
Paying for ATM usage: Good for consumers, bad for banks

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Objective

- To study different pricing structures for cash withdrawals from ATMs
- To compare welfare of consumers and banks
- Provide some insight into public policies such as prohibiting ATM surcharges and mandating zero interchange fees

Model

- Two banks competing for consumers in two dimensions deposits and withdrawals
- Each bank is trying to attract the other's customer and limit its own customer from using the other's ATM
- Consider 3 pricing structures
 - ▶ Fixed fee with unlimited transactions
 - ▶ Fixed fee with foreign fees
 - ▶ Fixed fee with foreign fees and surcharges imposed by other bank

Bank's problem

- Maximize profits by setting account fee, foreign fee and surcharge independently and setting interchange fee by collectively
- Profits are higher when there are no foreign fees or surcharges and interchange fees are set jointly
- Number of ATMs are higher when there are foreign fees and surcharges
- In other words, competition results in too many ATMs
- Interchange fee is neutral with surcharging resulting in reduced surplus extraction from consumers

Consumer's problem

- Maximize utility when opening account based on account fees, number of ATMs of each bank, and usage fee
- Prefers foreign fees and surcharges to no fee
- Prefers ATM surcharges when shopping space is less concentrated

Comments

- Competition generally improves consumer welfare and worsens bank welfare
- Basically, there is tension between greater surplus extraction with fewer ATMs with pricing restrictions and greater cost to attract customers by installing more ATMs with surcharges and foreign fees
- However, surcharging may worsen both consumer and bank welfare, i.e. when shopping space is concentrated
- Generally, policymakers ban surcharges to improve consumer welfare but here opposite effect if shopping space is not concentrated

Extensions

- Consider asymmetric competition as seen in banking markets
- Consider removing the fixed withdrawal constraint
- Consider other payment instruments that compete with cash