of customers to buy certain products based on the projected NPV of a product to a customer, and suggests different products to different customers, or even no selling attempt at all (see Appendix 7 for the model).

The SALSA sales system (see Appendix 8 for screenshot) enables targeting cross-sell offers to specific customers likely to be interested in particular products. To avoid inundating the customer with offers, SALSA prevents Capital One associates from offering the same product twice within a short period of time. Associates are not encouraged to sell more than one product during a single call, even if SALSA suggests more than one product offer. As one sales associate explains: "the target time for a call is challenging – this means you really need your sales pitch honed and ready!" This minimizes the chances of wasting the time of both customers and associates.

The SALSA system also uses accumulated data on customers to suggest how to react to specific customer requests. For example, if a customer asks for a credit line increase, a reduced APR or a cash advance, data on past behaviour and risk assessment are used to decide whether to grant the request or not.

Collections

The Collections department deals with customers who have fallen behind with their payments or with accounts affected by fraud. The department is split into three main areas: Payment Assistance, Recoveries and Fraud.

In ***Payment Assistance,*** Capital One associates work with customers who are behind with their payments to try and help them recover their account. For example, if the customer cannot pay his bill because she is unemployed, Payment Assistance may put her in contact with a recruiting agency. If the customer is ill, payments may be temporarily suspended. In other circumstances, customers who are behind with their payments may be offered revised terms, enabling them to make smaller, regular payments. The overriding goal is to keep customers until they can pay and help them not to default.

> "We believe we are better than most working with all customers to come to satisfactory solutions", explains Elithorn. "For example, other card issuers might ask customers what they intend to do, in order to get out of debt, or give them few workable options. We might say that for a specific customer, based on our data, the best solution would be to lower its interest rate. We are still a long way away from individual solutions, but closer to it than most others in this field."

In ***Recoveries,*** Capital One looks after those customers whose debt has been charged off and whose accounts are no longer open. The objective is to work with the customer to recover as much of the debt as possible.

Finally, the ***Fraud*** team has two fundamental tasks: to help customers who have been victims of fraud and to prevent fraud itself. In the case of fraudulent activity, the team closes down the old account, writes off any fraudulent charges and transfers genuine transactions into a new account. Customers affected by fraud usually need a higher level of support, and the fraud team is trained to treat each case with sensitivity. A wide range of systems is in place to help prevent fraud, including real time transaction models and account behaviour pattern systems. Very often, the fraud customer service team call customers to let them know that they might have been victims of fraud, even before the customer realizes it. This is yet another strong selling point for Capital One from the Customer Relationship Management perspective.

Co-operation between M&A and Operations

Given the large number of tests carried out and new products developed within Capital One each year, there clearly has to be a great deal of co-operation between these two major departments. For example, when introducing a new product, M&A and Operations work very closely together. While M&A designs the product, develops marketing material and follows up customer responses, Operations collect regular feedback from customers and make improvement suggestions. The information from Operations is also used to improve the NPV models that serve as decision-making mechanisms.

Much of the information on customers that is used to craft strategy is obtained from front-end associates, who are, of course, closest to the customer. There is a partnership between Operations and M&A to review the risk perspective of present as well as future strategies. Of course, such a tight link between Operations and M&A would not function without the enablement through IT. Furthermore, numerous permanent or *ad hoc* cross-functional teams, composed of members from Operations and M&A, exist to define, for example, the credit policies for new and existing products.

Information Technology (IT)

IT sits at Capital One's head table and reports directly to the board in its own right – it is highly valued as the enabler of business strategy. The IT division performs a broad function, ranging from pure business issues and decisions on how the company should deploy its resources and finances, through applications and software engineering, to detailed technical issues of hardware, operating systems and networking. After Operations, IT is the company's second-largest division.

Against common practice in the financial industry, Capital One chose to *in-source* the majority of its IT capability, relying on the speed, management acumen and expertise of its in-house provision. Much of the IT intellectual property of the business is implemented internally, which proves that IT has become a core competence. This department offers a full-service capability to the business (Operations and M&A), covering the spectrum of products and processes through their genesis and complete life cycle. It houses the data, performs guardianship of the information, excels in data warehousing, and assures that the information can be readily accessed. All the terabytes of customer behaviour data are kept indefinitely in-house for online or near-online access. Through query tools, batch updates and transactional data, IT provides the tools that enable IBS to work successfully.

IT interacts with the company in the following domains:

- Prospect Pool and Solicitation Management.
- Account Acquisition.
- Account servicing and call-centre technologies.
- Core systems.

Prospect Pool and Solicitation Management

Capital One differentiates itself from the competition because of its internal prospect pool management and solicitation process. Rather than outsourcing the data on a prospect's behaviour and lifestyle, Capital One runs an in-house database with this information, that targets and selects customer audiences and matches products according to the prospects' profiles. The information gathered over the years on Capital One customers has proved to be very useful in this perspective to tailor products to individuals.

Traditionally, Capital One has been using direct mail campaigns to target new customers. This approach has proved to be very beneficial since it allows the company to predict gross and net response rates to various offers, according to the product, customer type and creative process chosen. This allows an accurate prediction of its marketing effectiveness. Once the campaign results are received, data are introduced back into the Prospect and Solicitation Management system, to provide further data that will improve future acquisition programmes.

Account Acquisition & Management

When a prospect becomes a customer, Capital One creates an account on the account management system, where all interactions with customers, from account detail changes to transactions and payments, are recorded. This information will create the customer profile, which allows the company to differentiate offers according to customer preferences. In fact, front-end customer acquisition processes rely upon sophisticated sets of credit models and automated decision algorithms to process the high volume of applications via the various channels (telephone, Internet, mail). Hardcopy applications are scanned and retained on optical disk. This information is subsequently communicated to credit bureaux and external fraud prevention agencies that provide Capital One with up-to-date information about applicants. All the raw data are recycled to MIS on a daily basis. This consolidates the core of the IBS account management programmes through which Capital One can develop reward schemes, change fees and products or make special offers to customers. In order to protect existing accounts against potential fraudulent card activities, expert real time neural network solutions are deployed to trigger the alarm at the earliest possible instant.

Account servicing and call-centre technologies

The call-centre is supported by Automated Call Diallers, Power Diallers, Voice Response Units (VRU) and local systems integrated with voice solutions. Many of the special systems for customer contact (cross-sales, balance transfer, retention and correspondence activities) are specifically designed to support the IBS approach. The system also stores information on customers' telephone numbers, which allows it to identify the origin of the call and route it to the most suitable associate. The sophisticated form of Computer Telephony Integration (CTI) ensures efficient customer handling and provides high quality service. (see Appendix 9 for systems infrastructure description). When customers call in, they can choose to talk to an associate or to use the VRU system. The VRU, which currently handles about 7,500 calls every day, is used mainly for tasks such as balance enquiries.

Core Systems

In addition to the development of solutions to the Operations and M&A, IT also develops and maintains solutions in other departments of the company, such as the Finance or the HR departments. IT also develops the *Internet* system that allows customers to apply online, get real time information and manage their accounts. It also maintains the *Intranet* system, which provides accurate and accessible information to the company and functionality to all associates.

Human Resources (HR)

The Human Resources function is critical to Capital One's CRM strategy. Finding and keeping top quality associates is key to the company's success. HR is responsible for two main activities: Managing associate selection and supporting and developing the company culture.

Associate Selection

Capital One considers the hiring process crucial and wants the selection process to be as science-driven as the overall customer strategy.

Hiring & Training: All associates are hired and evaluated based on the same criteria, which the company believes helps to prevent the formation of cliques. During the recruitment interviews, they test analytical and conceptual skills. The company also performs "behaviour interviews" in order to access candidates' competency by asking them to provide examples of situations where they supported change, managed several tasks or made difficult decisions.

> "We do not hire for specific experience, but for competencies," explains one of the recruiters." We try to find the best fit between a person and a role, and then train them. For example, we have a systems testing manager who used to test racing car engines before joining us – he had no direct experience, but certainly possessed all the competencies we were looking for."

Specific training, including some cultural induction, is offered for new "hires". Managers at all levels are offered a range of performance and skill enhancement classes that are carried out by either in-house trainers or external organizations. There is also a learning centre with books, videos and simulations, which are grouped around the core competencies that the company seeks to build. Career development is another important aspect. Capital One has a highly structured people management process which include 360° appraisals twice a year, personal Development Action Plans (DAP) to help employees prepare for their next job and a weekly one-to-one 10-minute meeting between each associate and their manager to discuss key issues. In fact, the company won a Training Magazine award in 2001 in the US and was featured as the '3rd Best Place to Work in the UK' in 2001 by *The Sunday Times* newspaper.

Evaluation: All associates are evaluated every six months. Half of the evaluation is based on targeted achievements and the other half based on Capital One's defined core competencies. Several categories are used to evaluate the competencies of call-centre associates and team supervisors. Among the key elements are: communication, support of others, integrative decision-making, responsiveness to feedback and coaching, taking ownership and job specific knowledge. Evaluation is taken very seriously, and if metrics turn negative, managers spend time attempting to understand what went wrong. Says Mitch Beres:

> "We see ourselves as coaches, rather than controllers or discipliners, nurturing talent and providing freedom. Even if our associates get it wrong, good coaching should help them improve – and we avoid getting the atrophy that often exists in other organizations."

Compensation: Incentives are an important part of the compensation package for all Capital One associates. For example, front-line associates can achieve a bonus of up to 14%, based on their results and competencies. Senior managers are awarded share options as well as cash bonuses. On several occasions, since the company floated in 1994, options have been awarded to junior associates on a one-off basis to share the feeling of ownership throughout the company. Also, a subsidized share purchase scheme allows all associates to purchase stock at a substantial discount on the market price. Take up is currently running at about 20%, and ownership behaviour is very visible.

> "People really watch the stock price – there is a refreshing clarity on the fact that what we do affects the share price, and, since we have share options, it makes a real difference to us", reports an operations manager.

Company Culture

As Capital One searched for suitable premises to house its operations centre in Nottingham, its main goal was to bring most activities in-house and under one roof, as well as creating a springboard for new products and businesses and a centre for recruitment. Combining all operations in one main location would also have the advantage that new employees could be more easily integrated.

Housing: A place with the potential to meet these goals was found in a huge, 1950s' building that matched not only Capital One's accommodation needs but also its culture of openness. They kept the two huge floor areas of 10,000m^2 and a smaller second floor of 2,800 m^2. Call-centre and professional areas are not differentiated, allowing flexibility in use and reinforcing the company's open business culture. The open-plan spaces, in which most associates work, are arranged in team configurations, while a few glass-fronted offices and meeting rooms are separated from the main areas. The building also has a convenience shop with refreshments, 'relaxation rooms', training rooms, a library and locker rooms with showers. Also, a large staff restaurant, with relaxed design elements, provides the feel of a trendy restaurant or bar.

The atmosphere of the huge floors of the Capital One building is busy and professional, yet relaxed and colourful. The associates' cubicles are personally decorated with photographs and nametags, cuddly toys sit on almost every computer, inflatable palm trees stand in the corridor and remote-control air balloons fly through the room. On the computers, 'Golden Nugget' stickers signify each sale of a priority product made by that associate. There are flipcharts showing how the different teams rank against one another. On the 'Wall of Greatness', associates who have received special company awards are shown alongside great people from American history, like Henry Ford, Thomas Edison and Muhammad Ali. As Scott Woolveridge, Operations Processing Manager, sees it:

> "What you see reflected in our decoration is that we try to avoid being a manufacturing shop. Our raw material is our people – so let them be themselves and have an environment to suit! If people are having fun, they do a better job – that's why we give them all these cuddly toys and stress balls. We want to make people feel they belong to something. And they do."

Culture of Involvement: Developing this strong culture of employee involvement was a conscious decision and part of the business plan. "If you do not treat the people who deal with customers as well as you want them to treat those customers then you are in trouble," continues Woolveridge. "People on the front-line need to be empowered – they *are* the company as far as customers are concerned. We try to take care of individual needs, so it is a natural step for this to be translated into customer treatment."

In line with its focus on associates, Capital One aims to create a culture of involvement and buy-in for all objectives. "We spend a lot of time explaining our objectives and ensuring that they are meaningful for everyone – where we are going and why – which is what creates a sense of excitement, of ownership, of understanding why we are making certain trade-offs," explains Paul Hawker, Collections Manager. Trips, simulations and training programmes are some of the other tools that Capital One uses with its managers to ensure that objectives are aligned, and to create a common language and methodology. Managers estimate that they spend about 10% of their time on creative activities. They comment that it greatly helps them in decision-making, as they tend to "assume positive intent on the other side of any discussion and know that we are all trying to do the right thing."

The company conducts an associate survey twice a year, containing more than 100 questions to "help the company remould itself for the future" as one manager puts it. The survey completion rate is well over 90% and the data obtained are carefully analysed by managers. While some questions evaluate overall work satisfaction, others request more specific detail such as quality of management communications and stress levels. Using regression analysis, Capital One identifies the key drivers of employee satisfaction and devises action plans to improve weaknesses and exploit the opportunities identified.

Capital One is considered as one of the UK's top employers in 2001[1], and employee satisfaction is extremely high: 97% of staff regard the company as a friendly place; 96% report that people are willing to give that bit extra to get the job done; and 66% (20% above the market average) believe that they are getting a fair share of company profits. Associate turnover is extremely low – the attrition rate at Capital One's call-centre is around two thirds of the average figure of 35% at a standard call-centre. In Capital One's non-call-centre functions, turnover is even lower, and there has been virtually no senior management turnover.

Continuous Improvement: Improvement suggestions from front-line associates are highly encouraged. An example of an improvement suggestion made by call-centre associates is the 'APR indicator'. Call-centre staff noticed that customers often wanted to discuss their APR, so IT and M&A built in a quick access function that enabled them to view a customer's effective yearly APR without needing lengthy calculations. There are high levels of

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[1] Sunday Times (2001), "The 50 Best Companies to Work For." p. 9.

motivation and co-operation for these initiatives. Those employees who contribute with particularly valuable ideas are given awards and highlighted on posters around the building.

There is also a high degree of co-operation among the various departments in the improvement process. As one operations manager explains:

> "Our business is all about IBS, change and innovation – that is true for every department involved, and it is very liberating that there is no 'who's in charge' debate. There is an overall acceptance that we will change, and that we will launch new products – some will succeed, others will fail. We don't have conflicts of issues as regarding 'Marketing wanting to do this, but Operations not wanting to.'"

Future Challenges

Building a Deeper Understanding of Customer Needs

While acknowledging the success of their approach, Capital One's Operations management is concerned with taking their understanding of customers and their behaviour further. Today, Capital One knows which product a given customer holds, which financial transactions they have made and what interactions with the company have taken place. However, the company still knows relatively little about the customer as an individual, which would enable a deeper understanding of their behaviour and needs.

> "If we could identify why customers call, we could segment them according to their needs – for example, if customer X calls mainly to check his balance, then he could immediately hear the message 'Mr.X, your balance is… if you have more questions, please press one,'" envisages Mitch Beres.

Increasingly, the company realizes that profitability is not necessarily driven by product ownership, but by customer characteristics (e.g., if they are working or studying, married or single, with or without children) and by product usage. Consequently, Capital One needs to ensure that it is able to address real customer needs at an individual level.

Managing Costs

In terms of cost structure (e.g., cost-per-customer account), Capital One's costs are currently higher than those of most of its competitors. The company views its heavy investment in IT and people as justified, but also seeks to keep costs within limits. David Farlow, Director of Operations Strategy, comments:

> "We don't need to be more costly than our competitors. In fact, as IBS helps us to know our customers and their needs better, we should be well positioned to decide where to spend our resources. However, we are not yet at the part of the curve where increased spending on IBS does not add incremental value."

There is general agreement that associates are an expensive resource, and that they should be allocated to the highest value activities while lower value activities might be treated as a commodity, be outsourced, or at the limit, not serviced. It is debatable to what extent VRUs and the Internet can decrease operational costs.

Co-ordinating Channels

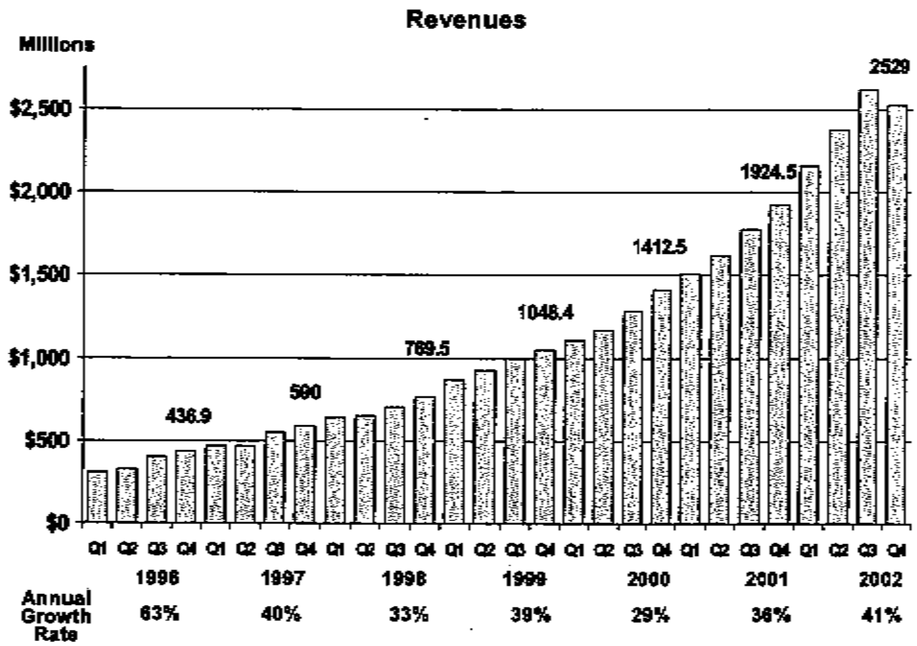
Capital One clearly sees a challenge in co-ordinating its customer interaction through all its different channels, which are currently co-ordinated, yet not fully aligned. "As every contact with the customer is precious, our next step will be to integrate our systems further so as to view customers through the same lens and align customer communications fully," explains Mark Sanders, Sales Manager. Sanders also believes that the company has to work to avoid giving conflicting messages to customers. "There is a clear degradation of responses when customers receive too many mailings, and we have to avoid an uncoordinated situation where Account Management contacts a customer to raise their credit line and then Sales contacts offer them a new product."

The fact that additional communication channels, such as websites and e-mail now exist, and others might be established in the future, creates future challenges. As Sanders continues: "Whenever we add a new channel, we witness an increase in demand also in the older channels because of the need for explanation. For example, customers telephone to make sure their Internet payment was processed okay." Furthermore, when information comes from new sources or when it is more frequently published, enquiries increase. For example, there are more customer enquiries now that balances are produced continuously on the Internet than when the traditional paper version was mailed once a month. Of course, this can be viewed either as a cost or an opportunity.

Appendix 1
Selection of Awards & Accolades

2001	Capital One is named the 3rd 'Best Place to Work in the UK' by *The Sunday Times*. Capital One named in *Forbes* 400 list - Best Big Companies in America.
2000	Capital One is named in the *Information Week 500* for innovation in IT. Capital One receives *CIO 100 award* for Customer Excellence (the second consecutive year of recognition from CIO).
1999	*Business Week* names Capital One Number 15 in its list of top 50 performers in the S&P 500. *ComputerWorld* ranks Capital One Number 13 in its list of the '100 Best Places to Work in IT'.
1998	Rich Fairbank is named Executive of the Year by *Credit Card Management* magazine. *Future Banker* names Rich Fairbank and Nigel Morris "Future Bankers of the Year". Capital One is named in the *Information Week 500* for innovation with information technology.
1997	*Forbes* names Capital One as one of the fastest-growing companies in its list of top 25 'Champs'. *Beyond Computing* presents Capital One with its Gold Award for successful integration of IT and business strategies.
1996	Capital One wins the *Gartner Group* 'Excellence in Technology' Award.
1995	*Credit Card Management* magazine names Capital One 'Issuer of the Year'.

Appendix 2
Growth of Capital One's Revenues (Worldwide Operations)



Source: Company annual reports.

Appendix 3
Comparisons of Selected Credit Card Rates and Balance Transfer Offers, June 2002

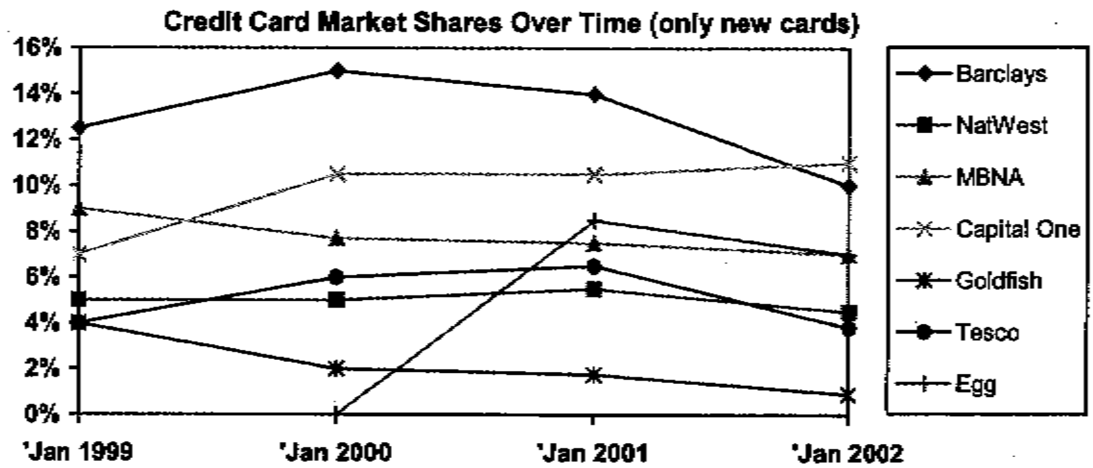
	Standard Rate (%)	Balance Transfer Rate (%)
High Street Banks:		
Abbey National*	14.9	1.9
Bank of Scotland	17.9	0.0
Barclaycard	14.9	6.9
HSBC	18.9	4.9
Lloyds TSB	17.9	1.9
NatWest	17.4	5.9
Royal Bank of Scotland	16.9	2.9
Selected other providers:		
American Express	19.5	4.9
Capital One	12.9	6.9
Egg	13.9	0.0
Goldfish	17.9	4.9
MBNA	15.9	0.9
Tesco	14.9	1.5

* cards issued by MBNA
Source: Moneyfacts.

Appendix 4
Credit Card Brand Shares in the UK

Base: all credit card holders.

Source: MORI Financial Services, June 2002.



Base: all credit card holders.

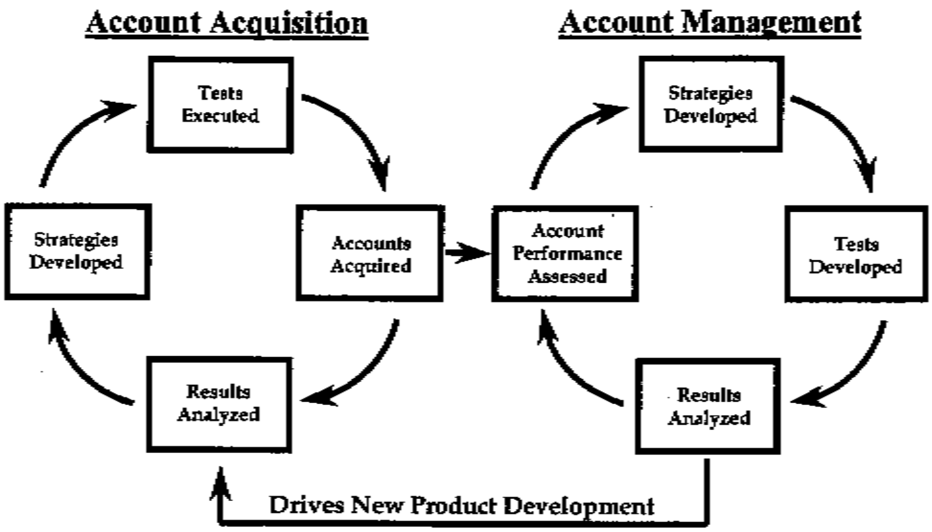
Source: MORI Financial Services, June 2002.

Appendix 5
Number of Payment Cards in Issue: 1992 - 2001

	Credit Cards Number of Cards (m)	Debit Cards Number of Cards (m)	Charge Cards Number of Cards (m)
1992	28.28	22.60	2.35
1995	28.27	28.44	2.51
1999	41.42	46.08	3.45
2001	51.70	54.31	4.43
% change 1992-2001	+96.8	+140.3	+88.1

Source: APACS/Mintel.

Appendix 6
Test & Learn Strategy



Appendix 7
NPV-Based Cross-Selling Process

1. Customer 4324 1223 7874 3335 calls in

2. System checks whether any sale is permissable in this channel (e.g. have we tried a CSM approach recently)

3. Product priority is sourced from the NPV table

4324 1223 7874 3333	16	30	40	21	1
4324 1223 7874 3334	43	22	9	45	24
4324 1223 7874 3335	12	59	8	43	3
4324 1223 7874 3336	0	1	5	12	33

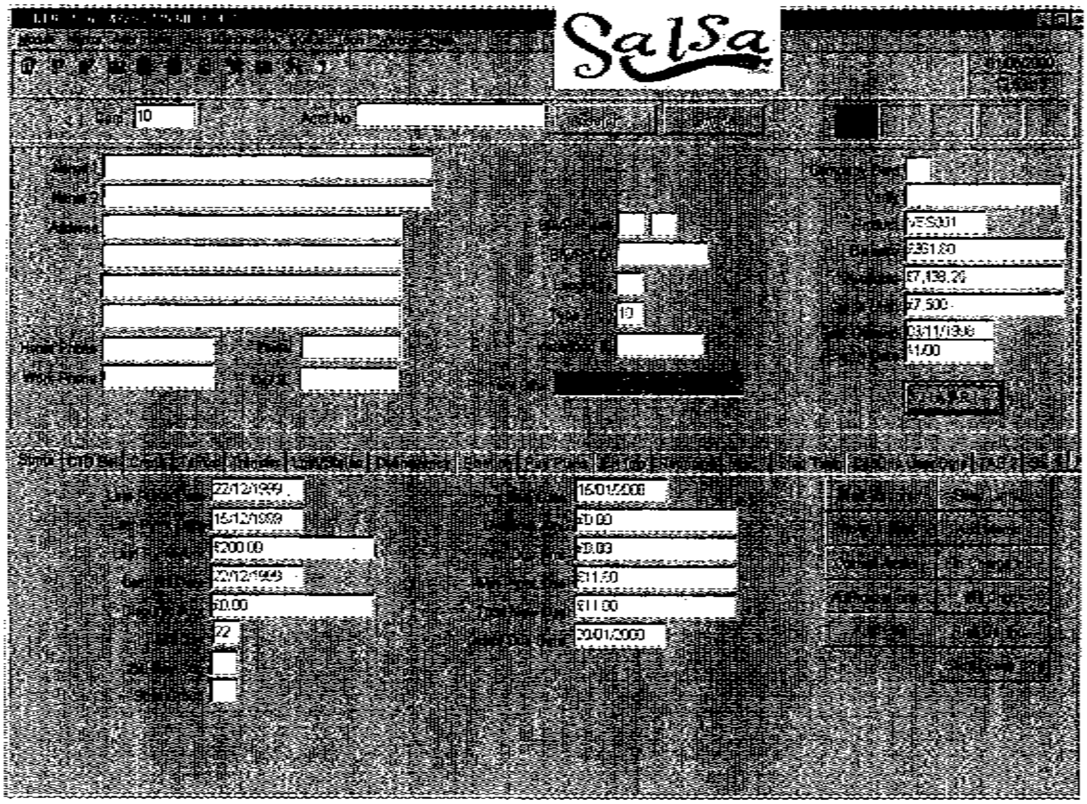
Its PPI, BT, CPP, Loan, Shopping

4. System checks whether approaches are allowable on these products. E.g. excludes product if customer already holds it or where the product has been attempted recently

5. The list of products we are "happy to offer" is shown to the associate, with the primary product at the top of the list.

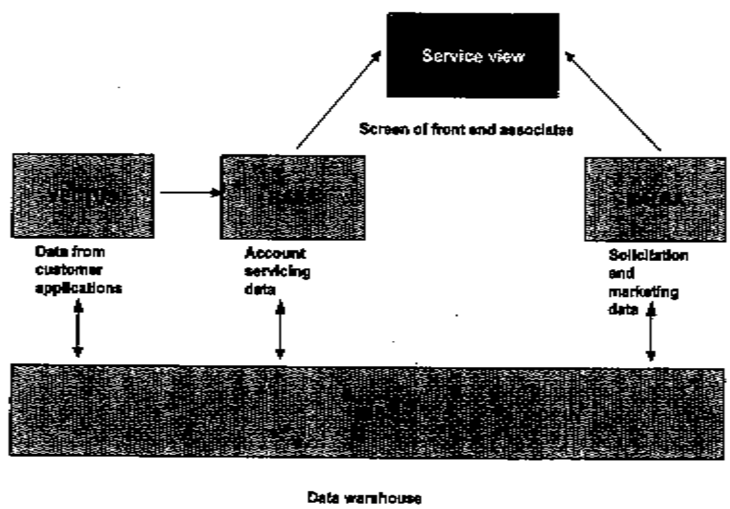
Appendix 8

Screenshot from Customer-Service Computer Screen ("Salsa" System)



Appendix 9
Systems Infrastructure

Different systems working together



Use of data