Getting the Most From ATM and Debit Card Programs

How Effective Outsourcing Can Positively Boost Offerings

By Valerie Killifer,
reporter
ATMmarketplace.com

ATM and debit card programs have become as inherent to a bank's offerings as checks and deposit slips.

With the advent of debit cards in the 1970s, the United States card market has grown exponentially. By 2000, more than two-thirds of American households had debit cards. According to Boston-based consultancy TowerGroup, the number of in-store purchases made with debit cards from 1999 to 2003 jumped 10 percent. Today, one-third of all purchases in the U.S. are made with debit cards, a 50 percent increase in only seven years.

Industry experts and analysts agree that the card market is exploding. And with the advent of stored-value, loyalty and card-points programs, long-term change is imminent.

Stored-value or gift cards were launched in the mid to late 1990s by banks and credit unions that wanted to provide a plastic option to unbanked and underbanked consumers. Stored-value cards also came in handy when it came to providing a service for customers who were unable or unwilling to use credit cards.

Jim Tingey, senior vice president of administrative services for PDNB Electronic Banking Solutions, a division of California's Palm Desert National Bank, said card-program outsourcing makes sense for the majority of small- to mid-sized FIs. "I think outsourcing is the right approach for most banks," he said. "Many banks are benefited by outsourcing until they reach a very specific volume size."

INDEPENDENT SALES ORGANIZATIONS AND PROCESSORS — SUCH AS ELAN FINANCIAL SERVICES, DATA CENTER INC., FIFTH THIRD PROCESSING SOLUTIONS AND COLUMBUS DATA SERVICES — HAVE GOTTEN INTO THE CARD GAME.

So who's getting into the card game? Processors and independent sales organizations.

Processors have increasingly gotten in on the action, offering card-management services to FIs and the ISOs they work with.

U.S. Bank, through processing arm Elan Financial Services, provides ATM, debit and credit programs to 3,400 FIs and merchants. And processors like Data Center Inc., Fifth Third Processing Solutions and Columbus Data Services also offer similar services, and in some cases have done so for many years.

A COMPETITIVE EDGE

An increasing number of FIs, large and small, have explored outsourcing their card programs.

Depending on the program size, an FI could spend big bucks investing in support and solutions for its various cards, said Jan Estep, Elan's business manager. That is why many banks and credit unions are exploring outsourcing options.

"Depending on the (FI's) size, it's a huge investment to support all of those payment types," she said. "Also, technology changes at a very rapid pace. That is why an FI might look to others to provide services."

According to Celent LLC, a Boston-based consultancy, a typical top-tier North American FI will spend more than $50 million annually to operate an ATM division. (Celent, "ATM Outsouring: A Global View." 2003.) Add that to the cost of a card program, and an FI can easily spend $75 million or more per year on a division and service that could be outsourced to a third party.

"For small- to mid-sized FIs, the economics are such that it's much more economical for them to outsource," said Peter Kulik, EFT product manager for Cincinnati-based Fifth Third Processing Solutions. "Providing a card program certainly adds a competitive component, but there's also a money-making component."

THE MIGHTY DOLLAR

In terms of debit cards, banks can drive revenue through signature-based rewards programs. Signature-based transactions have higher interchange rates than PIN-based transactions. Those rates have prompted FIs to create programs designed to drive signature-based transactions. In some cases, FIs that outsourced their card programs saw a 50 percent interchange increase in less than two months. In other cases, FIs saved 25 percent over providing the services themselves.

However, those profits aren't always the norm. Tingey said interchange rates vary among FIs, and in general the revenue structure will not deliver dramatic results unless the FI is pulling a reasonable number of debit transactions.

"The principle reason for these programs is to attract individuals to the bank and for providing additional programs," Tingey said. "It is really customer-service-driven for the bank as opposed to revenue."

It also is not a question of whether a small- to mid- FI can support an in-house program. It's more a question of, 'Where do you want to spend your next dollar?'

"Any FI could develop solutions themselves," Estep said. "It's really about 'At what cost?'"

SECURITY, SECURITY!

Outsourcing also helps an FI keep up with ever-changing industry rules and regulations without the high expense.

"One of our priorities on the core and ATM sides is to be technologically advanced, so we can give our customers the same service any large bank can offer without paying the price the big guys have for in-house systems," said Sarah Fankhauser, senior vice president of customer relationships, products and services for Hutchinson, Kan.-based Data Center Inc.

Data Center Inc. provides processing and technology solutions to banks across the U.S. "We try to know what the big guys are doing and want to be able to offer those services," Fankhauser said.

By outsourcing card services, costs remain low because it is spread between their clients, Kulik said.

"Larger FIs are finding it more economical (to outsource) than to do everything in-house," Kulik said. "One of the things driving this is fraud. The cost of managing fraud and the cost of compliance to prevent fraud is increasing. By the nature of fraud, as the industry adapts, the fraudsters adapt as well; so it requires ongoing vigilance every day."

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WHERE ARE MY REWARDS?

Rewards programs such as debit- and credit-driven points programs, and loyalty cards, have changed the card market for FIs and credit-card companies.

Credit-card companies started to launch rewards campaigns in the 1980s to drive card usage and build customer bases.

"Rewards programs have certainly changed debit cards, but they've probably changed credit more," Kulik said. "However, if a customer prefers to use a debit card, then rewards can be a big bonus."

The majority of banks are not limited in the types of programs they can offer, but they need to choose programs wisely, said Columbus Data Services president Ron Schuldt.

CDS, like other processors, offers almost any program an FI would want to market.

"By having operational and transactional services handled by somebody else, banks can focus on marketing the cards and their customers."

— MADHAVI MANTHA, SENIOR ANALYST, CELENT LLC.

Madhavi Mantha, senior analyst for Celent

Schuldt said his company can develop a customized program or follow program guidelines provided by an FI. The processor's level of involvement depends on the bank or credit union. "It depends on what they want to do or not want to do," he said.

GOING TO MARKET

Without the financial burden of carrying an in-house program, FIs can shift their focus to other aspects of the card game.

"By having operational and transactional services handled by somebody else, banks can focus on marketing the cards and their customers," said Madhavi Mantha, a senior analyst for Celent. "If you're a small FI and want to have a card program but it's not a core competency, you really need a cost-effective resource and efficient way to deliver the program."

Citing Capital One and MBNA as two FI examples, Mantha described how they each took a card-marketing program to the next level.

"These institutions really grew a national card program virtually from the ground up through savvy marketing and technology," she said. "They set the bar very high in the card space overall."

Many processors have marketing programs in place that an FI can use to launch and sustain a card program. Those programs can help an FI build relationships with potential personal and merchant-related customers through initiatives at every level.

For example, if an FI's ATM is placed in a convenient store, the processor can track which ATM/debit cards are used at that store and then target those cardholders with a marketing campaign that brings them to the bank. Processors also can track ATM transactions to help a bank or credit union determine whether it should build a branch near the off-premise ATM's location.

ISOs play a role in marketing an FI's card program as well.

"ISOs are actually more of the marketing arm," Tingey said. "Whether for general purpose or gift cards, ISOs can become marketing entities. By the time you look at all the individual structures (of an FI) marketing is critical and marketing the right relationships with ISOs is critical."

In the card market, an ISO has the potential to expand its business long-term and help the bank or credit union build relationships with merchants. "ISOs would be out selling the service," Schuldt said.

FINDING A THIRD-PARTY PROVIDER

FIs interested in outsourcing their card programs need to keep several things in mind. Breadth of service, flexibility, updated fraud programs and the ability to manage a card portfolio are important things to factor when researching a processor.

For the last 10 to 12 years, processors that provide card programs as a way to

Outsourcing Checklist

- ✔ Breadth of service
- ✔ Flexibility
- ✔ Updated fraud programs
- ✔ Card portfolio management

differentiate themselves have flooded the market. For CDS's Schuldt, offering a card-management program "was a huge growth opportunity."

But growth isn't the only reason more processors are getting into the card game.

"We have seen the benefit organizations get from having a processor doing it all for them," Estep said. "I can look at the ATM and see who it's being used by. I can look at a debit card and see where it's being used. If you use one partner for both, and have consolidated reporting or queries across the board, there's some unique information FIs can have for targeting."

But what type of services should an FI look for when trying to determine the best processor?

Processors need a full card-product line. This is important, Estep said, because as an FI's needs change, so too should its processor's offering.

Finding a processor that can help an FI manage its debit portfolio and profitability should be another consideration. Processors that understand how to grow profitability and that can put incentives — such as rewards programs — in place to drive transaction volumes are a good bet, Kulik said.

For FIs that also have an ATM portfolio, it is more cost effective if the processor provides all of the services.

"For most processors it's more expensive to do one or the other because it involves an interface to another organization," Kulik said. "ATM and debit card programs are tied pretty tightly together. If the processor isn't doing both, it increases the cost of providing the service."

At DCI, every transaction is routed internally through the company so it never has to go out to a third party for settlement. Those transactions are much less costly for DCI customers, Fankhauser said. In addition, transactions that have to be routed through a third party are costly for DCI, but less expensive for DCI's customers. Why? Because DCI's transaction-volume pricing is spread between 200 clients.

FOR SMALL-TO MID-SIZED FIS, OUTSOURCING A CARD PROGRAM MAY BE ONE WAY THEY CAN MEET GROWING MARKET DEMANDS.

Small banks can save money as well by using the same processor to manage both their ATM operation and their card base. CDS' Schuldt said banks that outsource both their card and ATM programs save money while providing true "on us" transactions.

"By managing both, the banks save interchange fees when the cardholder uses one of their ATMs," he said.

A NEW CARD ENVIRONMENT

Card-management programs are an increasingly popular way for banks and credit unions to offer ATM, debit, stored-value and rewards programs. An effective card program will be a large investment for any FI, and a big adjustment.

When an FI outsources its card portfolio, control always is an issue.

"There is no question that you give up some control because you are relying on a third party. But if you've put together a good business case, then that points to outsourcing as a potential benefit," Celent's Mantha said. "Working with a third party also will mean limitations in flexibility. But if the choice is between no program and a program with specific parameters, it's still often a better choice than having no program at all."

Despite the adjustments, the benefits of outsourcing often times outweigh the drawbacks.

"If you're a small FI and want to have a card program, but it's not a core competency, you need to have a program and you really need to have a cost-effective resource and efficient way to deliver the program," Mantha said. "It's similar to the ATM — it's a must-have and it has got to work."

In the United States, a cultural shift from cash to plastic has occurred. As the shift continues, the onus will increasingly fall on banks to offer a variety of card services designed to meet everyone's card need. For small- to mid-sized FIs, outsourcing a card program may be one way they can meet growing market demands.

ABOUT THE SPONSOR

Columbus Data Services (CDS) of Dallas, Texas, is a third-party processor that provides independent sales organizations and small to mid-size financial institutions with cost effective, state-of-the-art technology for ATM terminal driving, transactions processing and card-based management needs. CDS also provides stored-value card programs, private label card programs and vault cash programs.
Visit www.columbusdata.net for more information.