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Meeting the demand

With rosy forecasts ahead, payment processors are tuned to servicing prepaid products

by: **Richard Mitchell**

Few payment instruments are undergoing as much expansion – and success – as prepaid cards. Also known as stored value, these magnetic stripe products are being distributed by thousands of retailers and financial institutions to enable users to initiate purchases at the point of sale (POS) and withdraw funds from ATMs by electronically accessing funded accounts linked exclusively to the card.

The rapidly growing base of issuers and acquirers are being lured by the promise of lower processing costs, greater income and a tighter relationship with customers. Third-party processors, meanwhile, are upgrading and fine-tuning their prepaid products and services to meet the varied demands of a growing customer base.



Gift cards are perhaps the most recognized – and popular – prepaid instruments, but a variety of stored value applications in both closed- and open-loop systems also are becoming prevalent. More businesses, for instance, are issuing prepaid cards to employees in lieu of checks; foreign-born workers are using cards instead of wire transfers to provide funds to relatives outside the United States and healthcare organizations; and government departments are positioning cards as vehicles for distributing benefits.

Major payment organizations, including Visa USA Inc., MasterCard International Inc. and American Express Company already support a multitude of prepaid applications and expect to launch additional

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products over the next few years. Visa, for instance, has identified more than 35 potential product types, including workers' compensation, employee relocation and petty-cash applications.

This enhanced focus on prepaid by payments organizations, merchants and vendors will trigger a surge in transaction volume over the next several years, analysts predict. Aite Group LLC, a Boston-based research firm, estimates that annual consumer spending on prepaid cards will reach \$257 billion by 2009, up from \$63.4 billion in 2004.

And the growth opportunity still is tremendous. Aite reports that personal consumption expenditures in categories targeted by prepaid issuers totaled \$2.3 trillion in 2004, yet the application accounted for just 2.7 percent of sales. By 2009, prepaid spending will account for only 8.6 percent of a \$3 trillion personal-consumption market, Aite projects.

"Prepaid is hot, and it will continue to grow because large spectrums of companies are getting involved in programs," says Ariana-Michele Moore, senior analyst for Celent LLC, a Boston-based research and advisory firm.

Such participants range from small merchants in closed-loop programs who distribute gift cards that can only be redeemed in their stores, to financial institutions in open-loop systems that issue Visa- and MasterCard-branded products for use in all locations that accept the associations' credit and debit cards.

"As additional issuers and acquirers adopt prepaid to round out their payment card offerings, they will need the services of vendors who are capable of supporting a wide variety of products," Moore says.

Technologies behind the trend

Many of those processors, meanwhile, already are implementing technologies that are designed to make it easier for retailers, independent sales organizations (ISOs) and financial institutions to launch and manage programs.

"There is much jockeying by processors for future business, especially for payroll- and employee-related types of relationships," says Steve Mott, principal at BetterBuyDesign, a Stamford, Conn.-based consulting firm, and the former vice president of electronic commerce for MasterCard International.

Mott notes, however, that many established processors aren't prepared to support all the applications that are starting to gain traction. "It will take a while for many large vendors to configure their processing systems, and most would prefer to let other companies get the kinks out of the technologies first," he says. "Many of the newer prepaid applications initially will be supported by the smaller firms that are then likely to be acquired by major processors."

Application development

In the meantime, leading payment processors are focusing on the most prevalent applications. Nova Information Systems Inc., an Atlanta-based credit card processor, primarily supports prepaid cards that are used for recurring closed-loop transactions in retail locations, including movie theaters, ice cream parlors and video arcades. Among the acquirers are operators of a regional landfill in St Louis County, Minn., who charge consumers for trash deposits at the site, and by Oil Changers, a 36-store chain in California, that distributes cards that contain credits for oil changes.

The vendor offers a variety of products that are designed for different-sized merchants. Small mom-and-pop stores, for instance, can launch 100-card programs and pay just \$29 a month for card issuing and processing services, says Michelle Graff, Nova vice president of marketing.

Companies with larger volumes are able to leverage higher-end packages that often include custom card designs featuring a merchant's logo or other artwork; bulk activation, in which hundreds or thousands of cards can simultaneously be loaded with value; and premium reporting capabilities, which allow cardholders to check their card balances via the internet.

Nova also offers direct settlement services that enable large franchisors to easily settle funds between franchisees. The processor, like many other large third-party vendors, is achieving greater economies of scale, resulting in lower processing costs, by integrating prepaid into a system that also supports credit, signature and PIN-based debit, electronic check services and other ancillary payment applications.

Transaction fees for large merchants typically range from 20 to 25 cents, and processing rates usually are lower for retailers that bundle prepaid with other Nova services, Graff notes. Prepaid transactions are initiated at the same merchant terminals that also accept credit and debit cards, and Nova offers consolidated reporting and funding for the various applications.

By supporting prepaid, vendors can display more attractive product menus and are better able to retain retail and bank customers, she says. "Merchants often view credit card processing as a commodity, but it becomes much harder for the retailer to leave a relationship when gift-card support is added because of the extra value," Graff notes. "It creates stickiness and builds loyalty."

She adds that the main challenge in marketing prepaid is getting retailers to understand the value of the application. Graff says merchants should be encouraged to study their entire return on investment from prepaid instead of just focusing on transaction fees. For instance, she notes that most retailers are unaware that the majority of consumers who initiate gift-card purchases often spend 25-percent more than the value on their cards in stores.

Many vendors, meanwhile, are working to expand the base of prepaid cardholders by making it easier for consumers to purchase products and add funds to their accounts. Greenwood Village, Colo.-based Western Union Prepaid, for instance, a unit of Denver-based First Data Corp., is selling reloadable MasterCard-branded products at about 4,000 Western Union locations across the United

States. Customers are charged \$14.95 for the plastic and must load at least \$5 worth of value when buying a card.

Cardholders can initiate purchases at millions of worldwide locations that accept MasterCard, and add value at more than 50,000 Western Union offices. Consumers pay \$3.95 for each reload. A maximum of \$950 can be added to an account each day, though balances cannot exceed \$2,500.

The Western Union Prepaid MasterCard is issued by Winter Park, Fla.-based BankFIRST, and transactions are processed by Western Union's sister company, First Data Prepaid Services. Western Union expects to enhance the product's value by gradually attaching additional services to cards, such as phone time, bill payment and money transfer applications. The newer apps will be tested in 2006, says Linda Priestap, senior vice president and general manager of Western Union Prepaid.

Unbanked consumers and persons who are unable to qualify for credit cards are among the key customer segments being targeted by Western Union. Such individuals already are frequent users of Western Union's money transfer services. Products will be promoted via direct mail and online advertising.

"The biggest obstacle in marketing prepaid is dealing with consumer confusion over how the product operates because it still is a relatively new category," Priestap notes. "But the popularity of the closed-loop gift card is helping to generate awareness about open-loop systems."

Because consumers are sensitive to program fees, she says it is important for issuers to consistently upgrade their prepaid products. "As awareness grows, consumers become savvy and will shop around for the best deals," Priestap adds.

Another First Data company, Englewood, Colo.-based ValueLink LLC, offers a wide range of services and applications for closed-loop gift-card programs. The vendor provides end-to-end solutions that include transaction processing, card design and production, help desk support, value-added marketing and internet products. Web tools include a plug-and-play application that integrates into retailers' electronic commerce systems and enables consumers to purchase prepaid cards electronically.

"Consumers who buy online are typically the stores' best shoppers, and they tend to purchase more cards with higher denominations," says Karen Larsen, First Data Prepaid Services vice president of marketing. To enhance card marketing, First Data tracks consumer behavior in relation to gift cards, including their spending patterns, awareness of applications and the amount of value typically held in accounts. The vendor then shares the data with its merchant customers so the retailers can refine their programs in accordance with shoppers' needs, Larsen says.

ValueLink operates an integrated POS system that supports credit, debit and prepaid transactions from a single card reader. The processor also will situate standalone gift-card terminals for customers that are not equipped to handle multiple applications. Such segments often include quick service restaurants and smaller

merchants, she notes.

Systems also can be configured to enable cardholders to check their account balances at the point of sale, via a voice-response system or through the internet.

While merchant pricing varies based on volume, Larsen says fees usually are pennies per transaction. "Lower stored-value pricing is triggering participation among the smaller retailers," she notes. "A decade ago it was not realistic for many of the merchants to have gift card programs, but now it is more affordable."

ValueLink already is developing programs that will support real-time currency conversion; contactless card applications at the point of sale to reduce transaction times; and the identification of customers by their fingerprints rather than cards for greater security.

Eye on the future

Larsen says ValueLink is achieving double-digit annual growth and expects the expansion to increase as more apps are added to cards. Larsen adds that deciding which of the many prepaid opportunities to pursue is perhaps the greatest challenge for processors. "Many of the ideas for new card uses are coming from the consumer, and the biggest difficulty is picking the most compelling and relevant product innovations to work on," she says.

Other processors gearing up to support new applications include Elan Financial Services and Genpass Inc., subsidiaries of Minneapolis-based U.S. Bancorp. The organizations, which provide prepaid, ATM and debit card services to financial institutions, ISOs and retailers, are integrating their payment platforms to provide more robust processing and achieve greater economic of scale, says Dominic Venturo, senior vice president of product marketing for Elan and Genpass.

Elan last year launched a full-processing solution for gift and payroll cards that includes card issuance, settlement, web hosting, the handling of disputes and adjustments and distribution of statements. The vendor's newest product is PayCard Plus, which enables consumers to exchange their payroll checks for prepaid cards at convenience stores. Persons receive either a PIN-only card that they can use to withdraw cash from ATMs and initiate transactions at the point of sale, or a MasterCard- or Visa-branded card that also allows them to initiate signature-based POS purchases.

While consumer expenses vary based on the size and type of check, Venturo says PayCard Plus prices typically are a third of those charged by most check-cashing operations. Fees at such locations often exceed \$15. "Prepaid is a natural evolution of the payment process," he adds. "People are using cash less and trying to get rid of the complexity of the check."

PayCard Plus is just the latest in what analysts project will be a plethora of new prepaid offerings that will take hold over the next several years as more consumers are made aware of the benefits of stored value.

"Education is the most important factor for further segment expansion," says Phil Chakiris, director of financial services for InComm, an Atlanta-based independent sales organization that markets prepaid services to retailers. "As more cards proliferate at merchant locations, additional consumers will notice the products and the expansion trend will continue."

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