

POWER EXH. 100  
esb 3-12-92

PRESENTATION - 3/25/91 Visa USA  
Membership Issues

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DEPOSITION  
EXHIBIT  
12  
05-11-113537  
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OVERHEADS - 3/25/91 - Membership

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## **Objective**

### **Analyze Membership Options**

- 1. Project Impact Of New Entrance Assuming Open Membership Continues
- 2. Project Impact On Members And Vice If Membership Is Restricted

- Purpose of the meeting: To Review results of analytical work as input to management decision regarding what to recommend to Board.
- This is management discussion, not meant as outline of Board presentation.
- Once we reach conclusion regarding what will be recommended to Board, will decide on what should be shared

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# **Objective**

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## **Analyze Membership Options**

- 1. Project Impact Of New Entrants Assuming Open Membership Continues
- 2. Project Impact On Members And Visa If Membership Is Restricted

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## Agenda

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- Background, Recent Growth Trends & Identification Of Potential Entrants
- Research
  - AT&T Experience
  - AT&T Cardholder Research
  - Member Solicitation Results
  - PSI Survey
- Analysis Of Membership Alternatives
- Legal Issues
- Conclusions

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# **Agenda**

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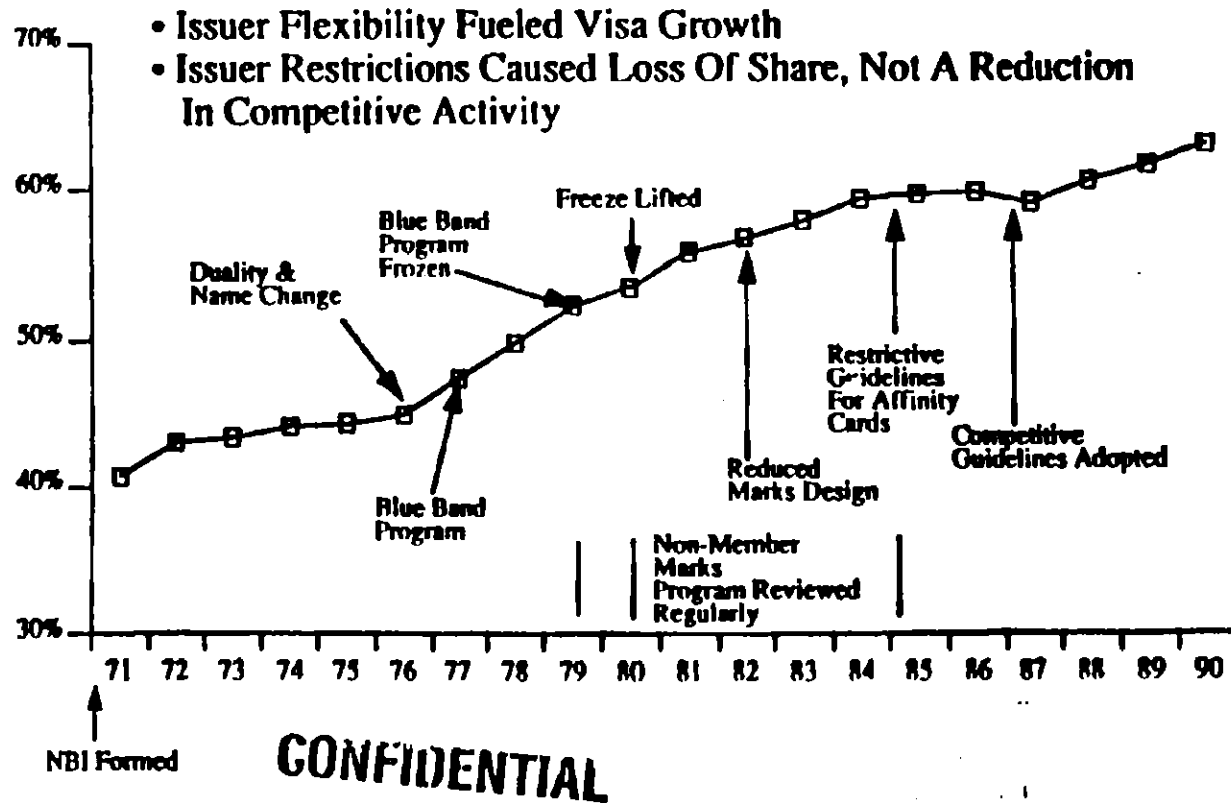
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# Visa Market Share Of Volume



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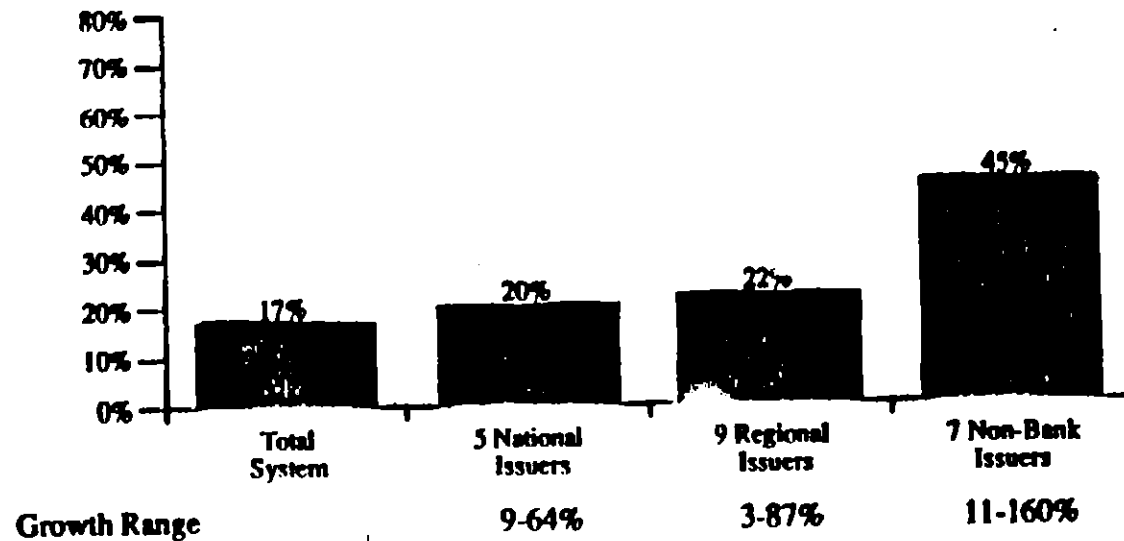


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## **Relative Growth Trends**

### **Volume Growth Second Half 1990 Vs. Second Half 1989**

- **Significant Growth Experienced By All Types Of Members**



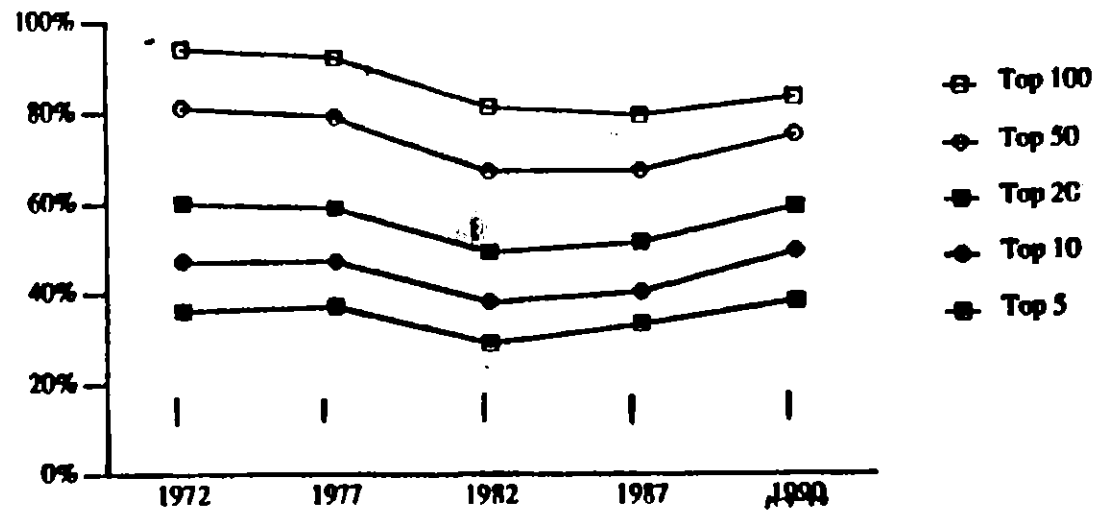
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# Concentration Trends

## Share Of Visa Volume



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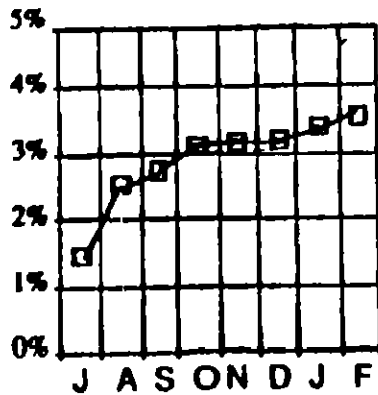
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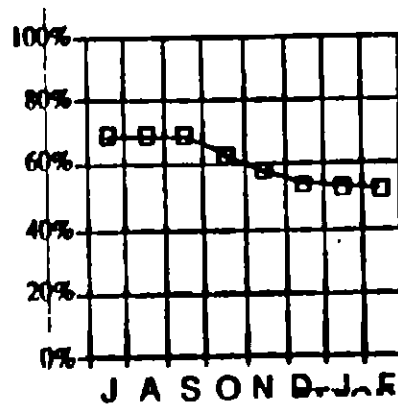
# AT&T Performance

- 4.8 Million Accounts @ 12/31/90
- \$1.65 Billion in Outstandings @ 12/31/90
- \$4.4 Billion in Volume to 12/31/90

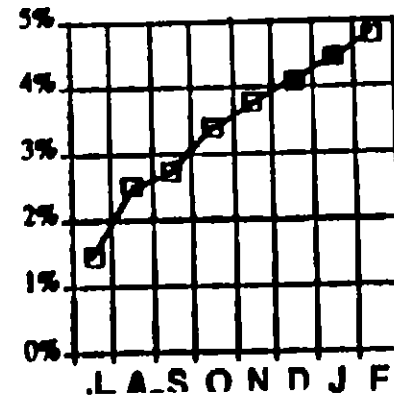
AT&T Share of Base II



Visa Share Of AT&T Per Visa POS



Adjusted AT&T Share Of Visa/MasterCard



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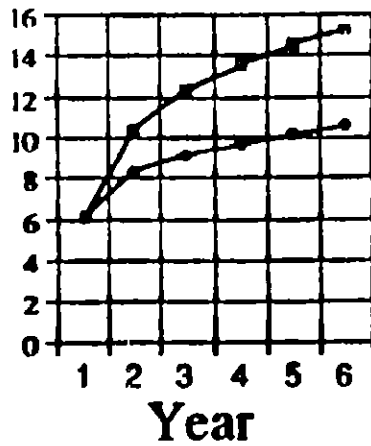
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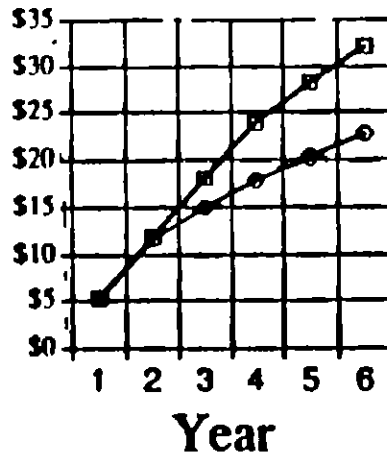
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# AT&T Projections

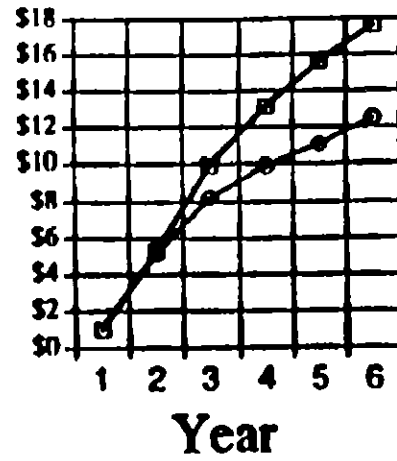
Accounts (millions)



Volume (billions)



Outstandings (billions)



◆ High  
 ◆ Low

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## **AT&T Visa Cards**

### **Relative Fourth Quarter Usage And Profitability Indicators**

	<b>AT&amp;T Visa Cards</b>	<b>Visa System Average</b>
<b>% of Accounts Active</b>	<b>66%</b>	<b>71%</b>
<b>\$ Per Statement</b>	<b>\$361</b>	<b>\$213</b>
<b>Transactions Per Statement</b>	<b>4.84</b>	<b>2.83</b>
<b>Percent Of Statements With Finance Charges</b>	<b>24%</b>	<b>66%</b>
<b>Estimated Ratio Of Outstandings To Volume</b>	<b>15%</b>	<b>55%</b>
<b>Fraud As A Percent Of Volume</b>	<b>.62%</b>	<b>.14%</b>

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## **AT&T Cardholder Research**

### **Preliminary Conclusions**

- **The Free Card Was The Overwhelming Reason For AT&T's Success, But It Is Unlikely That Anyone Else Could Duplicate AT&T's Success**
- **25-30% Of AT&T Usage Likely To Be New To Visa/MasterCard**
- **AT&T Cardholders Are More Active Than System Average But With A Much Lower Propensity To Revolve Implying That The Business Lost Has Lower Than Average Profits**
- **Maximum Decrease In Initial Success If Limited To MasterCard: 10-12%**
- **Conversion Of Current Visa Cards Likely To Reduce AT&T Business By Maximum Of 5%**

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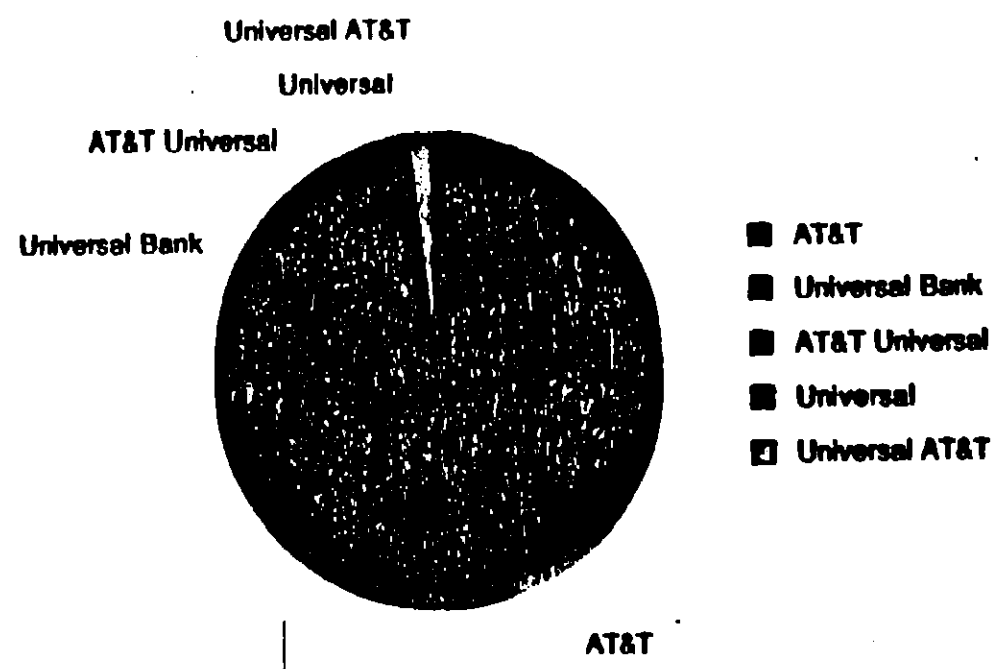
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# AT&T Cardholder Research

## Consumer Awareness Of Issuer



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## **AT&T Cardholder Research**

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### **Card Ownership**

- **77% Have Another Visa Or MasterCard**
  - **Average: 1.8 Other Visa Or MasterCards**
  - **33% Obtained From Institution With Other Banking Relationship**
  - **25% Obtained From Primary Bank**
  - **13% Affinity Cards**
- **57% Have a Discover Card**
- **16% Have An American Express Card**

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## AT&T Cardholder Research

### Relative Importance Of The AT&T Card

- 86% Of Their AT&T Cards Are Normally Carried Vs. 70% Of Their Other Cards
- 64% Of AT&T Cardholders Reported Using Their AT&T Cards In The Prior 30 Days Vs. Less Than 50% For Other Cards
- 43% Of AT&T Cardholders Said Their AT&T Card Is The One They Use Most Often
  - 35% Of Those With Another Visa Or MasterCard Use Their AT&T Card Most Often
  - 43% Of Those With Another Visa Or MasterCard Use Another Visa Or MasterCard Most Often
  - Discover Is Used Most Often By 20% (32% Of Those With A Discover Card)

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## AT&T Cardholder Research

### Relative Importance OF AT&T Card Features

	Weighted Score	% Ranking Extremely Important	Would Have Taken Card Without Feature
No Fee	4.55	79	12%
Phone Use	3.54	37	62%
Phone Discount	3.46	31	68%
AT&T Name	3.43	31	42%
24 Hour Service	3.33	28	66%
Credit Limit	3.12	22	NA
Interest Rate	2.67	18	NA

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## **AT&T Cardholder Research**

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### **AT&T As Issuer Makes A Difference**

- **78% Would Have Accepted A Similar Offer From Their Primary Bank**
- **66% Would Have Accepted A Similar Offer From Their Local Phone Company**
- **About 50% Would Have Accepted A Similar Offer From The Major Banks And Well Known Non-Banking Companies**
- **31% Would Have Accepted A Similar Offer From MCI**

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## **AT&T Cardholder Research**

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### **25-30% Market Expansion**

- **5% Of AT&T Cardholders Are New To General Purpose Card Market**
  - **10% Of AT&T Cardholders Have No Other General Purpose Card**
  - **One-Half Of Whom Cancelled a Visa And/Or A MasterCard In The Past Year**
- **15-20% Likely To Be Displaced From Discover**
- **5% Likely To Be Displaced From Amex**
- **Less Relative Impact On Visa/MasterCard Issuers With Other Banking Relationships**

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## **AT&T Cardholder Research**

- **33% Of AT&T Cardholders Cancelled At Least 1 Card In Past Year**
- **35% Of AT&T Cardholders Reported Using The Cards They Retained Less**

	<b>Distribution Of Cancelled Cards</b>	<b>Distribution Of Cards Used Less</b>
<b>Visa</b>	<b>44%</b>	<b>43%</b>
<b>MasterCard</b>	<b>42%</b>	<b>32%</b>
<b>Amex</b>	<b>9%</b>	<b>5%</b>
<b>Discover</b>	<b>5%</b>	<b>20%</b>

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## **AT&T Cardholder Research**

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### **Issuers With Other Banking Relationships Less At Risk**

- **Cards Cancelled In Last Year**
  - **14% Of Visa Or MasterCard From Issuer With Other Banking Relationship**
  - **27% Of Other Visa Or MasterCard**
- **Cards Used Less**
  - **20% Of Cards From Primary Bank**
  - **22% Of Cards From Issuer With Any Other Banking Relationship**
  - **29% Of Cards With No Banking Relationship**

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## **AT&T Cardholder Research**

### **Issuers With Other Banking Relationships Less At Risk (2)**

- **Intent To Cancel Or Renew**
  - **84% Of AT&T Cardholders Definitely Will Renew**
    - **1% Definitely Or Probably Will Not**
  - **77% Of Non-AT&T Visa Or MasterCard From Primary Bank Definitely Will Be Renewed**
    - **6% Definitely Or Probably Will Not**
  - **57% Of Other Visa Or MasterCard Definitely Will Be Renewed**
    - **13% Definitely Or Probably Will Not**

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## AT&T Cardholder Research

### Profitability Of AT&T Cardholders

- **AT&T Cardholders Are Older And Have Significantly Higher Income Than Visa Norm**
  - **Average Age: 52**
  - **Median Income: \$42,000**
- **64% Of AT&T Cardholders Reported Usage In Last Month**
  - **44% Of Non-AT&T Visa/MasterCard Users Reported Usage**
- **Average Usage Of AT&T Cards By Card Users: 4.8**
  - **Average Usage Of Other Visa/ MasterCard: 3.9**
- **80% Of AT&T Cards Reported "Paid In Full"**
  - **73% Of Other Visa/MasterCards Reported "Paid In Full"**
- **25% Of Households Reported Revolving Any Card**
  - **Other Surveys Suggest Norm Is 60%**

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## **AT&T Cardholder Research**

### **Importance Of The Card Brand Offered**

- **37% Of AT&T Visa Cardholders Claim They Would Not Have Accepted If MasterCard**
  - **14% Would Not Accept MasterCard At Renewal**
- **30% Of AT&T MasterCard Cardholders Claim They Would Not Have Accepted If Visa**
  - **10% Would Not Accept Visa At Renewal**

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## Member Solicitation Experience

- **Regression Analysis Of Member Solicitation Results**
  - **Objective: Identify Increase In Accounts Booked With Both Brands**
  - **In Progress**
- **First Chicago Summary Data**

### Visa Vs. MasterCard Gold

<u>Timing</u>	<u>%Added Visa Response</u>
Fall 89	15%
Spring 90	6%
Summer 90	13%

### Visa Classic To MasterCard Regular

<u>Timing</u>	<u>%Added Visa Response</u>
Fall 89	6%
Winter 90	15%
Spring 90	1%
Summer 90	5%
Winter 91	4%

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## **PSI Survey**

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### **Pricing**

- "It is clear, however, that the Universal Card did not cause the current round of price competition in the bankcard industry."

#### **% Of Accounts Without Fees**

	1989	1990
All Accounts	28%	29%
New Accounts	42%	45%

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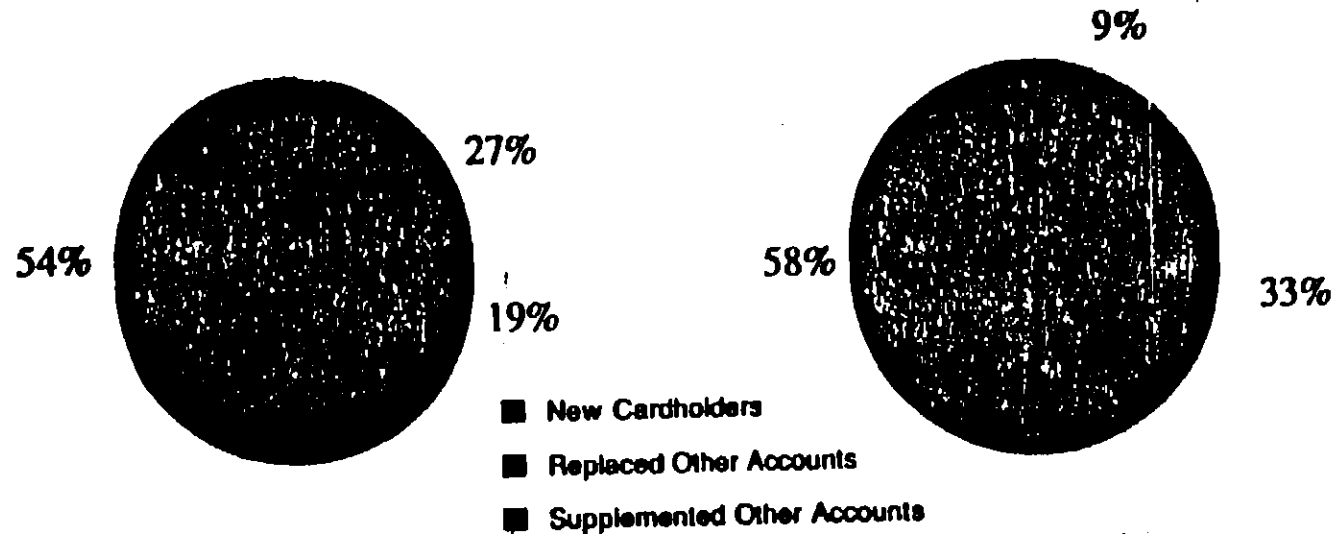
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## PSI Survey

### Market Expansion vs. Substitution

- In 1990, a much smaller percentage of new accounts represented market expansion.



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## PSI Survey

### Profitability Of New Business

- Most no-fee accounts are either inactive or are used as 30-day charge cards.
  - For every account with finance charges in a no-fee marketing program, there are 2 convenience users and 1 inactive.
- New accounts with annual fees are generating 2.5 times as much gross income as comparable accounts with no fee.
- Nearly 1/2 of new accounts opened in 1990 were opened by households with above average volume but modest credit needs
  - Average volume 50% higher than norm
  - Finance Charges 28% lower
  - Balances 26% lower

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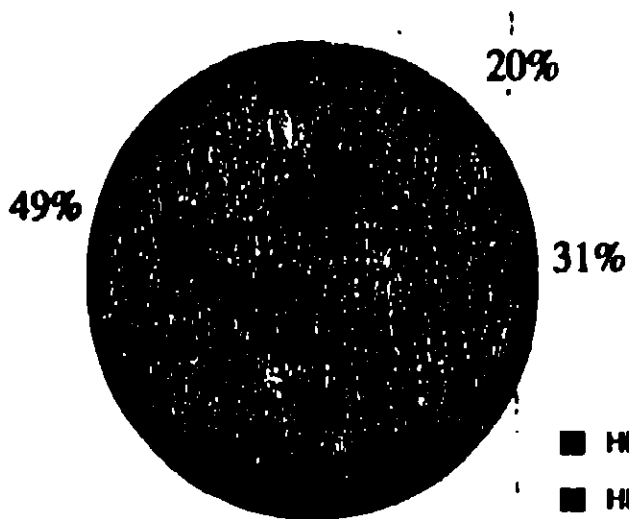
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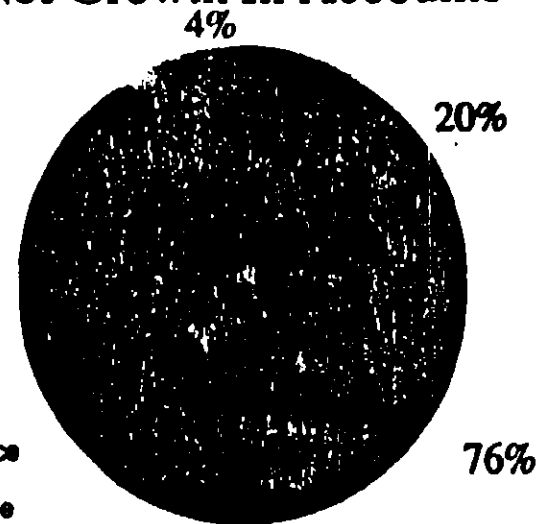
## PSI Survey

### Profitability Of New Accounts

All Households



Net Growth In Accounts



- High Balance
- High Volume
- Others

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## **Research Conclusions**

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- **25-30% Of New Entrants' Business Will Be Added Business For Visa or MasterCard**
  - **70-75% Substituted From Other Visa Or MasterCard Issuers**
  - **Substitution Likely To Be Less From Issuers With Other Banking Relationships**
  - **20-25% Substitution From American Express And Discover**
  - **Only 5-10% New To Industry**
- **New Entrants' Business Likely To Be Less Profitable Than System Average**
- **Forcing New Entrants To Issue MasterCard Only Will Reduce Their Success By 5-10%**

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# **Potential Entrants**

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## **Conclusions**

- **Potential Entrants Limited To Companies With Related Activities**
- **Majority Of Likely Entrants Already Participating**
- **Few Potential Entrants**
  - **None Combine Elements Of AT&T's Success**
  - **Total Impact (Excluding Sears) Likely To Be 2.5-3 Times AT&T's Success**

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## Potential Scenarios

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- 1. Visa Membership Restricted
  - MasterCard Open Membership Continues
  - Significant Differentiation Of Visa Brand
  - With Or Without A Continuation Of Issuer Duality
- 2. Visa Open Membership
  - Moratorium Ended
  - Free Rider Issue Addressed Through Pricing And Ownership Changes

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## **Key Assumptions**

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- **Without Added New Entrants**
  - **Industry Growth Will Slow Gradually To 7%**
    - **New Types of Affinity Programs Represent 5% Of System By 1995**
  - **Profit Margins Will Decline To 3.5% In 1991 And Continue To Decline Gradually By 10 Basis Points Per Year**
- **New Entrants**
  - **Will Use Free Cards As Key Selling Point**
  - **Card Usage Will Reflect System Norms**
  - **Total Impact 2.75 Times AT&T Results**
  - **25% Of Activity Will Be New To Visa And MasterCard**
  - **Denying Access To Visa Will Save 7.5% Of Activity**
  - **Potential To Accelerate Margin Declines**

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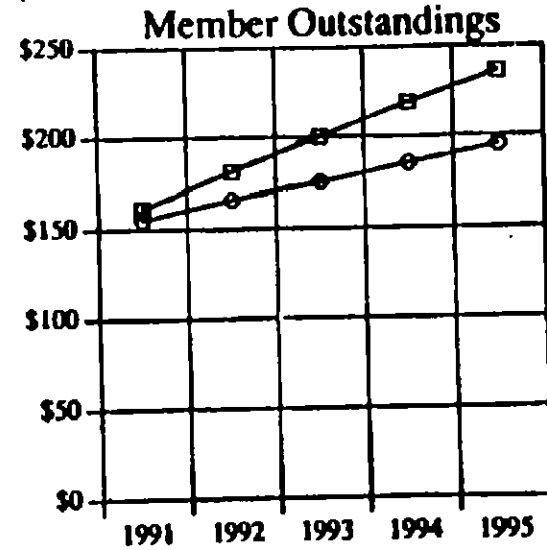
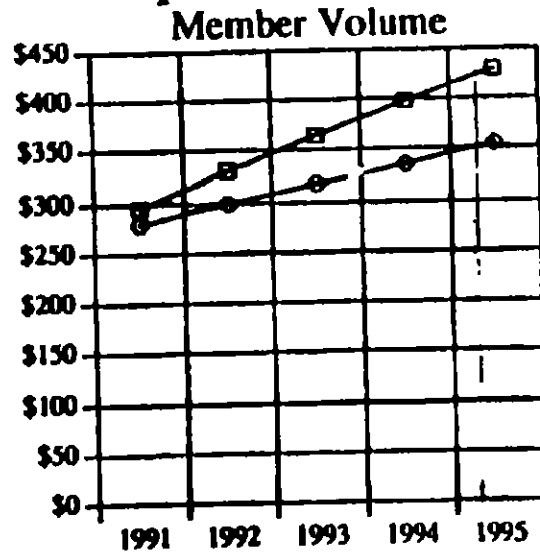
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## Open Membership

### Impact On Members (\$ billions)



- ▣ Total Bankcard
- Current Members

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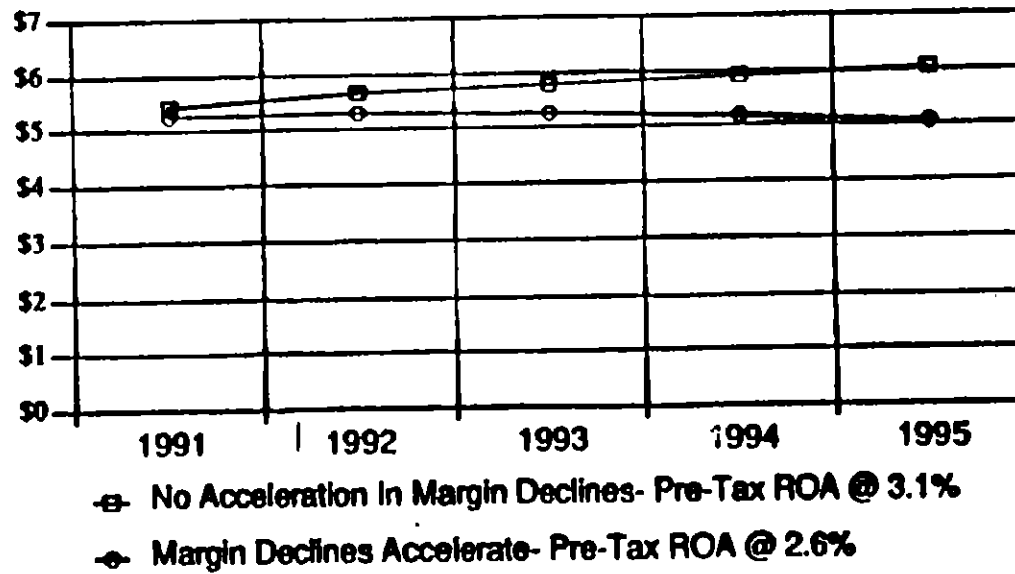
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## Open Membership

### Profitability Of Current Members Assuming No Price Premium For Visa (\$ billions)



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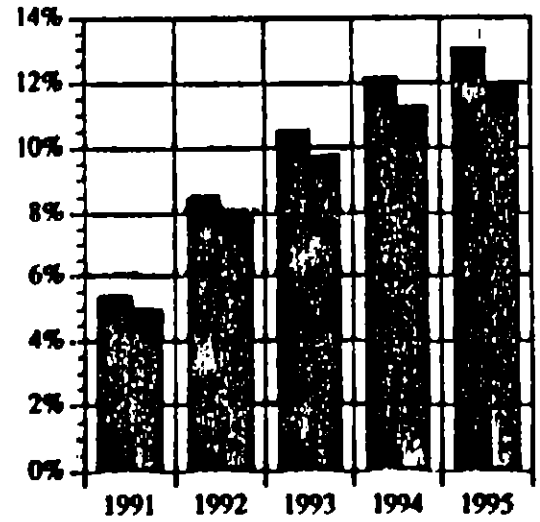
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## Impact Of Closing Visa

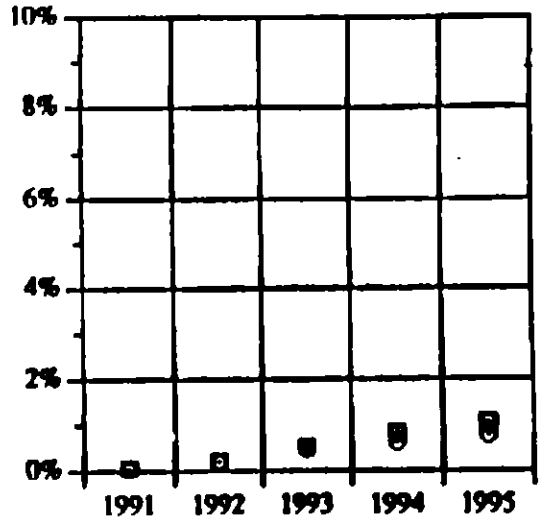
### New Entrants' Market Share



• Difference = 0.5-1%

- Visa Open
- ▒ Visa Closed

### Member Profit Difference



• Difference = \$25-30 mil/year

- ⊠ High
- ⊡ Low

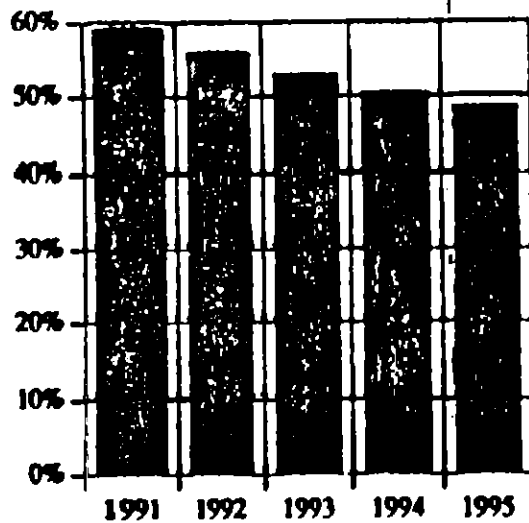
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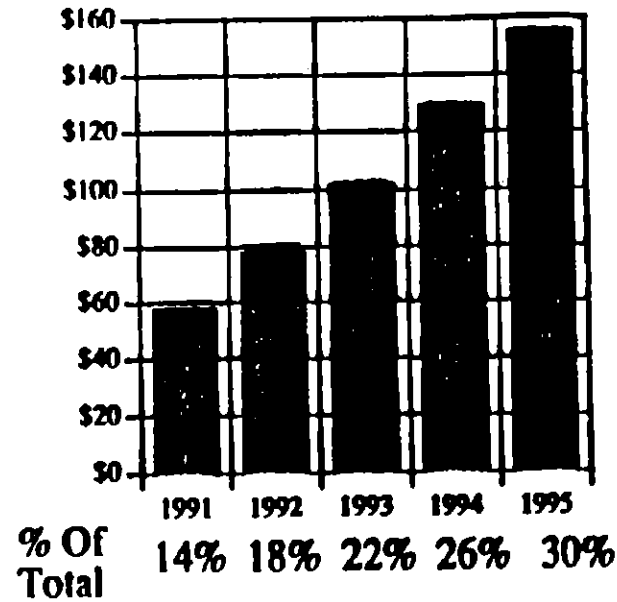
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## Impact On Visa Of Closed Membership

**Visa Share of BankCards**



**Lost Service Fees (mils)**



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## **Member Costs Of A Weakened Visa**

- **Loss Of Share To Amex, Discover & JCB Potentially Greater Than Added Loss To New Entrants**

**Loss Of 1% Share  
Costs Members  
\$70-80 Million Per Year**



**Added Cost  
Of Opening Visa  
\$25-30 Million Per Year**



- **Preference For Visa Likely To Decline With Fewer Visa Resources And Greater MasterCard Resources, Thereby Shrinking The Value Of Closing Visa**

- **A 4 % Share Shift To MasterCard Increases New Entrants Share by Same 1% That They Lose Without Visa - Anything More Is A Net Gain**

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## Other Member Impacts Of Balanced Market Share

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- Visa Has Fewer Resources For Building Market As A Whole
- Industry Standards
  - Develop More Slowly
  - Are Less Likely To Reflect Banking Interests
- Visa Board Loses Influence Within The Industry

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## The Brand Differentiation Opportunity

- Little Short Term Benefit To Members As New Entrants Gain Significant Market Share
- Maintenance Of Preference Requires True Differentiation And Added Marketing Resources
- Long Term Profitability Depends On Translating Preference To Premium Pricing Or Added Market Share
  - Member Profits Could Increase \$500-600 Million Over Next Five Years And \$250-300 Million Per Year Thereafter If Differentiation Works
  - Will Need To Spend First 5 Year Benefits
  - Practical Realities Make Success Unlikely

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## **Practical Realities Of Brand Differentiation**

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- **Price Will Still Be Used By Some Visa Issuers To Gain Share**
- **Visa Issuers**
  - **Likely To Resist Operational Differences**
  - **Pressure To Apply Visa Benefits To Maintain MasterCard Portfolio**
- **Marketing Features Easily Copied By Others**
- **Merchant System Enhancements Available To All Cards**
- **Major Changes In Visa - Issuer Relationship Required**

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## Implications Of Brand Differentiation

### • Positive

- New Entrants Capture Slightly Less Business
- Share Loss And Pressure On Visa Margins OffSet to Extent Visa Can Create Ongoing True Differentiation From MasterCard
- Greater Flexibility In Introducing New Visa Programs

### • Negative

- Sustainable Advantage Requires True Differentiation
- Visa Issuers Ability To Achieve Price Premium Limited By Bank Marketing Philosophy
- Significant Increase In Product And Marketing Cost Required To Sustain Price Premium
- Change In Visa/Issuer Relationship Required
  - Differentiation Virtually Impossible With Duality
  - Without Duality, More Standardization Across Issuers Likely
- Significant Increase In Visa Fees Required To Offset Loss Of Volume And Fund Differentiation Efforts
  - With Duality, Members Likely To Favor MasterCard
- Less Visa Focus On Building Industry And Cooperative Activities
- Increased Likelihood Of Share Loss To Amex, Discover, JCB

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## **Implications Of Open Membership**

- **Positive**
  - New Entrant Fees Cover Significant Portion Of Visa Operating Costs
  - Visa Maintains Marketing Advantage Via-A-Vis Amex & Discover
  - Visa Board Maintains Industry Leadership Position
  - Visa/MasterCard Cooperation Continues
  - Visa Continues To Have Resources Available To Build Industry
- **Negative**
  - New Entrants Capture Slightly More Business From Current Members
  - Impact On Margins Apply To All Cards
  - Differences Between Visa And MasterCard Continue To Be Minimized
  - Members Continue Playing Off Associations

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## **Brand Differentiation Strategy**

### **Impacts Of Prohibiting Duality**

- **Positive**
  - Only Feasible Way To Achieve Brand Differentiation
  - Visa Issuers' Future Tied To Visa's Future
  - Visa Able To Implement Innovations Without Considering Impact On MasterCard
- **Negative**
  - Cirrus/Visa Duality Must Be Addressed
  - Members Look To "Backdoor" Arrangements To Maintain Income From Cross-Selling
    - Visa Could Develop Second Brand To Offer Alternative
  - Some Members Choose MasterCard
    - Banks Who See Potential Advantage If Others Go Visa
    - Non-Banks And Affinity Issuers See MasterCard As More Committed To Supporting Their Future
  - Members Have All Eggs In One Basket
  - Visa Issuers Compete Harder With Each Other To Offset Attrition Of MasterCard Portfolio

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## **Current Visa Service Fee Pricing**

- **Initial Fees**
  - \$6 Per Million Of Assets
  - Not Relevant For Credit Cards Given Industry Structure
  - MasterCard Fee Is \$1 Per Card Issued 3 Years Out
- **Quarterly Fees**
  - Issuers Pay 100% Surcharge (6.9 Basis Points) For 5 Years
    - Sliding Scale Can Reduce Total Rate Below 13.8 BP
    - Merchant Volume Excluded
  - MasterCard Surcharge Is 4.5 BP,
    - Total Rate 13.5 BP
    - Effective Rate 15.8BP Due To Inclusion Of Cash
- **Acquisition Of Member Creates Loophole**

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## **Potential Fee Changes**

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- **Assess Joining Fees On Potential Or Performance**
- **Eliminate Sliding Scale For New Entrants**
- **End Time Limit On Surcharges**
- **Increase Service Fee Differential**
- **Impose Surcharges On Base Fees**
- **Impose Interchange Differentials**

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## Open Membership

### Proposed Principles For New Entrant Pricing

- **Joining Fees**
  - **Based On Potential Or Performance, Not Assets**
  - **Slightly Higher Than MasterCard's**
- **Ongoing Fees**
  - **Service Fees**
    - **No Sliding Scale**
    - **5 Year New Entrant Surcharge Set Higher Than MasterCard's**
  - **Base Fee Surcharge @ 25%**
- **Acquisition Loophole Closed**
  - **Change Of Control Reported To Visa**
  - **"Old" Members Acquired by Non-Members Subject To New Member Fees If Program Size Increases Significantly**

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## Open Membership

### Ownership Issues

- Voting
  - Participants Want Some Control
  - Private Franchisors Provide For Franchisee Control Over Some Aspects Of System
- Equity
  - Not Meaningful Under Current Financial Management Practices
  - Maximum Added Fees From New Entrants Equals About 10% Of Visa Budget Over Next 5 Years
  - "Shadow Stock" With Required Reapportionment Could Be Considered

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## **Definition Of Equity**

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- **Current Definition**
  - **Cumulative Service Fees Paid**
  - **No Adjustment For Inflation**
  - **No Recognition Of Relative "Risk"**
- **Proposal**
  - **Adjust Service Fees Paid To 1970 Dollars**
  - **Give Differential Weight To Different Stages Of System Development**
    - **1975 And Before**
    - **1976 - 1982**
    - **1983 And After**

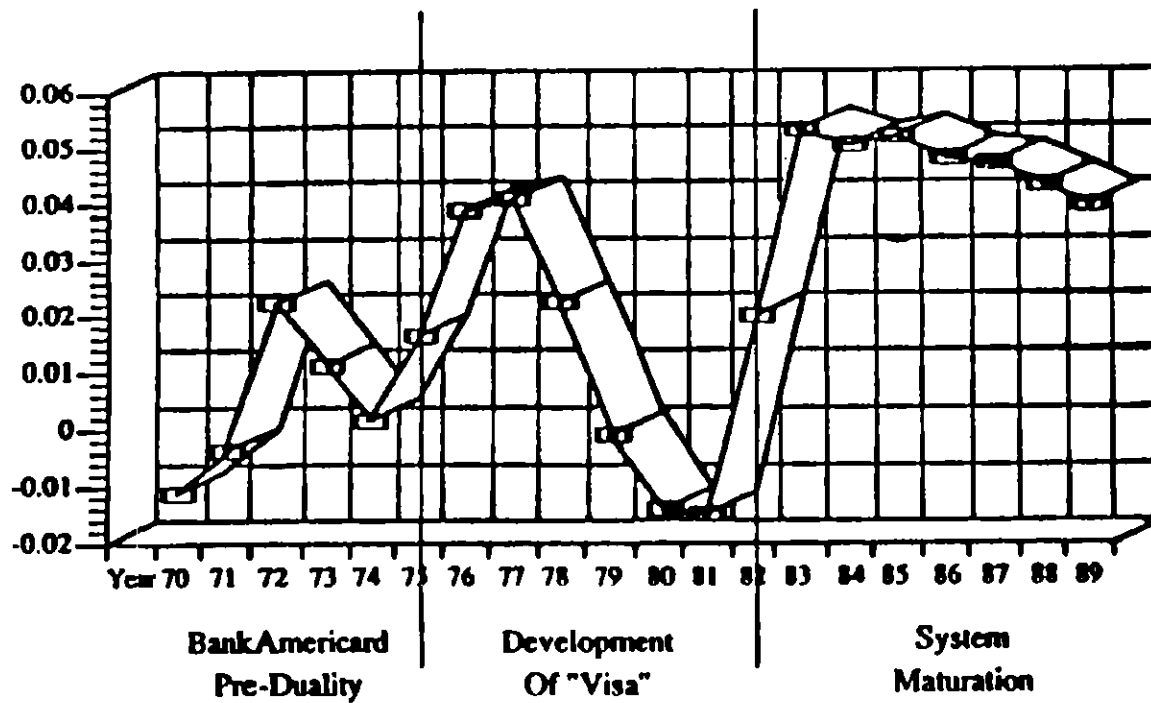
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# Membership Analysis

## Historical Returns



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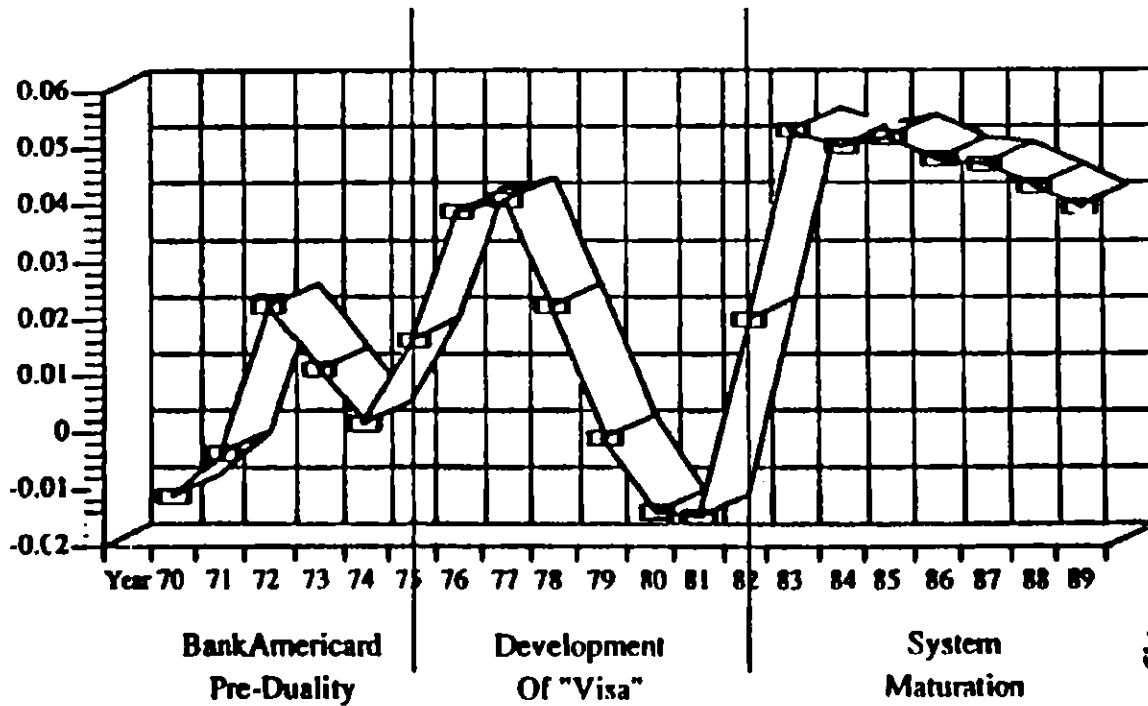
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# Membership Analysis

## Historical Returns



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**Potential Entrants**

**Persons Likely To Be From Selected Industries**

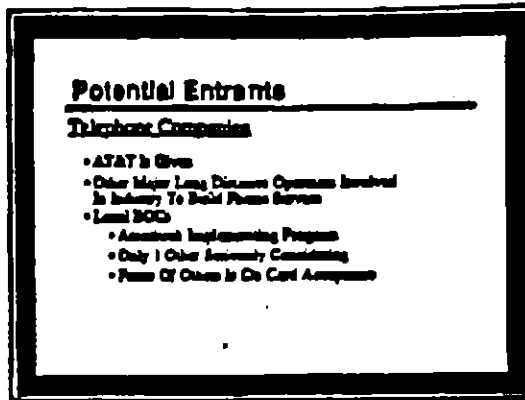
- Telephone Companies
- Banks
- Travel And Transportation
- Oil Companies
- Consumer Product Companies
- Insurance Companies
- Retail Brokerage and Mutual Fund Companies
- Commercial Property Companies

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- Non-bell company - So. New England Telco has had affinity program for several years
  - Results to date have not been noteworthy
- Although only 1 other telco evaluating it now, could change if Ameritech has great success
  - Those who have looked at Ameritech program question market impact

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## Potential Entrants

### Realities

- Majority Have Weak Capital Positions
  - Need To Focus On Basic Business
  - Potential Candidates For Co-Banking
  - Selling Proprietary Cards To Peer Capital
- Exceptions
  - Penney's - Already In
  - Sears - In Sale
  - Limited, Wal-Mart and K-Mart
    - Focus On Keeping Downside Down
    - Proprietary Cards Being Permitted As Way To Maintain Cash, Not As Potential Major Profit Center

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**Potential Entrants**

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**Travel And Entertainment**

- Airlines
  - All Except Delta Have Allotment Programs
  - West Coast Could Not Enter Domestic
  - Strong Cash Positioning Capital & Marketing Efforts On Building Asian Business
- Car Rental & Hotels
  - Many Have Allotment Programs
  - Care Invested Past Year On Marketing Efforts To Build Brand Position And Reduce Cost Of Advertising To Drive Demand
  - No Disincentive Of Incentive In Issuing Cards

- Current profitability of airlines make it highly unlikely they could do anything next year or so even if they wanted to.
- Even once it turns around, not likely

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## Potential Entrants

### Oil Companies

- Executive Cash Issuing Experience
  - Potential Co. Building Brand Loyalty To Sell Crude
- Crude Not Viewed As Major Profit Center
- Several Have Existing Affinity Programs
- No Significant Barriers

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**Potential Entrants**

**Consumer Finance Companies**

- Many Already Members
- Current Non-Members
  - GMAC - Liberty
  - Chrysler - Ten Many Problems in Car Business
  - TransAmerica
  - CIT
  - AVCO

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## Potential Entrants

### Insurance Companies

- Of Top 14
  - J Casualty Insurer
  - J Affinity Programs
  - New York Life Supplement Insurer
- Certain Non-Members
  - Equitable - Other Problems Are Key Priority
  - Connecticut General
  - Northwestern Mutual
  - Mass Mutual
  - Kemper
  - Fidelity Fund

- Issuers: Prudential, Aetna, Hancock, Travelers, CIGNA
- Biggest impact among insurance companies is not a major
  - Capital Holdings owns First Deposit Corp
  - Run as a standalone business, no ties to insurance activities
- Affinity: Met Life, New York Life, Mutual Of Omaha

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**Potential Entrants**

**Retail Brokerage & Mutual Fund Distributors**

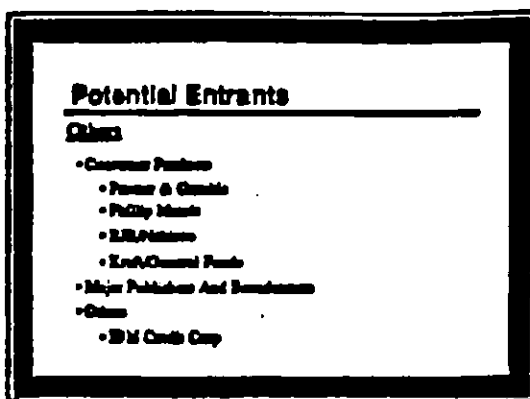
- Several Brokerage Firms Already Members
- Focus On Asset Management Accounts - Not Cash
- "Best-Of-The-Best" Affinity Program Widely Used Among New Members
- Top Mutual Fund Operators Already Members

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- The further away we go from companies with card, other credit or other financial service activities, the harder it is to view them as likely entrants
- Clearly, we could not totally forget about it, particularly for the top group if they feel that marketing prowess makes the difference and they buy into all the operational aspects of the business - they don't have to build any.
  - With the publicity over the Sears suit and AT&T's success, it may be that one or more may try it
  - However, they would have to be convinced that this added competition won't bring margins too far below their current levels.
    - Typical target ROEs for consumer product companies are in the low 20s - which is a lot higher than most banking companies look at as a good business
  - Factors mitigating against it are the places their goods are sold -the supermarkets - don't take cards, so they may see little direct connection
  - They are very focused on how the demographic changes of the 90s, particularly the aging baby boomers, will effect their businesses and they may view the consumer credit business as hitting its peak now
  - Accordingly, they would be unlikely to enter this business if they thought it was about to go into a secular stagnation or even decline.

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**Potential Entrants**

**Factors Used To Identify Candidates**

- Large Popularity Card Base
- Other Consumer Credit Activity
- Other Consumer Financial Service Activity
- Other Executive Consumer Relationships

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# Objective

## Analyze Membership Options

- 1. Project Impact Of New Entrants Assuming Open Membership Continues
- 2. Project Impact On Members And Visa If Membership Is Restricted

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