Revolution Card:

FEASIBILITY IN THE PREPAID MARKET

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The growing success of the prepaid market has inevitably led to new entrants scurrying to gain market share and find niches that enable long-term viability. With the popularity of American Express, Discover, MasterCard and Visa prepaid programs, is it feasible for a new card scheme to provide a significant value proposition and pose a threat to these long-standing incumbents?

Recently, a new entrant to the payments landscape is shaking things up a bit. Revolution Money, Inc. offers a credit card-based payments vehicle with increased security features. Specifically, the card, dubbed RevolutionCard, varies from traditional credit cards in that:

- There is no name or account number on the card.
- A PIN is required to use the card (both standard and disposable, one-time use PINs for extra security are available).
- No interchange is charged to the merchant.

Make sure you read that last item again—no interchange. The fee to the merchant is roughly 0.5 percent of the transaction, compared to a *minimum* of 2 percent for a Visa or MasterCard transaction (including interchange, switch fees, assessments and processor markup). This is the biggest differentiator of the card for merchants. Sure, the other items instill a sense of trust and privacy in the card for consumers, but it is the shift in business model that makes this product disruptive. And it is this disruptiveness that Steve Case, the founder of America Online Inc., was drawn to. His Revolution LLC has become Revolution Money's primary venture capital backer.

Revolution Money has used this model with some initial success. Through a deal with Fifth Third Bancorp's processing unit, RevolutionCard is now accepted by a substantial merchant base—though nowhere near the ubiquity of any of the major credit card associations or EFT networks. For merchants to accept the card, a software update to their terminals is required, along with updated processing agreements.

REVOLUTIONCARD AND PREPAID

RevolutionCard operates in the prepaid market by allowing customers to load funds from the customer's bank account to the card, so it operates as a prepaid card. In this capacity, RevolutionCard could be a player for mall cards given the limited population of merchants and need for ubiquity substantially reduced.

But does it really have a chance for success in the prepaid space?

THE POWER PARADIGM

Prepaid offerings can be segmented into merchant-centric and issuer-centric. For merchant-centric prepaid offerings, RevolutionCard must compete on price and functionality. There are no card brand interchange fees from which to differentiate itself. Additionally, most merchant-centric prepaid systems require the ability to load cards at the point of sale—something RevolutionCard does not currently profess to offer.

On the issuer-centric side, RevolutionCard does offer an interesting product. First, it is by definition anonymous since there is no identifiable information on the card. Second, loading and reloading funds are already in its functionality set. There are, however, two main issues that must be addressed: ubiquity and reduced interchange.

First, let's address ubiquity. RevolutionCard obviously must grow its merchant base to be successful. Merchant acceptance, or lack thereof, has doomed many card products over the years. To the consumer, an open system RevolutionCard has minimal value. There is just no way to ensure that the merchant at which you want to use the card will accept it. There is, however, a model that works nicely—mall—cards. As previously mentioned, upgrading a smaller set of merchant terminals to accept the RevolutionCard is feasible. Ubiquity, in this case, is a relative term to the population size. If all of the merchants at the shopping mall accept it, it passes the ubiquity test.

Second is the issue of interchange. For everything that is good about the RevolutionCard, it is the interchange model that is most disruptive. It is the selling point to merchants—an easy way to reduce card-related costs by 75 percent (2 percent vs. 0.5

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percent). But in this case, it is what dooms the proposition.

There is no doubt that the merchants would love the idea of the card being used. For the program issuer (in this case, the mall), however, it turns a revenue positive program into a revenue negative proposition. Let's look at this in a fairly simplistic view. A typical open system or hybrid system prepaid mall program uses interchange as the method of funding the program. The issuing bank and processor split the interchange with the program issuer.

THE PROGRAM ISSUER

While models vary depending on volume and structure of the processing contract, let's assume that the program issuer gets 50 percent of the interchange, or 1 percent of the transaction amount. This revenue is then used to pay the additional processing costs for card issuance, reloads, chargebacks, fraud, etc. Whatever is left over is the program issuer's net income. Reducing the interchange 75 percent reduces the share of interchange to 0.25 percent (though, since RevolutionCard fees aren't interchange, this isn't quite an equal comparison). Not a large fund to pay for processing.

THE ISSUING BANK AND PROCESSOR

The RevolutionCard model here is quite different. While there is an issuing bank by definition (currently First Bank & Trust in Brookings, S.D.), they are not in line to receive interchange, per se. The processor, in this case RevolutionCard and its affiliates (Fifth Third, the Jeanie Network) are used to getting all of the 0.5 percent of the transaction amount. It is safe to assume that there is little margin to provide a substantial amount of revenue to the program issuer.

SO, HOW MIGHT IT WORK?

With all of these inherent problems, one can envision a model that works—though it does require a bit of a niche market. First, it requires a program issuer that isn't looking to make money. A program issuer that is a coalition of merchants could be served quite well, for example.

The model works if RevolutionCard attacks the market by offering this service free to the program Issuer. Is this possible? There are ways to make it work. For example, if RevolutionCard's business model is to increase merchant acceptance, this could be a way to do so—increasing the value proposition to the merchants by offering an easily implementable gift card program in exchange for that acceptance. Alternatively, RevolutionCard could offer a prepaid card program that has slightly higher merchant fees to pay for the increased card issuance and management. For example, if RevolutionCard increased the fees to 75 basis points (still a far cry from credit or signature debit fees), the additional 25 basis points could offset the increased program management costs.

THE FUTURE OF REVOLUTIONCARD

The story of RevolutionCard is far from over. It will have to battle in an extremely competitive world to gain merchant and consumer acceptance. Perhaps it can leverage the Revolution MoneyExchange, a P2P Internet-based payment system, to increase consumer demand for the RevolutionCard and greater merchant acceptance. It could possibly use emerging payment markets, such as prepaid, to increase its brand awareness with both consumers and merchants.

It is also likely that the low fees that are its current selling points may increase—much like what we have seen in the PIN-debit market as it approaches signature debit pricing. This would allow new programs and features to be added, along with different constituents in the value chain to be compensated.

But with a convergence into a more traditional model, the disruptiveness would diminish—and the revolution may end before it begins.

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