The Gift Card Economy

Idea In Short

See the business system inside the stocking stuffer: 110 billion dollars in annual sales, a secondary market of market makers pocketing spreads, discounts that vary by retailer popularity and 1.7 billion dollars of spillage flowing to retailers as nearly costless profit. Spend your cards.

Everywhere, and Enormous

Gift cards ranked as the number one requested holiday gift for six consecutive years, and their convenience explains it: sold in grocery stores, easy to buy, more thoughtful than cash and genuinely useful, drawing no complaints from anyone.1 Ubiquity was obvious; scale was the surprise. The Corporate Executive Board pegged 2012 sales at 110 billion dollars, with more than 276 million Americans exchanging cards, and simple math puts that above 80 percent of the population either buying or giving one. A stocking stuffer that four in five Americans touch annually is not a novelty. It is an industry.

The Economics of Bad Gifts

Gifting is an imperfect science, as anyone who loves Christmas morning will still concede: much of the time givers do not know what recipients want, and recipients get things they will not use. Economists formalize the grumble, arguing that gifting wastes time on both sides of the transaction, with buyers driving around, guessing preferences, comparing prices, choosing colors, standing in line and wrapping, while receivers either shelf the result or spend further time returning it. Public radio's economics teams have produced cheerfully Grinch-like episodes on why economists hate presents and call December the most wasteful time of the year.2 Gift cards are the market's answer to the critique, offering more choice and lower transaction costs, with open-network cards functioning nearly as cash and big-merchant cards spanning enough categories to please almost anyone.

A Secondary Market Emerges

Unwanted cards once had two exits, regifting or online auctions, until a cluster of websites emerged to buy and sell them at a discount. The business model is instantly recognizable: these firms act like market makers in securities, briefly holding inventory and earning the spread between buying and selling prices, the same economics as the foreign-exchange counter at an airport. The process runs three steps: sellers unload cards at a deep discount to face value, the market maker marks the card up and the buyer acquires it at a smaller discount than the seller received. The margins were healthy, as one snapshot showed a platform buying a specialty clothing retailer's cards at a 21 percent discount and reselling at 10 percent off face, pocketing an 11 percent spread. Not too shabby, and several early platforms nonetheless closed over the years, a reminder that good spreads attract competition faster than they attract loyalty.

Discounts as a Popularity Index

The resale discounts vary considerably by retailer, and the variation is itself information. Specialty retailers carry thinner card inventories and deeper discounts, with one surf-wear brand showing 25 percent off, while super-popular retailers like the biggest discounter and the biggest electronics brand clear at under 3 percent. The discount table amounts to a live popularity index: the market prices how badly people want to shop somewhere. For disciplined savers the arbitrage is real, since a 7 percent discount on a home-improvement card ahead of a 2,000-dollar kitchen renovation adds up quickly, and the platforms also monetize the useless cards roaming most households' drawers. Coupon culture is not for everyone; buying planned spending at a discount should be.

Spillage: Profit From Forgetting

The industry's most remarkable line item is what never gets spent. Lost cards and abandoned balances, which retailers call spillage, were projected at 1.7 billion dollars in a single year, and the accounting is brutal in the retailer's favor: sales revenue with almost no associated cost, which is to say nearly pure profit. Every drawer holding a half-spent card is quietly donating to a merchant's margin, and consumer protection agencies publish guidance on card terms and expiration for exactly this reason.3

The Retailer's Side of the Ledger

Retailers have their own reasons to love gift cards beyond spillage. A card purchased in

December but redeemed in March effectively gives the retailer an interest-free loan for months, cash in hand well before the corresponding merchandise leaves the shelf. Cards also tend to increase total spend at redemption, since shoppers routinely add a few dollars of their own money on top of the card balance rather than stopping exactly at the card's face value. None of this makes gift cards a bad deal for consumers, but it explains why retailers promote them so aggressively at checkout counters every holiday season, well beyond simple customer convenience.

Reading Small Markets Well

The gift card system rewards study beyond its holiday role, because it compresses a full market lesson into pocket-sized plastic: a product that fixes a transaction-cost problem, a secondary market that prices unwanted inventory, spreads that signal popularity and a profit pool built on consumer inattention. Analysts who practice decomposing familiar small markets like this one build the reflexes for unfamiliar large ones. The personal conclusion is simpler: give cards without guilt, buy discounted ones deliberately and, above all, spend the balances before your forgetfulness becomes someone else's margin.

- 1Gift Card
- 2NPR
- 3Federal Trade Commission

Summary

Gift cards dominate holiday giving because they repair gifting's waste, and the economics run deeper: resale market makers earn double-digit spreads, discounts track retailer popularity and unspent spillage hands retailers almost pure profit. Economists approve, savers arbitrage and forgetful recipients fund it all.