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Managing Cash for Less
*Improving the
Efficiency of Banks'
Cash Operations*



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EXECUTIVE SUMMARY

Banks currently pay 80 percent of the bill to provide cash. In Europe, for example, this is worth about €84 billion annually. With rising fuel prices, traffic congestion, and increasing safety standards, this cost is forecast to increase. In addition, cashless payment is a fast-growing trend, which in some countries, such as the Netherlands, is already forcing up the cost per transaction.

In response, there are three waves of cost reduction that banks around the world are taking to reduce their cash costs.

The first wave is optimization of internal bank operations. Through more sophisticated cash planning, intelligent monitoring of ATM incidents, and rationalization of the ATM footprint, banks can cut their total cost of managing cash by as much as 10 to 15 percent.

The second wave is outsourcing. Transferring cash operations to third-party providers can lower costs, as outsourced providers typically achieve greater economies of scale. Contracts of this nature often give banks savings in the range of 15 to 20 percent, along with higher or equivalent service levels. However, outsourcing can lead to market consolidation and resulting price escalation and single-point-of-failure risk.

The third wave of cost reduction is the establishment of multi-bank cash utilities. By collaborating on cash processing, distribution, and machine management, banks can cut costs, manage outsourcing risks, and gain greater buying power with third-party providers. This approach has proved highly successful in Australia, Austria, and Finland, with reductions of 20 to 30 percent in the cost of cash operations.

THE EVER- INCREASING COST OF CASH

The cash circulating through society is supported by an elaborate and costly infrastructure, involving money processing and distribution operations as well as an intricate cash delivery network—ATMs, seal bag deposit systems, coin dispensers, tellers, lockboxes, etc. (*see Exhibit 1*).

The total European cost of providing this cash system is estimated to be €84 billion (US\$115 billion) per year, of which 65 percent is borne by the banking sector (*see Exhibit 2*). These expenses are expected to grow in coming years, due to rising fuel prices, traffic congestion, and increasing safety standards.

The growing popularity of new forms of non-cash payment in many regions and countries only serves to amplify concerns over the cost of managing cash. E-commerce and prepaid cards are augmenting traditional credit/debit cards to reduce dependence on physical currency, and mobile payments are also growing steadily. In Japan, for example, customers are using their DoCoMo cellphones to pay for taxis and for low-value items in convenience stores, and both MasterCard and Visa have developed similar payment solutions.

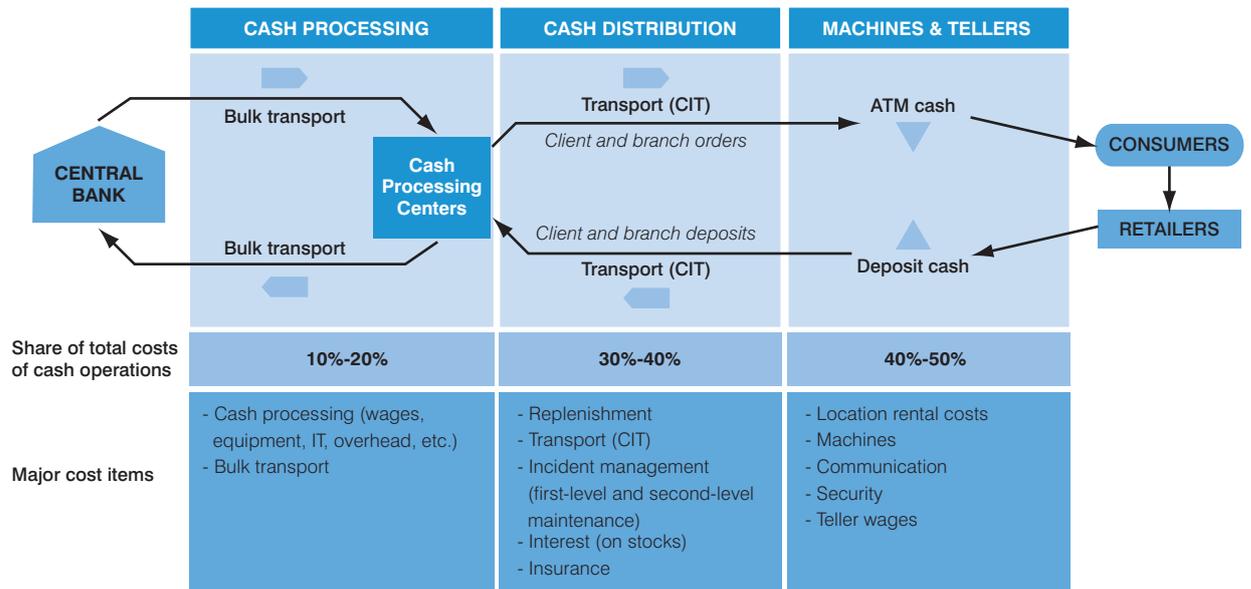
Non-cash transactions bring greater convenience and security, swifter

processing, and lower process costs. The speed with which different markets adopt such payments is influenced by factors such as the national banking and payments infrastructure, commercial practices, and consumer preferences and habits. In the Netherlands, for example, more than three-quarters of the payments larger than €10 no longer involve cash. As approximately 80 percent of the total cash costs are fixed, the cost per transaction will increase when cash volumes start declining.

To counter mounting costs, banks have sought a range of additional revenue streams from their cash operations. Stamps, train tickets, and prepaid cards have been sold successfully through ATMs in some southern European countries, although this approach has proved less popular elsewhere. Third-party advertising on ATMs (more common in markets such as the U.K. and the U.S.) produces modest additional revenues. Withdrawal charges are more controversial, as they often suffer the wrath of regulators, merchants, and consumers. Given the limitations of these various revenue-raising initiatives, it is unsurprising that banks are driving hard to improve their cash economics through cost efficiencies.

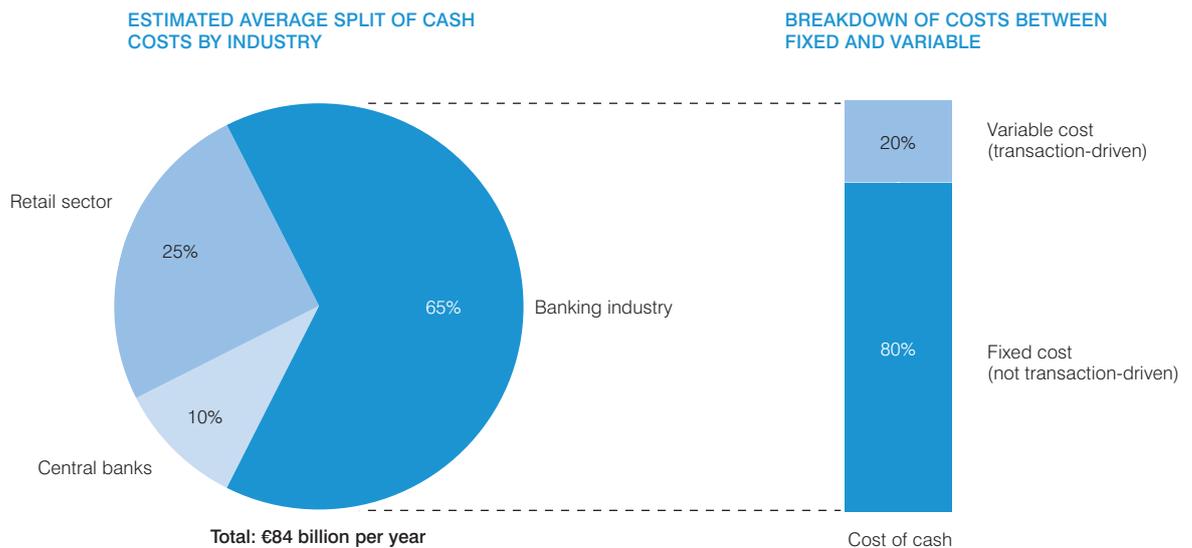
As approximately 80 percent of the total cash costs are fixed, the cost per transaction will increase when cash volumes start declining.

Exhibit 1
Overview of the Cash Infrastructure



Source: Booz & Company analysis

Exhibit 2
The Cost of Cash in Europe in 2009



Source: European Payments Council; Retail Banking Research; Booz & Company analysis

REDUCING THE COST OF CASH OPERATIONS

There are three “waves” of activities being used by banks to bring down their cash costs: process optimization, outsourcing, and multi-bank cooperation (see Exhibit 3).

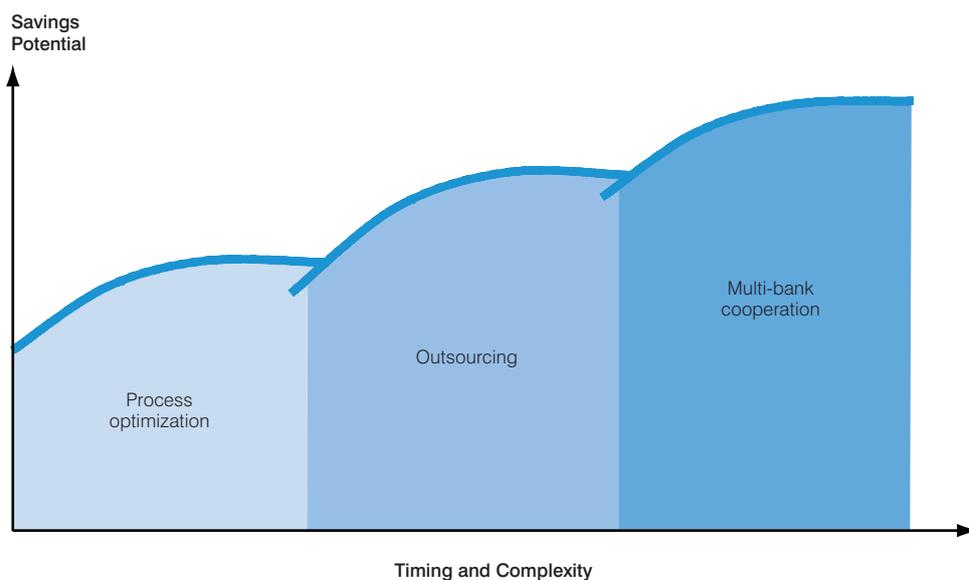
Process Optimization

Through more sophisticated cash planning, intelligent monitoring of

ATM incidents, and rationalization of the ATM footprint, banks can cut their total cost of managing cash by as much as 10 to 15 percent.

Advanced cash planning tools can help banks optimize the volume of cash held in ATMs and the frequency with which these machines are

Exhibit 3
The Three Waves of Cash Cost Reduction



Source: Booz & Company

replenished, reducing the expense of physically refilling them and holding banknotes inside.

More intelligent monitoring of incidents at ATMs avoids the unnecessary dispatch of maintenance teams and could save 20 percent or more on maintenance charges. To achieve such savings, banks are identifying whether an incident can be dealt with remotely or requires first- or second-level maintenance. In most geographies, about 10 percent of callouts are unnecessary and an estimated 30 percent of all first-level maintenance efforts are redundant because the incident requires second-level maintenance.

By rationalizing their network of ATMs, banks can remove redundant and underutilized machines and save on real estate, machine depreciation, and servicing and maintenance costs. Banks should also ensure that local management is incentivized to install ATMs only in locations where the returns justify the costs.

Outsourcing

Transferring cash operations to third parties, such as CIT providers, can lower costs, as outsourced providers typically achieve significant economies of scale. By outsourcing cash operations, banks can incur savings of 15 to 20 percent, with equivalent or higher service levels.

Many banks are already outsourcing basic elements of their cash operations, such as cash distribution and machine replenishment and maintenance. Some banks have gone a step further, passing responsibility for machine management, cash planning, and back-office activities to one or more external suppliers.

However, as these providers grow, they are managing more and more of the cash operations, which can leave banks very dependent on one provider that could push up prices. In the U.K., for example, G4S has managed to establish a dominant market position, giving it significant negotiating strength in pricing discussions with

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banks, as well as creating a single-point supply risk.

Multi-Bank Cooperation

By collaborating on cash processing, distribution, and machine management, banks can cut the cost of their cash operations by an estimated 20 to 30 percent—and avoid some of the risks inherent in outsourcing. A multi-bank cash utility carries out cash planning, machine monitoring, cash processing, cash distribution, contract management, and even reconciliation and reporting. Confidentiality of cash stocking levels (a competitive secret for many banks) can be maintained through the use of bank-specific parameters that are held by the utility on a highly confidential basis.

Such cooperation also helps banks and retailers rationalize on a wider scale, to reduce the number of ATMs in a particular area while increasing the traffic at each machine.

To bring costs down further, the utility may consolidate CIT operations within specific geographies and engage a single CIT provider

to distribute cash for all banks (and potentially retailers) in a particular region. This simplifies the logistics of moving cash to and from ATMs, reducing travel time and expense. Also, with a greater number of machines to service in a given area, maintenance teams should be more fully utilized.

And rather than have a single CIT provider for all of its national cash operations (as is the case for many banks at present), a consortium can increase market competitiveness and reduce single-supplier risks by using a range of different suppliers, each serving a different geographic region.

Joint processing of cash can also help a utility decrease its total number of cash centers. This makes more efficient use of existing assets and spreads the high fixed costs of these centers over a larger cash volume.

In Australia, the four major commercial banks—ANZ, CBA, NAB, and Westpac—jointly own and use the cash outsource provider Cash Services Australia (CSA), which was established in 2001.

CSA provides cash supply chain management, including processing and distribution, which allows the banks to eliminate their in-house cash teams while maintaining full security and confidentiality. The Netherlands is planning a transition to a similar arrangement. Beginning this year, Geld Service Nederland (GSN) will deliver cash processing and distribution services for the three major Dutch banks: ABN AMRO, ING, and Rabobank.

In Finland, the three major commercial banks (Nordea, OP-Pohjola, and Sampo) have jointly owned and operated the country's largest ATM network since 1994. Named Automatia, this partnership has enabled the banks to cut the number of machines by almost a third without any negative impact on customers' service levels. Geldservice Austria is a similar initiative, largely owned by Austria's Reserve Bank, demonstrating how cooperation between commercial banks and the reserve bank can bring down cash infrastructure costs.

CREATING A SUCCESSFUL UTILITY

If banks want to realize significant cost savings in cash operations and minimize the associated risks, they may have to venture into unfamiliar territory by working more closely with their competitors and building trusted relationships with outsourcers.

In establishing a multi-bank cash utility, banks should take into account the following key success factors:

A Considered Approach to Outsourcing

It is important to identify the elements of the cash processes that could be improved internally and those that should be outsourced, as well as to determine where the operations could benefit from increased scale through partnerships. A strong business case can galvanize action to seek the necessary changes, while the strategic plan should make allowance for risks such as security and supplier power.

Protecting Competitive Advantage

When entering into partnerships, banks should retain ownership of those cash activities in which they already have a clear competitive lead (e.g., machine placement). Such advantages should be clearly articulated and defended with factual evidence where necessary. Cooperation can be highly beneficial

in areas where it is difficult to differentiate, such as cash processing and logistics.

Cooperation with the Central Bank

The central bank is the one major public stakeholder with specialist knowledge of cash operations, and it can appreciate the value of a combined approach involving multiple banks. The central bank is also ultimately responsible for the provision of cash as an essential service and can provide appropriate neutral governance and public oversight to the partnership. Additionally, working closely with the central bank can help banks gain further process improvements. These include increasing the interest-bearing portion of the cash inventory and more efficiently transporting cash between the central bank and the bank cash centers.

Strong Governance over Relationships

A rigorous approach to any alliance can give banks the confidence that they are entering a confidential, win-win relationship. The first step should be a letter of intent and business case based on a detailed baseline for every participating bank. At this early stage, an independent third party should manage information, conduct analyses, and ensure fair comparison among banks.

Cooperation can be highly beneficial in areas where it is difficult to differentiate, such as cash processing and logistics.

CONCLUSION

As their cash costs continue to rise, banks will be under increasing pressure to manage their cash operations more effectively. Although internal improvements can bring significant benefits, outsourcing produces even greater savings—as well as higher risk exposure. Collaboration enables banks to cut costs considerably while minimizing

risks. In Australia, Finland, and Austria, jointly owned cash supply chain management providers have successfully brought down the cost of cash while maintaining security and confidentiality. Such initiatives also give the banks more bargaining power over suppliers and leave them less vulnerable to single-point-of-supply failures.

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