

2-1 A New Mission in Enterprise Growth

In June 2011, Kenneth Chenault, CEO of American Express (AXP), announced the formation of a new group within the company, Enterprise Growth (EG), to drive expansion into digital and mobile payments. “New technologies are redefining the payments business and creating opportunities that go beyond our existing businesses,” said Chenault in a press release. “The Enterprise Growth group is designed to extend our leadership into the world of alternative payments and create new fee-based revenue streams for the post-recession environment.” To lead the group, AXP hired Dan Schulman from Sprint Corporation (where he had headed the Prepaid Group after previously serving as founding CEO of Virgin Mobile USA, as president and CEO of [Priceline.com](#) Incorporated, and in other leadership positions). * “Technology [is] fundamentally going to change the way you might think about financial services,” Schulman said during one of his first meetings with EG, “just as the Internet has redefined one industry after another.” * EG, he continued, was designed “to challenge existing business models” and “to think about the intersection between software, software platforms, mobile apps, mobile technology in general, and financial services.”

For Alpesh Chokshi and Wesley Wright, this was the moment they had been waiting for. Both of them had been at AXP since 2001 and had worked in its prepaid business since 2005. When EG was formed, their group had moved into EG with a mandate to drive expansion beyond AXP’s traditional credit and charge business on a global basis. Chokshi was the president and Wright led product development. Before moving into EG, together with their team they had driven the expansion of AXP’s prepaid business into gift cards and reloadable cards. Now, with the support of Chenault and Schulman, they saw an opportunity to do something bigger—to move AXP into debit and checking spending, a large sector of payments in which it did not currently play (see [Exhibit 1](#) for AXP consolidated financial performance and [Exhibits 2, 3, and 4](#) for performance metrics of the U.S. cards business). Their team had begun calling the initiative Bank 2.0, indicating the application of technology to usher in a “next iteration” of banking.

Exhibit 1

Consolidated Financial Highlights

(In millions, except per-share amounts, percentages, and employees)	2011	2010	% INC/DEC
Total Revenues Net of Interest Expense	\$29,962	\$27,582	9%

(In millions, except per-share amounts, percentages, and employees)	2011	2010	% INC/DEC
Income from Continuing Operations	\$4,899	\$4,057	21%
Income from Discontinued Operations	\$36	—	#
Net Income	\$4,935	\$4,057	22%
Return on Average Equity	27.7%	27.5%	
Total Assets	\$153,337	\$146,689	5%
Shareholders/Equity	\$18,794	\$16,230	16%
Diluted Income from Continuing Operations Attributable to Common Shareholders	\$4.09	\$3.35	22%
Diluted Income from Discontinued Operations	\$0.03	—	#
Diluted Net Income Attributable to Common Shareholders	\$4.12	\$3.35	23%
Cash Dividends Declared per Share	\$0.72	\$0.72	—
Book Value per Share	\$16.15	\$13.56	19%
Average common Shares Outstanding for Diluted Earnings per Common Share	1,184	1,195	-1%
Common Share Cash Dividends Declared	\$856	\$867	-1%
Common Share Repurchases	48	14	#
Number of Employees	62,500	51,000	2%

denotes a variance of more than 100%

Data source: American Express annual report, 2012.

Exhibit 2

U.S. Card Services Selected Income Statement Data

Years ended December 31*(millions)***2011****2010****2009****Revenues**

Discount revenue, net card fees, and other	\$10,648	\$9,884	\$9,043
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Securitization income, net *	—	—	400
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Interest income	5,230	5,390	3,216
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Interest expense	807	812	568
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Net interest income	4,423	4,578	2,648
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Total revenues net of interest expense	15,071	14,462	12,091
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Provisions for losses	687	1,591	3,769
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Total revenues net of interest expense after provisions for losses	14,384	12,871	8,322
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Expenses

Marketing, promotion, rewards and cardmember services	6,593	5,744	4,362
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Salaries and employee benefits Operating expenses	3,662	3,623	3,385
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Total	10,255	9,367	7,747
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Pretax segment income	4,129	3,504	575
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Income tax provision	1,449	1,279	171
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Segment income	\$2,680	\$2,225	\$404
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Data source: American Express annual report, 2012.

Selected Statistical Information

As of or for the years ended December 31
(in billions, except percentages and
where indicated)

	2011	2010	2009
Card billed business	\$424.3	\$378.1	\$339.4
Total cards-in-force (millions)	40.9	39.9	39.5
Basic cards-in-force (millions)	30.4	29.7	29.5
Average basic cardmember spend (dollars)	\$14,124	\$12,795	\$10,957

*

U.S. consumer travel:

Travel sales (millions)	\$3,603	\$3,116	\$2,561
Travel commissions and fees/sales	8.3%	8.2%	8.4%
Total segment assets	\$97.8	\$91.3	\$57.6
Segment capital (millions)	\$8,804	\$7,411	\$6,021
Return on average segment capital	33.0%	35.0%	7.9%
Return on average tangible segment capital	34.8%	37.8%	8.6%

*

Cardmember receivables:

Total receivables	\$20.6	\$19.2	\$17.8
30 days past due as a % of total	1.9%	\$1.1	\$16.1
Average receivables	\$18.8%	\$17.1	\$16.1
Net write-off rate—principal only	1.7%	1.6%	3.8%
Net write-off rate—principal and fees	1.9%	1.8%	4.2%

Cardmember loans—GAAP basis portfolio:

Total loans	\$53.7	\$51.6	\$23.5
30 days past due loans as a % of total	1.4%	2.1%	3.7%
Average loans	\$50.3	\$449.8	\$25.9
Net write-off rate—principal only	2.9%	5.8%	9.1%

As of or for the years ended December 31*(in billions, except percentages and**where indicated)*

	2011	2010	2009
Net write-off rate—principal, interest, and *	3.2%	6.3%	10.4%
Net interest income divided by average loans * *	8.8%	9.2%	10.2%
Net interest yield on cardmember loans *	8.9%	9.4%	9.4%
Cardmember loans—managed basis portfolio:			
Total loans	\$53.7	\$51.6	\$52.6
30 days past due loans as a % of total	1.4%	2.1%	3.7%
Average loans	\$50.3	\$49.8	\$54.9
Net write-off rate—principal only *	2.9%	5.8%	8.7%
Net write-off rate—principal, interest, and fees *	3.2%	6.3%	9.9%
Net interest yield on card member loans *	8.9%	9.4%	10.1%

Data source: American Express annual report, 2012.

Exhibit 4

Calculation of Net Interest Yield on Cardmember Loans**Years ended December 31***(in millions, except percentages and where indicated)*

	2011	2010	2009
Calculation based on GAAP information:			
Net interest income	\$4,423	\$4,578	\$2,648
Average loans (billions)	\$ 50.3	\$ 49.8	\$ 25.9
Adjusted net interest income	\$4,490	\$4,684	\$2,451
Adjusted average loans (billions)	\$ 50.3	\$ 49.8	\$ 26.0

Years ended December 31

(in millions, except percentages and where indicated)

	2011	2010	2009
Net interest income divided by average loans	8.8%	9.2%	10.2%
Net interest yield on cardmember loans	8.9%	9.4%	9.4%

Calculation based on managed information:

Net interest income	\$4,423	\$4,578	\$5,501
Average loans (<i>billions</i>)	\$ 50.3	\$ 49.8	\$ 54.9
Adjusted net interest income	\$4,490	\$4,684	\$5,558
Adjusted average loans (<i>billions</i>)	\$ 50.3	\$ 49.8	\$ 55.0
Net interest yield on cardmember loans	8.9%	9.4%	10.1%

Data source: American Express annual report, 2012.

As the team focused on this opportunity, Chokshi imagined the concerns some of his colleagues might raise. The team would need good answers to a number of questions. The good news was that the EG team had “gone to school” with regard to the potential opportunity in Bank 2.0. The team was well aware of the magnitude of the potential market that was currently underserved by traditional banking services. In the United States, estimates were that more than one in four households (28.3%) were either unbanked or underbanked * and conducting some or all of their financial transactions outside of the mainstream banking system. * Even as EG’s initial research had gleaned some promising indicators, there was still much that needed to be worked out.

2-2 The Closed-Loop Network

AXP cards were accepted at fewer merchants than Visa or MasterCard. One reason was a perception that AXP transactions were more costly to the retailer or merchant due in part to different business models, fees, and pricing structures for processing transactions.

In the Visa and MasterCard business models, external banks and financial institutions owned the relationship with the cardholder (in the vernacular of credit card business models, these were called “issuers”). Issuers provided cards to their customers that bore a Visa or MasterCard logo, and set the interest rate and any fees on the loans the cards would deliver. When the cardholder bought a meal at a restaurant, a transaction network sent the amount of the purchase to the restaurant’s bank for authorization (the restaurant’s bank was known as the “acquirer”). After the transaction was approved and cleared, the issuer bank received a percentage of the sale based on the interest on the loan provided to the cardholder at the time. The acquirer received a fee from the restaurant in the form of a discount fee (an industry average of 1.2%). * Visa or MasterCard received their revenues for the ownership and management of the transaction-processing services and data management for the entire system. Their business models were based on increasing the number of times that a consumer used a card (“transaction-centric” models). An important distinction in this model was that neither Visa nor MasterCard made any loans to the consumer. Thus they received no interest on the loans made to consumers for their purchases.

AXP’s business model, however, had it serving as both the issuer and the lender. Thus the analogous strategy was a “spend-centric” one. In this approach, AXP’s cardholders were provided their cards by the company’s own banking subsidiaries. AXP received its primary revenues from the discount fees charged to merchants (which were higher than the industry average: an estimated 2.4%). * The important distinction in AXP’s “closed-loop” network was that the company had the ability to leverage spending data about its customers to create more tailored rewards/offer programs for customers and to share high-level trends and business insights about spending patterns with merchants.

An important performance metric in this model was that customers spent higher amounts per purchase. One study indicated that the average payment volume per transaction for AXP cards was around \$150, while Visa’s was one-third that amount. * This also made AXP members attractive to merchants seeking more affluent customers, and the company used internal data to match merchants with affluent customers that would likely buy their products. Since credit risks were borne internally by AXP’s banking subsidiaries, any interest on loans to members was another source of revenue that Visa and MasterCard did not receive.

AXP's business model was supported by a complimentary advertising campaign designed to attract affluent consumers who would tend to spend more per purchase. From 1987 to 1996, the AXP ad campaign tagline was "Membership has its privileges." * Ads often featured images of cardmember celebrities, from Elvis Presley in 1958 * to Robert DeNiro in 2004's "My Life" campaign. * The brand became widely associated with affluence and exclusivity, and its average annual spend per cardholder tended to be higher than that of AXP's competitors. The average annual spend per card increased at a double-digit rate from 2009 to 2011, growing from \$11,505 to \$14,124. * Industry analysts were well aware of the differences in approach: "This contrast is evident in the numbers; Visa has more than 2 billion cards in use worldwide and processes more than 60 billion transactions per year, while AmEx has just 107 million cards in force and processes just 6 billion transactions per year. Despite this disparity, American Express has annual gross revenues of \$33 billion while Visa earns just \$14 billion per year." *

2-3 Experiencing Exclusion

The EG team recognized that it needed to better understand the Bank 2.0 customer. Rather than simply relying on third-party research about financial inclusion, the team sought to engage directly with the experiences of underbanked people by trying to make payments without accessing credit or checking accounts. Chokshi, for example, stood in line for at least half an hour before attempting to cash a personal check at a check casher. The standard check casher, he found, took between 2% and 5% of the face transactional value. This process, Chokshi discovered, was the first of several instances in which underbanked people lost both money and time relative to affluent customers. Once their checks were cashed—at a substantial price in fees—they had to stand in another line to get a money order to pay their bill. Given the difficulty of finding time to stand in lines—*This is like a part-time job*, Chokshi thought—people often had to contend with late fees.

At a meeting, the team members shared with each other that at least 50% of Americans lived paycheck-to-paycheck. “Most have enough money to cover expenses,” one team member explained. “It’s a timing issue. It’s cash flow. The populations we’re talking about can’t [take on more debt]. They have no savings, they have no flex.” As a result, this segment often resorted to payday loans.

The next task was to develop a specific go-to-market approach. The team had been thinking about an innovative product: a prepaid, reloadable card that could do many of the things one would normally have to go to a bank to do. The physical-branch-based system was increasingly unreliable—not only because of rising fees, but also because branches were closing across the country. In a meeting room, the team wrote on a board: “It’s expensive to be poor” and “2,300 bank branches closed last year, 95% in low-income areas. 70 million people in the United States are unbanked or underbanked; they pay 10% of their income on fees and interest to complete everyday transactions.” EG thought 10% was about the amount this portion of the population would spend on food. It troubled the team to think that people spent so much money just to change their income from one form to another (see [Exhibit 5](#) for key indicators of unbanked and underbanked consumers and markets). Through technology, EG believed it could reimagine what it meant to be part of the financial system. Based on this meeting, it was clear that AXP supported the idea.

Exhibit 5

Unbanked and Underbanked Consumers in the United States

In 2011, FDIC surveyed 45,000 U.S. households to determine their degree of participation in the banking system. The resulting survey results are projectable to

the entire U.S. population.

Definitions and Key Findings:

- **Depository Institutions.** Banks and credit unions that provide insured checking and savings accounts up to \$250,000. *There are approximately 90,000 depository branches in the United States.*
- **Alternative Financial Services Providers.** Financial institutions that provide any of the following services: non-bank money orders, nonbank check-cashing services, nonbank remittances, payday loans, rent-to-own services, pawn shops, or tax refund anticipation loans (RALs). *Approximately 25% of households used some form of AFS in the 12 months prior to the survey. Almost 10% used two or more AFS products.*
- **Unbanked Households.** Households in which no individual holds a checking or savings account in an insured depository institution. *8.2% of U.S. households are unbanked, up 0.6% since 2009. An estimated 24.2 million U.S. households are underbanked. An estimated 9.9M households are unbanked.*
- **Underbanked Households.** Households in which an individual has a checking and/or savings account but used AFS providers in the past 12 months to meet financial needs. *20.1% of U.S. households are unbanked, up 1.9% since 2009. An estimated 24.2 million U.S. households are underbanked.*
- **Banked Households.** Households in which all individuals are fully engaged in the financial mainstream, and did not use AFS in the past 12 months. *68.8% of U.S. households are fully banked, down 2.5% since 2009. An estimated 88.2 million U.S. households are banked.*
- **Unbanked Cash Households.** Households in which no individual has a depository account, and have not used AFS in the last 12 months. *29.5% of unbanked households rely purely on cash.*
- **Employment Status.** Not surprisingly, banking status is positively correlated with employment. *64.1% of all underbanked households, however, have members who are employed.*
- **Income.** Having a depository account is positively correlated with income. *40.8% of underbanked households make less than \$30,000 in annual income. 17.1% of all underbanked households, however, make between \$30,000 and \$50,000, and 18.3% of all underbanked households make \$75,000 or more.*

- **Home Ownership.** An estimated half of all U.S. homeowners are underbanked (52.1%).

Source: Federal Deposit Insurance Corporation Department of Depositor and Consumer Protection, "2011 FDIC National Survey of Unbanked and Underbanked Households: Executive Summary," September 2012.

In 2010, EG had acquired Revolution Money, a payments company. * Revolution Money's technology formed the foundation for a beta digital payments product, a prepaid card supported by an online platform. * This new product gave customers a way to conduct peer-to-peer transfers and to make payments online; it was reloadable via debit or credit card or checking account. As a beta digital payments product, it was not an outstanding success, but the team believed the platform itself still held plenty of potential.

Wright wondered how much internal resistance he might encounter if he proposed a new product that relied on the same platform as the beta product. Though the initiative was the result of aggressive innovation, it did not see much traction, and skepticism rose in the company as a result. The digital payments initiative required investment that had far less certainty than AXP credit cards, for which the cost of acquisition and the typical consumer payback were already known. The EG team would be operating in an entirely new market that had uncertain metrics of performance.

Chokshi wondered if EG could use the acquired software platform and knowledge to evolve the AXP mission, moving from an iconic brand for the affluent to an inclusive brand with a much greater reach. "The less money you have, ironically, the more it costs you to manage and move it," he'd written in his notes. AXP could change that by starting to serve a segment that was historically unable to access the company's products. The new concept, Bank 2.0, was a way to increase the consumer base and to develop a new kind of relationship. The more affluent, typical credit and charge customers had access to financial and payment services from a sizable range of institutions and formats. The ideal Bank 2.0 customer would conduct the bulk of his or her financial activity via the platform, including direct deposit of paychecks.

Though AXP's credit and charge businesses were strong, the company saw a chance for growth by offering an alternative to debit, checking, and cash. Global payments amounted to \$34 trillion dollars each year; credit and charge constituted \$6 trillion of that total. * What remained was a market opportunity of \$27 trillion in cash, check, and debit that AXP hadn't accessed before. The advent of the Serve platform opened a door to that world. As one member of the EG team put it, "Every company wants to be a growth company [...]. The only way to do that over time is to get new customers." *

Bank 2.0 was not actually a bank, but it would enable people to use their mobile phones in ways similar to how they would use a bank branch. Mobile banking transactions were considerably cheaper for financial services firms. William Demchak, president of PNC Bank, estimated that banks saved \$3.38 per transaction when a customer deposited a check by

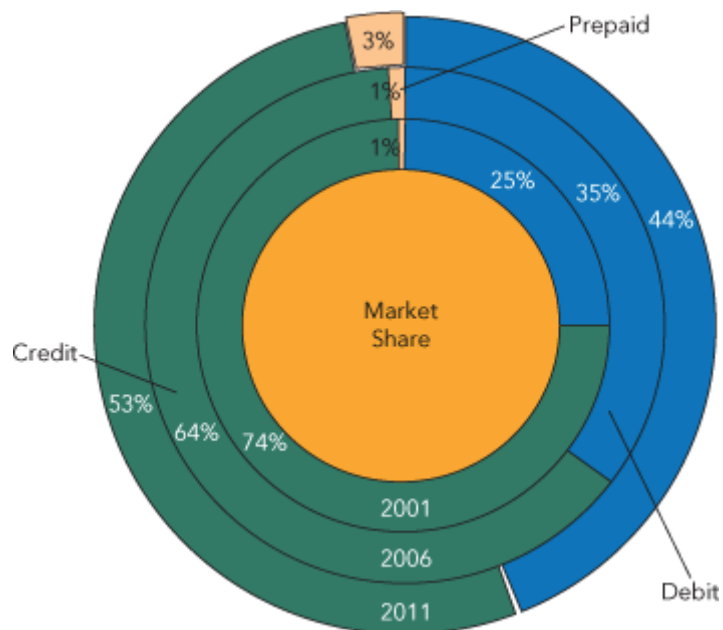
snapping a photo of it on a mobile phone versus depositing it at a teller window. ✨ The language for such a product was still coming into existence. Defining this category was a challenge AXP would have to face. Other companies had attempted to rebuild the banking sector and had met some challenges: how to achieve scale with the underbanked consumer, technological hurdles to truly enabling mobile and nonbranch delivery, new regulatory requirements of being a banking provider, and getting past the scrutiny of consumer interest groups that were notoriously skeptical of banks' efforts involving moderate-income consumers. (In 2010, the Consumer Financial Protection Bureau [CFPB] was formed, in part, to demystify the agreements consumers made with providers of financial services). ✨

2-4 Options in a Competitive Landscape

The EG team wasn't alone in recognizing the opportunities in a changing landscape in financial services. Consumers were gradually changing the way they made transactions, altering the medium they used to make their payments. See [Exhibits 6 and 7](#) for indicators of the movement to a greater reliance on debit and prepaid cards among U.S. consumers. [Exhibit 8](#) provides the purchase volume, market share, and 2010 growth rates of leading U.S. card companies.

Exhibit 6

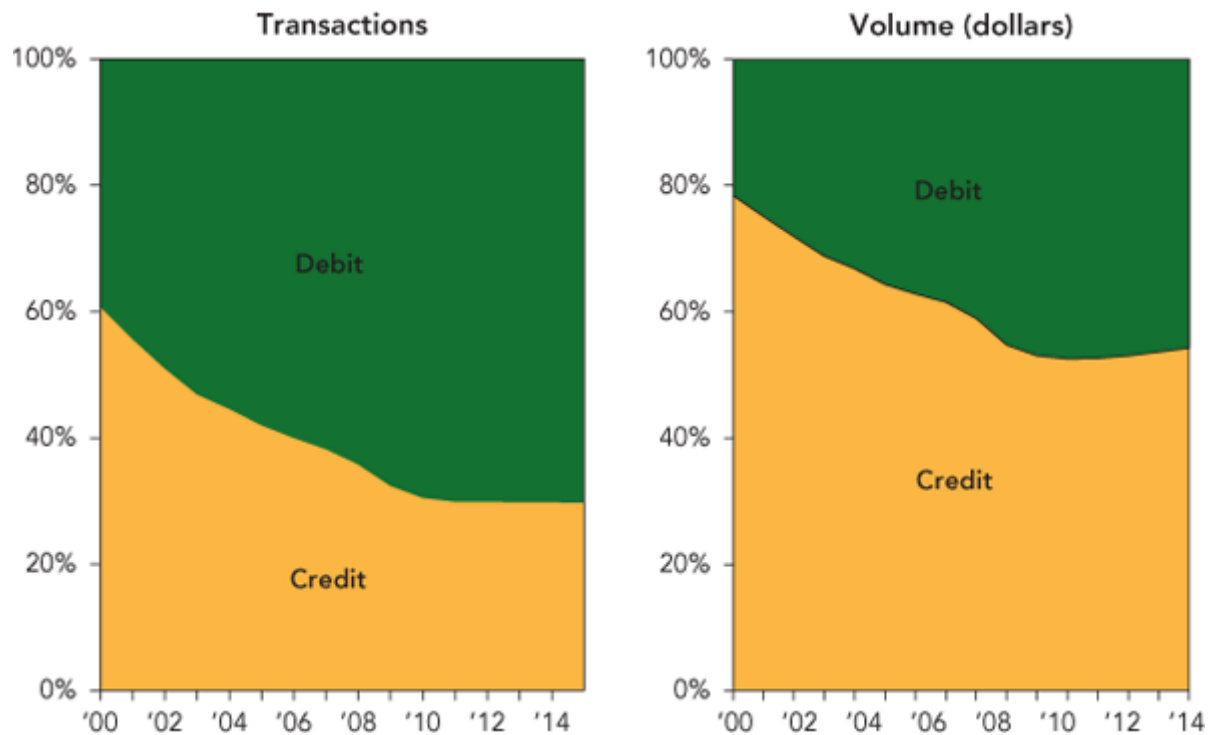
Purchase Volume on U.S. General-Purpose Cards by Type



Data source: Case writer adaptation of data from the Nilson Report, 2012.

Exhibit 7

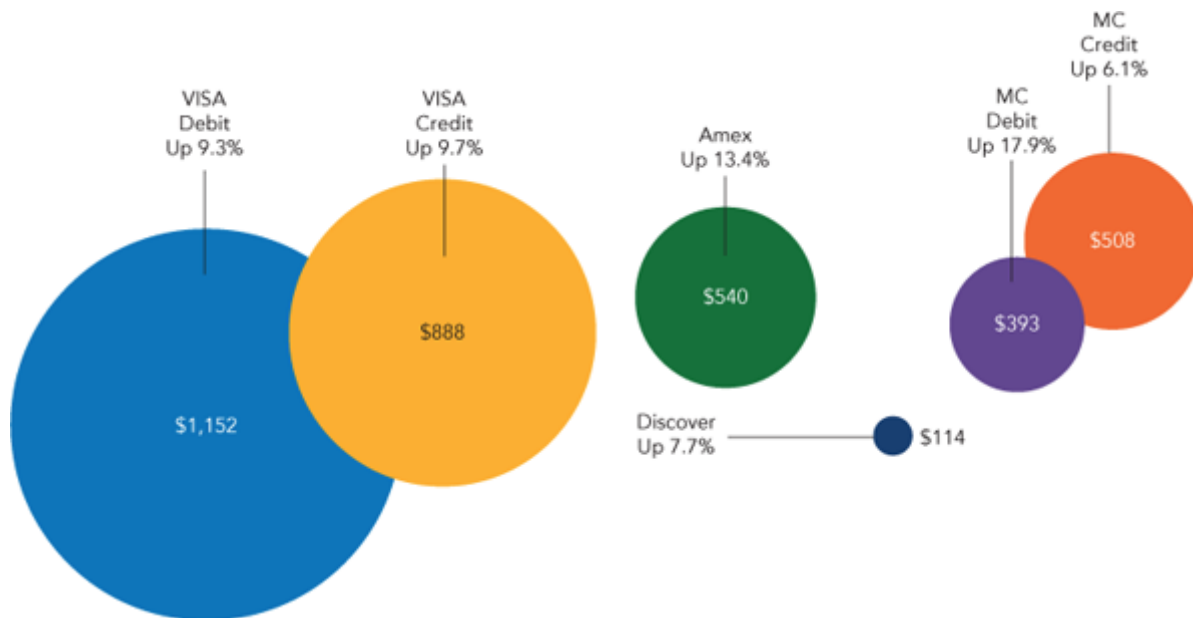
U.S. Payment Cards by Type (Market Shares) and Manner



Data source: Case writer adaptation of data from the Nilson Report, 2012.

Exhibit 8

Purchase Volume at U.S. Merchants, Market Size, and Growth, 2011



Data source: Case writer adaptation of data from the Nilson Report, 2012.

Although the Bank 2.0 initiative team was attempting to serve the underbanked, the team knew that the term “underbanked” was in some ways deceiving. First, underbanked consumers regularly engaged in financial transactions—those transactions were simply outside of the traditional banking system. For example, they performed many transactions in cash and used check-cashing centers, payday lenders, and remittance companies (known as alternative financial services [AFS]). * The team recognized that all of these were potential services that could be provided by payments companies. Second, in addition to

these AFS competitors, a cadre of technology start-ups was already attempting to enter the market with novel solutions. * For example, Green Dot was testing the marketplace through a partnership with Wal-Mart, while GoBank and NetSpend had forged relationships with check cashers. Square Cash had also launched, providing an opportunity for consumers to send and receive money to and from one another. Each of these entrepreneurial firms was leveraging mobile and digital technology to offer consumers easier and cheaper alternatives to traditional banks. The largest of these, Green Dot, became a publicly traded company on the NYSE (ticker: GDOT). On July 21, 2010—Green Dot's opening day—the firm was valued at 27 times 2010 profits. Green Dot's owners sold 4.56 million shares at \$36. Early shareholders in Green Dot included Wal-Mart and Sequoia Capital. * The entry and growth of these firms suggested that there was a market to be served, but which of them would eventually institutionalize and scale?

The team also wondered about the response of traditional depository institutions such as banks and credit unions. According to recent studies by SNL Financial, there were approximately 96,000 bank branches in the United States, but the aggregate number of branches had actually been decreasing in recent decades and the pace of closure had increased since the financial crisis of 2009. In fact, no single U.S. state experienced net bank-branch additions in the cumulative period running from 2010 to 2013. *

There were prevailing economic imperatives for this trend: first, structural costs of branch banking were making it difficult to maintain brick-and-mortar presence, especially in lower-income and rural communities. Real estate, maintenance of physical spaces, and labor costs for tellers, branch managers, and security personnel made paper-thin margins even smaller. Associated Banc-Corp, the largest banking chain in Wisconsin, estimated that it saved \$300,000 with each branch closure. * A study by consulting firm Simon-Kucher & Partners estimated that two-thirds of existing bank branches were unprofitable, and that an individual branch needed to establish deposits of \$30 million to establish break-even profitability. * Recognizing that the traditional brick-and-mortar model was becoming difficult to maintain profitably, these banks were also investing in mobile and Internet banking. Traditional depositories might see AXP's entry into depository alternatives as a portentous move into their space.

Another front of competition came from the growing number of traditional merchandise retailers that had begun to enter financial services. Recognizing the advantages of their extensive footprints and interaction with a broad base of consumers, these efforts were structured around the core assumption that retailers' current customers had unserved financial services needs that, if met, could build their spend in stores. "You've got to remember, Wal-Mart is intended to be a one-stop shop," said Charles M. Holley Jr., that company's CFO. "The more kinds of services we can offer our core customer like that, the better for them." * Merchandise retailers sensed a second opportunity: general distrust of traditional banks. "A lot of [our] members think their bank fees are too high, or the trust level has gone down over the years, or they're having issues with debit and credit cards," said Jay Smith, Costco's director of business and financial services. *

One challenge that merchandise retailers entering financial services faced was that consumer advocates expressed skepticism or outright resistance to these entries. On one hand, they appreciated the general goal of getting a broader range of financial services products into the underbanked. Yet they were also concerned about differences in the level of regulatory scrutiny retailers received relative to traditional depository institutions. “These products can come with high fees and few real protections,” said Norma P. Garcia, a senior lawyer for Consumers Union. Wal-Mart sought a banking charter for almost a decade and, after facing considerable opposition from advocacy groups, eventually abandoned the effort in 2007. *

Home Depot, Costco, Office Depot, and Sears, among others, had experimented with financial services. But these efforts had shown mixed results. In December 2013, TCF Bank, based in Wayzata, Minnesota, announced it would close 37 branches in Jewel-Osco supermarkets. “Within all of TCF’s branches, customer behavior is changing,” a TCF executive said. “Clearly, there are fewer visits in all of our branches than there used to be.” *

AXP had previously entered new markets through cobranded efforts in their credit card business. In recent years, these partnerships had led to the introduction of the Costco TrueEarnings Card and the Delta Air Lines SkyMiles credit card. Both of these were rewards credit cards, however. Bank 2.0 would be an entirely different business model and serve an entirely different customer segment.

Imagine two hypothetical payment card customers: Oscar (credit card customer) and Eunice (prepaid card customer). Oscar opened a new credit card on the first day of the year. Over the course of the year, he charged an average of \$700 each month. In February, he missed his payment in full. In April, he had an emergency and took out a \$300 cash advance. In October, he paid off the balance in full, and then he began spending again at the old average rate in November and December. Eunice, a parent in a family of four, opened a prepaid card account on the first day of the year. She and her family charge \$800 per month on their collection of prepaid cards. Due to unexpected financial shortfalls, they withdraw funds using out-of-network ATMs 17 times over the course of the year. Both Oscar and Eunice present very different returns and costs for a payments company. The customer lifetime value of each customer to a payments company would vary based on behavior and business model. See [Exhibit 9](#) for the relevant revenues and fees for a prepaid customer and a credit card customer.

Exhibit 9

Value of Prepaid versus Credit Card Customer *

Sources of Revenue	Sources of Costs
Prepaid Customers	

Sources of Revenue**Sources of Costs**

Discount revenue	2.4%	Operating expense	6.0%
Float revenue	4.8%	Acquisition costs	\$7.00
Fee revenue		Other services	
Initial activation/purchase fee	\$3.95	Fraud expense	1.0%
Monthly usage fees	\$1.00		
Direct deposit/cash reload	\$0.00		
ATM fees (in network)	\$0.00		
ATM fees (out of network)	\$2.00		
Foreign transaction fees	2.7%		

Credit Card Customers

Discount revenue	2.4%	Operating expense	11.00%
Annual fee	\$75.00	Acquisition costs	\$80.00
Rate revenue		Loan loss provision	2.7%
Regular rate on purchases	17.6%	Benefits	
Cash advances	21.0%	Travel insurance	1.25%
Balance transfer rate	15.6%	Credit insurance	1.00%
Fee revenue		Fraud insurance	0.76%
Late payment fees	\$35	Rebates	1.00%
Overlimit fees	\$25	Miles	1.00%
Cash advance fees	\$5.00	Cash back	1.00%

Sources of**Revenue****Sources of Costs**

Minimum finance charges \$4.00

Foreign transaction fees 2.7%

Source: Case writer adaptation of company documents.

2-5 History of Prepaid Products at American Express

AXP was founded in 1850 as a freight delivery service. * Since its most profitable deliveries were to banks, it soon developed financial products and services, including money orders and traveler's checks. * Eventually, product lines expanded to include currency exchange, international travel services, military banking ("provid[ing] banking services to U.S. military personnel and their families stationed abroad"), charge cards, and credit cards. * As AXP contemplated the Bank 2.0 concept, it reflected on its history of prepaid products. The first prepaid product was the traveler's check, which debuted in 1891; its more recent prepaid products included the American Express Gift Card, launched in 2002, which grew in 2009 by expanding into Canada. * The process of launching gift cards in the Canadian market provided experience that managers could draw on during the Bank 2.0 discussions.

Unlike traveler's checks, which could be purchased at financial institutions, prepaid cards demanded a distribution model far more similar to consumer packaged goods than to credit or debit cards (and more similar to what Bank 2.0 would also require). The matter of distribution channels entailed basic retail questions: In what store(s) would the products sell, and how would AXP introduce these products?

The business model evolved further when product managers removed the cards' monthly inactivity fees, the result of which seemed to be a positive effect on sales. In 2010, AXP introduced another prepaid product, the PASS card. * The company saw that the prepaid industry as a whole was moving beyond gift cards and into reloadable products. PASS was designed for parents and teenagers; effectively, it was an allowance card. Chokshi described it as "driver's ed for the teen's wallet." * Parents could reload the card with their AXP credit cards or checking accounts. In theory, PASS could reduce the instances of teenagers asking for money. It was also a response to an increase in online spending; teenagers were more and more likely to make purchases through the web.

Initially, PASS had a monthly fee of between \$3.00 and \$4.95—"industry practice," according to product managers—which AXP waived during the launch. * Reintroducing the fee was difficult. There were clear advantages to choosing a reloadable card over cash: parents could track the money they gave to their children, teens could spend online, and there were protections for lost or stolen cards. But product managers determined that the cash system was not "broken" to such a degree that people were eager to pay for PASS each month.

Galvanized by what it had learned, the executive team sought to turn PASS into a "general purpose reloadable card" that was sold in retail stores and online. From PASS, the team had gained a platform and capabilities that could be leveraged into a new product, the American

Express Prepaid Card. The prepared card also removed the monthly fee. Around the same time, the team launched four or five other products, testing to see how they would perform. One product manager described this as an incubation period, during which the team noted changes in the prepaid industry. One trend stood out: prepaid cards were adding the same features people would normally find in a checking account. “That was the real opportunity,” one manager said. It was time to “push beyond traditional prepaid.”

The team behind PASS wondered if part of the card’s limitation was its online distribution model. In discussions about Bank 2.0, EG considered how the process of opening a new financial services product should feel. The team agreed it was more than simply downloading an app. By filling out a brief application with a name, address, and date of birth; activating a physical card; and moving funds into the card’s account, one created a “much deeper relationship.” Traditional banks, through their retail operations, established personal relationships with their customers. How could EG replicate the service customers appreciated with this business model?

With a technology-based prepaid financial services product, EG was betting that it could form that deep relationship with a new segment of consumer. Like many retail products, the success would rely on scale: the margins might be low, but high volume would compensate. EG’s vision for Bank 2.0 enabled the team members to act as “consumer champions,” providing underbanked people with financial services that came with fewer fees. With fewer fees, achieving high volume was essential. PASS had demonstrated that online distribution wasn’t enough.

Even with a firm grasp of what Bank 2.0 could be—a reloadable prepaid card with direct-deposit capabilities—the EG team surfaced a few options for further research and consideration: provide a technology-based service without the personalization consumers were accustomed to in retail banking; build a brick-and-mortar retail sales operation; or find a partner. The first option seemed to fall short of the consumer promise the team envisioned. The second seemed not only expensive in time, training, resources, and personnel, but would also likely bring AXP under the aegis of an entirely new regulatory regime. The third option was interesting, but how to go about “dating”? The ideal partner would be familiar with the segment AXP wanted to reach. Even if such a partner could easily be found, the company had to consider its traditional customer base. Finally, what would be the effect of any of these major changes on AXP’s identity?

2-6 An Expansion in Brand Identity and Business Model: “From Exclusive to Inclusive”

The working notion within the EG team was that the brand would make an overture to customers who didn't qualify for charge or credit cards. The company surveyed its traditional customers to get a sense of their reaction to the change. The results conveyed enthusiastic support from credit and charge customers, who seemed to agree with a sentiment Chokshi had expressed in a meeting: “Why wouldn't you want to serve more people?” Chokshi noted that business models based on credit scores necessarily excluded potential customers. Bank 2.0 would not be based on a credit score. A prepaid model, in which AXP took a customer's money, was entirely different from the postpaid dispersal of credit. Such a product could be more accessible than the traditional AXP customer.

As EG conducted early focus groups, it faced the difficulty of describing the product. Technically, Bank 2.0 was neither a bank account nor a traditional prepaid card; what could AXP call it instead? The company's marketing team concluded that the best definition was “a debit and checking alternative.” As the team described Bank 2.0's benefits, focus groups responded with disbelief. Bank 2.0 would not charge their customers annual or overdraft fees, and a minimum balance was not required. ✨ There were multiple ways to load funds for free, including direct deposit and mobile check capture. ✨ Peer-to-peer transfers were possible, as was the formation of subaccounts for family members (with the option of setting spending limits). ✨ It simply seemed too good to be true.

As one product manager observed, focus group participants were most concerned about security. “They actually know the banking system better than people that are banked,” he said. People with several jobs who managed multiple income deposits often had experience with a range of financial services, and they developed strong preferences. At one focus group, a man explained that he knew what time of day his paycheck was deposited. For AXP to succeed in a market it hadn't explored before, these were the types of concerns Bank 2.0 would need to address.

Chokshi had described the Bank 2.0 initiative as an “aspirational brand.” He added that “safety, security, trust is for everyone, not just the affluent.” He acknowledged that the new target market might not have an affinity for the brand—even if, as focus groups suggested, people knew they could trust AXP. “Millions of people knock on our door and we have to say no to them on the credit card side because they don't have the right [...] credit scores,” Chokshi said. Bank 2.0 was a way of welcoming these same people.

2-7 Reaching the Underbanked: How to Distribute the Product?

The team knew that a key success factor would be whether there were concerns among the existing franchise of cardmembers about “diluting the brand” with Bank 2.0. One potential alternative would be to distinguish this franchise through its distribution channel. Perhaps innovations in distribution could help build a bridge between traditional AXP and the underbanked segment.

Schulman had come to EG with start-up experience. He believed that the biggest impediment to a company’s future success, ironically, was its past success—a tendency “to become wed to what was and not what could be.” He hoped Bank 2.0, and EG in general, could be seen as a complement to AXP’s iconic brand.

In a meeting, the team wrote on a board the qualities it sought in a distribution channel for the new product. Effective delivery through novel channels would require investments in systems and expertise that AXP didn’t currently have, such as merchandising and CPG. Bank 2.0 was unlike AXP’s earlier prepaid products—it was a technology product, not just a card—and it had to stand out on the shelf. As a whole, the prepaid industry presented enormous challenges. Though it was easy for a customer to sign up for a product online, there was no guarantee that he or she would *use* the product. * Since part of Bank 2.0’s appeal was its minimal fees, AXP wanted customers to engage fully with the product by signing up for direct deposit. At a bank, customers received a folder (or some kind of documentation) describing the benefits of opening an account; similarly, technology products often came with booklets that described the item’s features. Bank 2.0 packaging would need to be heftier than a simple plastic card.

The EG teams saw plenty of reasons to move forward with Bank 2.0: AXP had already spent millions of dollars on the Serve platform, and this was a way to take advantage of the investment. Without losing its traditional affluent customers, the brand could expand into new markets, fulfilling a wish to participate in financial inclusion—to be “consumer champions.” If more and more consumers wanted to pay with AXP products, it would become harder and harder for merchants to turn them away. Furthermore, AXP already had 22,000 ATMs that could be made available to the Bank 2.0 customer. On the board, EG posed a question: “Why go into infrastructure when you can replicate it?” Perhaps the team had to shift its point of view: perhaps a familiar infrastructure would be comforting to consumers, who would not have to learn about an entirely new kind of product.

2-8 Calling the Question

Chokshi and Wright sketched out a few remaining key questions that would need to be answered in the realization of the EG team's goal of "reimagining banking." They were:

- **Viability of the market?** Was this demographic too much of a financial risk for too little return? The team knew that the company's first reloadable prepaid card, PASS, had not been a great success; did it make sense to try the model again?
- **Build or partner?** Assuming that this new target market was potentially valuable, how would AXP reach those consumers? Should it seek out a recognized partner who already had a strong relationship with the underbanked? Or build on the AXP brand's existing equity in the marketplace?
- **Acquire?** Should the company acquire one of the new entrants, such as Green Dot or Netspend?
- **Competitive response?** How would traditional retail bankers respond to EG's entry? Would partnering with an established retail banker be the best choice for a distribution channel, or should EG innovate and create its own channel?
- **The advocates?** Was it possible that skeptical consumer advocates would wonder why an iconic brand such as AXP was pursuing the underbanked? And if so, how would that skepticism hurt the franchise?

As company veterans, Chokshi and Wright asked: Was AXP ready for this level of innovation—essentially, creating a new financial services category? Was building that category by itself possible or financially prudent? Though they were unsure whether AXP would move forward with Bank 2.0, Chokshi and Wright were certain that the mission of increased financial inclusion would be central to their future at the company.
