HOW NOT TO LAUNCH A PRODUCT

by Steve Brown

There is certain lore that all bankers should know. It not only ties our industry together, but also keeps us from making the same mistakes as the past. One great lesson in new product development is brought to us by Bank of America. It was 54Ys ago that BofA gave the final go ahead for a novel idea to extend revolving credit to retail customers. Unlike lines in the past, The Bank would not require a set payoff schedule or a maturity. Customers got instant access to credit and the Bank would receive a healthy interest rate plus fees. The idea sailed through and by Mar. 1958 (8Ys before Mastercard); plans for a new product roll out began. Unfortunately, the product introduction was a catastrophe. The Bank, like most banks, found that the problem wasn't so much customer demand, but that bank staff was reluctant to explain it (as they didn't fully understand it). As a result, for the first couple of months only a few hundred cards were sold. Instead of focusing on internal education, the Bank decided to bypass internal marketing and send out 60,000 unsolicited cards to customers in the test market of Fresno, CA. At that time, the Bank's credit model (on key punch cards) consisted of 4 factors - credit balance, payment history, time as a customer and balance. The Bank put together two lists of customers - those that should receive cards and those that shouldn't. In an epic fail, the two lists got switched by the Los Angeles main branch and the cards ended up in the wrong hands. Hand-to-mouth living customers receiving the cards and no surprise - thought it was a gift from the heavens. Unfortunately, the Bank didn't realize their error until it was too late and delinquencies hit 22%. To make matters worse, the press and clergy back then felt it was an act against God to put credit into the hands of consumers and they blasted the Bank at every turn. Afraid of fighting back, the Bank was largely silent - a strategy that ended up hurting customer perception. If that wasn't enough, weak security procedures allowed thieves easy access to a case of blank cards stored in a warehouse in Los Angeles. The thieves successfully blackmailed the Bank and forced it to repurchase the cards for an undisclosed sum or risk them being counterfeited. At the end of the day, the Bank racked up $20mm in losses (about $150mm in today's dollars) and the BankAmericard was deemed a failure. After a long debate about killing the program, the Bank rightly decided to listen to the customer, many of whom wrote letters thanking the bank for their new credit product and for giving them credit at a time when they needed it most. As a result, the Bank decided to continue the effort based on new credit and security procedures. Over time, the Bank developed a wide merchant network and talked other banks into carrying the program. It took about 10Ys, but the program became a clear success and in 1976, the Bank changed the name of the division to Visa and in 2008, it had a tremendously successful IPO (giving The Bank needed capital at the time). As a side note, the head of the project, Joe Williams, was fired from the Bank for bungling the launch after his first year of being in charge. Not able to find a job in banking, but sensing an opportunity, Joe ended up forming an investor group and purchased Chase Manhattan Bank's floundering credit card program in 1962. Chase, in an attempt to copy BofA, also ended up having poor acceptance and higher than desired credit losses Joe positioned the card as a luxury item, beefed up procedures and credit underwriting and successfully sold it to American Express, where it became the iconic green and white card.

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BANK NEWS

Heavy Competition

Community banks should know Bank of America has launched a new 401(k) service designed to capture small business clients. The service targets small business owners with an online solution that can be set up in 30 minutes and gives employees various investment options for retirement. BAC indicates its research finds 58% of its 4mm small business customers use online banking and 66% are trying to offer benefits to help attract and retain employees, so the product is well positioned.

Done & Gone

The holding company of HomeStreet Bank announced its regulators have terminated a cease and desist order dated May 2009, effective yesterday.

Ridiculous and Scary

A bill that passed the Senate in GA would apply to recourse loans on properties in the state that are sold to third parties at a discount. Under the bill, buyers would not be able to go after the guarantor for more than the price paid for the loan plus interest. The bill would also be retroactive, potentially leading to large losses for buyers. Banks oppose this, as it would reduce flexibility in selling loans and make workout negotiations with borrowers much more problematic.

Price Declines

It is interesting to note that differences in data collection techniques result in S&P/Case Shiller reporting home prices fell 3.7% from Nov 2010 to Nov 2011, while CoreLogic finds a 4.3% decline and Zillow reports a 4.6% drop. It is clear prices have fallen, but just how much remains a mystery.

Fed Sim

The NY Fed published a report that discusses how the unemployment rate could fall to about 6% by 2014 based on simulations driven by historical patterns. That rate would be much faster than most predict if true.

Investment Leverage

Assuming Libor as a cost of funds, it takes about 15x leverage in ARMs and 12x leverage in 15Y 3.5% MBS investments for banks to produce a 15% ROE. If you are thinking about this strategy, let us talk you in or out of it (depending on the rest of your balance sheet).