ANALYST OPINION

ATM Fleet Refresh in the Shadow of the Financial Crisis (Analyst Opinion)

Will cost pressures make outsourced ATM management accelerate?

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DATAMONITOR OPINION

Catalyst

Banks remain under considerable pressure to cut costs in the current economic environment. With a widespread lack of capital for costly upfront investments, the opportunity to rent hardware and associated services becomes an attractive, and in some cases the only feasible, option to struggling banks.

Summary

The banking industry is going through dramatic changes. For many financially stressed banks this means having to find alternative ways of financing their investments in technology assets. This analyst opinion examines the trend toward full ATM management outsourcing. Datamonitor notes that:

- The recent macroeconomic environment has resulted in increased pressure on costs, and there are many banks which are suffering extensively during the current financial crisis.
- ATM vendors continue to innovate and adapt to their markets, with the current focus being on offering ATM management outsourcing services.
- Financially struggling banks may find the outsourcing alternative a necessity going forward.
- Banks should carefully analyze their current and future total cost of ownership of their technology assets, and evaluate the outsourcing alternative.

Comment

Renting or leasing equipment is nothing new in the United States. For example, cable TV companies typically rent their cable boxes to their customers, and provide their service for a monthly fee. It is also quite popular nowadays to lease cars for business purposes, due to tax benefits and a better view of operational expenditure.

IT outsourcing services have already become prevalent within many business functions. For example, areas such as core systems are already widely outsourced to service bureaus among lower tier US banking institutions. Datamonitor estimates that more than half of the smaller banks outsource their back office operations already. It is also becoming more popular to outsource technology platforms for other business functions, such as e-banking. Furthermore, banks are becoming more and more interested in outsourcing overall IT management and further development of their technology stack.

It is also nothing new within the banking industry to lease equipment such as ATMs or self-service kiosks. Overall ATM management goes well beyond the simple purchase/renting of hardware and the maintenance involved: it also includes management of hardware installation, cash handling, communication, occupancy, and processing. Sourcing of these segments has been quite diversified to date.

Technology vendors compete very aggressively under constant competitive pressures. Many innovations, upgrades, and enhancements are therefore being aggressively marketed to technology buyers. For example, ATM and self service devices manufacturer and distributor Diebold is launching several new innovations designed for specific banking customer requirements to entice new business. New functionality such as instant check scanning, cash recycling or envelope-less deposits are considered as tempting offerings due to the fact that such technology not only facilitates increased customer satisfaction, but most of all, should reduce overall costs associated with checks and cash handling.

While many innovations are appealing to technology buyers, new products are also typically relatively expensive at the early stage of the product lifecycle. Many banks are suffering extensively during the current financial crisis and have been forced to adopt increasingly aggressive cost-cutting strategies. Even those banks not under such pressures are nevertheless cutting costs equally aggressively as well. A worldwide survey of 200 IT decision makers within retail banks conducted by Datamonitor in the fourth quarter of 2008 shows that cost-cutting is the most important objective driving banks' IT strategy in 2009.

While banks in the US are under strong budget scrutiny, many find that they have additionally increased operational expenditures caused by increases in insurance premiums payable to institutions such as The Federal Deposit Insurance Corporation or the National Credit Union Association. These institutions are under considerable pressure to quickly build up the necessary capital base that would cushion against possible additional financial turbulence.

That said, many banks still need to compete for new clients (as a run for new deposits, in order to repair capital bases, is under way now) or improve service levels within distribution channels. While navigating the stormy seas of the crisis, banks are increasingly looking at reducing their upfront capital expenditure on new investments and shrinking current IT budgets. Consequently, these days many banks focus on engagements based on outcome-based pricing, which is quickly replacing time and materials costing methods. In addition, the demand that technology vendors share the project risk is on the rise. Some vendors have responded to this demand, but also charge a premium on the risk, although in conjunction with convenient payment terms.

ATM management outsourcing is a growing area and is being considered by many banking executives these days, especially by those who struggle to get capital for their investments but still have to tackle their aging technology assets. The idea of not owning the equipment but renting it together with associated services is a pain-reliever for many. In addition, it is worth pointing out that ATM location, functionality and usability is considered an important competitive differentiation, while the underlying technology or back office processing is simply a commodity.

To look at just one example: Already under budget scrutiny and needing to replace an aging ATM fleet, Community Bankshares, based in Georgia in the US, has decided to enter into an ATM management outsourcing agreement with Diebold. Even though the bank traditionally developed and maintained most of its technology assets in-house, IT executives believe that the new model will reduce their overall ATM management cost going forward and improve customer satisfaction. Moreover, this new strategy allowed the vendor to deploy the recently rented 58 machines within a three month period, as opposed to the estimated twelve months had the installation been managed in-house.

To outsource or not, that is a question that many IT executives need to answer these days. Traditionally among the large banks, the issue of maintaining control appears to be a key inhibitor to widespread uptake of ATM outsourcing offerings. This can also be the case with smaller banks, notably those that are family-owned and thus have a strongly defined internal culture. Vendor credibility is therefore essential, and the larger institutions in particular will also seek reassurance that both their customer service levels and their overall delivery strategy will not be compromised.

For many executives who may not have the necessary skills in-house, or simply do not have the capital required for investment and are under strong pressure to reduce their current IT budget, the idea of full ATM management outsourcing is becoming an attractive, or in some cases the only feasible, alternative.

Recommendations

Banks need to carefully analyze the total cost of ownership that is associated with the overall fleet management of ATMs, and benchmark it against vendors' rates for outsourcing services, and if possible against peers.

Many smaller and medium-seized US banks should consider such alternatives, as various outsourcing services are prevalent in the industry already.

Some financially struggling banks of all sizes should consider the outsourcing alternative as a necessity going forward. Banks may also consider selling their fleet to a vendor and renting it instead, in order to increase their capital base in the short term.

Banks entering new markets should evaluate short-term ATM outsourcing agreements, in order to mitigate the risk of uncertainty of a projected business development.

Ask the analyst

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