



## Gift Cards Are Here To Stay

### Why retailers should take them more seriously!

*By Jason Praw, J.C. Williams Group*

Perhaps like no other product, gift cards provide retailers with one of the most creative and cost-effective ways of bringing customers into stores. Leaders in gift card retailing have stayed at the forefront of the industry by being early adopters and by responding to customers' increasing need for convenience.

The sales advantages for a retailer who has a gift card program are staggering. When customers come in with a gift card, many spend more than its value, and those who do, will spend on average almost twice its amount. In comparison with gift certificates – gift cards' antiquated relative – gift cards lead to less fraud and increased sales.

Gift card programs don't come cheap, however. The cards and technology to produce them can be expensive. Another downside is that most retailers record gift card sales as revenue after they are redeemed, not when purchased.

Yet despite these disadvantages and with sales expected to be around \$70 billion by 2006, gift cards are helping retailers expand their top-line revenue, increase gross margins, reduce handling costs, attract new markets and customers, build their brand, and satisfy customer demand.

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## Brief Gift Card History

When companies such as Blockbuster and Kmart began testing gift cards in 1995, the gift certificate was still alive and well. With the success of gift cards, however, the certificates have been fading fast. Starbucks, an innovator in gift cards, has issued 18 million cards since 2001. In 2003, gift cards accounted for 10% of all transactions. Starbucks' gift card is the only card that lets the holder buy another gift card or "re-gift."

More than 50% of all retailers and almost 40% of malls now offer gift cards. Gift cards allow retailers to generate more revenue and are far less likely to be counterfeited. Yet despite the resounding success of gift cards, many retailers have chosen to stick with their current gift certificate programs. For those programs that work, it may make sense for retailers to stay with the certificates. But here also are some intriguing facts that may change a few minds.

## The Gift Card Advantage

The U.S. gift card market has grown from \$1 billion in 1995 to \$45 billion in 2003, and is expected to rise to \$70 billion by 2006. In fact, consumers spent an estimated \$17 billion on gift cards this past holiday season alone. Wal-Mart reported that its gift card sales were up more than 20% during the 2003 holiday season. An estimated 45% of the U.S. adult population (some 97 million people) purchased a gift card between August 2002 and 2003 (up 23% from the previous year). Creative marketing and increased convenience are fuelling much of this growth.

The biggest advantage to the retailer of using gift cards is the incremental sales. More than 20% of consumers spend more than the initial face value of their gift card, and those who do, spend nearly twice as much (90%). Incremental sales are even more of a factor during the holiday season; a \$100 gift card is worth more than \$200 one day after Christmas, when the heavy promotional activity has kicked in.

Unlike gift certificates, which are often stored in the cash register, gift cards are prominently displayed. Studies have shown that retailers who have switched from gift certificates to cards have increased sales from 50% to 100%. Costco Wholesale Corp. switched from certificates to cards in May 2003 and saw its sales volume more than double. It attributes the success in part to the greater flexibility of the cards. "Certificates have a set dollar amount," says Richard Galanti, CFO of Costco. "Gift cards can be for any dollar amount and people like to give them to their kids going away to college."

### Some spending data:

- Findings show that consumers will spend \$150 to \$200 a year on gift cards. The 45-54 and 55-64 age groups will spend \$160 to \$230 and \$190 to \$240, respectively. Higher income families will spend more still, with those making over \$100,000 spending close to \$220, on average. Men also spend an average of \$10 more per gift card than women do.
- The average gift card value purchased is \$50, almost twice as much as the gift certificate average. Fifty percent of all purchased cards fall in the \$20 to \$25 range.
- Forty percent of shoppers using a retailer's gift card purchased items at full price, compared to 16% of shoppers using other payment methods.
- Consumers purchased on average 5.6 cards last year – one more than in 2002.
- Households with teens purchased 7.5 cards on average.
- About 10% of consumers buy cards for themselves, but 60% said they have reloaded value on a previously purchased card (mostly on coffee and fast food).

Gift cards are far more difficult to counterfeit than their gift certificate relatives, and those who have the means to do so prefer to spend their time duplicating credit or ATM cards. Another factor that decreases fraud is that gift cards have no value until they are activated at the checkout – as opposed to certificates, which often have a pre-printed dollar amount on them.

Along with the drop in fraud, retailers benefit by not having to return cash from unused portions of gift cards, which they had to do with the old paper certificates. This helps generate multiple trips to the same retailer and ensures refunds are not carried to competitors. Alternately, if the consumer does not return, the unused cash is put back into the retailer's pocket. This phenomenon, called breakage, only occurs in about 10% of cases and has been decreasing due to the overwhelming acceptance and awareness of gift cards. This was far more of a problem with gift certificates that would often get lost, misplaced, or ruined. The lower breakage rate with gift cards is also due to the constant reminder a branded gift card gives consumers each time they open their wallet.

The gift card also offers the consumer portability and prestige. As opposed to certificates, gift cards have the feel of a real gift. Teenagers, in particular, love them because of the sense of empowerment they feel when deciding what to buy with the card.

## The Downside

As mentioned, the production of gift cards isn't cheap. Cost ranges from \$0.50 to \$3.00 per card, depending on how many are ordered, the type of technology employed, and the services that go along with it. When you take into consideration the \$30,000 to \$50,000 implementation costs, usually through a third party, many small and medium size businesses simply can't afford to switch yet. Nonetheless, as the big retailers adopt the new technology, more and more of the smaller retailers will climb on board as the costs come down.

Another current disadvantage is that gift card sales get recorded only upon redemption – not when they are purchased. This can create an unusually strong January, when in fact the gift card was bought in November or December. As a result, these sales are not included in the year-end. One survey reported that by January 5, 2004, 50% of the holiday gift card recipients had already redeemed some or all of their cards.

## Marketing

Many retailers have ruthlessly promoted their gift cards because they've found it a very cost-efficient way of driving traffic. Gift cards, with their sleek, eye-catching designs and logos, help retailers with branding. For example, some Best Buy gift cards have holograms; Bloomingdale's holiday gift card included a picture of Harry Connick Jr.; and Target has about 16 designs for their gift cards and keeps them current with the seasons and holidays, as well as offering birthday and other special occasion cards. It even offered a gift card that doubles as a Christmas tree ornament.

Gift cards are often used as promotional items, encouraging savings to the consumer while ensuring return trips to the retailer. Several examples: Circuit City gave out \$25 to \$100 gift cards to shoppers who spent from \$299 to \$1,000. Last Thanksgiving, Sears gave away \$10 gift cards with tire purchases. Home Depot has used gift cards as promotions as well; some deals have included an \$80 gift card for a purchase of \$200 or more, which amounts to a 40% price promotion.

## Fees

Retailers have varying gift card policies. Some gift cards expire over a certain period (for example, 12 months) and others just depreciate each month if the card remains inactive (usually around \$2.50/month after 24 months of inactivity). These fees are usually the result of the retailer using a third party to process and maintain their gift card program. J. Crew charges \$2.50/month and Toys 'R' Us charges \$2/month after two years of inactivity. Some fees start even sooner. Mall owner Simon Property Group sells a gift card at its 160 shopping centres, in partnership with Visa, and charges a \$1.50 fee for the purchase and a \$2.50/month fee starting after six months of inactivity.

The new trend among retailers is to have no fee and no expiry-date gift cards. This has proven very popular with consumers who resent being victims of the small print. Circuit City, for example, has gift cards that don't expire and don't have any fees imposed on inactive cards, as do Target, Blockbuster, Starbucks, and The Limited. Sears' cards do not have any fees and have recently removed expiry dates as well.

## Future

Consumer convenience has and will continue to drive gift card sales and innovations. Improved technology has also helped retailers to create gift card service that improves convenience for shoppers. Some examples of new and future trends in gift cards are:

- The ability to replace or reissue a lost gift card. An original cash receipt is needed in most cases. Home Depot does this.
- Because gift cards are not active until scanned, grocery stores have begun carrying a variety of gift cards for movie theatres, coffee shops, and even clothing stores.
- Gift cards can be used in-store and online allowing consumers the flexibility of shopping when and where they want. Circuit City, The Gap, Sephora, Macy's, JCPenney, and Sharper Image offer this.
- Currently, about 80% of gift cards are purchased in-store. This is changing, as the number of gift cards sold online increase, especially electronic gift cards. It allows gift recipients to get their gift instantly and eliminates shipping costs.
- The multi-channel perspective will continue to grow. For example, the new Napster under Roxio Inc. is expanding its pro-retail side with gift cards in some 20,000 retail locations including RadioShack, Best Buy, Safeway, and Kroger stores. These new offerings make Napster easily available both online and at retail, where the Roxio brand is extremely strong. The Napster gift card offers 15 music downloads for \$14.85. This is especially popular for young people without their own credit cards. The gift card recipients use a code on each card to complete an online purchase.

- The “segmented” gift card is also on the horizon. This is a gift card that could be used at a number of unrelated retailers, both in-store and online, thus reducing the number of cards one has to carry around.
- The idea that gift cards reduce the number of people returning unwanted holiday and birthday gifts is extending even further: several Websites that allow consumers to sell or swap their unused or unwanted gift cards. For instance, a Website called [www.certificateswap.com](http://www.certificateswap.com), which was launched in December, allows dissatisfied recipients to sell their gift cards for a 7.5% processing fee. You can even give someone Certificate Swap’s own gift card, GiftBux, which she or he can then spend on a gift card of choice. Not surprisingly, eBay has hundreds of gift cards listed at any given time, where sellers offer their gift card at a price discounted from face value. Buyers pay [certificateswap.com](http://certificateswap.com), who hangs onto the money until the buyer has received the card. Over 400 different retailers and restaurants are available. Other sites include [swapagift.com](http://swapagift.com) and [swapshop.com](http://swapshop.com).

## Some Helpful Hints

It is quite shocking how some retailers are not taking advantage of their current gift card programs – and for no good reason. Here are some helpful hints to optimize your gift card program:

- Start early. If a retailer wants a gift card program to be up and running before Christmas, it has to start getting all the pieces together in February or March.
- Place the gift cards where consumers can see them, for instance, by the cash.
- Multi-channel: gift cards should be sold in-store, online, and in catalogue. They also should be redeemable at all channels.
- Gift card promotions: retailers should give them away in magazine inserts or as rewards for other purchases, to name just two examples. The cards give consumers a reason to shop at a store and act as a constant reminder of the retailer. Remember, a consumer who is given a \$5.00 gift card likely will spend \$10.00+ at that retailer.

Gift cards provide too great a financial reward for retailers, large and small alike, to ignore. Just be sure to take an assertive and thorough approach when implementing them.

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