Cap One's Warning: 'Near-Term' Digital Investment Is 'a Negative Trade', January 23, 2015 by JJ Hornblass

No one would accuse Capital One Financial Corp. of skimping on its innovation efforts and budget. Cap One was one of the first banks to start a lab, was essentially founded as a technology-first company, and continues to push the innovation envelope.

So when Richard Fairbanks, the chairman, president and chief executive of Capital One, pours a bit — but only a bit — of cold water on innovation spending, it deserves notice.

Yesterday, during Cap One's earnings call, Fairbanks bluntly declared that Cap One's digital investment was only going up, and that the return on that investment will likely not be there for "the near-term." However, Fairbanks still argued that digital investment remains of paramount importance, not just to Cap One, but to all financial institutions.

[A] lot of the impacts of digital are really sort of hard to measure, and it really relates to the way we work. But things like going paperless, driving people away from some of the more expensive channels into the digital channels, and some of the transformation in terms of marketing to be more online and so on — these have facts that we measure and … the numbers are starting to grow. … [J]ust take digital itself: that is a net trade that has costs a lot higher than benefits at the moment, in terms of what you can purely measure, because we're investing heavily in digital and … there is almost nothing that we're investing in digital where the primary objective is to save money.

So why is Cap One making those investments under those circumstances? Fairbanks explained:

This digital transformation is such a comprehensive revolution. It really allows for things to be faster and way better for the customer, a better associate experience, much better controlled from a compliance point of view, more scalable and, yes, lower cost. So right now, one of the important net negative trades is what's happening on just the pure cost side with respect to digital. By the way, the overall economic benefits of digital — I would argue that an important reason that we're on the growth trajectory we're on in the card business is, in fact, because of our digital success, not only in terms of the customer experience, but really in things like how we do marketing and things like that.

So … I believe the long-term payoff of the digital investment is going to be very significant. In the near-term, from the cost line, this is going to be a negative trade. …

What's the timeline for Cap One's digital investment? Try 20 years. That's the number of years Stephen Crawford, Cap One's CFO, specified yesterday.

Here's how Fairbanks put the time horizon into perspective:

I think in the long run, there is going to be very significant cost benefit from all these digital investments. But the biggest benefits and the reason we're doing it is in almost all cases not for that reason.

And what I am most excited about is actually the opportunities to generate growth and to generate better real-time decision making to make better credit decisions. And in the end, build a deeper franchise through very significant improvements in the customer experience and things that really create more loyalty and more stickiness with customers. And so over the years, it will be very, very hard for us to measure that, because digital and digital investments are more and more turning us into a digital company as opposed to a company that just tries to digitize what they do, or the phrase I said earlier to build digital on the side of a bank.

This transition to a digital bank, in part, cost Cap One a 10% increase in non-interest expense to $3.3 billion last quarter. In other words, going digital does not come cheap.