PGDM (IB), 2019-21
Services Marketing
IB-310
Trimester – III, End-Term Examination: July 2020 (On-line)

Time allowed: 1 Hrs 30 Min
Max Marks: 30

Roll No: ____________

Case Study
Read the attached case study and answer the following questions.

1. Evaluate the service proposition of the company from the customer value point of view. (10 marks) (CILO 1)

2. Identify the company's competitor/s. What are the strengths of the competitor/s? (10 marks) (CILO 2)

3. Evaluate the alternatives before the company of reaching the customers. What will you recommend to the company and why? (10 marks) (CILO3)

Richard Ivey School of Business
The University of Western Ontario

IVEY

W11189

CARDSWAP: CONVERTING UNWANTED GIFT CARDS INTO CASH

Professors Neil Bendle and Michael Taylor wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

INTRODUCTION

> CardSwap is Canada's #1 site for discounted gift cards. Whether you want to buy gift cards at a discount or sell them for cash, CardSwap offers the simplest way to get what you want. Sell. Swap. Save.
>
> CardSwap.ca

In early 2011, Zaheed Poptia, co-founder of CardSwap.ca (CardSwap), sat at his desk in the Toronto office from which he managed the company. CardSwap was an online service that provided consumers with the opportunity to convert unwanted gift cards into cash. Poptia was convinced that his small Canadian company created great value for its customers: there was an average of $1 billion of unwanted gift cards entering circulation every year; consumers who owned these unwanted gift cards were prime candidates for the CardSwap service. CardSwap offered a strong value proposition to consumers while ensuring a healthy return through commissions on every transaction. Problems remained, however, because CardSwap was a relatively small company and had no access to the large advertising budgets that might be needed to reach consumers through an extensive multi-media strategy. How much should the company be willing to spend to acquire a customer? How best could this new company use its limited resources to communicate to customers the benefits that CardSwap had to offer?

HISTORY OF CARDSWAP

As with many entrepreneurial ventures, the idea for CardSwap arose from personal experience. In 2008, Poptia had recently married and had gratefully received many wedding gifts. Unfortunately, he found that many of the gifts he received were not especially useful. Upon returning the unwanted gifts he received gift cards or merchandise credits from the respective retail stores. Poptia would have preferred cash, but was instead stuck with hundreds of dollars worth of gift cards for stores from which he did not need anything. He could try and sell the cards on eBay, Craigslist or Kijiji (a free local classifieds site in

Canada) but there were considerable problems involved in selling cards on these sites. The young entrepreneur used his business training at the Richard Ivey School of Business, Harvard University and the National University of Singapore to analyze the problems that consumers faced when using general markets such as eBay. Poptia looked at each of the pain points in the market (see Exhibit 1) and was determined to come up with a solution to these frictions in the market. His analysis led to the CardSwap business plan.

Once Poptia had established his idea, the next question he needed to address was how to get his gift card operation up and running. Personal connections were very important here. Poptia's wife, Frances Ho, was involved in the real estate industry. In 2008, this industry was suffering from the effects of the global recession. Ho focused her attention instead on the gift card industry and decided that a website could be created that would easily connect buyers and sellers of gift cards. She hired an external web developer to design a simple user interface and six months later, www.CardSwap.ca was live.

Substantial difficulties remained, many of which revolved around fraud prevention. For example, how could CardSwap:

- Verify the value on a card? Gift cards were flexible in that, unlike certificates, they could hold an updated balance. Unfortunately, this meant there was no way to know the value of a card simply by looking at it;
- Prevent sellers from using a card online (via the unique UPC code) even after selling the physical card?

Other practical problems existed. If a CardSwap customer sent in a card and it was lost in the mail, who would take responsibility? Customers would not want to risk not being paid, but CardSwap would be vulnerable to claims regarding cards that had not been mailed unless it had an effective fraud prevention system.

Aside from these operational problems, Poptia had to clarify his personal involvement in the project. He had a very stable and appealing job as co-founder and vice-president at a private equity firm in Toronto. Poptia had no need to try a new venture but the fledging CardSwap business was receiving positive press and was beckoning him. The market opportunity was significant and it seemed to him that the funds for the business could largely be internally generated. Consequently, Poptia, as many entrepreneurs before him, was left with a decision: was it worth leaving his job to try and capture the market opportunity that the secondary market for gift cards in Canada represented?

RISE OF THE GIFT CARD MARKET

By early 2011, the gift card market had come of age. Gift cards had become ubiquitous in the retail environment. Consumers were inundated with choices of cards and could purchase them at convenience stores, online retailers and even grocery store registers. Looking at the gift card market in 2011, it was hard to imagine that the market was only 17 years old. In the mid-1990s, forward-thinking retailers such as Neiman Marcus and Blockbuster replaced the traditional gift certificate with plastic cards. These plastic cards were harder to forge than traditional gift certificates, easier to use at electronic checkouts and conveyed a more professional brand image than paper gift certificates. It seemed that once this breakthrough had been made nothing could hinder the rise of the gift card market. The U.S. National Retail Federation found that during the 2010 holiday season gift cards were expected to be the most requested item for the fourth year in a row.[1] Growth in the use of gift cards was a major phenomenon across many developed countries, although Canadian and Western European consumers lagged behind their U.S. counterparts a little.

In 2010, less than half (45 per cent[2]) of U.S. consumers had not purchased any gift cards in the last 12 months. Those who did not give cards often regarded the giving of gift cards as somewhat impersonal. However, this non-giver percentage was steadily declining each year and among younger people gift cards were especially popular. Many people embraced the practice of giving gift cards for both personal and business gifts. This development was welcomed as a practical solution to the problem of gift giving.[3] Cash was widely seen as not showing thought had been put into the gift. Tangible gifts on the other hand often ended up being hidden at the back of closets or only brought out when the gift giver visited. Better to give a gift card which gave the "gift of choice" and let the recipient decide on a present that they wanted.

TYPES OF PRE-PAID CARD

Gift cards were part of a wider change in the economy with the proliferation of pre-paid cards. By 2011, there were multiple types of cards that carried value — for things like gaming time, wireless minutes and even currency in virtual worlds. Broadly speaking there were two categories of pre-paid cards: 'open loop' and 'closed loop.' Open loop cards could be used almost anywhere and were processed in a way similar to bank debit cards. Such cards helped address the problem of limited access to bank accounts among certain sectors of the population.

Many retailers sold open loop cards but most major retailers also offered their own cards. Such retailer-issued cards could only be used to buy goods at the store that issued the card. These closed loop cards, so called because the same retailer sold and redeemed the card, offered numerous forms of innovation. Most cards ran through standard card payment systems but some retailers processed cards through their in-house bar-code reading system. Using bar codes allowed the offering of a variety of cards of different shapes and designs, such U.S. retailer Target who offered cards with their dog Bullseye riding a mechanic bull. Other cards had additional functions such as doubling as a night light or allowing voice messages to be recorded onto the card. Virtual cards were sold online with retailers such as Amazon.com encouraging customers to email electronic gift cards to their friends and family. The proliferation of smart phones had encouraged retailers to create virtual cards that could be delivered directly to smart phones, which could then be scanned at the checkout.

THE SIZE OF THE GIFT CARD MARKET

The closed loop gift card market had grown from being unknown in the early 1990s into a massive enterprise by the late 2000s. According to one estimate, some $87 billion[4] of cards were authorized in the United States in 2009. The Canadian market had developed in a similarly dramatic fashion. For example, from 2003 to 2005, Canadian large retailers increased their participation rates in gift card programs from 53 per cent to 82 per cent. By 2005, all home electronics and appliance stores surveyed by Statistics

[1] *"Gift Givers Listening To Recipients As Gift Card Spending Expected To Rise," National Retail Federation, November 17, 2010, www.nrf.com/modules.php?name=News&op=viewlive&sp_id=1033, accessed March 3, 2011.*
[2] *"2010 Prepaid and Gift Cards," Mintel Group, June 2010, p 9.*
[3] *Joel Waldfogel, Scroogenomics: Why You Shouldn't Buy Presents for the Holidays, Princeton University Press, Princeton, 2009.*
[4] *"Consumer payment trends in the U.S.," Packaged Facts, April 2010, p. 159.*

Canada issued gift cards.[5] Further impetus to the market was offered by the practice of stores issuing refunds using gift cards, which helped prevent fraud and tied those receiving a refund to the store in question.

The market had been growing at a considerable pace and by 2009, the Canadian gift card market was estimated at $6 billion.[6] Many gift cards were welcomed by recipients; however, not all were. Either as a result of poorly targeted gifts, small balances on partially redeemed cards, refunds from stores the consumer did not want to visit or forgetfulness, the full value of cards was not redeemed. A rule of thumb suggested that unredeemed card balances amounted to around 10 per cent of the value of all cards each year[7] and some argued that the value of unredeemed cards was actually much higher. The Consumers' Association of Canada took a dimmer view of the gift card market, suggested that 30 to 40 per cent of gift cards were never used. This led them to conclude that people should not give gift cards: "'Never buy a gift card,' says [Consumers'] Association [of Canada] President Bruce Cran, who encourages giving cash instead. 'There are no redeeming features [of cards] at all so far as consumers are concerned.'"[8]

The vibrant gift card industry in Canada suggested that not all consumers followed this advice. A glance at Canadian retailers suggested consumers seemed to be embracing gift cards in a way that approached the enthusiasm of their U.S. neighbours. According to a Deloitte survey, American consumers planned to buy gift cards for five out of 17 gifts purchased in 2010; the average value of each card was expected to be $31.20.[9]

THE BENEFITS OF GIFT CARDS

Gift cards helped gift-givers by allowing them to avoid thinking extensively about what to buy. Furthermore, recipients could choose what they really wanted rather than what the giver thought they should have. Although gift cards were not as flexible as cash and represented a risk — promises to redeem from a company depended upon the financial health of the company — few consumers seemed to value cash more highly as a gift.

Active promotion by retailers was a major factor in the success of gift cards. The retailer saw many benefits delivered by closed loop cards. Cash was given to the store in exchange for a piece of plastic that typically only cost $0.05-0.20 to produce. The retailer did not have to give out a tangible product until later when the card was redeemed; this smoothed out sales across the year and reduced the number of unwanted goods that would be returned and consequently have to be re-sold after the holiday season.

The precise legal ownership of unused balances generated an interesting debate in the United States, with some states attempting to confiscate the balances from retailers as unclaimed property. In Canada, retailers' cards were generally not allowed to expire and companies were required to redeem old cards; however, in practice, cards that had not been redeemed after a certain period of time were unlikely to ever be redeemed. Many suggested that such 'breakage,' as it was called in the industry, was an important consideration for

---

[5] *Daniel Bahta, Rhonda Tsang and Monica Weise, "Gift Cards: The Gift of Choice," Statistics Canada, http://www.statcan.gc.ca/pub/11-621-m/11-621-m2006051-eng.htm, accessed March 3, 2011.*
[6] *Star Library, Gift cards: By the numbers, Toronto Star, November 13, 2010, p. M2.*
[7] *Daniel Horne, "Unredeemed gift cards and the problem of not providing customers with value," Journal of Consumer Marketing, 24 (4), 2007, p. 193.*
[8] *Jennifer Wilson, Don't let those cards go to waste; How to get the most out of the stack of cards you will likely receive this holiday season, Toronto Star, November 13, 2010, p. M8*
[9] *"Deloitte's 25th Annual Holiday Survey," Deloitte Development LLC, 2010, p. 3. In June 2011, the U.S. and Canadian dollars were roughly equivalent.*

retailers while others worried about the long-term viability of gift cards if retailers pursued business models focused on breakage.

Retailers also benefited from receiving cash up front for the promise of delivering a future product or service. The positive cash flow benefits of gift card sales were greatly valued by many retailers. In addition to the relatively easy-to-measure advantages retailers received from issuing cards, they often benefited from the ways in which cards changed consumer behaviour. Gift cards generated in-wallet advertising and brand equity could be enhanced by association with gifts given on pleasant occasions, such as holidays. Once the consumer had a gift card this would drive them to spend the cards where they may see other offerings from the retailer. Indeed, consumers were very likely to spend more than the value of the gift card when using it. [10] Consumer psychology experts claimed that the form of payment changed people's willingness to spend money[11] and that consumers who used gift cards were less price-sensitive than those using cash.

Much of the advantage of increased spending — called lift in the industry — benefited retailers who specialized in relatively expensive items such as clothing. However, retailers who sold comparatively small-value items saw cards as a way to encourage consumers to form purchase habits. Starbucks' coffee chain actively encouraged customers to buy gift cards for themselves by offering promotions to those using the cards.

MECHANICS OF CARDSWAP

> When you receive that gift card you won't use this holiday season for the store you would never shop in, don't just shove it into a drawer. A Toronto-based company called cardswap.ca has come up with a way to monetize that present.
>
> Garry Marr, Financial Post[12]

CardSwap allowed users to extract value out of their grandma's gift card to a store that hadn't been in fashion since the 1960s. It also helped solve the problem of unwanted gifts and refunds to stores that the consumer had no intention of revisiting. Exchanging a card through CardSwap turned a piece of plastic into cash.

CardSwap was not the only company to set up a market for unwanted gift cards. As a 'market maker' CardSwap had similarities to eBay; however, despite eBay's great success it was not clear that the U.S. company would easily dominate the gift card exchange market. eBay relied on a system of user ratings to help generate consumer trust that goods would be delivered as specified. Gift cards contained value which could only be verified by those with specific equipment, which allowed for greater potential of abuse in the transaction. Many gift card buyers felt they wanted a process whereby the value of the gift card could be guaranteed by a reliable third party prior to any payment being made. This is where CardSwap and its rivals entered the picture.

Most companies using a similar business model to CardSwap, such as Plastic Jungle and Cardpool, were U.S.-based and did not offer services specifically targeted to Canadian consumers. There were frequent

[10] Daniel Horne, "Unredeemed gift cards and the problem of not providing customers with value," Journal of Consumer Marketing, 24 (4), 2007, p. 193.
[11] For example, Priya Raghubir and Joydeep Srivastava, "Monopoly Money: The Effect of Payment Coupling and Form on Spending Behavior," Journal of Experimental Psychology: Applied, 14 (3), September 2008, pp. 213-225.
[12] Financial Post published Nov. 20, 2010, accessed March 3rd 2011

administrative difficulties for Canadians using U.S. exchanges and retailers often differed across the border. There were also increased difficulties facing the secondary gift card market in Canada. First, in the United States, secondary card markets often offered their customers the ability to electronically print prepaid registered shipping labels to mail in their gift card at less than $2 per shipment. No such option existed with Canada Post, greatly increasing the logistical problems CardSwap faced. Registered shipping was available in Canada, but at a cost of approximately $7-10 per package the economics of this approach would seriously impact the potential profitability of exchanging all but the most expensive gift cards.

A second difficulty was that Canadian retailers, unlike U.S. retailers, had not yet embraced electronic use of gift cards. Among national retailers in the United States, 50 per cent had the ability to accept electronic gift cards; this meant that secondary markets in the United States could eliminate the need to physically mail the gift card. In Canada, however, less than 10 per cent of national retailers were able to accept electronic gift cards, meaning that the logistics involved in running a secondary gift card market in Canada were necessarily more cumbersome than in the United States. Furthermore, while U.S. entrants were slow in their attempts to challenge CardSwap, Canadian rivals showed no such reluctance. Each wanted to attack CardSwap's position as the dominant Canadian gift card market and Poptia knew that if he could not offer a smooth, cost-effective service, someone else would.

There were significant processing challenges to be overcome in order to offer consumers the best service. CardSwap continuously reviewed its technical infrastructure to make sure it could deliver the best possible service to consumers. The technical challenges were exacerbated by seasonality in the business. The demand peak in the business mirrored the major gift-giving season, meaning processing capacity had to be much higher than the capacity needed to process the average number of gift cards on any given day. The basic process involved sellers listing their unwanted gift cards on CardSwap.ca (see Exhibit 2) and providing the UPC number of their gift card to CardSwap. The company used this UPC number to check the outstanding balance on the card online. One of CardSwap's strengths was the in-house tool it had developed to quickly validate the balance. Unfortunately, many retailers did not have online validation systems; in these cases a phone call would have to be placed to the retailer's number at the back of the card to verify the amount. CardSwap could also verify when and where the gift card was last used in the event of potential fraud. Once the authenticity of the card was verified CardSwap made an offer to the seller; if this offer was accepted, the listing became active. A review of the CardSwap site demonstrated that not all cards were created equal (see Exhibit 3), as Ho noted: "The bigger the retailer, the easier it is for us to resell to somebody else."[13]

Cards for popular retailers with a large number of stores and a comprehensive and popular product line traded at a price relatively close to their face value (e.g. $0.90 to the dollar), whereas cards for less popular retailers or those with a more limited number of stores could trade at a substantial discount (30 to 40 per cent off their nominal value). A buyer would visit the site, view offer prices and decide which cards they wished to purchase; the buyer would then make a payment which would be held securely by CardSwap until the seller sent the card. Once the buyer received the card the seller would receive payment. In the event of a problem, buyers were issued full refunds, thus removing the buyer's need to trust the seller.

Initially, CardSwap took a six per cent commission on each card sold, with a minimum commission of $4.50. This meant that very low-value balances were not a good fit with the CardSwap business model. These small and irredeemable balances may be guessed roughly 25 per cent of the value of cards outstanding.

---

[13] Kelly Roche, "Website turns gift cards to cash," Ottawa Sun*, December 28, 2010, www.ottawasun.com/money/2010/12/28/16691546.html, accessed March 3, 2011.*

While margins depended heavily on the retailer — indeed, one of CardSwap's competitive advantages was its pricing intelligence gained in its first couple of years of operation — CardSwap's success would depend on its ability to make competitive quotes to sellers, which would generate enough margin when sold to buyers. Variable costs were such that the initial six per cent intermediary fee left very little profit. CardSwap had to contend with the costs of validating each card (which would be higher for cards from retailers without online automated verification systems), fees involved in accepting electronic payments (interchange was generally around two per cent of the total) and the cost of mailing cheques to sellers. Cardswap considered increasing its six per cent fee, but ultimately decided that customer reaction would be negative to any increase. Instead, CardSwap used its superior knowledge of the market to predict which cards would sell easily and offer higher prices for these more valuable cards. Poptia also saw potential to create value for customers by offering sellers the opportunity to give their cards to charity.

GENERATING CUSTOMERS

The relatively thin margins in the industry meant that CardSwap saw scale as the key to success; consequently, the most important challenge for CardSwap would be ensuring access to customers. As a small company CardSwap could not afford an extensive advertising campaign, but it needed to spread awareness about its services — how could the company do this?

There were a number of possible advertising alternatives. Most obviously, the company could adopt a traditional media approach and place an advertisement in the daily free paper distributed in the Toronto area – advertising in the METRO, for example, would cost around $400 per day and would reach over 500,000 readers.[14] However, Poptia wondered how many of these readers would actually pay attention to the advertisement.

Another approach was search engine optimization. This method of advertising would involve the conscious management of CardSwap's position on search engines through effective site design. Search engine optimization would not require any direct variable cost per search but was far from free it would require considerable skill and attention on the part of management. Similarly, social media sites, such as Facebook and Twitter, were very popular but Poptia wondered how, specifically, he could use these methods to promote CardSwap.

An alternative approach to online search was paid advertising, also known as search engine marketing. Paid search depended on the popularity and relevance of the terms used but a rule of thumb might be that Google might cost CardSwap around $0.50 per click. CardSwap could also use an approach similar to traditional advertising but on the Internet, i.e., banner advertising. Banner advertising might cost CardSwap around $30 per 1,000 impressions — known in the industry as a $30 CPM.

Looking at these numbers, Poptia wondered how much he should be willing to spend on gaining new customers. He also believed it necessary that the company continue to generate a positive cash flow. He would therefore be nervous about any plan that took into account customer value over more than one year as the cash from these might be too uncertain to rely upon.

One thing CardSwap was proud of was the ability to "earn" media attention. The company felt it had a great story to tell. How could the company leverage its story? What media might be interested in this

[14] *"Metro Toronto Spring/Summer 2011 Sales Presentation," p. 14 Metro, http://metromediakit.ca/user_content/MediaKitImages/4%29MetroToronto-NADbank2010-FINAL1.pdf, accessed September, 7, 2011.*

story? When should it expect to be most effective at generating interest? Any plan for the future of the company would have to specify how it should generate media interest.

DRIVING CARDSWAP FORWARD

Poptia was convinced that this business model was offering real value to consumers. The value of the CardSwap business depended upon the future of gift cards in Canada. Did they present the sort of value to consumers and retailers that would suggest the rise of gift cards was not just a temporary phenomenon? If gift cards were to continue, how valuable was the CardSwap business? What strengths did CardSwap have to make Poptia believe the company could survive as Canada's largest secondary gift card market? Determining how CardSwap could relay the message about the benefits of the company in a way that was financially feasible for a relatively small company was a critical task. There were a lot of decisions to make but Poptia felt that with the right choices, CardSwap could become an important feature of the Canadian retail market.

Exhibit 1

SECONDARY GIFT CARD MARKET AND ISSUES CARDSWAP SOLVES

Platform		Kijiji Craigslist eBay — Pain Point	Solution — CardSwap
Sellers	**Market**	▪ Find buyer in unfocused market	▪ CardSwap buys directly
	Time	▪ Inundated with inquiries over many days	▪ Fast one-time process to register and sell
	Price	▪ Lots of negotiation/haggling/low-balling	▪ Up to 85% of face value of the card (average 75%)
	Coverage	▪ Local only	▪ Across Canada
	Convenience	▪ Arrange time/place ▪ Deal with no-shows	▪ Comfort of home or office
Buyers	**Trust**	▪ Unable to verify amount on the card	▪ Amount verified by CardSwap
	Fraud	▪ Is the card stolen? No recourse	▪ Product 100% guaranteed by CardSwap
	Payment	▪ Must pay cash – untraceable	▪ Secure payment through major Canadian banks
	Convenience	▪ Arrange time/place ▪ Deal with no-shows	▪ Wish list provides notification when a gift card from a preferred retailer is available on CardSwap
	Safety	▪ Meet a stranger	▪ Do not deal with strangers

Source: CardSwap.ca.

Exhibit 2

SCREENSHOTS FROM CARDSWAP.CA

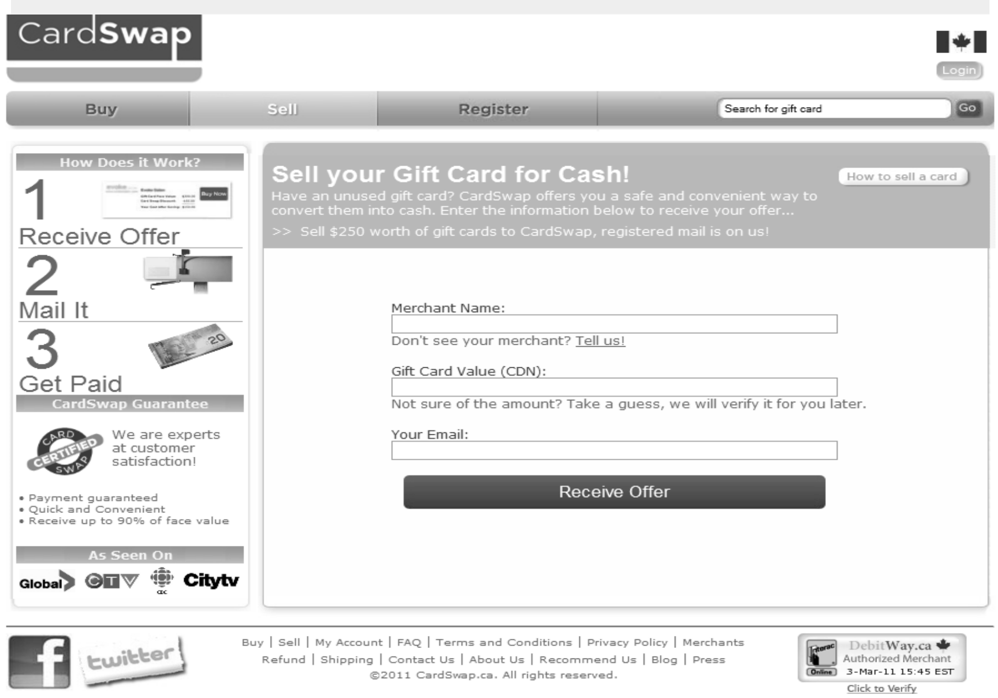

Exhibit 2 (continued)

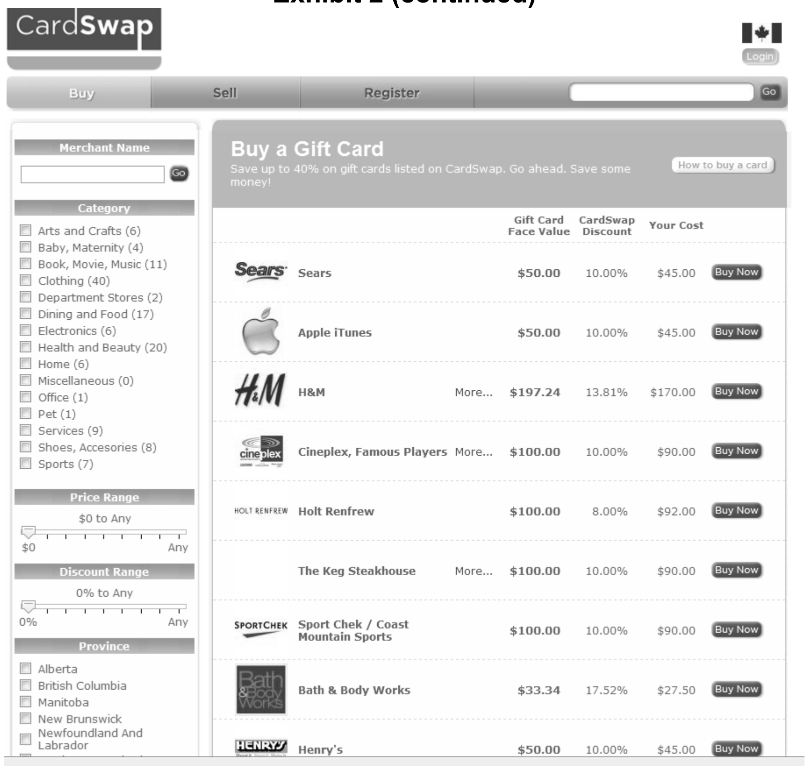

Exhibit 3

DISCOUNTS FOR BUYING SELECTED GIFT CARDS: CARDSWAP 03/032011

	Gift Card Face Value	Card Swap Discount	Your Cost to Buy
Sears	$50	10%	$45
Sunglass Hut	$50	16%	$42
AMC Theatres	$100	30%	$70
The Source	$50	12%	$44
Spa Utopia	$50	24%	$38
American Eagle	$100	11%	$89
Moxie's Classic Grill	$100	12%	$88
Apple iTunes	$50	10%	$45

Source: CardSwap.ca.