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## A Guide to the ATM *and* Debit Card Industry

**T**hree years ago, economists from the Federal Reserve Bank of Kansas City published *A Guide to the ATM and Debit Card Industry*. Since then, there have been a number of important developments in what has been a dynamic time for this industry, say Fumiko Hayashi, Rick Sullivan and Stu Weiner, authors of the *Guide* and its follow-up, *2006 Update*.

“The purpose of this new publication is to document these trends and patterns by updating the data we presented in the original book,” Hayashi says. “*Update* also discusses implications for the current and future state of the industry.”

The most important development is the two segments—ATM and debit—in some sense are going in opposite directions. The ATM industry has matured and stagnated.

Major players are vying for market position and adopting different business strategies to adjust to the maturation of the industry. Meanwhile, the debit card industry is expanding rapidly with new players, partnerships, products and markets.

“Here the challenge is how to preserve and enhance market position—and not be left behind,” Hayashi says.

### **Important industry changes**

There are many reasons for the divergence between the ATM and debit card industries, but they are related. It’s become easier to use payment alternatives, such as debit and credit cards, and as a result, consumers don’t need as much cash.

The total number of ATM transactions peaked around 2000 and generally has been

declining since. The number of ATM networks is also in decline, and the top three firms now process more than 55 percent of ATM transactions.

One interesting, long-run trend in the ownership structure among large regional networks is the emergence of nonbank and single bank forms of ownership at the expense of bank joint ventures. Meanwhile, the largest financial institutions continue to expand their ATM fleets, perhaps in conjunction with building branches. There have been few changes in wholesale pricing and continued increases in some retail ATM fees.

In contrast, debit is the fastest-growing retail payments type in the United States. Signature debit has a 3-to-1 lead in merchant outlets over PIN debit, but both methods have worked to develop their markets, and merchant acceptance has grown steadily.

There is a tremendous amount of network competition in the industry. The original book discussed three competitive battlegrounds within debit card networks: competition among regional PIN debit networks, competition between regional and national PIN debit networks, and competition between PIN and signature debit networks. All three remain and likely will continue, Hayashi says.

The debit card industry faces a challenge from another payment industry, the automated clearing house (ACH) system, which is developing a number of payment options that could substitute for debit.

This shift from paper-based transactions, along with the rising predominance of debit card transactions, raises a number of important policy issues related to safety, efficiency and accessibility.

## **Policy, fraud and data security considerations**

Answers to policy questions are not easy, say the books' authors. The challenge for policymakers and industry participants alike is to stay informed and ready to make solid, sound decisions.

Amid heightened public, industry and government awareness, both data security and fraud concern spans the industries—a compromise of debit card data can enable a fraudster to exploit either the ATM or the debit function.

“Data security and fraud is a cloud that hangs over the ATM and debit industry,” Sullivan says.

During 2006, two major debit card PIN breaches resulted in hundreds of thousands of dollars stolen from consumers. The year prior has been identified as the worst for data security breaches. Additionally, fraud was the primary reason for a 2005 surge in chargebacks on several networks.

However, the United States may well be able to fight fraud by improving security systems for magnetic stripe cards.

“This can help foil exploits such as card skimming and clandestine observation of ATM customers,” Sullivan says.

While there are concerns that a shift from magnetic stripe to chip cards would be expensive, this is an available solution that could considerably strengthen debit card security.



Consumers are also important because their behavior ultimately determines payment methods used, based on factors such as risk of fraud, consumer protection, price, convenience and incentives.

## What lies ahead

“It seems likely that there will be further shake-out in the ATM industry in light of the saturated and possibly overbuilt market,” Weiner says.

To what extent depends on deployers finding a profitable mix of functionality, pricing and location. Unless significant changes are made, difficult adjustments are likely.

Banks place heavy emphasis on the ATM as a delivery channel for financial services, and because few bank customers use other functions, ATMs are mostly viewed as cash dispensers. However, they cannot be thought of as substitutes for tellers as the demand for cash declines.

and product innovation. The authors envision four scenarios:

- Both PIN and signature continue to grow, shifting slightly into each other’s market share. Customers maintain their preferred method.
- The two methods converge and become indistinguishable to consumers, such as PIN-less and signature-less debit.
- PIN networks use price, convenience and risk advantages to gain on signature debit.
- Networks enhance their signature debit products (via consumer protection and incentives) and market share over PIN debit.

A wild card for PIN and signature debit is whether ACH alternatives for retail payments become increasingly viable. There is a good deal of effort in developing these products.

“ Debit will likely become an even more important payment method in the future. ”

“Some banks hope to change consumer perceptions of ATMs by adding new functionality, such as imaging capability for taking deposits,” Weiner says.

Because check use is also declining, ATMs could be used to initiate ACH transactions for person-to-person or bill payments, as is done in other countries. Nonfinancial services dispensed through ATMs, like vending machines, is another option. This could be an opportunity to sell many items, with cash access as one of its features.

“Debit will likely become an even more important payment method in the future,” Weiner says. “The conflict between merchants and card issuers, and also how the PIN and signature debit rivalry resolves, will be key.”

PIN and signature debit will be affected by factors including pricing, costs, profits, security

“Each scenario has some plausibility,” Weiner says, “but which of these scenarios is most likely is hard to predict. It would be best for the market to lead to a payments system with the most desirable set of characteristics in terms of efficiency, safety and accessibility, and combinations of payment alternatives may best serve this goal.”



BY BRYE STEEVES, SENIOR WRITER

## FURTHER RESOURCES

### A GUIDE TO THE ATM AND DEBIT CARD INDUSTRY: 2006 UPDATE

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