



Prepaid Cards & ATMs: A Marriage of Convenience

A compendium of secondary research and primary commentary pertaining to ATMs as a more convenient, secure, efficient and profitable option for distributing prepaid gift cards, transit passes, venue admissions and other proprietary payments cards (sports arenas and theme parks).

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Introduction

Prepaid, stored value cards are a recent phenomenon in America and are spreading rapidly around the world. Gift cards make up the largest segment of prepaid cards and are a more convenient gift alternative or means to manage ongoing purchases without being limited to the amount of cash a consumer carries. *The Tower Group* estimated that approximately \$80 billion was spent on such cards in the U.S. (2006).¹ Another card industry management firm estimated that the average purchaser of gift cards purchased 4.9 cards in 2006.

According to the *Mercator Advisory Group*, 568 million in-store gift cards were purchased in 2005 at card issuing merchant locations while 56 million additional gift cards (about 10 percent of in-store purchases) were obtained via the Internet or via "J-Hook" distribution channels.² Research analysts differ on growth patterns but generally agree that growth ranges from 6 – 9 percent through all channels with 2006 in-store sales growing between 34 and 51 million cards and distributed gift cards growing between 3 and 5 million cards.

Currently, consumers desiring to purchase such cards must either (1) visit a merchant location that sells its own card, (2) visit a supermarket or other mass merchandiser that has a J-Hook display of many cards and execute the purchase and activation at the check-out counter, or (3) go online to order a card to be sent in the mail. All three methods are time consuming to the consumer as well as time consuming and costly to merchants.

This paper identifies an emerging strategy that holds particular promise for the ability of ATMs to dispense gift cards – particularly in-store gift cards – in addition to cash. Having gift card dispensing at the ATM (in addition to cash) creates an additional income model for the existing (and often underutilized) ATM infrastructure, thereby creating an economically viable distribution solution that is cost effective and simple to implement.

The authors employed a variety of research methods, in addition to analyzing market research data where available, in order to provide a detailed look into the cutting-edge gift card industry along with the highly researched and proven ATM industry. Because a hybrid of these two technologies is a recent phenomena, the authors relied on research information along with information compiled from interviews of experts in the ATM and gift card industries.

This paper explores distribution issues in the gift card market, and then continues with an analysis of the current state of the ATM distribution channel. Then we'll discuss how combining these technologies can benefit consumers and what other companies have done to meet this growing consumer demand.



Prepaid Gift Cards

Key Concepts

- *Consumers need additional forms of gift card acquisition*
- *Merchants need alternative forms of prepaid card distribution*
- *Merchants need to distribute gift cards more cost effectively and securely*
- *Restaurants and shopping malls and other business groupings are prime targets for ATM cash and gift card distribution*

Gift cards have become an amazing consumer phenomenon in a few short years as more merchants and national card systems have embraced them for sale to consumers. When Blockbuster Video launched the first such card in the late 1990's, the payment system industry generally equated the card to a plastic gift certificate and waited to see what consumer reaction would be. In light of the evolution of cards as payment devices, the advent of stored valued or prepaid cards was the next logical step in card payment devices and was made possible by the ubiquitous penetration of card activated point-of-sale terminal devices and the growing "under served" and "unbanked" consumer markets.

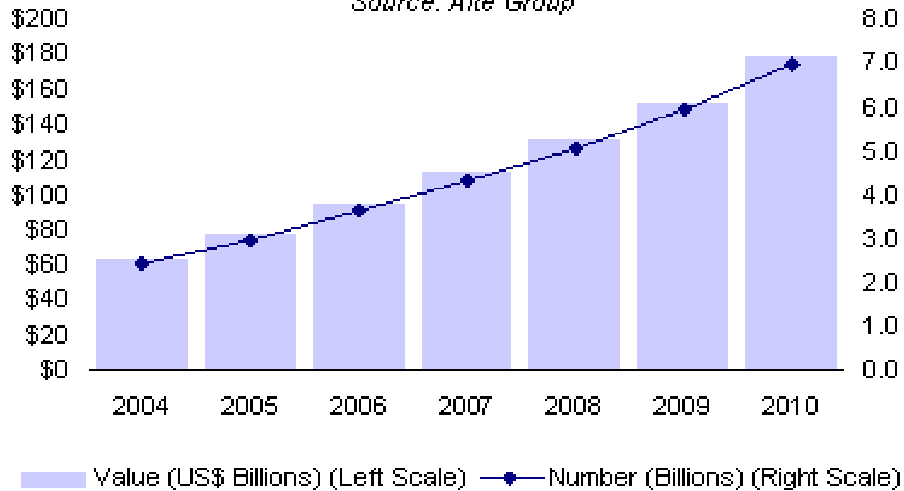
Prepaid cards fall into four principal categories to fit a variety of needs and purposes (although some researchers have delineated as many as 34 separate categories). The four major categories for our purposes are gift cards, general-purpose cards (refunds and incentives), payroll cards, and health spending account cards. Total spending on all prepaid cards in 2005 is estimated by the *Mercator Advisory Group* to be \$165 billion and is estimated to reach \$236 billion by 2009.³

Gift cards come in two forms – "Closed Loop" and "Open Loop." "Closed loop" cards are germane to a single merchant or group of merchants (Private Label) while "open loop" cards carry national and international card system branding (i.e. Visa, MasterCard) enabling them to be used and accepted anywhere the card mark is displayed. *TowerGroup* estimated that more than \$80 billion would be spent on gift cards in 2006 of which nearly \$60 billion was for merchant closed loop cards.⁴ Earlier in July 2007, the *Aite Group* published a new report predicting that total open and closed loop gift card purchases would reach \$117 billion in 2007 and \$178 billion by 2010.⁵ *Aite Group's* historical and future look at transactions and transaction value is depicted in the graphic chart on the next page.



Number and Value of Branded and Private Label Prepaid Card Transactions (U.S.A.)

Source: Aite Group



Research findings by *The Marketing Workshop* found that nearly 90 percent of adult consumers have purchased a gift card within the last three years.⁶ In 2006, it is estimated that 46 percent of all gift shopping was for gift cards. The average purchaser bought 4.9 gift cards having an average value of \$46 (nearly the same amount as the average ATM cash withdrawal and debit card purchase). Some 53 percent of gift card purchasers buy between 1 and 4 cards while 30 percent buy between 5 and 10 cards. Other significant findings include ten percent of gift card purchasers believe that they have purchased a gift card as the result of seeing or hearing an advertisement, while twenty percent of gift card recipients say that they have received a gift card from a merchant they did not normally frequent, and became a regular shopper as a result.

Interestingly, about a third of purchasers buy one or more cards for their own personal use. Surveys by *The Marketing Workshop* indicate that the primary reasons have to do with creating their own convenience, budget spending, saving and putting money aside to be sure money is used for a specific item or purchase, and fear of carrying too much cash or not having enough available cash. The study produced for *Comdata* showed findings that more than eight respondents in ten say that they are more likely to purchase one gift card over another if a discount coupon for their personal use is included.⁷

The Benefits of Gift Cards to Retailers are Significant

There are several significant benefits to retailers that offer gift cards. Retailers benefit from the long float on their issued cards. According to *The Marketing Workshop*, only 58 percent of gift cards purchased were redeemed within one month of purchase.⁸ Breakage or the amount never redeemed averages ten percent with a significant portion of that being attributed to people who never use the card. *TowerGroup* estimated 2006



breakage at \$8 billion, about ten percent of estimated sales.⁹ Studies from *Archstone Consulting* also show another benefit for retailers, in that almost 50 percent of customers spend more than the original amount on the gift card upon redemption, and other studies have confirmed that consumers add an average of 17 percent when redeeming their gift cards.¹⁰ Retailers' transactions paid by their own gift card means that there are no card discount fees to be paid and check out transactions move faster. For "open loop" or branded gift cards, retailers usually benefit from a sharing of the \$2 - \$10 in fees usually placed on the sale of the gift card.

Though gift cards were expected to be a common holiday gift, they were even more popular than projected. According to a recent survey, consumers spent an average of \$164.81 on gift cards, up from the \$146.20 they expected to spend. As a result, gift card spending during the holidays was \$27.8 billion, higher than the \$24.8 billion initially estimated by the *National Retail Federation*.¹¹ Predictions are for 2007 sales to increase 4.8% over the 2006 totals.

Gift cards to a department store were the most popular to give, as 37.9 percent of consumers said they gave a gift card from that type of store. Restaurants (26.8%) were also a popular choice, in addition to bookstores (18.0%), electronics stores (16.2%) and discounters (14.8%).¹²

Gift Card Sales are Significant and Growing

Several companies that operate gift card platforms have announced significant growth in their gift card sales. "Organic growth in the retail segment was very strong at over 20 percent, driven primarily by robust demand for gift cards," said Kathryn V. Marinello, president and chief executive officer of *Ceridian*, in announcing the company growth for *Comdata*.¹³

Even more telling is a 2005 survey conducted by *First Data Prepaid Services* of 1,003 adults. The survey showed that 50% of respondents said they preferred to give a gift card over cash. "There is tremendous potential for growth in the gift card market, especially as it pushes down into small merchants," says Ariana Michele-Moore, a senior analyst for Boston-based consultancy *Celent LLC*. Another industry expert predicts that within 10 years, prepaid cards can represent \$700 [billion] to \$800 billion in volume. Gift cards truly present an emerging market opportunity for growth. The *First Data* survey also revealed that nearly six out of 10 respondents, or 59%, either purchased or received a gift card in the previous 12 months, up 23% from 2001.¹⁴ Experts in the industry have said that the study data really demonstrates that gift cards have been embraced by the public.

Younger Aged Consumers Appear to be Embracing Gift Cards Over Cash

Younger-aged consumers are also embracing gift cards. Elizabeth Olson, writing for the *New York Times*, noted the increasing use of payment cards for small ticket purchases. She writes "more consumers — especially younger ones — are shunning cash and paper checks almost entirely."¹⁵ Numerous articles in other newspapers have mentioned this recent phenomena -- that teens prefer receiving a gift card over receiving cash. Part of the increase in the use of plastic relates to comfort with things electronic, such as ATMs. And to foster this attitude, card companies have been running television advertisements



showing how cards make the payment process faster and the “odd person out” is the one using cash.

Bob Skiba, Executive Vice President and general manager of *Comdata*, noted that the demographic sweet spot for gift cards is the 18 – 29 age group and that among teens there was a 77% increase in the number of gift cards purchased this year from last year (7.6 cards vs. 4.3 cards) and that remarkably 89% of teens will spend more than what is loaded onto a gift card.¹⁶ Chris Truelson, Senior Vice President of Product, Marketing & Business Development for *TSYS Prepaid*, mirrored that statement by reporting that “in the 18-34 age range, 41% of this group considered prepaid as a preferred payment type.”¹⁷

When Implementing Expanded Distribution Points, Several Restaurants Have Experienced Measurably Significant Gift Card Sales Growth

As mentioned, several industries have experienced significant growth in gift card sales, notably restaurants and merchant stores. In a recent *Brinker International* quarterly report (Brinker operates more than 1,100 restaurants including *Chili's*, *Romano's Macaroni Grill* and *On the Border*), strong company growth was attributed to its shift from paper gift certificates to stored-value gift cards. Sales topped \$101 million, representing a 30% increase over their prior fiscal year. Although the majority of gift cards were sold to customers visiting their restaurants, a growing number were purchased through third-party retailers and online corporate sales. Their strategy -- to expand these points of distribution -- resulted in \$36 million in sales during the holiday, for an impressive 62% increase over the prior fiscal year by increasing their methods of distribution.¹⁸

Other restaurant owners have also shown impressive sales in their gift card programs, even though the restaurant staff may be preoccupied with their duties pertaining to serving restaurant patrons. In a *RestaurantOwner.com* survey, they found that the average gross gift card revenue was over \$14,000 per respondent, the median amount of additional revenue reported was \$5,000, and 21% of their restaurant gift cards were reported as being unredeemed.

Experts Say the Gift Card Market Still Has Room for Significant Growth

With all this growth in sales and widespread consumer adoption, it would seem that the market has reached a saturation point. However, according to *Prepaid Media* in a June 2007 report, industry officials consider the retail gift card market penetration to be embryonic, with usage reaching only about four percent of all payment types – leaving significant room for growth. *Mercator Advisory Group* and *The National Retail Federation* have also stated that the gift card market is expected to experience significant growth for several years. With the potential for greater market penetration, providers are exploring new distribution channels and enhancing gift cards with added functionality and appeal, resulting in a continued evolution of the product.



Prepaid Market Issues

Key Concepts

- Consumers are more likely to acquire gift cards if they are more widely available, especially if the card comes with a coupon that the purchaser can use when it is purchased for someone else.
- Prepaid cards are exploding (especially gift cards) with over 90% of volume being in-store cards. Merchants love them for future sales and breakage. Merchants hate them for checkout disruption and purchase clutter at so-called in-store malls.
- There are limited distribution channels and current channels have experienced increased fraud.

The outlook for gift cards appears bright but there are two significant issues that could seriously threaten the industry's full growth and profitability.

Distribution Issues

The first of these involves card distribution. There are three ways that a consumer can acquire a gift card:

1. Visit the retailer and purchase the card in an over-the-counter transaction (most widely used).
2. Purchase a card over the Internet at the retailer's website (accounts for 20 percent of gift cards purchased).
3. Search through one of the gift card j-hook malls (featured below) established by *BlackHawk Network* in a supermarket or convenience store.

While purchasing a card directly from the merchant is most widely used, the transaction process for many merchants – especially restaurants – is time consuming and distracting. In a restaurant, for example, store managers dislike the interruption such purchases have on wait staff and bartenders as it hinders faster table turnover. While such merchants like the benefits of the card, there is hesitancy to promote the gift card as it is a distraction to fulfill the sale. In many cases, store managers only support the program in response to customer requests – much as was done in the day of paper gift certificates.

The j-hook mall is *BlackHawk's* answer to providing wider distribution. As a division of *Safeway Stores*, *BlackHawk* distributes gift cards on behalf of merchants and other entities via, in many cases, mammoth j-hook displays in supermarkets, convenience stores and service stations. Such retailers are offered the opportunity to set up gift card malls and share in the distribution fees that *BlackHawk Network* charges a commission to retailers and manufacturers whose gift cards they distribute.

Placement of a company's gift card on the mall display is much like product placement on a grocery store shelf with over a dozen rows and columns of cards. The customer selects the card and then takes it to the check-out counter to make the purchase. This process adds to the amount of customers waiting in the check out line and can increase wait time. Information from *National In-Store Research* shows that one in ten shoppers leaving a store without making a purchase cited the *wait to check out* as a factor in their



decision not to buy and notes that customer satisfaction levels, when forced to wait in line in excess of 4 minutes, fall below 80%.¹⁹ With more merchants focusing on the customer experience, merchants are increasing their awareness of these customer issues and the successful ones focus on doing everything possible to maximize a positive experience tailored to each customer.

Security Issues

The second key issue concerns *security*. Fraud is rapidly rising. Crooks are able to scan and record the card's serial number from the j-hook package and rerecord the number on a magnetic stripe of a previously purchased card. They merely wait until they know that the card with the stolen number was purchased and then begin spending. This is particularly attractive for stores with high value merchandise like *Home Depot*. We could not find any publicly available figures that attribute the size of such losses, although according to *Comdata*, 62% of gift card losses are attributable to dishonest employees, 13% to counterfeit or skimmed cards, and 13% to stolen cards.²⁰

In March of this year, *PRNewswire* indicated that two recent fraud breaches highlight the need for tighter controls on prepaid gift cards and increased protection from debit skimming. The first fraud fallout from the *TJX* fiasco was foiled at a *Wal-Mart* near the University of Florida in Gainesville as a ring of thieves from Miami were apprehended attempting to use gift cards which were converted from stolen *TJX* credit card account numbers. It is estimated that up to \$8 million in cards were loaded on gift cards purchased at *Wal-Mart* and *Sam's Club* retail locations in Florida. The full scope of the impact has not been fully determined outside of the state of Florida.

To counter this trend, *BlackHawk Network* and larger retailers are spending large sums to better secure card packaging, restructuring encoded serial numbers with check digits and other encryption techniques, and instituting more complex checkout procedures – all adding to the cost of distribution, increasing checkout time for the seller and the receiver, and increasing product control costs.

Despite these issues that could seriously threaten the growth and profitability of prepaid cards, merchants are seeking ways to meet continually rising consumer demand. "As gift cards increase in popularity, retailers are looking for more convenient ways to sell them," said Phil Rist, Vice President of Strategy at *BIGresearch*.²¹ Distribution will be a key issue for large and small merchants. *Mercator Advisory Group* predicts that even the largest merchants will eventually partner with distributors for their gift card sales and that consolidation has already occurred.²² Firms like *First Data*, *TSYS Prepaid*, *eFunds*, and others demonstrate how the scale economies enjoyed by specialized processing organizations may bring the costs down in the industry. As industry participants enhance features and incorporate other innovations, prepaid gift cards move one step closer to achieving their potential as a transformational financial services product.



ATMs

Key Concepts

- *The ATM market is flat in mature markets.*
- *Consumers perform more transactions at ATMs than at any other delivery channel.*
- *Advanced ATM functions are needed and are already supported at existing ATMs.*

ATMs are an important part of everyday life. According to the ATMIA, ATMs are the main distribution channel for humanity's favorite form of payment (cash).²³ The first ATMs were installed to provide consumers with the convenience of 24/7 transaction service and to create a more cost-effective transaction for financial institutions. Eventually, ATM networks formed, and a new factor entered the equation: the ATM could generate revenue through interchange fees. This gave rise to the ATM ISO (independent service organization).

The ATM market's rapid growth to around 400,000 ATMs demonstrates that Consumers are willing to pay for convenience. Roughly two-thirds of the 400,000 ATMs are operated by ISOs and merchants that account for a majority of the 27 million daily transactions at ATMs. The most popular ATM transaction continues to be cash withdrawal, and the typical lifecycle of a unit is 7 to 10 years.

Half of All Adults Use ATMs Regularly

According to the *American Banker's Association*, more than half of all adults use ATMs regularly, with 40 percent of them visiting ATMs at least 10 times a month. That can equate to a lot of foot traffic and revenue for retailers and ISOs that make good ATM placement decisions.

Behavior research further indicates that 78 percent of American consumers regard ATMs as very important to their everyday living (compared to 56 percent for email) and finding a convenient ATM can be easy, considering that there is one ATM for every 284 American households.

In studying which consumers typically use ATMs, an *American Banker's Association* 2006 survey found that 26% of 1,000 respondents used the ATM over other forms of banking and that in the 18 to 34 age group, one-third preferred to use the ATM; while in the 35-54 age group, 27% preferred to use the ATM over any other method of banking. A *Javelin Strategy & Research* report produced even more striking results when they reported that throughout the 12 months leading up March 2007, among bank customers between the ages of 18 and 29, "80% used an ATM."

ATM Market Issues

It's no secret that the U.S. ATM market in recent years has been relatively flat. The advent and growth surge of prepaid gift cards and greater use of cash back options at retailers are key contributors. Industry experts estimate a decline in the number of deployed ATMs as a result, despite the fact that consumers perform more transactions at ATMs than at any other delivery channel. This demonstrates that ATMs are made to



handle greater volumes of transactions, but with recent declines in per ATM transaction volumes, ATMs are currently underutilized as a delivery channel.

As early as 2004, findings from the *ATM Deployer Study* showed the industry at a crossroads. ATM deployment growth was outpacing transaction growth, resulting in the declining per-ATM transaction levels. Declining revenues, coupled with fixed or increasing costs driven by regulatory requirements (e.g., Triple DES) and increased rent and cost of funds, have been putting increasing pressure on ATM deployers and ISO's to make a profit. Deployers currently earn an average of \$1,104 per month at their on-premise ATMs, and \$1,013 at their off-premise ATMs. On the expense side, deployers incur average monthly expenses of \$1,444 per on-premise ATM, and \$1,450 per off-premise ATM, although there is significant variation between deployer segments.²⁴

As a result of these declining profit margins, the ATM industry is in search of a new model, but not one that entails a dramatic change for the consumer. "ISOs don't want to move away from ATMs. What they really want is an ATM that does more things," according to Hamed Shahbazi, chairman and chief executive officer of *TIO Networks Corp.* "The core application of cash dispensing isn't as profitable as it used to be."²⁵

Consumers Respond to Convenience

The factor driving the desire to expand services at the ATM is that consumers have shown that they will respond enthusiastically to the convenience of anytime, anywhere financial transactions. But the question to ask is whether a channel dependent on transaction revenue can really sustain itself... if that revenue stream dwindles. The obvious answer is "probably not, *unless that channel makes some fundamental changes.*" As financial institutions begin to rationalize their self-service channel for the realities of the future, the first challenge will be to define the role that the ATM will play within the complex retail delivery environment that is becoming the new reality.

Over the last two years, the search for a new model has prompted many deployers to re-evaluate the role of the ATM. Financial Institutions continually operate their ATMs at a loss and are looking for new ways to reinvent and revitalize their current network. ISO's are being squeezed by falling profit margins from decreased transaction volumes coupled with increased costs of rent, servicing contracts, cost of funds, and are looking for alternatives to generate revenue. Patty Hayward, Senior Analyst of the Debit Advisory Service for *Mercator Advisory Group* indicates that the US ATM market is stagnant: "As the US market contracts with less ATM's shipped in 2006 and the number of transactions per ATM falling, the industry must take a look at what is on the horizon. The market is clearly changing at a rapid pace, but why are ATM's not taking on any new roles?"²⁶

What it really comes down to is this: Is the ATM purely a cash dispenser, or is it a strategic customer delivery channel? How deployers answer that question underpins their ATM strategy, and determines how they manage their ATMs — from how many ATMs are deployed, to the locations where they are used along with the functionality they support.

Advanced Functions Needed

In light of the growing trend in self-service, industry efforts to expand and enhance the utility of U.S. ATMs are underway. Retailers have sought to combat the decline in



transactions through the implementation of ATMs with advanced functions, such as the ability of the ATM to immediately accept, scan and clear deposited checks, which was recently introduced based on the new "Check 21" capability by the *National Automated Clearinghouse (ACH)*. Advanced-function ATMs open up the opportunity to generate increased revenue and profit in the same small footprint that currently supports ATM transactions only, said one expert.

When it comes to advanced functions, ATMs were already designed to contain technologies that enable the self-service channel to become a productive point of contact for a large number of financial products and services that were previously considered impractical. Now that IP communications have been standardized and Services Oriented Architectures can facilitate the connection of self-service to other delivery channels, an avenue has been provided that can include a wide range of products and services that might otherwise have been unavailable at the ATM. Yet, despite these enhancements to ATM and IT technology, few financial institutions have incorporated this technology to increase the utility of the ATM beyond the capabilities that were introduced 35 years ago. As cash withdrawals have been the main thrust of the ATM's utility, one can not underestimate the ability for this channel to deliver other products and services and in providing a satisfying consumer experience.

ATM Market Opportunities

Key Concepts

- *Merchants are more likely to have an ATM at their locations if they can dispense cash and their own gift cards and gift cards of others.*
- *Consumers trust ATMs over other forms of self-service.*
- *Due to its very nature, processing costs for self-service are significantly lower than having attended service.*

Dispensing of prepaid cards via the cash tray of ATMs – especially the merchant's own ATM -- is another distribution alternative with attractive benefits. *ATMs have proven to be the most secure, trusted, and cost effective means to distribute cash while being more convenient to consumers and would bring those desired features to gift cards.* Consumers understand how to use ATMs and appreciate their location convenience. Merchants would appreciate that their gift card could be dispensed from their own machine more securely and cost effectively than prevalent time-consuming and expensive over-the-counter means -- the merchant need only replace sold card sheets into the ATM's cassette when inventory runs low (existing cassettes can hold between 400-800 gift cards).

Multicassette ATMs permit the option for multiple kinds of cards to be dispensed – an attractive feature to card distributors like *BlackHawk Network* and participating retailers who would have a more cost effective means to earn distribution commissions.

It makes sense for a financial-services company to target ATM deployers. ATM players know financial transactions, from processing and equipment to deployment. "The future of ATMs and self-service terminals lies in multitasking," according to *NCR Corp.* chief executive Bill Nuti. That means self-service terminals like ATMs can provide items from cash to theater tickets and driver's license renewals. And the article mentioned that diversification will play a major role in his company's growth.²⁷ Mentioned was that Nuti is hopeful that self-service terminals will be used by consumers to pay bills, renew



driver's licenses, and buy bus and lottery tickets, gift and phone cards and even casino chips.

Scott Holt, a product marketing manager for *Tranax Technologies*, was cited as saying that the ATM is a logical host for new transactions — especially those of a financial nature — because of its longer history with consumers. "Consumers trust ATMs. I don't believe they have the same public perception of security yet about kiosks."²⁸ One expert noted that the kiosk industry wants to align itself with the ATM industry because of the ATMs successful penetration into high-traffic retail locations.

Reducing reliance on cash is also an important consideration for ISO's. According to Samantha Guthrie, president of turnkey ATM provider *Automated ATM Solutions*, a site with moderate foot traffic might need anywhere from \$6,000 to \$16,000 in cash in their machine each week. "This is a major drain on basic cash flow for the business," Guthrie said. "Plus, few owners are willing to trust an employee to load that amount of cash in the unit."²⁹ Prepaid products offer an alternative that can reduce the reliance on only cash in the ATM.

Automated Self-Service Terminals Save Time and Money for Merchants and Customers

Merchants can no longer ignore the advantages and cost savings that automated self-service terminals bring. Distribution via multi-function terminals is a recent phenomenon with some inherent advantages. According to the *Self-Service Expo*, the average processing cost of a ticket transaction is \$3.68 by an employee versus \$0.16 through a kiosk³⁰ (*an ATM's cost may be even lower*).

Regal Entertainment has been successful in its installed base of 260 Fujitsu 8000 Series terminals that dispense both cash and tickets in its movie theaters and has plans to add 250 more units, said J.E. Henry, the chain's chief information officer. The new terminals will replace 280 ticketing-only kiosks previously used by *Regal*. Since January, *Regal* customers have conducted more than 200,000 cash transactions and purchased more than 1.2 million movie tickets at the machines.³¹

When multi-function kiosks were first introduced, they were heralded as the eventual savior of the ATM world. However, these machines are both expensive (up to three to four times the cost of a cash dispenser focused ATM) and not customer intuitive. It's estimated that there are approximately 75,000 such kiosks deployed. As one industry pundant succinctly put it, "The kiosk is a square four solution in a square one world." Changes in customer behavior are too great to affect broad acceptance and use in the short-term.

Unlike multi-function kiosks that try to provide so many functions to meet a variety of applications and may even take a while for widespread consumer adoption, it has been demonstrated that when a kiosk is highly focused for a specific environment, the deployment can be immediately successful. The www.SelfService.org website features a case study entitled, *Prepaid Loyalty Card Solution Eases Customer Overload*, where *St. Clair Interactive* provided an automated solution for *Dave and Buster's* restaurants and fun centers, in order to improve customer experience and reduce labor costs for distributing and recharging *Dave and Buster's* prepaid loyalty "Power Cards." The case



study addressed how the two companies teamed to create a self-service solution that would decrease customer lines and waiting times, and also reduce labor costs. In order to develop an automated solution, *St. Clair* developed a customer-friendly interface integrated with kiosk hardware supplied by *KIOSK Information Systems*, so *Dave and Buster's* customers could buy, check and recharge their Power Cards quickly. After an initial pilot of seven kiosks, apparently it was successful, so they rolled it out to over 200 kiosks in 47 *Dave and Buster's* locations. *Dave and Buster's* IT manager said that customers were quickly adopting the self-service technology and that customer lines and staffing costs decreased. The end result was stated that *Dave and Buster's* saved \$2.1 million in fiscal year 2007 due to this automated solution for dispensing and recharging their cards.³²

As demonstrated in the *Dave and Buster's* case study, it becomes evident that when it is easier for the consumer to understand and use the technology from focused set of functions, self-service terminals and kiosks that are focused on a specific application (such as delivering financial card products) have been successful, as also proven by companies like *Livewire Kiosk* that by itself sells millions of dollars of discounted tickets and gift cards through a handful of self-service kiosks each year.³³

The Self-Service Evolution

Key Concepts

- *Customers are driving self-service.*
- *Consumers want the ATM to do more and gift cards are highly regarded as an additional feature.*
- *The ATM is the most secure and economical means to dispense and can more securely, efficiently and profitably distribute gift cards than the J-Hook method or over the Internet.*

The ATM is the most well-known unattended self-service terminal and consumers perform more transactions at ATMs than at any other delivery channel.

According to *IHL Consulting Group*, "When it comes to paying for goods and services, consumers continue to take matters into their own hands." The group found in a recent study that North American consumers are on pace to spend more than \$525 billion at self-checkout lanes, ticketing kiosks and other self-service machines in 2007, which represents a 16% increase from the \$438 billion spent in 2006. "We expect that expenditures made at self-service kiosks will rise by about 20 percent this year and another 18 percent in 2008," according to Greg Buzek, president of *IHL Consulting Group*. "Demand for self-checkout systems and other kiosks should push the dollar value of transactions to nearly \$1.3 trillion by 2011."³⁴

New technologies make it possible, for the first time, to reach those individual customers with individual experiences. "Retailing has changed from a product-centric business to a customer-centric business," stated Jeff Collard, president of digital signage company *Omnivex*. "Shopping is now a user experience where services and products must be built around individual customers."³⁵ Self-service is demanding a new look when it comes to the design of in-store experiences. Rufus Connell, research director of information



technology for business research and consulting firm *Frost & Sullivan*, mentioned that perhaps the most consistent factor for success is that a kiosk delivers one primary function for the end-user.³⁶

Customers Are Driving Self Service

In a new research summary about product adoption produced by the **American Association of Advertising Agencies**, the innovations that were considered the best as “home runs” were those innovations that offer great technological improvements with limited behavior change. Dispensing a gift card from an ATM meets this criteria, as existing ATM self-service customers wouldn’t be required to undergo a significant behavior change, while this offers a technological improvement that is in demand by a lot of consumers. A *Comdata* 2007 survey confirms this, in that *53 percent* of adults say they would be very or somewhat likely to purchase a gift card at a kiosk or cart at an airport or shopping mall.³⁷ With a high adoption rate, instead of the ATM being a financial liability, the ATM that dispenses cards and cash can become an asset to consumers and merchants alike.

NCR CEO Bill Nuti was quoted that a new “customer-driven self-service movement” is taking shape, driven by three converging technology developments: self-service automation, the Internet and mobility. “Integration of the three will be key to reaching customers.” Consumers have fueled the growth of self-service, as evidenced by 2006 data. Last year, individuals booked 560 million plane tickets, rented 600 million DVDs, printed 8.8 billion digital prints and purchased \$300 billion in goods and services, all using self-service technologies. Self-service is expected to account for 58 percent of all customer service interactions by 2010, up from 35 percent in 2005, according to recent research.³⁸

Other research about the popularity of self-service shows that *71 percent* of 18- to 24-year-olds prefer self-service terminals, and *64 percent* of 25- to 34-year-olds prefer self-service terminals (from the *National Restaurant Association*). More than *94 percent* of consumers have used self-checkout, and *40 percent* of consumers who have used it say they “really like it,” while 27 percent of consumers use self-checkout more than 70 percent of the time (from *IHL Consulting Group*). An *Opinion Research Corp.* survey of consumer attitudes found that *43 percent* of respondents say they have chosen one provider of goods or services over another because it offered *self-service*.

Two Industry Leaders Have Self-Service Gift Card Distribution Underway

Industry giants *Elan* and *Tranax Technologies* have presumably analyzed the market data for unattended gift card sales from a self-service terminal and are now dedicating resources to distributing gift cards.

Elan Processing, the transaction processing subsidiary of *US Bancorp* and third largest ATM driver in the country, plans to launch a kiosk that will dispense prepaid cards in merchant locations as well as in financial institutions. *Elan* will begin testing the kiosk system, called *Pass Plus*, in the next few months. The system will be designed to dispense prepaid cards, according to *Elan*. Plans are for the kiosks also to provide check-



cashing, bill payment and ATM cash withdrawal functions.³⁹ No other details were found at the time of writing this report.

Tranax Technologies is the nation's third largest ATM manufacturer with over 90,000 ATMs deployed in North America. For automated gift card dispensing, Tranax offers the *Mini-Bank 4000* coupled with a sidecar gift card dispenser. Tranax's objective is to transform the ATM from a cash dispenser into a "bank-in-a-box," by providing a full range of banking services to the "unbanked," such as bill payment, check cashing, money transfer, pre-paid calls, cell phone top off, depositing of checks, ticketing for major entertainment and sporting events, and dispensing cards for pre-paid gifts through a side car containing up to 100 gift cards. According to company president Hansup Kwon, "With more self-service, comes greater consumer demand, especially in the financial-services space."⁴⁰ The article mentioned that the market is more advanced now than it was even four years ago, and financial institutions and retailers who jump aboard now will quickly attract a loyal following.

With industry leaders *Elan* and *Tranax* newly involved in the dispensing of gift cards, although both solutions will require investment into new machines and/or equipment, it will be interesting to follow their developments and see the level of success they achieve.

Conclusion

Experts estimate that 624 million retail gift cards were purchased during 2005. Industry officials consider retail gift card market penetration to still be "embryonic," reaching only about four percent of all payment types – leaving significant room for added distribution and growth. Analysts may differ on growth patterns, but generally agree that added distribution will need to take place in order to satisfy expanding demand in a market that is growing by an additional 34 to 51 million gift cards per year, and that this growth will continue for the foreseeable future.

Experts are also saying that a new "customer-driven self-service movement" is taking shape. This is evidenced by expectations that consumer spending will grow to \$525 billion at self-checkout lanes, ticketing kiosks and other self-service machines in 2007. The *Opinion Research Corp.* survey findings that 43 percent of respondents have chosen one provider of goods or services over another because it offered self-service seems to confirm that consumers want the added convenience of self-service.

The companies that sell gift cards through a terminal seem reluctant to provide specific sales data to the public, which makes it difficult to determine current market penetration. Our private research concludes that only 2 percent of gift card purchases are done through self-service terminals, even though industry-leading survey data indicates that *53 percent* of adults say they would be *very* or *somewhat likely* to purchase a gift card at an unattended terminal. This could indicate a specific market niche that is still in its infancy (in a market that is considered "embryonic"), and this niche could be poised for significant growth by tapping into current marketplace trends.



Industry leaders, *Elan* and *Tranax Technologies*, see value in dispensing gift cards through an unattended terminal and have devoted significant resources to bringing new machines to market for ISO's that want to deploy these specialized machines.

A New Emerging Technology

An emerging gift card dispensing technology is also already being used in the market – this technology enables ISO's, merchants, and ATM driver/processors to use their existing ATMs to dispense gift cards and cash through their current mechanisms. *Better ATM Services* (<http://www.betteratm.com/>) doesn't compete with anyone, but rather enables all participants in the ATM channel to retain their current relationships and pricing models, while adding the capability of dispensing gift cards (along with cash) from their existing ATM's cash tray, which can hold from 400-900 gift cards. The gift cards are dispensed *just like currency* without any per-item transaction fees to disrupt current pricing models and client relationships; enabling ISOs, processors, merchant card providers, ATM manufacturers (who desire to sell more multiple-tray machines) and ATM driver/processors free to structure their offerings, set their own pricing and compete as they do today.

According to an *ATM Marketplace* feature on future trends, "Consumers will now have another, more convenient, option to obtain a gift card... both consumers and merchants avoid over-the-counter purchase hassles and check-out time delays. Merchants will appreciate the cost-saving features from lower labor costs that automation brings, including greatly reduced theft worries, enhanced gift-card promotion, and better service to customers for conveniently obtaining both cash and gifts cards."⁴¹

The ability to quickly expand the utility of existing deployed ATMs, by dispensing gift cards and cash, without the need for additional equipment, has recently generated a lot of interest in the ATM industry and may set a new standard for retailers wanting an automated gift card solution through their retail ATMs. The following appeared in a September 24, 2007 article by David Breitkopf in the *American Banker*:

H. Leon Majors 3rd, the president of the payments research group at *Phoenix Marketing International* in Rhinebeck, N.Y., said the market is still undecided about whether ATMs should offer advanced financial services. Some ATM operators want to offer new types of transactions, because "those machines are very much at the mercy of cash usage, which is falling," Mr. Majors said. "Here is something you can add on that will give you some incremental transactions, so you're not completely at the mercy of failing cash."⁴²

The retail ATM is entering a new phase. For merchants, an increasing consumer demand must be met with the ability to provide the best ATM services. Merchants that can provide those services will play a leading role in shaping consumer habits. Dispensing a gift card from an ATM cash tray offers a product that is in high demand by a lot of consumers, while allowing the time-place-value convenience offered by an unattended 24/7 terminal.

To this end, for those considering prepaid programs, experts are recommending not to wait for a "winning strategy" to come along. In the world of emerging payment systems, you have to create your own.



Acknowledgments

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Also, special thanks to Mike Lee, CEO ATMIA (www.atmia.com), for providing editing help along with pertinent information and facts from ATMIA's July 2007 whitepaper on the many benefits of ATMs. Interestingly, while the U.S. ATM market is flat, Mike's research indicates that there is considerable global expansion of ATMs -- with one new ATM being installed somewhere in the world every 6 minutes. The forecast by RBR for end 2007 is 1,731,200 ATMs in the world, compared to 1,644,065 at end of 2006. Global growth was 6.4% last year according to RBR, which presents a growing worldwide channel for currency dispensing, along with additional opportunities to explore distribution of prepaid products through this growing global ATM network.