THOUGHT LEADERSHIP

VIEWPOINT

Payment Processing Trends – Part 3: The Promise of Prepaid Cards

By Bala Janakiraman

BEST PRACTICE BRIEF: Payment Processing Trends – Part 3: The Promise of Prepaid Cards By Bala Janakiraman

In Part 1, Jason Pavona looked at select populist (e.g., the rise of the "credit cautious" consumer) and political influences (for example, the Durbin Amendment,) in 2010 and their implications for direct marketers in the coming year. In Part 2, Bala Janakiraman discussed how direct marketers have the ability to effectively "unlock" data stored within a transaction. Capturing information at the time of authorization enables them to adjust their sales approaches to the needs and spending patterns of consumers. This construct of intelligent or "smart" authorizations has the potential to generate additional sales in the short-term while providing longer-term opportunities for targeted marketing campaigns that enhance customer lifetime value.

The Prepaid Industry at a Glance – 2011

In spite of an economy that is still experiencing what is perceived in many circles as a "jobless recovery,"[1] prepaid credit and debit cards continue to grow in popularity. There are many reasons for the uptick, several of which have direct implications on and for electronic retailers.

At the 10,000-foot level, prepaid cards reflect the politics of inclusion (i.e., they are readily available to anyone, in any demographic and virtually for any reason); they are also unique in their ability to assimilate individuals for whom prepaid cards literally serve as lifelines.

Industry research supports this stratification. For example, according to a 2009 survey by the Federal Reserve Bank of Boston[2] nearly one-third of consumers own some kind of prepaid card.

Reloadable prepaid debit cards (e.g., those that allow you to spend up to the amount you have pre-deposited into the account), represent one of the fastest-growing segments of the financial services industry. According to independent research commissioned by MasterCard®, the total value of branded prepaid cards is expected to exceed $440 billion by 2017.

And, thanks to the influence of banks, the value of prepaid cards continues to climb. With regulatory curbs placed on overdraft programs and the Durbin amendment threatening to place restrictions on the income banks with assets above $10 billion can earn on debit interchange, many banks are considering replacing free checking accounts with general purpose, reloadable prepaid cards. This shift is made even more significant as reloadable prepaid cards have become both depository vehicle and economic on-ramp for the so-called unbanked and underbanked.

Moreover, prepaid trends, regardless of economic climate, will continue to shape the card acceptance experience for electronic retailers for some time to come. Indeed, as this article unspools, I hope to be able to assert this proposition—the deeper the dive into the "inclusion" factor, (e.g., converting every prepaid card carrying consumer into a customer, regardless of transaction type), the easier its translation and applicability to all consumers.

Barring unintended consequences of the Durbin amendment, it is likely that banks will continue to sell prepaid cards and consumers will continue to adopt prepaid cards for payments. As a result, online merchants can expect to see increasing usage of prepaid cards at checkout. This brings up the question of how to manage prepaid payments without impacting conversion and consumer lifetime value while taking advantage of emerging trends such as social giving.

Gift Cards & The Rise of "Social Giving"

Prepaid cards are not only about inclusion. They are also very much about choice. This bifurcation (or division) between open and closed-loop cards ultimately presents sales opportunities for electronic retailers closely matched to the needs of consumers and the type of prepaid card they're using.

In distinguishing between open loop (consumer, corporate incented and payroll) and closed loop (gift) cards The Mercator Advisory Group, a market research firm based in Maynard, Mass., estimates that the total dollars loaded onto all prepaid cards will grow 19.5 percent from $384.8 to $460 billion in 2011[3].

Much of the growth in the open loop market will be from general-purpose reloadable cards, consumer incentive cards, social security, unemployment and other government load cards, as well as corporate incentive cards. For the open loop sector, Mercator predicts a compound annual growth rate of 47.9 percent between 2006 and 2012—much greater than the 5.3 percent predicted for closed loop cards. For open loop cards, Mercator predicts a total load volume of $292 billion in 2012 up 383 percent from $60.4 billion last year.

Open loop gift cards experienced strong growth at 54 percent to $7.7 billion. Consumer incentives cards grew 52 percent to $4.2 billion. Reloadable payroll cards grew 26 percent to $17.2 billion, while payroll cards grew 64 percent to $3.37 billion. Court ordered payment reloads grew at 64 percent to $3.37 billion.

For example, on the closed-loop side, gift cards will lead the growth no matter which way the economy goes for a number of reasons: First, if someone cannot afford to buy a friend or family member the gift the recipient truly wants, the giver can at least help defray the cost of the desired item with a gift card. Second, gift cards allow the recipient a choice of how they spend the funds on the cards. Third, gift cards retain the convenience of purchasing, ease of giving, and consumer choice that make them a desirable gift.

Technology shifts are also creating new opportunities for retailers that could also increase gift card loads. One trend that will help closed-loop cards is the growth in virtual cards that cost less to deliver and can be instantly sent to a recipient and customized in a variety of ways. Second, social gifting, which allows more than one consumer to contribute to the same gift card, will increase the loads onto closed-loop cards. Third, pairing cards with loyalty programs can make them more attractive to potential buyers. The size of the markets involved in each of these trends is hard to determine because they are so new, but these will all soon play a major role in the prepaid market as a whole.

One prepaid segment that will likely see growth in an improving economy is the payroll card segment. Mercator estimates that the payroll segment will grow 15 percent, from $22.7 billion in 2010, to $26.1 billion in 2011. Mercator notes in its analysis that this may change depending on the direction of the economy.

Another segment that will grow and compete with payroll cards is the general-purpose reloadable segment. Most major suppliers offer direct deposit as a loading option and provide incentives such as reduced fees for those who use the service. Consumers could be motivated to use general-purpose reloadable cards for a variety of reasons including bill payment, savings accounts, and portability from one job to another.

Mercator estimates the total dollars loaded onto general-purpose reloadable cards in 2010 totaled $42.1 billion, and forecasts that this number will grow by 68 percent, to $70.7 billion in 2011. Several factors will influence this segment including the economy, the adoption of these cards by consumers for budgeting purposes, and the possible use of prepaid cards as a low-end checking account replacement by financial institutions.

Along with wages paid on prepaid cards, more companies will use prepaid cards to distribute incentives and benefits both to their own employees and to customers and partners.

Make Every Prepaid Consumer a Customer

Using some real-world examples, let's examine how continuity/installment payments and one-time payments with prepaid cards are managed today.

Most continuity/installment billers do not allow prepaid card payments on their websites. Who has not heard of the example of an $800 gym membership being bought with a prepaid card where there was enough money to cover only the first of eight easy payments of $100 each? In order to avoid these losses, continuity/installment merchants periodically procure prepaid BIN files from their acquirer or some other third party data provider and load it in to their order management systems. When a cardholder attempts a continuity/installment purchase, a look up on the BIN files determines if the card is prepaid and if the card is prepaid, then the cardholder is prompted to use a different form of payment to complete the sale.

While this strategy to "filter" payments on prepaid cards worked in the past when most cards were non-reloadable, continuing to apply it with increasing adoption of reloadable cards can mean only one thing—turning away legitimate customers!

The solution here is to distinguish between reloadable and non-reloadable prepaid cards in real-time so that the website can interact intelligently with the cardholder. If the card is not reloadable, politely decline the payment and prompt the cardholder for another form of payment. If the card is reloadable, then treat the cardholder the same way you would treat a debit or credit cardholder and allow the transaction to processes normally. This will allow the retired senior citizen to complete the transaction on their reloadable prepaid card that receives social security payments. Ka-ching!

One-time payments with prepaid cards do not require any special processing unless the card is a non-reloadable card such as a gift card. Consider this: most consumers have no idea what is the remaining balance on their gift card. As a result, it is very common in the brick-and-mortar world for consumers to complete a purchase by splitting the payment using up the available balance on their prepaid card and pay for the remaining amount with another form of payment.

Why doesn't the consumer have the same payment experience in the online world? Why don't prominent e-commerce retailers allow consumers to split payments across multiple cards when this has always been an accepted practice in their physical, retail locations?

The secret to making this happen is the adoption of partial authorization in the online world. With a partial authorization, you are telling the issuer that you will accept less than the full amount of the authorization request. When the issuer sees this request on a gift card that has a $12 balance on a $25 purchase, instead of declining the transaction with an Insufficient Funds response, the issuer partially approves the transaction for the $12 amount and passes the approved amount back to the merchant. The merchant can then prompt the consumer for the $13 balance that can now be completed with a different form of payment. Ka-ching!

However the prepaid world shakes out—open vs. closed-loop, reloadable vs. non-reloadable—there is little doubt that it is in the interest of retailers both online and in brick-and-mortar locations to give every consumer the opportunity to also be a customer, regardless of how they (choose to) pay their bill, whether it is prepaid, debit or credit.

ABOUT THE AUTHOR

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Footnotes

(1) http://finance.yahoo.com/news/Jobless-Recovery-The-New-investopedia-2578071100.html?x=0&.v=1

(2) http://www.usatoday.com/money/perfi/credit/2011-01-18-prepaid18_CV_N.htm

(3) Mercator Advisory Group, March 1, 2011 Analyst: Ben Jackson