# Just One Word: Plastic How the rise of the credit card changed life for the FORTUNE 500--and for the rest of us.

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(FORTUNE Magazine) – Legend has it that the revolution began over lunch at Major's Cabin Grill back in 1949. It was an old-school New York City power lunch. As waiters served martinis and steaks to the midday crowd, Alfred Bloomingdale of department-store fame and his dining companion, financier Frank X. McNamara, were finishing their meal when something unexpected happened.



As one version of the story goes, the check arrived and they discovered they didn't have enough cash to pay it. McNamara had to call his wife to have her bring over money to cover the bill.

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But rather than feeling embarrassed, McNamara was inspired. "Never again," he reportedly vowed. He and Bloomingdale cooked up a scheme to launch a network of restaurant charge accounts so that big-spending plutocrats like themselves wouldn't have to worry about carrying around cash to cover their tabs. This network, which became Diners Club, was the first charge card company.

At the time the concept seemed novel--in the early days people would line up at checkout counters to watch someone pay with plastic--if not particularly revolutionary. But it was revolutionary. "In 5,000 years there have been only four times that we have changed the way we pay: There was barter to coinage; coins to paper; paper to checks; and then cards," says David Evans, economist and co-author of Paying With Plastic.

Today, of course, the credit card is like the telephone: It just is. You can't buy a plane ticket, book a room at most hotels, or rent a car without one. And if all you could use were cash, you'd have a hard time shopping on the Internet. In fact, last year marked a milestone in business history: For the first time ever, Americans bought more stuff in stores--clothes, groceries, toys--with cards than with cash. In total, American consumers carry around one billion different pieces of plastic and use them to make nearly $2 trillion of transactions a year. That roughly calculates to 20% of the GDP.

The impact plastic has had on business is almost too huge to measure precisely. There are no economic data on how many purchases would or would not have been made over the years were it not for cards. Nor are there numbers for how much money cards have saved companies by making transactions faster, more efficient, and more seamless. But look at almost any company on the FORTUNE 500, and it's clear how dependent American business has become on plastic.

For Citigroup, No. 6 on the FORTUNE 500 last year, cards are huge business. It issues some 145 million cards worldwide, which bring in $19 billion in revenues--25% of the total. For J.P. Morgan and Bank One, joining card operations was part of the rationale behind their recently announced merger. Combined, their cards will be 16% of the overall business, making J.P. Morgan/BankOne the biggest card issuer in the country.

Other companies have built entire businesses around plastic. Dell, No. 36 on last year's FORTUNE 500, couldn't exist in its present form without it. The company has created one of the most successful operations in the world by manufacturing and selling computers faster, cheaper, and more efficiently than anyone else. Imagine what a cash-only world would do to Dell's speed and efficiency. How much would it cost the company to wait five to seven business days for each customer check to clear? What would it do to its operations to have its boxes waiting that long for shipment? How many sales would it lose when people decided it was easier to buy in a real store? It's safe to say that Dell would have had a lot more trouble coming up with the $35 billion in revenues it made last year without plastic.

Wal-Mart, the largest company in the world, would still be awfully big in a cardless economy. But how many of its millions of customers would have passed on that new DVD player or Weber grill if they hadn't been able to borrow the money for it so easily with their credit cards? FedEx, Amazon.com, eBay--all of these companies have to some degree built their empires around the convenience of plastic.

The most extraordinary episode in credit card history is the great Fresno Drop of 1958. The brainchild of a Bank of America middle manager named Joe Williams, the "drop" (which is marketing-speak for "mass mailing") was an inventive tactic to give Americans their first highly addictive taste of credit card living. Keep in mind that charge cards in those days--like Diners Club or American Express--were mainly used by jet setters, businessmen on expense accounts, and ladies who lunched. One American Express ad of the era told its customers, "You are part of a group whose finances and credit rating are among the top 5% of the nation."

The middle class used cash. To buy a plane ticket, for example, you'd physically hand over a wad at a travel office. To reserve a hotel room, you'd mail in a check. If you wanted to buy a new dress, or golf clubs you couldn't quite afford, you'd save till you had the cash to buy them or pay on some sort of installment plan. Of course the middle class did have access to credit, but it was a cumbersome process. It meant going to the bank, talking to the lending officer, and proving you were a stand-up guy.

Williams wanted to change that. In September 1958, he mailed out 60,000 credit cards, named BankAmericards, to nearly every household in Fresno. Mind you, these cards arrived in the mailboxes of people who had never seen--let alone applied for--a card like that. (It goes without saying that banks don't send out credit cards anymore without an application and a credit check.) But now thousands of ordinary people suddenly found that thousands of dollars in credit had literally dropped into their laps.

The appeal of credit cards was the same then as it is now: They make spending easy. Maybe too easy. "There's something about plastic that makes people make purchases they might not have made previously," says Maria Nemeth, psychologist and author of The Energy of Money. "If you had to lay out all the dollars you were using to purchase something, you might think twice about buying it. With plastic, there is no real psychological connection that you are spending money." Adding to the inherent appeal of credit cards was a pent-up urge to splurge. After years of scrimping and saving during the Depression and war years, Americans of the 1950s felt rich and prosperous, and they wanted to spend. "Thrift is now un-American," declared FORTUNE in 1956.

BankAmericards in hand, the residents of Fresno were now free to spend at will. And spend they did. They went on such a spree, in fact, that in the second year after the Drop, they racked up $59 million of purchases on their BankAmericards ($350 million in today's dollars). The credit card age had arrived.

By the mid-1960s cards were in such high demand that other banks that wanted in on the action joined Bank of America to form an association around the BankAmericard. The individual banks issued the cards; the association handled the marketing and back-office processing. (In 1976 this association changed its name to Visa.) In 1960 there were 233,585 BankAmericards in use; by 1968, more than one million. In 1966 another group of banks formed Interbank, later known as MasterCard. All told, between 1966 and 1970 approximately 100 million cards were mailed out. (In 1970, the government outlawed the mass mailing of unsolicited cards.)

This postal blitz led to big spending: In 1970, volume on credit cards topped $7 billion. "It was like finding a genie in a bottle," says Lewis Mandell, economist and author of The Credit Card Industry.

And like a genie, cards brought trouble too. For one thing, banks were mailing out so many credit cards that they were losing track of which customers got what, where they got it, and for how much. Some 10% of the cards sent out by U.S. banks were never accounted for. During one mass mailing in Chicago, newborns were sent credit cards. The carbon-paper slips that credit card transactions were written up on were fast becoming a quagmire for the industry. Chuck Russell, a former Visa CEO, recalls taking over an entire gymnasium once to organize all the paper. "The whole room was filled with piles and piles of sales drafts that we couldn't reconcile. Those drafts were worth millions of dollars--and we didn't know whose accounts to debit. Our customers thought we were Santa Claus," he recounts in the company's corporate history.

Then there were the delinquencies. "A few people didn't quite grasp the idea that at the end of the month, or later, they would actually have to pay for what they bought," the corporate history recounts. The delinquency rate on those first cards was 22%. (Today it's closer to 2%.)

Another problem was credit card crime, which was born almost the minute credit cards were. In one incident thieves broke into a Bank of America warehouse, stole unembossed cards--which were as good as cash--

and then audaciously offered to sell them back to the bank. In 1969 postal workers in Washington, D.C., stole 1,000 cards. Shopkeepers cooked up scams, charging fictitious sales to nonexistent credit cards. One theatrical agent bought $3,794 of airplane tickets on stolen cards and sold them to his clients at a 50% discount. In New York there was a mini-industry of stolen card dealers who bought bad cards for $25 and sold them for $150.

Given the rampant errors, delinquency, and fraud, it shouldn't come as a surprise that the banks lost money on credit cards for years. Bank of America racked up $20 million in losses on the cards within a year of the Fresno Drop--a huge sum back then--and Williams resigned. Between 1967 and 1970, Wells Fargo lost $7 million on its card business; Bankers Trust lost $10 million between 1968 and 1970. In 1973, 15 years after the Drop, banks lost a total of $288 million on cards.

Into this fray entered Dee Hock, the legendary CEO of Visa. Hock, who took over BankAmericard in 1970, turned out to be just what the troubled industry needed. From the start, he believed that plastic could beat cash. To get there, it needed two things: to be faster--and to be everywhere.

Hock saw early on that cards needed computers. In 1973 he spent $3 million building the first electronic credit-card processing system. It was primitive by today's standards--cashiers had to give the credit card number over the phone to someone in a back office who would then manually enter the number into a computer--but it was still a huge improvement. The typical credit card transaction had been taking five minutes; the new system brought it down to 56 seconds and allowed BankAmericard to process 5,000 transaction in one hour. (Today Visa can process 5,000 purchases in one second.) Computers cut down on time, paper, and fraud. And all that, of course, cut costs: Within a year, Hock's new electronic system saved the banks that issued BankAmericards $30 million.

The more difficult challenge was getting his cards to work everywhere. The relationship between stores and cards has always been tense: Retailers like the sales that cards bring in but hate paying the fees on those sales. Throughout the 1970s many stores, including J.C. Penney, Montgomery Ward, and Sears--the big three of the day--refused to accept third-party plastic. Retailers often had their own cards, which they wanted their customers to use, and viewed other cards as rivals. But Hock was relentless, and during his tenure he persuaded more than a million merchants to accept Visa.

In 1979, Hock had a breakthrough: He finally persuaded J.C. Penney to accept Visa. The deal made headlines, and other stores followed. Thanks to these efforts, it's rare today to go into a store that doesn't accept at least one of the big cards. Even the last major stronghold of cash-based commerce--the grocery store--has succumbed. At the beginning of the 1990s only 5% of supermarkets accepted cards; now more than 90% do. (The tension between card issuers and stores isn't completely gone: In 1996, Wal-Mart, along with other merchants, sued Visa and MasterCard over their debit card fees. The big-box retailer forced Visa to cut its debit fees, and in February kicked MasterCard's debit cards out of its stores.)

By the time Hock left Visa in 1984, the card industry had been transformed. For the first time since its inception, plastic was starting to make a profit. What's more, he'd set it on a path of near universal acceptance--even overseas. Today travelers can take a trip across the world from San Francisco to Singapore with just a few dollars and a piece of plastic in their pockets.

Throughout the 1980s and 1990s, the card industry exploded. Indeed, there were whole new categories of cards invented during this time. Affinity cards, first introduced in the '70s, took off as everyone from Mothers Against Drunk Driving to the National Hockey League came out with a card. AT&T unveiled its Universal Card, offering phone minutes in exchange for dollars spent using it. American Airlines teamed with Visa to introduce its air-miles card, one of the most successful innovations in the industry. Today you can get any number of "reward cards" that offer an amazing array of freebies--hotel rooms, groceries, clothes, insurance, books, even cash back. The recent Starbucks Visa card, which awards points toward cups of coffee, was launched in October, and within a week 25,000 people had applied for it.

Debit and ATM cards, which both started in the '70s, also hit it big in the early '90s. Thanks to advances in technology, stores started installing machines at their checkout counters that enable customers to swipe an ATM or debit card, tap in a security code, and pay for their purchases without having to use cash or credit. Debit cards are now the fastest-growing sector in the industry. According to The Nilson Report, an industry publication, by 2007 the volume on debit cards will double, to $1 trillion.

Ironically, the future of plastic might not actually be plastic. Several companies are experimenting with ways to eliminate cards altogether. One startup called Pay By Touch has come up with a way to pay by putting your finger on a scanner. Its website declares that it is "completely eliminating the need to carry cards, checks, or cash." Other companies such as Vodafone and T-Mobile are making it possible to pay remotely by using a cellphone. MasterCard and American Express are currently testing ways to pay using wireless chips that could go anywhere. "It could be worn on clothing or even implanted under the skin," Art Kranzley, MasterCard vice president, recently told American Banker. In the future, it seems, we'll be paying for lunch with our forearms.

Plastic has changed American life. We pay bills, our rent, even our taxes, using cards. We get mortgages, in part, because of credit records we've built up by using plastic. Anyone can buy almost anything anywhere at any time: a computer from Dell at 3 A.M., a sweater from L.L. Bean on the commute home, a phone call from 30,000 feet in the air.

Think about how much time it used to take to buy, say, a new TV. Chances are the process went a lot like this: You found out how much it cost, you visited the bank to get the right amount, and then you went back to the store to buy it. Now you see that 48-inch plasma screen at Best Buy, briefly yearn for it, even more briefly wonder whether you can really afford it, and then throw caution to the wind and buy it on the spot. Indeed, stores count on our making impulse buys. And a massive, intricate, transglobal technological and financial infrastructure is waiting all day, every day, to make that impulse buy as easy as, well, an impulse buy.

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