A First Data White Paper

Rethinking Outsourcing in Light of Economic Conditions

Changing economic conditions are turning old arguments against outsourcing upside down as organizations seek ways to cut costs. Four potential functional areas are explored.

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May 2009, REV 6-09

Introduction

The recent sharp downturn in the economy is forcing financial institutions and billers to reconsider their approach to providing non-core functions. In light of the new business realities, the old arguments against outsourcing have been turned upside down. How else can organizations dramatically cut costs while at the same time enhance customer loyalty, bolster risk management and meet regulatory compliance requirements! Consequently, outsourcing is growing in popularity as more organizations conclude that the risks of outsourcing non-core functions are losing their relevance and may not be valid in today's harsh economic environment. This paper describes why there is renewed and intensified interest in outsourcing to cut costs quickly, avoid new capital investment, remove assets from the balance sheet, and address ever-increasing regulatory reporting and compliance burdens.

Current Situation

Headlines continue to broadcast bad news about our current economic crisis. *The New York Times* has called this downturn the "Great Recession" and few economists are prepared to declare that we have hit bottom yet. Financial institutions have taken the biggest blows in this financial crisis: Between February 2007 and February 2009, the top 14 banks experienced a staggering market capitalization decline of 74 percent[1]. The weakening economy is forcing financial institutions large and small to implement dramatic cost-cutting measures to offset increased loan losses, and corporate billers have not been immune to this credit crunch. With less money available for loans, many consumers are strapped for cash and unable to make their payments for utility services, insurance, medical bills, retail shopping and more. According to a recent poll in the U.S. regarding payment delinquency, of the people willing to complete the survey, 12 percent have a credit card payment that is 30 or more days past due. Eight percent have a loan 30 or more days past due, which is a 58-percent increase in the past 12 months. Six percent have a mortgage payment 30 or more days past due, which is a 67-percent increase in the past 12 months[2].

Outsourcing Gaining Traction

Financial Insights, an IDC company, has identified that the number one trend for bank technology in 2009 will be outsourcing to improve efficiency. The current environment has driven financial institutions that just a few years ago had no interest in outsourcing non-core functions to reconsider their stance. The pendulum began to swing sharply away from investing in in-house systems in 2007, when an estimated 70 percent of new core systems for banks were outsourced versus 30 percent for in-house systems[4]. This was a complete reversal from 2004 when a reported 77 percent were in-house systems versus 23 percent outsourced[5]. Currently, about 53 percent of financial institutions manage their core systems in-house, but what about non-core functions? Outsourcing is now more popular than ever with financial institutions as capital investment for operations is tightly rationed, limiting outlays to only those with compelling business cases, high returns on investment (ROI) and low risk. Consequently, long-term infrastructure investment decisions, including non-mandatory investments in non-core functions, are being deferred while management focuses on short-term tactical necessities. In the current recession, business managers with P&L responsibility must take immediate actions to improve the following areas for their organizations:

- → **Asset Management:** Need to get assets off the books to reduce depreciation, maintenance and replacement expenses
- → **Cash Flow:** Improve collections and Days Sales Outstanding (DSO)
- → **Margin:** Need to reduce ongoing operating costs

Draconian measures are being implemented, including divestitures and large-scale headcount reductions. The unemployment rate nearly doubled to 8.9 percent during April 2009, up from 5 percent in April of 2008,[6] and could soon reach 10 percent. *American Banker* articles have announced the layoffs of over 200,000 financial services employees in the past 12 months. Ultimately, these layoffs will diminish in-house capabilities across the board from front-line brick-and-mortar staff to talented information technology (IT) programmers.

Infrastructure Investment Needs Are Growing, but Budgets Are Shrinking

Flat and declining budgets make it harder to maintain service levels that meet or exceed customers' needs and expectations. There is intense pressure to cut costs, stretch budgets and keep systems in compliance. Resource constraints make it increasingly difficult for financial institutions to maintain competitive differentiation and retain customer brand loyalty:

- → *InformationWeek* magazine recently conducted a survey of 451 business technology professionals who reported that IT budgets for two-thirds of companies are flat or decreasing[7]

→ The Tower Group has forecast a 5- to 7-percent reduction in discretionary spending on technology for 2009[9]. This is the first time in recent memory that IT budgets for financial services call for a decrease in spending, resulting in delayed or shelved projects
→ In February, IDC forecast that the North American banking industry will spend 4.6 percent less on IT (both internal and external) in 2009 than it did in 2008
→ New regulatory mandates will place even further strains on shrinking IT budgets

Outsourcing Drivers

Eighty-three percent of companies identified cost cutting to be the key financial driver for outsourcing, according to a recent *InformationWeek* Analytics survey[10]. Tower Group identified that the priorities for U.S. banks are to reduce discretionary spending and cut costs through consolidation and outsourcing[11]. Outsourcing is becoming increasingly attractive, supplying the following benefits:

→ Provides predictable monthly costs that are aligned with transaction volumes
→ Reduces the cost of operating and maintaining existing systems and technology
→ Mitigates technology obsolescence
→ Eliminates capital investment in certain replacement equipment
→ Utilizes new technologies as they become available
→ Provides formal business continuity and recovery plans (developed and implemented by vendor)
→ Enables the sale of select equipment and real property and termination of leases
→ Transfers challenges with staffing, systems conversion and training to a specialist
→ Transfers the burden of keeping up with regulatory reporting system requirements

A Deloitte Consulting Outsourcing Advisory Services Analysis in 2008 surveyed over 300 executives[12] who deemed that the top two primary drivers for outsourcing initiatives are to reduce costs (64 percent) and leverage technology expertise (56 percent).

Benefits Outweigh Perceived Outsourcing Risks

The benefits outweigh the traditional arguments against outsourcing, which focus on loss of control, competitive differentiation, service concerns and cost.

There are risks in outsourcing, but today, more than ever, there is leverage to ensure third-party providers are committed. The services offered by a vendor are their core competency functions. Superior third-party providers understand that success means meeting the needs of their customers by concentrating on their core functions.

High-quality third-party providers appreciate that quick and efficient application of best practices and keeping their products and services on the cutting edge are requirements. They must deliver pre-eminent service, including increasing resource capacity when necessary and remaining compliant with both the agreed-upon service levels and regulatory requirements. That is, third-party providers have skin in the game, too, and can be essential partners for financial institutions and billers.

The Deloitte Consulting Analysis referred to previously revealed strong evidence refuting the long-established concern surrounding the cost of outsourcing. The study found the savings from outsourcing for a variety of functions were generally greater than 25 percent versus in-house budgets for the same functions.

Figure 1. Range of Savings From Outsourcing Various Functions

Function	Percent of Total Cost Savings From Original Budget (Prior to Outsourcing)
Payroll	10 to 30 percent
Accounts Payable	30 to 60 percent
Accounts Receivable	25 to 55 percent
Billing Processes	25 to 55 percent
Reporting Services	25 to 55 percent
Payment Services	25 to 60 percent

Source: Deloitte Consulting 2008 Outsourcing Advisory Services Analysis

What to Outsource

Based on the outsourcing drivers outlined above, this paper will address four non-core activities that financial institutions and billers should focus on to realize significant bottom-line impact in the shortest amount of time through outsourcing:

1. **Get Paid:** Remittance and Electronic Payment Processing
2. **Get the Bills and Statements Out:** Print and Deliver by Mail or via eStatements
3. **Retain and Grow Profitable Customers:** Analytics for Loyalty Programs and Risk Management
4. **Turn an Expense Into a Profit Center:** Leverage the ATM Channel for Much More than a Cash Dispenser

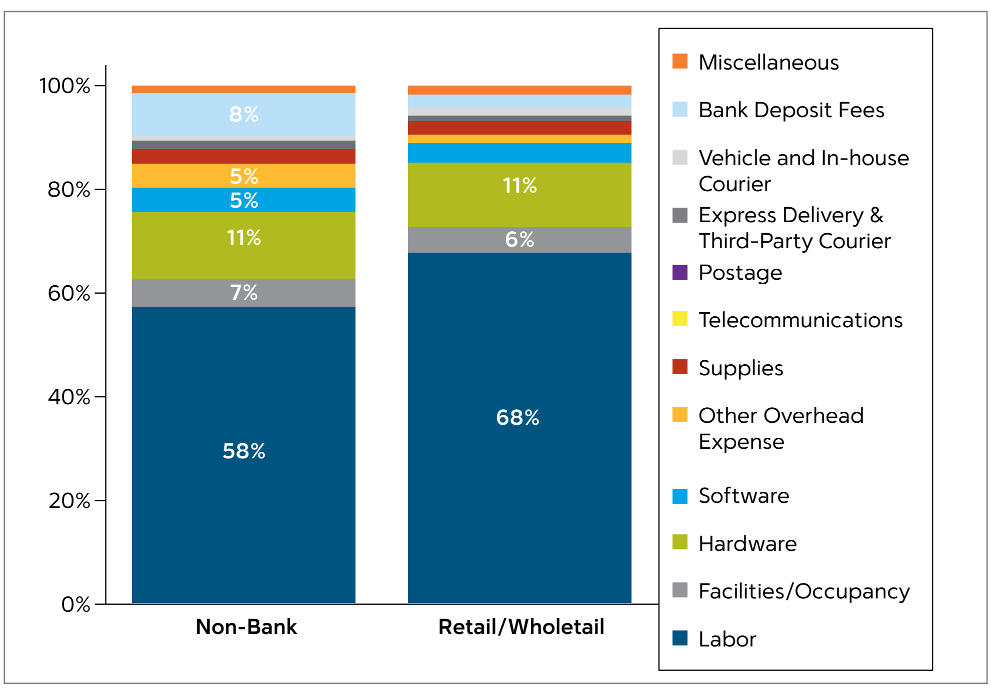
Job #1: Get Paid! Remittance and Electronic Payment Processing

Today's primary objective is to get paid for products and services already produced and delivered. In these challenging times, it is critical that organizations receive and post customers' payments quickly and accurately. However, the world of collection tools and lockbox processes is changing rapidly: Declining paper check volumes, the increase in electronic payments and the advent of multiple consumer convenience payment channels are only a few examples. It is not an easy option for many organizations to update these non-core operations in-house while also managing their unit costs.

Financial institutions and billers need to determine if their existing systems can readily adjust to this evolving world of payments and if they can keep pace with rigorous regulatory compliance requirements, while still keeping up with the ever-changing best practices. Most billers and financial institutions have found their solutions nearing the end of their technological life, resulting in an immediate need for financial investment. For many mid-sized billers, the question is whether or not they have reached the tipping point where it is no longer economically practical to continue handling their remittance/lockbox processing in-house.

Along with system issues, financial institutions and billers should look at staffing expenditures when considering outsourcing. Two-thirds of payment processing costs are staffing related; therefore, cutting headcount can have the quickest and largest impact. Figure 2 shows that 58 percent of non-banks' and 68 percent of banks' lockbox expenses were for labor.

Figure 2. Monthly Operating Budget Mix (per Site)



Source: TAWPI Remittance Processing Benchmarking Study

The key functions performed by in-house staff include mail preparation, extraction, keying and balancing. Often, a third-party vendor can provide these activities and other 24/7 staffing activities more cost-effectively and efficiently due to volume-based economies of scale. In addition, new availability policies for paper check payments converted into ACH debits via ARC and Check 21 based Image Cash Letters (ICLs) have created an opportunity to extend deposit cutoff times and permit payment processing work to be spread advantageously throughout the day and across facilities. This can improve operational efficiencies for larger processors that often have multiple facilities distributed across the country.

Below is a comprehensive comparison of payment processing challenges before the economic slide versus challenges since the drop began.

Payment Processing Challenges

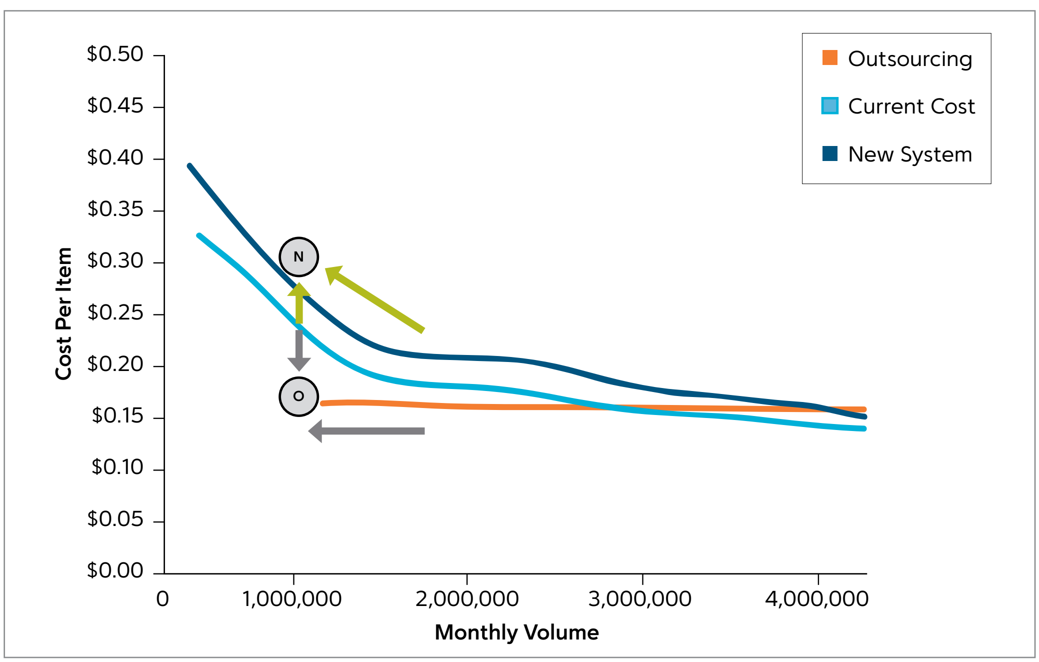
Pre-Credit Crunch	Current Situation
In-house systems adequate despite declining volumes	Need upgrades for Image Cash Letters as banking system moves to image clearing and ACH eChecks (ARC, WEB) Platform and technology nearing end of life
Acceptable staffing levels	Need to reduce headcount
Capital investment funds limited but available	Need to cut investments/sell assets
Increased walk-in payment volumes	Walk-in payments can be up to five times as expensive as mail-in payments—need for a remote capture solution to move images of a paper payment into the deposit and A/R processing workflow and account posting systems
Online/mail-in payments managed in separate areas of the organization or functional silos	Lack of integration leads to costly system duplication, difficult frontline and back-office issue handling, and inability to quickly address customer inquires about payments and balances
Expansion in consumer payment options but in-house systems adequate	Growth of options more rapid and complex, including mail, IVR, card, online, and, on the horizon, mobile
Able to keep up with compliance issues	Succession of consumer security and privacy regulations in play (i.e., PCI, ACH, Check 21, various privacy laws, Reg AA, AB, D, E, UDAP, Reg Z, and the Credit CARD Act), with only more to come

Strategic Implications of Outsourcing a Paper-Based Payment Processing System

In general, the largest lockbox operators are finding that it is best, from a financial perspective, to invest in new in-house systems, and the smallest find it prudent to defer the decision. However, mid- to large-sized in-house lockbox operators have determined that outsourcing can not only reduce their per-item costs, but ensure that those costs are maintained throughout the period of the contract. In contrast, investing in new systems will increase per-item costs, in some cases by twice as much as what could have resulted from use of a third-party lockbox provider.

Figure 3 illustrates the economics that are driving in-house remittance processing past its tipping point in favor of outsourcing. As check volumes fall, an organization can take advantage of market prices to keep per-item costs relatively flat by outsourcing and move toward position "O" on the chart (Outsourcing). If an organization purchases a new system, its costs will move them toward position "N" (New System). Even if an organization defers the decision, its costs will continue to rise.

Figure 3. Per-Item Cost Impact of Remittance Outsourcing



Organizations with monthly volumes from in-house retail lockboxes ranging from 400,000 to 2.5 million items can see significant cost advantages in outsourcing.

Job #2: Get the Bills and Statements Out—Print and Deliver by Mail or Via eStatements

Job number two is to get bills and statements out promptly to improve collections and reduce Days Sales Outstanding. Accuracy is key as exceptions can delay the overall payment process. Efficient billing systems help organizations maximize their receivables management operations and reduce the expenses associated with supporting a variety of communication and payment methods/platforms. For example, using full-process or highlight color and flexible billing stock on paper statements can lead customers to respond to the bill sooner—up to 30 percent of recipients will pay more quickly than with black-and-white bills. Similarly, electronic bill delivery can improve cash flow by speeding up payments and reducing mail float, while paper bill suppression helps provide significant incremental cost savings. Major benefits can be achieved in the short term by leveraging the latest paper and e-billing advances, but billing may be a difficult area to fund given other competing priorities in the current economy. For this reason, more billers and financial institutions are looking to outsource their print and mail functions to experts since electronic delivery is growing, document archival solutions are needed and integrated capabilities are a requirement. To speed up DSO, specialized statement printing and mail shops are going beyond merely supplying an organization with billing delivery, traditional remittance processing and/or electronic bill payment. These third-party providers are helping billers and financial institutions to leverage their entire statementing and receivables processes through state-of-the-art communications and payment tools.

With all of these payment choices, billing is becoming increasingly intricate, and meeting expectations can be overwhelming, if not impossible, without assistance from third parties who can provide up-to-date and readily integrated systems. As with the management and implementation of other non-core functions, it is expensive for a financial institution or biller to maintain expertise and systems to deliver services economically in this complex and ever-changing environment. Outsourcing can reduce complexity while cutting costs.

Volume of Paper Bills and Statements Will Decline

Similar to the lockbox and remittance processing economic trends, paper statement print and mail is forecast to follow a similar downward trajectory. United States Postal Service research shows a small but important decrease in the number of paper bills and statements received per household between 2005 and 2007[15]. This is a sign of a turning point as consumers are increasingly adopting e-bills and Paper-Turn-Off (PTO) of monthly statements for convenience, for environmental benefit and to reduce costs. A Forrester Consulting study[16] recently reported that respondents regularly received at least one e-bill. (These respondents were in the group who understood that their bank offered e-bills—which was 54% of the entire study population.) Consumers indicate that the most appealing features of e-bills were due-date reminders, convenience and assurance that bills are never paid late. Some billers are able to charge fees for paper statements which encourage customer adoption of eStatement delivery integration with bill pay Web sites. Through a variety of methods, financial institutions and billers are increasingly looking to reduce costs by driving faster adoption of paperless billing. The cost and DSO benefits are significant, but the shift creates the need for careful investment and resource planning when it comes to print and bill/statement delivery. The best results are realized when print and e-billing operations are integrated to drive maximum efficiency in bill messaging, customer-preferred bill delivery method and bill treatment based on payment history, all of which can be successfully delivered in a more cost-efficient approach by a third-party provider.

Compliance with Billing and Statementing Regulations

Compliance for financial institutions and billers is a costly undertaking and becoming more difficult, especially due to the conflict between how customers' information is presented to them, how data must be protected against breaches and fraud, and how to provide various government agencies with information about suspicious activities and money laundering. These are just a few of the current billing/statementing regulations and procedures that must be followed by billers and financial institutions: Fully Redundant Business Continuity Planning (BCP or DR), SAS 70 reporting, Regulation Z Rules (Truth in Lending) and its changes, and, of immediate importance, revisions to Reg AA (the Unfair or Deceptive Acts or Practices (UDAP) final rule[17]) and the Credit CARD Act of 2009. The Pew Charitable Trust recently reviewed 400 cards offered by the largest issuers and concluded that "nearly every U.S. credit card has at least one feature that the Federal Reserve Board and other regulators would deem 'unfair and deceptive' under the new rules."[18] The same will hold true under the CARD Act as well.

UDAP and the CARD Act present one of the most time-sensitive and potentially resource-intensive compliance issues today. Compliance with UDAP is required by July 2010 and as soon as August 2009 for the CARD Act, and for financial institutions and, potentially, for billers that issue credit cards, the two together require nothing short of a complete redo of statements and critical business billing operations workflows. They affect how and when information is presented in a statement, how and what fees are assessed, and how payments are applied.

UDAP's key elements include the following:

- **Payment Allocation Method:** Payments in excess of the minimum must be applied to the higher interest rate balances. However, during the last two billing cycles prior to a deferred interest promotion expiration the entire amount of excess must be applied to that balance
- **Late Fees and Related Charges:** Card issuers must not treat payments as late unless they have implemented reasonable policies and procedures designed to ensure that billing statements are mailed or delivered at least 21 days before the payment due date. Additionally, card-issuing organizations must provide warnings to customers regarding the highest late-payment fee which they may incur. This requirement is even more problematic for minimum payment and statement disclosures which must include a toll-free number to call for repayment amounts and fees, as it will increase costs and may require additional staffing levels
- **Double-Cycle Billing:** Card issuers will be prohibited from including finance charges in balances held over two billing cycles as a result of a consumer losing a grace period
- **Interest Rate Increases on New and Existing Balances:** Interest rate increases will require a 45-day notice for changes in disclosed terms and increases in the minimum payment amount. There are also complex limitations on accounts in their first year

The CARD Act contains similar requirements and restrictions, as well as additional requirements and restrictions relating to prepaid cards, gift certificates, store gift cards, enhanced consumer disclosures, mandatory consideration of a consumer's ability to repay, mandatory review for possible interest rate reductions, and more. The card industry is only growing in complexity, which makes it critical to stay current. Compliance with the new requirements will require that financial institutions and billers expend resources to review and modify their credit card statements, billing and overdraft processing systems. For institutions currently handling billing in-house and facing major expenses to comply, now is the time to reconsider an outsourcing solution. Investments in system updates and print operations at a time of flat or declining volume levels and constrained budgets will be difficult to justify.

Below is a comprehensive comparison of previous bill/statement delivery challenges and today's challenges.

Bill/Statement Print and Delivery Challenges

Pre-Credit Crunch	Current Situation
In-house systems adequate for printing and mailing	Statement and bill printing systems are run in silos; not always integrated with electronic delivery and payment channels
Batch systems okay	One-to-one marketing needed to prioritize and optimize delivery; need the tools to apply advanced analytics to deliver targeted messages and offers
Acceptable staffing levels	Need to reduce headcount
Capital available but limited	Need to cut investments/sell assets
Black-and-white printing adequate	Color printing helps spur faster collections and can highlight messages/promotions
Mail costs manageable	The May 11, 2009, postal rate hike exacerbates costs coupled with the USPS' need to close a $2 billion budget deficit, which may include a move to 5-day mailing. These factors may slow down mail bill delivery and increase DSOs
Mail delivery adequate	Potential reduction in delivery service; must pick up mail when available
Regulations requiring more disclosures	Many regulations in place and being discussed by federal agencies; UDAP compliance will be especially difficult
Slow consumer adoption of paperless billing	Increasing adoption of paperless billing and statementing as a "green" initiative
Limited integration between billing, customer retention and collections	Need analytics and automated alerts to link relevant customer marketing and payment reminders

Strategic Implications of Outsourcing Bill/Statement Delivery

Similar to the lockbox, paper billing and statements will face a financial squeeze as volume shifts to electronic. There are options available from third-party specialists who have integrated systems that can eliminate functional silos and provide both reduced costs and better service. In more complex outsourcing arrangements, managers can reduce asset intensity by vacating fixed assets and selling equipment at the same time, eliminating the need for continuing capital expenditures to support non-core functions and satisfying compliance requirements.

Job #3: Retain and Grow Profitable Customers—Analytics for Loyalty Programs and Risk Management

The third focus during this economic downturn should be retaining profitable customers and minimizing charge-offs. In normal times, financial institutions apply the expert method (single most effective variable and best segmentation method) or traditional predictive analytics (algorithms compare current and historical data from thousands of accounts to determine a behavior score) to maximize customer acquisition, minimize credit risk, and drive retention and usage. Today, marketing analytics and risk models must change direction rapidly to drive a laser-like focus on profitable customers for both acquisition and retention. The models must predict default rates using nearly real-time assessments, optimize collection tactics on slow-paying customers, re-price unprofitable accounts and reduce risk by lowering credit limits and/or closing inactive accounts. Traditional methods of mathematical model building and campaign execution are simply too slow and often inaccurate given the potential for rapid deterioration of customers' personal financial situations. The campaign management systems used to support modeling, data scoring, list compilation and customer communications are IT-resource intensive to set up and expensive to acquire and maintain. Many financial institutions can execute only three to four new campaigns per year, but need to be testing three to four times that many in order to meet the changing needs of the business. Hosted outsourced marketing analytics tools are available and able to help financial institutions meet their needs for new customer acquisition, customer risk management and customer retention campaigns in many ways:

→ **Reducing balance sheet risk** while avoiding blanket shutoffs that hurt customers' credit ratings and goodwill

→ **Minimizing charge-offs** by proactively identifying and pre-empting customers likely to default, and reacting with changes in rates, credit lines, payment options or payment reminders

→ **Improving collections models and strategies** by creating flexible payment plans and focusing resources on the customers with the ability to pay

→ **Balancing the organization's risk tolerance needs** with models to predict customer profitability and propensity to respond

→ **Retaining of and stimulating multiple product usage** by profitable customers through targeted marketing campaigns. Each step of the campaign can be completed by working with third-party partners—from modeling, scoring and segmentation to list compilation, campaign design and execution to rewards fulfillment, and results tracking and analysis
→ **Conducting more targeted campaigns** more quickly each year. For example, advanced customer analytics tools have made it possible for a large bank to increase the number of customer marketing campaigns from three to four per year to twelve per year
→ **Increasing flexibility and ability to do more lifts/pulls/segmentation.** Customer analytics can speed up the process of identifying receptive customers for new targeted offers
→ **Improving the return on marketing dollars** through better targeting of offers. Focus on the right person at the right time with the right offer

As was referenced in the First Data white paper on *One-to-One Customer Risk Management*[19] (2009), a recent Aite Group survey of 24 retail financial services firms reported that database marketing efforts are hindered by slow cycle times and inflexibility[20]. The survey responses highlight the need for advanced customer analytics to deliver successful one-to-one marketing programs and the challenges of traditional approaches:

→ **63 percent believe** the process for building and implementing new database marketing models is broken or challenged
→ **62 percent claim** their model development cycle is always or usually too long
→ **59 percent report** they are never or infrequently able to conduct quick and accurate campaign scenarios

Traditional predictive analytics, while an improvement over simple rules-based decisioning, is difficult to implement due to heavy reliance on IT resources for data aggregation, data scoring, list management, testing and refinement. A new hosted predictive analytics model—strategic predictive analytics—has emerged as a more efficient and cost-effective method because it integrates the modeling and campaign management processes, enabling much greater speed and flexibility. Strategic predictive analytics leverages traditional predictive analytics' ability to generate behavior scores using algorithms, but it goes further by enabling more current and free-form data sources, using real-time simulations to determine break-even points and dramatically improving ease of operational integration. This allows financial institutions to develop and test new acquisition, retention and risk models, all with less time and less reliance on scarce IT resources.

When tested for use in collections optimization, strategic predictive analytics is able to increase revenue up to 15 percent over traditional approaches.[21] Additionally, financial institutions and collection agencies were able to decrease collection costs 10 to 25 percent by reducing the number of collectors working accounts, reducing costs for letters and dialing efforts, and using fewer IT resources when placing predictive analytics strategies into production. Specifically, strategic predictive analytics can help address today's challenges that are noted below.

The chart that follows shows a comprehensive comparison between using in-house analytics systems (or no analytics at all) previously versus today's extensive challenges and the need for analytics.

Customer Data Analytics Challenges

Pre-Credit Crunch	Current Situation
Card profitability supported by expanded budgets	Charge-offs increase and sales volume decreases; dramatic cutbacks in marketing budgets
Growing budgets	Decreasing budgets that require better targeting and volume lift
Customer risk management not a big concern	More critical to identify at-risk accounts, proactively identify which of those accounts are potentially viable and define actions to retain or close those accounts
Continued concentration on winning new customers	Focus on shutting down risky and unprofitable accounts rather than new-customer acquisition
Decisioning analytics nice but not critical	Ability to fund and deliver successful campaign results dependent high-quality data and analysis tools
Loyalty programs limited in scope to per-dollar spent by cardholders	Merchant-funded loyalty programs a necessity. Gives merchants the opportunity to focus marketing efforts and dollars on relevant, valuable customers, making marketing dollars work harder; gives financial institutions more relevant loyalty programs that are more effective
Saturation of market with similar points programs	Need to drive new sales with targeted offers and alternatives to commoditized points programs
Broadcast marketing	Ability to pinpoint offers to customers through targeted media

Strategic Implications of Outsourcing Data Analytics

Changing economic conditions, risk tolerance and regulatory mandates are driving a tremendous need for financial institutions to reinvent their marketing and risk management models at breakneck speed. These activities require substantial IT support which is not widely available. More organizations are turning to hosted outsourced modeling platforms that require only minimal IT involvement and can increase both speed and quality of campaign execution.

Job #4: Turn a Cost into a Profit Center—Leverage the ATM Channel

Both cost savings and revenue increases can be achieved by extending the role of ATMs as an interactive self-service channel. A 2007 Javelin Research study showed that 42 percent of bank clients cite ATM access as a key criterion for selecting a financial institution[23]. Leveraging ATMs as a strategic asset through personalization and one-to-one marketing can simultaneously increase profitability and reduce the cost-per-impression (CPI) for customers and prospects as they wait for their transactions to be processed. Advanced features can be obtained and supported most quickly and cost-effectively by outsourcing ATM services to specialist providers.

The number of ATM cash withdrawals peaked between 2003 and 2006[24]. This decline may be due to consumers' diminishing need for cash as debit and credit card acceptance and cash back at the point of sale has become more common among merchants. In this mature market, cash dispensing alone is no longer enough. Furthermore, the Check 21 regulation regarding image deposit technology is forcing financial institutions to take a closer look at their ATM operations with a goal of upgrading their fleet of aging ATMs.

The new generation Microsoft Windows®-based ATMs simplifies integration with advanced interactive customer relationship management systems to drive personalized marketing messages to identified card customers. TCP/IP (the set of communications protocols used for the Internet and other similar networks) makes it easier and less expensive for financial institutions to create and distribute targeted marketing campaigns through the ATM—for most institutions, ATMs are a leading touch point for interacting with customers and non-customers.

For years, financial institutions have outsourced their ATM terminal driving and transaction switching. In the new business environment, financial institutions are seeking a long-term, integrated partnership with a single provider that can deliver a full-service approach to management with improved ATM performance, predictable monthly expenses and the opportunity of profit-generating solutions. Ideally, a complete ATM outsourcing provider offers a comprehensive solution that includes the following:

- → **New equipment leasing** that provides the latest in ATM hardware and software from a leading manufacturer
- → **Performance management services,** such as monitoring, to ensure optimal ATM availability and data analysis for real-time transaction information
- → **Servicing** that remotely monitors machines for issues, such as jammed cash dispensers, and provides on-site maintenance
- → **Cash replenishment and funding** with daily ATM balancing
- → **Cash management services** to help forecast cash needs for each ATM in the fleet
- → **Customer relationship management services** that allow you to capitalize on the ATM as a channel for targeted advertising of services to customers
- → **Deposit automation services** with check imaging, which allows financial institutions to make deposited funds immediately available to customers using check imaging and note acceptors

There is another critical quality to look for when choosing a full-service program provider that should not be minimized: An ATM outsourcer with experience in leveraging one-to-one customer marketing via the ATM can help financial institutions more quickly reap the loyalty and cross-sale benefits that are enabled by the more advanced technologies.

According to Tony Hayes, a noted authority on ATM program economics and a partner with Oliver Wyman, "We are seeing growing bank interest in full-service outsourcing. That is, rather than outsource various tasks to disparate vendors, more and more banks are looking to shifting the entire operational responsibility to one provider. With the current model, the bank tends to spend most of its time managing vendors and assumes all of the financial risk of declining volumes. With full-service outsourcing, there is much clearer accountability, allowing the bank to get back to managing its business, and the budgeting process is much simpler. In fact, there are several examples of banks around the world that have gone even further and taken the cost of ATMs off their books altogether. Instead of burdening the bank's balance sheet with ongoing capital investment in the channel, these banks have entered into sale-and-leaseback programs, whereby the bank divests ownership of its terminals and, in return, gains the latest ATM technology without a CapEx (and operating costs are hardwired as a fixed monthly cost)." Hayes concluded by noting, "At the end of the day, banks are in the banking business, not the ATM business. Anything that can simplify operations, improve the customer experience and reduce costs ought to be seriously pursued in the current environment."

ATM Program Challenges

Pre-Credit Crunch	Current Situation
Slowing volumes and revenue per ATM due to saturation and maturation	Declining revenue as consumers reduce travel and spending; ongoing migration from cash to cards, especially debit cards
Focus on cash withdrawal fee income	Focus on customer retention and new services (e.g., online bill payment)
Single Item deposits in envelopes	Envelope-free deposits with check imaging; bulk note acceptors for cash deposits
O/S/2 operating system on leased lines	Windows TCP/IP environment allowing enhanced features but requiring security patches and vigilance for viruses and hacking
Balance inquiries	Targeted messaging and cross-sell screens
ISO (independent sales organization) growth	ISO financial deterioration
Need to contain costs	Need to cut costs
Funding used for data encryption system upgrades and ADA compliance	Little funding for updating to new machines; need to look at leasing ATMs

Strategic Implications of Fully Outsourcing an ATM Program to a Single Provider

The quality of the ATM customer experience sets expectations for other services and loyalty to the financial institution. Having the latest functionality is a positive differentiator, while having older systems can cost customers. Upgrading systems in-house is an expensive proposition and is IT intensive. Outsourcing a complete ATM program to a single source can help manage financial institutions' costs while providing leading edge technologies and the highest levels of ATM performance. These benefits, in turn, lead to greater customer satisfaction and allow financial institutions to reap the loyalty and cross-sale benefits that are enabled by these more advanced technologies.

Rethinking Outsourcing Options as a Path to Benefits

The current business environment is leading organizations that had no interest in outsourcing proposals a few years ago to now take a hard look at both traditional outsource services such as remittance processing and bill/statement print and mail/eStatement delivery, as well as newer outsourcing models like analytics and ATM program management. In addition to potential cost savings from outsourcing, using third-party support can help financial institutions and billers become more efficient by breaking down data silos and facilitating the convergence of internal legacy systems.

Considerations	Payments & Remittances	Statements & Delivery	Analytics & Loyalty	ATM Management
Predictable monthly costs that are aligned with transaction volumes	X	X	X	X
Reduces the cost of operating and maintaining existing systems and technology	X	X	X	X
Mitigates technology obsolescence	X	X	X	X
Eliminates the capital investment in replacement equipment; facilitates next generation technology	X	X	X	X
Utilizes new technologies as they become available	X	X	X	X
Provides the business recovery and contingencies for facility service interruptions	X	X		X
Potential for sale of existing real property and lease terminations	X	X		X
Transfers challenges with staffing, systems conversion and training to specialists	X	X		X
Reduces the degree of operating leverage (or fixed costs) and mitigates increased per-item costs as volume decreases	X			
Transfers the burden of keeping up with regulatory reporting and other requirements	X	X		X

Conclusion

Outsourcing is not a new idea—just more timely and attractive now. What has changed is the flexibility and offerings available from the outsourcer. The current economy, new technological needs and new regulations are leading more financial institutions and billers to migrate from in-house to outsourced non-core functions. Outsource vendors who compete with one another, and whose core business is to provide these services, have good reason to make capital expenditures to buy the latest technology and to employ the necessary people to serve customers and maintain their competitive edge. A smaller scale company either has to try to keep up by investing scarce cash or operate at a competitive disadvantage. Labor-intensive, important but extraneous activities can often be performed faster, better and more cost-effectively when outsourced to providers who can share economies of scale with their customers.

Deep recessions often add a second, strategic objective for P&L managers: free up scarce cash for deployment elsewhere to focus on core capabilities. There is now a greater flexibility in offerings from outsourcers and an overall increased receptiveness to outsourcing in general by organizations. This makes the business case for outsourcing more appealing as traditional measures of hurdle rates and/or goals to maximize long-term equity value may no longer apply.

Through outsourcing, an organization's cash is freed up by a reduction in the amount invested in the business operation, and is accompanied by either a concomitant reduction in service levels or making the remaining dollars invested more productive. Outsourcing provides a strategic alternative that meets all of the P&L manager's business objectives in a severe economy.

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The Global Leader in Electronic Commerce

First Data powers the global economy by making it easy, fast and secure for people and businesses around the world to buy goods and services using virtually any form of payment. Serving millions of merchant locations and thousands of card issuers, we have the expertise and insight to help you accelerate your business. Put our intelligence to work for you.

About the Author

In her role leading First Data's Financial Services Product Group, **Margaret Haynes** is responsible for managing and overseeing all product life-cycle management functions for the services that First Data provides to clients within the Financial Services segment. She manages a team of individuals who are focused on developing new service offerings, expanding existing capabilities and leveraging the vast capabilities First Data has to offer to provide solutions to clients' needs.

Prior to her current role, Haynes served as senior vice president within the Recurring Payments division of First Data, where she had responsibilities for the relationship and development organizations.

During her 17-year tenure with First Data, Haynes has held other management level roles in relationship management, contracts and strategic sourcing, product management and development, testing and implementation, and new business development.

A graduate from Northwest Missouri State University with a bachelors' degree in accounting and business management, Haynes also earned an MBA in personnel/ human resource management from the University of Colorado.

For more information, contact your First Data Sales Representative or visit firstdata.com.

First Data. Solutions Guide

Cut Costs by Outsourcing Non-Core Functions

Many organizations have argued against outsourcing for years, concerned about loss of control, competitive differentiation, service concerns, quality and cost. However, in today's economic climate and with advancements in technology, the benefits of outsourcing what are really non-core functions may well outweigh past concerns.

First Data offers a host of solutions that represent our core competencies as covered in the accompanying white paper, "Rethinking Outsourcing in Light of Economic Conditions." Your organization, in turn, can concentrate on meeting the needs of your customers and focus on what you do best. By viewing us as your financial services partner, we can help you improve overall efficiency, leverage economies of scale and target the right customer.

Financial institutions and billers should seriously consider outsourcing these four non-core functions to realize significant bottom-line impact in the shortest amount of time:

Remittance and Electronic Payment Processing

- → Addresses the issue of declining paper check volumes
- → Handles technology upgrades and addresses aging platforms
- → Reduces mail float and deposit float with decreased bank fees
- → Increases efficiencies of exception processes through automation
- → Supports the increase in electronic payments
- → Offers multiple consumer convenience payment channels
- → Helps keep unit costs down
- → Keeps pace with new regulatory compliance requirements
- → Invests in the latest equipment to handle remittance/ lockbox processing

Bill and Statement Print and Electronic Mailing

- → Avoids continued capital investment for print and mail functions
- → Ensures that bills and statements are issued promptly to improve collections and reduce Days Sales Outstanding (DSO)
- → Offers the latest paper and e-billing solutions
- → Handles the growing area of electronic delivery
- → Addresses the issue of document archival solutions
- → Meets compliance regulations related to billing and statementing

Analytics for Loyalty Programs and Risk Management

- → Provides analytics tools and risk models to zero in on acquiring and retaining profitable customers
- → Targets the right customer with the right message
- → Helps to predict default rates using nearly real-time assessments
- → Optimizes collection tactics on slow-paying customers
- → Re-prices unprofitable accounts
- → Reduces risk by lowering credit limits and/or closing inactive accounts
- → Offers a hosted predictive analytics model—strategic predictive analytics—to easily test new acquisition, retention and risk campaigns
- → Eliminates concerns regarding scarce IT resources

The ATM Channel

- → Enables personalization and one-to-one marketing campaigns
- → Offers advanced features using the newest technology
- → Simplifies marketing through new-generation Windows-based ATMs
- → Helps engender loyalty and cross-sales

First Data wants to talk with you about your specific challenges. Whether it's how to gain synergies through remittance processing and bill/statement delivery via mail or e-statements, how to effectively market to an audience of one, or how promoting lines of credit and loans can help in this economic climate, First Data has the tools and consultative expertise to work with you.

For more information, contact your First Data Sales Representative or visit firstdata.com.

*Please refer to the chart on page 2. The chart aligns with the solutions highlighted on this page.

Cut Costs by Outsourcing Non-Core Functions

First Data Outsourcing Solutions

	Customer Objectives which speak to Outsourcing	Remittance and Electronic Payment Processing	Print/Mail & e-Statements	Loyalty & Risk Management Analytics	ATM Outsourcing	Back Office Services	Lines & Loans
Improve Efficiency	Expedite the processing of check deposits by moving to image clearing or ARC	●			●		
	Cut investments/sell assets	●	●		●	●	●
	Walk-in payments are on the increase; need Remote Capture services	●					
	Get assets off the books and reduce depreciation		●		●		
	Improve collections and Days Sales Outstanding (DSO) for better cash flow	●	●				
	Reduce ongoing operating costs for a better margin	●	●	●	●	●	●
Leverage Economies of Scale	Reduce headcount	●	●	●	●	●	●
	Online and mail-in payments handled in silos; integration needed to eliminate cost duplication	●					
	Time consuming for customer service staff to handle inquiries when systems are completely separated	●				●	●
	Customers expect us to accept every form of payment–mail-in, walk-in, phone-in, online and mobile	●					
	Meet regulatory requirements, which are becoming more onerous		●	●		●	●
	Lower charge-offs and increase sales volumes despite a decreasing marketing budget		●	●			
	Collect payments more efficiently	●					
	ATM fleet is outdated but the upgrades are cost prohibitive				●		
Target Market the Right Customer	Relevant and cost-effective loyalty program			●			
	Communicate more effectively with customers		●	●	●		●
	Managing level of risk is key in this climate			●			●
	Set ourselves apart from the competition		●	●	●	●	●
	Minimize risk and target most profitable customers and prospects		●	●	●		●
	To be competitive, our goal is one-to-one marketing		●	●	●		●

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