REACHING NEW CONSUMER GROUPS
THE TRANSFORMATIVE IMPACT OF GIFT CARDS

Tony Fontaine, Vice President,
Business Development, Interactive Gaming, Daily Fantasy and Lottery, Incomm
www.incomm.com

GIFT CARDS 101: A QUICK LOOK AT THE MARKET

They're ubiquitous. Walk into anywhere you shop and you'll see them; they're gift cards and according to Card Hub the gift card market is estimated to approach $140 Billion. Whether you buy them as a last resort gifting option, a convenience shopper, a card enthusiast or budget tamer, the CEB Tower Group shows that Americans purchase an average of 5 gift cards a year and spend $213.02 on them.

The consumer appetite for gift cards has grown to encompass nearly every activity that consumes America's pastime. Think of how people spend their money and you will find a gift card that corresponds to that interest. While the majority of gift cards allow the purchaser to tailor their gift towards a known interest of the recipient, Nearly a quarter of gift cards (23.3%) are purchased to be used as gifts that the recipient can use for non-specific specific purchases. These gifts end to take the form of a debit card whereby the purchaser can select a gift card with the assurance that the recipient will receive a gift that they are sure to appreciate. Debit card gifting helps remove the doubt that a person giving the gift may encounter when trying to select the right gift for someone special whose interests may be changing, or not really understood.

GIFT CARD PROGRAM CONSIDERATIONS:

The decision to offer a gift card program is one that requires a great deal of thought. Companies normally get one shot at getting or a retailer's plan-o-gram (that gift card space that may take up the end cap of an aisle, a portion of an aisle, or an entire aisle). When a company decides to offer a gift card, what considerations do they need to take into account when they are trying to define the kind of gift card program that's best for their product? What do retailer's look for when they decide whether or not?

When a company sells a gift card there are two primary factors to consider; customer acquisition and monetization. These two factors unfortunately may be at odds with each other. Customer acquisition refers to a gift card program that is designed to attract new customers to your product or services. The primary goal of customer monetization, on the other hand, is to entice existing customers to spend more on the company's products or services.

For the purpose of this discussion, let's stick with customer acquisition programs. The common fallacy of gift card programs is that by putting a gift card in retailer, the exposure alone will create success. This simply isn't true, gift cards don't acquire customers; gift card marketing does. What gift cards alone can do is be an extension of an advertising campaign, if you are willing to accept part of the costs into advertising and not customer acquisition, then there is some additional funds for gift

Gift Cards Purchase Statistics
Average Number of Gift Cards Purchased (2011)

Type of Consumer	Average Number of Gift Cards Purchased	Average Purchase Amount Per Card	Average Dollar Amount Spent Annually
Budget Tamer	6.70	$43.36	$291.72
Card Enthusiasts	6.10	$44.87	$274.82
Helpful Husbands	4.60	$42.32	$194.56
Convenience Shoppers	4.00	$441.75	$167.41
Last Resort	3.30	$40.18	$131.45
TOTAL	5.00	$42.96	$213.02

Gift Cards Consumers Expect to Purchase								
Gift Card (by Merchant Type)	2006	2007	2008	2009	2010	2011	2012	2013
Book Store	N/A	N/A	N/A	24.4%	23.7%	19.8%	20.8%	18.9%
Catalog	N/A	N/A	N/A	2.7%	3.2%	3.3%	4.2%	4.6%
Coffee Shop	N/A	N/A	N/A	13.0%	13.9%	15.9%	8.1%	19.6%
Craft Store	N/A	N/A	N/A	2.7%	3.8%	3.7%	4.8%	4.9%
Department Store	N/A	N/A	N/A	38.4%	39.2%	38.7%	39.1%	40.3%
Discount Store	N/A	N/A	N/A	16.3%	14.7%	13.0%	14.2%	14.5%
Electronics Store	N/A	N/A	N/A	18.8%	19.0%	19.8%	19.3%	20.1%
Entertainment (movies, etc.)	N/A	N/A	N/A	15.5%	14.1%	18.2%	18.8%	18.7%
Gas Station	N/A	N/A	N/A	9.3%	9.3%	11.1%	11.0%	12.0%
Grocery Store/ Gasoline	N/A	N/A	N/A	10.6%	10.8%	11.9%	12.6%	13.8%
Home Decor/ Houseware Store	N/A	N/A	N/A	3.3%	3.9%	4.3%	4.8%	4.5%
Home Improvement Store	N/A	N/A	N/A	9.8%	8.9%	9.4%	9.7%	9.1%
Office Supply Store	N/A	N/A	N/A	1.8%	2.2%	2.2%	2.6%	2.5%
Online Merchant	N/A	N/A	N/A	5.3%	6.3%	8.9%	11.2%	12.7%
Restaurant	N/A	N/A	N/A	33.4%	33.4%	33.8%	33.3%	34.2%
Salon/Spa	N/A	N/A	N/A	5.6%	6.1%	5.7%	6.2%	5.9%
Shoe Store	N/A	N/A	N/A	2.7%	3.6%	3.7%	4.7%	6.1%
Specialty Clothing Store	N/A	N/A	N/A	7.2%	6.9%	7.6%	7.5%	7.9%
Sporting Goods Store	N/A	N/A	N/A	5.4%	6.4%	6.3%	6.4%	6.2%
Visa/Master Card/ American Express	N/A	N/A	N/A	22.1%	23.8%	24.4%	24.1%	24.4%
Other	N/A	N/A	N/A	4.7%	4.6%	4.0%	3.4%	3.9%

NOTE: *The sum of the % totals may be greater than 100% because the respondents were allowed to select more than one answer.*

card marketing. This means that before a company launches a program, it must fully analyze the true customer acquisition cost in terms of advertising (reinforcing customer awareness) and acquisition (prompting the gifting impulse).

There are four basic components to a gift card program: card costs, technology and distribution costs and marketing costs. Most companies understand what their customer acquisition costs in their day to day business. But there also may be different matrices for advertising that must be accounted for. This will be very important in defining the budget for the gift card marketing program.

Acquiring a customer in a new channel should not be out of line with current customer acquisition costs, but the existing costs do not include card, technology and distribution costs. Card costs are directly associated with the kind of program that the company wants to offer. There are two basic programs that need to be assessed; open loop and closed loop. The card costs can vary significantly different between the two types of programs.

CLOSED LOOP GIFT CARD PROGRAMS: UNDERSTANDING STORED VALUE AND TRANSFER VALUE

A closed loop program is the most common gift card program offered by online and physical retailers, restaurants and entertainment venues. It is called a closed loop because the activation and redemption of the gift cards takes place on a network that connects the activation at retail and the redemption with the program provider. This network forms a loop a loop between activation and redemption, and is closed to limit redemption to only gift card program issuer; hence the term closed loop. These gift cards can't be used for anything other than their intended specific purchase purpose. If a purchaser gives a movie theater gift card to a friend on their birthday, that card can only be used at the specific movie chain. The gift card issuer contracts with a company to provide card activation, and then integrates their Point of Sale (POS) with that company to facilitate the redemption of the gift card. At the time of activation, when the consumer purchases the gift cards, the technology provider associates the amount of funds receive with that specific gift card. This is often referred to as a load, or loading the gift card. The funds which have then been loaded on the card are subtracted from the card at the time of redemption.

This all happens on a network, commonly called rails, supplied by the company providing activation. InComm is a major provider of closed loop rails. The technology provider collects the funds from the sales of the gift cards (minus the amount of commissions due to the retailer, distribution and technology fees) and remits the funds to the gift card issuer. There are two basic transaction methodologies associated with closed loop gift cards; transfer value and stored value. With a transfer value gift card all of the funds loaded on the gift card are consumed, or transferred, at the time of redemption. Once redeemed, there is no value left on the card, and the card may not be used again. The most common use of this type of redemption is to transfer funds into the program providers' wallet, which are then consumed at a later date; think online music and games.

The second transaction methodology is called stored value. Just like it sounds, the funds that are loaded on the card are kept in an account associated with that card. The recipient of the card can chose to use the funds all at once or incrementally until the funds are depleted. Once depleted the card no longer has any value (although a gift card program may be developed to support subsequent reloading of the card as well). A processor is required to keep the accounting accurate and ensure that funds are available upon redemption. The technology partner may supply this service, or a third party processor can be contracted to provide this functionality.

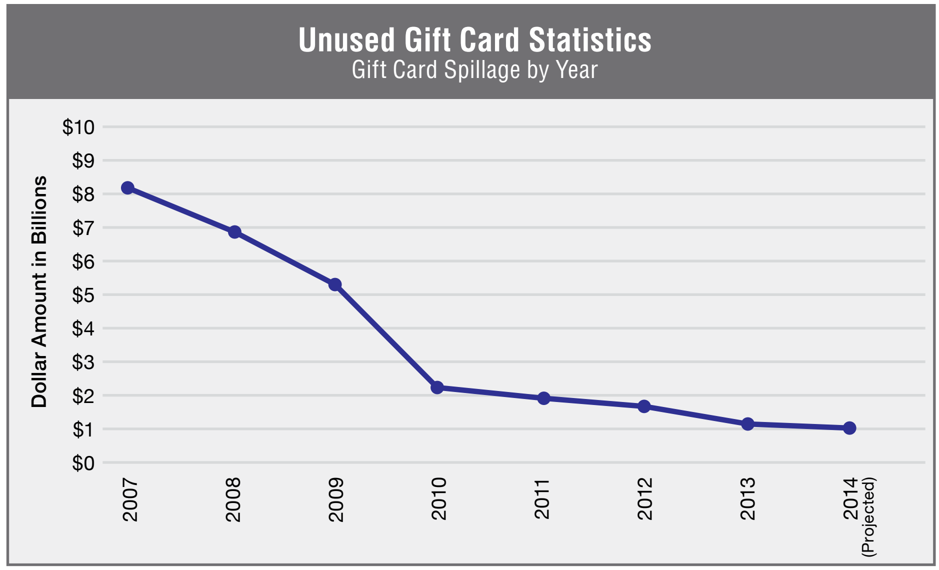
WHAT HAPPENS TO THE UNUSED FUNDS?

Both methodologies may result in unused funds left on the card. This is called breakage, or spillage. The process of uniting lost or abandoned funds with the owner of those funds is called escheatment. In the long term, gift card breakage can enhance the bottom line of the card issuer, or the state treasury depending on the escheat laws of the state. The gift card issuer is responsible for breakage, so it's very important to understand their state laws.

GIFT CARD PRICING STRATEGIES

Gift cards can be offered at many different price points, depending on the capability of the retailer's POS. A gift card is said to have a fixed denomination (or just denom) when the price of the card is set; each card is then purchased for a fixed fee. Common fixed fees are $25.00, $50.00 and $100.00. Since this means that a retailer would need to give up one peg space for each card, some retailers have the ability to offer multi-denominations on one card. This is called a select denom card. Instead of having 3 cards with a fixed denomination on each card, the consumer can select which denomination they want to purchase the card for and the card can be activated for any of the denominations listed on the card. Think of it as 3 fixed denom cards in one. This not only saves the retailer peg space, but the issuer now only needs to print one card to support several denomination, saving the issuer card costs. Some retailers can support what is known as open, or variable, gift card pricing. Gift cards using this pricing allow the purchaser to pick a gift amount from within a range set by the issuer. For example, the issuer may set the range to be $20.00 to $200.00. Now the person can select the amount of the gift they would like to give, as long as it is within the range listed on the card. This essentially provides the consumer with a greater range of gifting options.

Distribution and technology costs are directly related to the type of program implemented. Retailers and technology providers earn their revenue in one of two ways with closed loop cards; either a margin is paid by the gift card issuer (an embedded margin) or a fee is paid by the consumer (purchase fee). When the gift card issuer provides an embedded margin, the purchaser pays no fee and receives the full card value at redemption as was paid at activation. For example, if the issuer is offering a 10% margin on a $50.00 gift card, the consumer will redeem the card for $50.00 in value, and the retailer and technology provider will split $5.00. The technology provider will remit $45.00 to the gift card issuer. Cards sold with a purchase fee set a flat rate on the amount the consumer pays, and also on what the retailer and technology partner receive. This can be beneficial to both the consumer and the issuer if the retailer POS supports select or open denom cards because the consumer sees value in loading more funds to the card (lees fees to load ratio), and the issuer gets the benefit of an increased load value. Conversely, retailer's see lower margins to scale in this scenario when compared to an embedded fee. For this reason, retailers may be more hesitant to carry a card with a higher variable load option.



NOTE: *Gift card spillage has declined significantly since 2009 due to the passage of the Credit CARD Act in May of that year. The CARD Act prohibits gift card funds from expiring* ***for five years*** *from the date of issuance.*

Source: CEB Tower Group

OPEN LOOP GIFT CARD PROGRAMS

Unlike closed loop gift cards where redemption is restricted to the issuer's products and services, and the transactions run on the rails of the technology provider, an open loop card provides the greatest flexibility for the recipient for redemption. Because an open loop card is a debit card that is co-branded with credit/debit card network association, like Visa, MasterCard and Discover, (it will have their logo on the card) the funds associated with it can be used anywhere that accepts an association branded card.. All open loop programs are stored value. The loop for redemption is open because the card can be used at any provider that accepts network branded cars, and the card can be redeemed for any product. All purchase transactions take place via the association rails. A bank partner will host the account from which funds received from the purchase of the card will be accessed for purchases made by the recipient of the gift card. Upon activation of the gift cards the technology provider will manage the funds transfer and work with the card program issuer to ensure that the funds are available to cover purchases made by the holder. The consumer may elect to spend the entire balance of funds available, or use the cards funds incrementally on multiple purchases. Therefore, all open loop cards utilize a stored value methodology for redemption.

Open loop cards are highly regulated by the Federal government, it is crucial for any company investigating an open loop program to acquire in-depth knowledge of the requirements involved with offering this kind of program.

Here are just a few items that a company should be knowledgeable of before considering an open loop program:

- With an open loop gift card program, the funds for redemption are held by a bank, not the company offering the program. That means the bank will need to approve the program, and the escheatment laws are governed by the jurisdiction of the bank.
- Since the transactions are taking place over the card association's rails, the card association will also need to approve the program.
- Although using a Restricted Authorized Network (RAN) implementation the redemption can be limited to specific retailers, redemption cannot be restricted to the programs products. That means that not necessarily all of the funds used to purchase an open loop gift card will used to purchase the company's products and services.
- Since the purchase transactions are conducted over the network rails, they are subject to merchant fees (often referred to as interchange). That means the retailer accepting an open loop gift card for purchases will incur fees. Will this be a barrier to acceptance for your card program?
- The issuer of the gift card will also need to work with a program manager (normally the technology provider or processor) to determine how the program will be setup and managed. A number of rules regarding the cardholder must be identified. Will there be ATM access allowed? Will it be reloadable? Will there be any fees associated with the program (monthly fees, dormancy fees, balance inquiry, PIN or signature debit purchase fees?

A program based on open loop technology can be a very effective solution for the right type of program. However, due to the regulatory requirements and the expense and complexity of initiating and managing one, the benefits may not justify the cost when compared to a closed loop program.

UNDERSTANDING CARD COSTS

Card costs for a closed loop gift card are mainly based on just how exciting the issuer wants the card to appear. Card costs for a standard card can be very low (think $0.20–$0.35 depending on volume) for a nice basic card. But if the issuer wants holographic paper and special effects, the sky is the limit! An open loop card requires secure packaging that is tamper proof. Contained in the package are cardholder agreement that lays out the terms and conditions which detail usage, fees and other pertinent information that the cardholder needs to know. The packaging will also include the CR-80 (the plastic card that gets swiped with a purchase). These components can add up fast, but a good rule for forecasting is that an open loop program will cost 5–7 times whatever was planned for a closed loop card.

The next step at understanding card costs is knowing your customer and where they shop. With this a good technology partner can help with a plan to put your cards into the distribution channels that make the most sense. The numbers of cards sold is directly related to the distribution channel that will be offering your cards. Typically, chain drug is the single most popular destination for purchasing gift cards. Consumers but their greeting card and then purchase the gift card to accompany it. Big box is the next largest retailer; both of these are also the most difficult to land a new card program (and may not be the right audience). The discount channel ad convenience stores are also important channels, and to a lesser amount the grocery channel. A reasonable starting place is to forecast 2-5 cards per month, per location (with the high end of the forecast for chain drug and big box. With this example in mind, if the company is forecasting a launch that will be regional or state specific, there may be 3,000 retail locations for your target market. So, a total forecast of 9,000 cards per year. This is a low number of cards so the cost will be on the high side perhaps $0.35 /card. At $0.35/card for a closed loop program, the single card cost for 1 month would be $1,050.00, so for three cards per month the total would be

Continued on page 89

G. Medenica: Credit for that really belongs to my immediate predecessor, Stephen Martino. I inherited an excellent organization from Buddy and Stephen. Regardless of when the initiatives originated, there is now a very strong funding mechanism in Maryland for responsible gaming. Last year that funding was almost $4 million. Because the funding mechanism is tied to the numbers of slot machines and table games in the state, funding will increase by nearly $1.5 million a year when our sixth casino opens.

In 2010, the agency established the Maryland Alliance for Responsible Gambling, which gives us a forum for collaboration between our staff and the problem gambling treatment community and other stakeholders. Last year we joined the World Lottery Association and are now participating in their four-step process to become certified at higher levels of responsible gaming. I think all of those factors have contributed to the responsible gaming community viewing the Maryland Lottery as their friend. And that feeling is mutual.

Your Internet and digital initiatives are not transaction-enabled. But you do have a digital strategy that connects you to your online player in non-transaction-based ways.

G. Medenica: We have three mobile apps and numerous second-chance drawings that we run through My Lottery Rewards, which is our customer loyalty website. Last September we launched a new app which allows players to scan their tickets to find out prize amounts and to enter those tickets into their My Lottery Rewards accounts. Also, we are about to launch an e-playslip capability for one of our apps. Players will be able to create a playslip on their phones, and then flash those phones in front of the scanners at retail locations to generate a ticket.

In order to evolve with the marketplace and today's consumer, we're embracing social media and digital media. While we've made it a priority to integrate these more contemporary methods of communication into our relationship with players, the retailer still serves as the distribution partner for all things lottery. ■

Reaching New Consumer Groups by Tony Fontaine ... continued from page 79

$4,150.00. There is normally some form of warehousing or distribution fees involved, so budgeting $0.05/card would be a safe start. That adds a nominal $150 per month for a total of $900.00 or $5,050 total per month. Since card production can take up to 3 months, the initial card order to launch the program will be for a 4 month period. This means that the company should be prepared to spend $20,200. By comparison under the same example the card costs could be closer to $2.50 per card. So including warehousing and distribution the total is $22,950. Assuming three cards per location, the result is $91,800 for the initial 4 month channel load. Depending on the program goals, and the product margins, an open loop gift card program may be too expensive for such limited distribution. However there are economies of scale to be gained in card production.

DEVELOPING A GIFT CARD PROGRAM IN REVIEW

In the example above it appears that an open loop program may not be the obvious choice. However card costs decrease significantly with volume, so if this were a pilot program with greater distribution potential after a successful pilot, and the goals met the expectation in this limited release, it may make sense to launch an open loop program.

Here is some basic groundwork that needs to be understood in advance:

- What are the most important goals of the program, building awareness through presence in the retail market? Acquiring new customers? Incenting existing customer to buy more?
- What is the target retail market for the gift cards? Demographics and geography?
- Will marketing leverage the gift card program to acquire new customers at the current cost per acquisition rate?
- Does the advertising budget for customer acquisition contribute to the gift card marketing program budget?
- Is it necessary that all of the funds used to purchase gift cards be used to purchase my products?
- Is there enough margin to sustain an embedded 10-15% commission (minimum)? Or will a purchase fee be required?
- Will interchange fees have an effect on the acceptance of my gift card program's acceptance?
- Is there a distinct budget for card production?
- Do I have the right technology partner to ensure a plan for success?

Each individual company needs to set their goals and expectations, align their marketing and advertising teams, and work closely with their technology provider in order to ensure success. Programs need constant monitoring and nurturing to remain successful. So unless your company has had a great deal of experience in launching gift card programs, one of the most important objectives any company can have is to find a good technology partner that can advise and guide you through the process. ■