Cost excellence
Viewing costs from a new perspective
Global survey
July 2017
Foreword

Banks have cut billions in expenses from multiple parts of their business in the aftermath of the 2008 financial crisis in an effort to maintain return-on-equity goals while operating in an economic environment characterized by interest rates at a near all-time low and much stricter capital and regulatory requirements. The economic dynamics have started to change for the financial services, and banks are poised for growth. However, this is not a valid reason for banks to stop their cost reduction programs.

By strategically reducing or eliminating costs, and in particular by optimizing infrastructure costs, banks can be leaner and more agile in this changing economic and regulatory environment. They will be better positioned to face increasing threats from FinTech firms that are aiming to introduce disruptive technology-enabled business models. Ultimately, banks can reallocate funds they saved to invest in products and technologies to defend and/or grow market share.

The allocated cost base accounts, on average, for 40% of a bank’s balance sheet; however, our clients are not satisfied with the tools and reporting they have available to manage these costs. Banks are seeking to simplify their allocation framework, increase cost transparency and ultimately identify cost reduction levers.

We are seeing the financial services industry pursuing three major objectives:

1. Improve cost transparency. Gather better understanding on the allocated cost base, identify cost drivers, increase visibility on how costs flow through the services delivery value chain and increase the use of unit costing with volume drivers that reflect how the cost recipients manage their business (e.g., number of loan applications processed as opposed to CPU usage time).

2. Increase cost influenceability. Generate insights on how to optimize cost-to-serve through changes in consumption behavior and more accurate demand management. Assign clear cost accountability and incentive cross-organizational dialogue based on proactively reducing costs rather than defending the allocation charges.

3. Improve cost sustainability. Embed virtuous cost reduction behavior within financial planning and business performance reviews. Adopt cost analytics with the right balance between lagging and leading indicators to manage costs before they are incurred.

In the last five years, we have seen our clients undertaking several cost reduction initiatives. While delivering on short-term reduction targets, these initiatives have been typically subject to three unintended consequences: difficulties tracking the estimated reductions back to the bottom line; inability to retain the cost savings over long periods of time, and prevention of recurrence of these same costs upon increase of business volumes.

To achieve sustainable cost optimization, banks needs to shift from managing expenses toward analyzing what really drives the cost, and rethinking their service delivery operating model to reduce cost-to-serve without harming revenue growth. Additionally, cost reduction needs to be enabled and supported by foundational capabilities such as service catalog and taxonomy, cost analytics, allocation and profitability methodology, governance, cost accountability and technology.

Through this report, we will share findings and insights from our conversations with large banks across the Americas, EMEA and APAC, including our analysis and viewpoint on leading practices and our experiences in designing and delivering strategic cost management programs.
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Jump-start your path toward your target state with immediate benefits

About the survey

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Introduction

This report includes insights on cost allocations from our conversations with about 30 senior finance officers, representing 13 financial institutions across the globe. We also included additional material depicting EY’s views on different aspects of this topic, leading practices and methods for improving performance.

The survey results indicate that firms across different geographies are facing similar challenges when managing the allocated cost base, and they aspire primarily to achieve the same improvements: cost transparency, simpler allocation processes and more effective cost-cutting tools.

While there are occasional differences — for example, in the propensity of firms to leverage international lower-cost locations to deliver key portions of their allocation process — we are seeing the emergence of global trends among respondents.

Throughout this report, we will comment on the main components of cost allocations, as well as analyze some of the key enablers, such as cost analytics and integration with financial planning, that strengthen the ability to influence and control the allocated cost base.

This report is organized into five main sections:

1. **Better questions for top-tier cost management.** This section proposes a few thought-provoking questions that are helpful to look at when considering the actual purpose of cost allocation and its role in supporting cost management.

2. **Cost excellence supporting decision-making.** This section presents senior management viewpoints on cost allocation, including a perspective on the ongoing costing transformation within the financial service industry.

3. **Deconstructing cost allocation.** This section focuses on the three building blocks of cost allocation: service catalog, costing methodology and allocation drivers. It offers a perspective on the current state of the banking industry and presents a vantage point from which to evaluate emerging trends and EY’s viewpoint on leading practices.

4. **Cost excellence success factors.** This section connects cost allocations with other key finance and business processes, emphasizing the need for an integrated enterprise-wide approach to costing.

5. **Jump-start your path toward your target state with immediate benefits.** Finally, EY presents its view on how to start a cost allocation transformation.
## Changes in cost allocation

### Unclear, and often conflicting, cost accountability models

Cost allocation typically generates organizational friction around who takes up which costs rather than collaborating to reduce the enterprise cost base.

### Complex allocation methodologies that do not reflect the way the service recipient manages its business

- 53% of the allocated cost base is distributed through volume-based drivers.
- However, only 40% of the cost base is distributed through volume-based drivers that reflect business activities.
- 100% of survey respondents recognize their need to improve cost transparency and have started a transformation program.

### Insufficient actionable cost insights

Inability to identify cost drivers and reduction levers and understand how changes in consumption behavior lead to cost savings.

### Complex allocation methodologies that do not reflect the way the service recipient manages its business

- 77% of survey respondents are not using easily reconcilable drivers between allocations and financial planning.
- 69% of survey respondents based their allocations on one or more service catalogs, however, 23% of our clients adopted one enterprise-wide catalog.

### Numerous steps and recursive allocations cause loss of transparency

- 46% of survey respondents are using a two-step allocation process: first, they allocate to business units, then from business units to products, customers, legal entities and countries.
- 60% of survey respondents that are using a two-step allocation claim that transparency is lost between the steps.

### Cost analytics do not cover the entire cost base and impair the ability to manage costs in a forward-thinking way

- 58% of survey respondents do not extend the use of analytics to the entire cost base.
- 54% of survey respondents do not have sufficient cost analytics available to drive down costs.
- 38% of survey respondents claim they do not have enough resources to extend the use of cost analytics.
Playbook for a cost championship

**Accountability**
End-to-end cost accountability assigned to service recipients to incentivize the right cost behavior

**Transparency**
Allocations based on a service catalog that reflects how the recipients manage their businesses instead of depicting the providers’ view

**Ability to act**
Continuous dialogue between service providers and recipients based on identifying actionable cost levers instead of simply defending allocation charges

**Consistency**
One enterprise-wide taxonomy and service catalog to improve consistency and cost transparency

**Simplicity**
Allocation methodology that is simple and retains transparency on cost drivers

**Sustainability**
Cost analytics to allocate costs more fairly and drive down costs in a sustainable way
Questions to self-assess your cost management capabilities
The starting-five questions to assess how cost allocations enable actionable and sustainable cost management

01 **Impactful**
Are we actively managing costs before they are committed?

02 **Transparent**
Are we producing cost reporting that has the right level of detail?

03 **Insightful**
Are we managing costs or just expenses?

04 **Actionable**
Are we simply reporting numbers or generating actionable insight?

05 **Continuous**
Are we reducing costs as part of our cost management routines or only as one-off exercises?

**Well-planned**
Do we have a game plan for continuous improvement or transformation of our cost allocations?
Are we actively managing costs before they are committed?

Issues

- Most banks use expense reporting and cost allocation as accounting processes to analyze and distribute costs after they are incurred.
- The tools to proactively manage costs are typically either unavailable or are communicated in a way that does not reflect how the cost recipients manage their businesses.
- Cost allocation often leads to internal disputes over who is responsible for which costs, with little benefit to enterprise cost management.

Insight

Banks should incentivize proactive and forward-looking cost management through:

- Assigning of end-to-end cost accountability to the cost recipients
- Adopting of a single enterprise-wide taxonomy and service catalog to improve consistency and facilitate dialogue across the organization
- Embedding cost allocation and management within financial planning and business review
- Sharpening cost analytics to identify cost drivers and the organizational unit that can either control or influence them
Are we producing cost reporting that has the right level of detail?

Issues
- Cost reporting is typically a proliferation of details with a limited amount of information that can be acted upon.
- Reports are often not tailored to users, and service recipients and providers typically leverage the same generic reports.

Insight
Cost reporting should:
- Focus on clearly identifying the origin of the cost of the drivers, and methodology for the allocation
- Be tailored to the users – service providers need to gain insights into how to optimize their value chain and reduce cost to serve, while recipients need to understand how to reduce costs through changes in consumption behavior
- Allow for complementary cost analyses to:
  - Identify areas of focus (controllable vs. non-controllable costs)
  - Tailor cost cutting to not harm growth (revenue-related vs. non-revenue-related costs)
  - Identify short-term opportunities (discretionary vs. committed costs)

Leading institutions use cost analytics to allocate costs more equitably and transparently, and to reduce costs by leveraging forward-looking analyses.
Issues

- Banks tend to focus on managing expenses against a budget instead of optimizing the cost to serve.
- Often budgets are out of date shortly after they have been approved; consequently, they do not always represent the proper terms for comparisons in setting cost reduction targets.
- Connection to profitability reports is weak and untapped as a lever to reduce costs.

Insight

Banks should shift their focus from expense management toward cost management via:

- Increased transparency on how costs flow through the service value chain.
- Periodical comparison of cost to serve:
  - Internally against similar services and trends over time of the same service.
  - Externally against the cost of purchasing the service via an outsourcing vendor.
- Rolling forecast captures the most up-to-date insights and allows for better management of costs in a forward-looking manner.
- Periodic review of value-for-spending and service recipient satisfaction.

Banks should leverage profitability reporting with cost analytics to adjust product and customer mix when appropriate.
Are we simply reporting numbers or generating actionable insight?

Typical examples of cost reduction levers enabled by cost allocations

**Business-driven**
- Establish continuous dialogue between service providers and recipients based on identifying actionable cost management levers instead of disputing and defending the allocation charges
- Plan continuous improvement through integration of cost allocation with financial planning and analysis (FP&A)

**Alignment of cost accountability to ability to influence**
- Improve clarity on cost ownership throughout the organization
- Align cost ownership with ability to control and influence the cost
- Improve cost analytics and collaboration between recipients and providers to identify saving opportunities

**Process and data efficiencies**
- Establish a cost management and expense reporting center of excellence (CoE) to manage the multiple ongoing costing initiatives while avoiding duplication of activities and more efficient data management
- Look at opportunities to leverage cost allocation capabilities to address costing/pricing of critical business services (Living Wills) and transfer pricing
Are we reducing costs as part of our cost management routines or only as one-off exercises?

**Issues**

- Cost reductions are typically pursued as one-off exercises to meet top-down targets.
- Cost takeout opportunities from corporate overhead charges cannot easily be assessed during the business review process.
- Most banks face difficulties in tracking cost savings back to individual profit and loss statements.
- Cost analytics at most banks still do not extend to the full cost base and are predominantly backward-looking indicators.

**Insight**

Banks should embed cost reduction behaviors within the business review cadence and build/strengthen cost analytics in order to:

- Improve the ability to track volume consumption and achieve more equitable allocations
- Increase the visibility of cost drivers
- Improve the focus on forward-looking management of costs through increased usage of leading indicators
- Track cost savings back to individual P&Ls, improving the link between cost reduction and performance management

Overall, banks should seek to provide their team members with better tools, standard frameworks and transparency (understanding of cause and effect) in order to drive better spending behaviors.
Based on our answers to the previous questions, are we satisfied with our cost allocations or do we need a game plan for change?
Do we have a game plan for continuous improvement or transformation of our cost locations?

**Issues**

- Banks typically apply basic incremental improvements that make their current state just slightly better.
- The prevailing trend is toward point solutions instead of developing broader capabilities.
- The change approach often does not consider opportunities for optimization at the enterprise level.

**Insight**

Banks should manage the multiyear transformation through an approach that delivers immediate value to the organization and offers a sustainable change path.

Short-term benefits are achievable through:

- Guiding principles endorsed by senior management
- Improvement on governance, including cost accountability
- Dialogue between service providers and recipients that is based on forward-looking continuous improvements as opposed to backward-looking arguments
- Centralized policy to improve consistency at the enterprise level

Mid-/long-term sustainable cost management is achievable through:

- One enterprise-wide service catalog and taxonomy
- Increased usage of unit costing with volume drivers that are linked to business activities
- Insightful cost analytics that cover the entire cost base
- A dedicated technology solution
Cost excellence supporting decision-making
The case for change

40% of the cost base is made up of allocated costs

80% of banks are not satisfied with the level of transparency and insights available to manage the allocated costs

100% of banks have ongoing cost allocation programs

100% of banks say that “cost transparency and simplification” and “cost reduction” are the primary drivers for the transformation
A new focus on cost allocation

While banks continue to pursue additional cost efficiency opportunities, many are reasonably satisfied with the level of cost optimizations achieved with the front office and have shifted their attention to identifying efficiencies within the allocated costs. Allocated costs account for about 40% of the entire cost base; however, most executives interviewed declare that they do not have enough insights into what drives these costs to the degree needed to pursue their cost reduction goals.

Need for better cost insight

Cost allocation as an enabler for better cost management is a priority for each of the executives interviewed; however, only 17% believe they have sufficient insight into what actually drives the cost and what steps they can take to influence it.

Cost allocation also remains important to customer and product profitability. In particular, executives would like to maintain cost transparency as costs flow from functions to business lines in order to allow for more accurate profitability calculations.

Banks are also increasing their attention on how they can improve management of their “stranded” costs, while implementing changes in business and product mixes. The industry is looking at optimizing businesses and products based on return on capital, profitability and contribution to the bank’s overall strategic agenda. However, some are discovering that “switching off” businesses does not automatically eliminate their related costs. One of our respondents has claimed that despite closing half a dozen branches, instead of having fewer costs as expected, the costs have actually increased.

“How does cost allocation support the pursuit of our strategic priorities?”

Key messages:

- Banks consider cost allocation an important vehicle to support numerous strategic priorities related to enterprise value, tax and compliance.
- Our clients indicate support of cost management, including cost reduction, as the most important priority.
- Many of our clients believe that they must invest in order to improve how cost allocation contributes to cost management and cost transparency.

“Cost allocations sometimes obscure the costs rather than support cost management.”

Finance executive – global systemically important financial institution
There is general satisfaction toward compliance, but opportunities still exist for better efficiency

While banks recognize the important role that cost allocation plays in maintaining compliance with regulatory requirements and a defendable position with the scrutiny of tax authorities, they feel their current state is adequate to allow them to achieve these objectives. Although executives recognize there are significant opportunities for improving efficiency in these areas (in particular, in terms of data and process optimization), they would consider changes only if those opportunities would enable significant strides toward enterprise cost reduction.

Why is it important to improve cost allocation, as well as its contribution to cost management?

- There is an industry-wide focus on further reducing costs.
- Allocated costs have a material impact to the bottom lines of business units.
- Balancing granularity and efficiency is difficult at large financial institutions.
It’s all about controllable expenses

The emerging trend in cost management is to align cost accountability according to the actual ability to drive down costs across the organization and support a more proactive collaboration between service providers and recipients. Banks have recently focused on differentiating costs between those that are controllable and uncontrollable. As this is the prevailing trend in cost management, banks are still investing in building out their capability to fully support this effort.

Influenceability is achieved primarily through better and more accurate demand management, as well as changes in consumption behaviors that lead to both lower charge-backs to the recipient and lower costs for the overall enterprise.

Service recipients to own end-to-end costs

A few financial institutions are pushing toward a cultural change where the front office is assigned accountability for the entire cost base. This reinforces cost ownership and helps the organization focus on traditional overhead costs.

EY’s view is that financial institutions should make the lines of business accountable for the entire cost base. This incentivizes them to engage in better dialogue with each function, challenge the provider to optimize their cost to serve, in particular for non-revenue-related costs, and ultimately work together toward reducing costs.

Key messages:
>
- Banks are applying complementary lenses on their cost base; however, the stronger requirement is to determine controllable vs. non-controllable costs from a business unit perspective.
- Our clients have recently invested in improving their ability to analyze costs between “run the bank vs. change the bank” and “fixed vs. variable.” Our clients claim that their current ability to deliver on these lenses is satisfactory.

"We are trending towards the expectation that each business will own end-to-end costs.”

Finance executive – global systemically important financial institution
Reduce costs without harming growth

Banks are also examining their discretionary costs vs. committed costs to identify actionable areas for short-term results. This approach is valuable across the entire organization, but banks seem to adopt it more frequently to analyze the cost base within functions (most often technology services) rather than at the enterprise level.

While cutting costs remains one of the highest priorities for financial institutions, not all costs are equal. Certain costs are foundational to a bank’s ability to grow revenue. Recognizing which costs to cut and which ones drive revenue is key to supporting sustainable and profitable cost cutting. The alternative is that banks will see costs returning to pre-cut levels once business volumes rise.

Revenue-related costs should still be subject to review with the objective of identifying efficiency opportunities.

Our viewpoint on profitably cutting costs is a three-part formula:
1. Create stronger cost accountability
2. Identify actionable cost-cutting opportunities
3. Optimize costs that drive revenue generation and cut, whenever possible, costs that are not directly linked to growth

Cost management is more than just expense management

Many banks recognize that cost management is more than just expense management. Expense management is a healthy cultural trait that pushes every layer of the organization to operate within their budget and consider their expenses carefully. While this needs to be preserved, it does not necessarily help banks transform their costs.

Our view is that banks should analyze their cost to serve, including expenses and assets, and understand how costs flow through their delivery value chain. This will identify levers to optimize the supply chain and reduce unit cost from a shared service function perspective. To achieve this, our clients need to increase the transparency on their allocated cost base.

“Understanding discretionary costs is very important because you need to know what is most actionable.”

Finance executive – global investment bank

“To be effective in cost management, you really need to understand the driver and the origin of the cost.”

Finance executive – leading international banking group

“Banks are very good and rigorous at expense management but not at cost management.”

CFO enterprise staff functions – large US bank

Expense management vs. cost management

- Expense management is knowing the cost of every item purchased and who bought it, and measuring that expense against the allotted budget.
- Cost management is identifying and driving down the actual cost to serve.
Cost allocation operations tend to be centralized

There are different models currently being used throughout the industry for cost allocations. The most frequently used models leverage centralized functions or federated functions within business units. While each model has its strengths and weaknesses, the majority of our respondents (nearly 92%) run their allocations through centralized hubs in conjunction with support teams embedded within the lines of business.

European banks better exploit international lower-cost locations

Many banks that use centralized functions leverage lower-cost locations to conduct part of the cost allocation operations. In particular, about 50% of centralized personnel sit in lower-cost locations. However, banks in the Americas and EMEA use different localization strategies. Most US banks tend to maintain operations domestically; although, the use of lower-cost domestic locations is not necessarily the result of a cost allocation strategy, but rather it is a product of managing the broader organization’s global footprint. EMEA-based banks are more effectively utilizing lower cost internal locations. We are seeing well developed cost allocation hubs in Eastern Europe, India and the Philippines among our survey respondents. This enables relatively higher efficiencies, particularly in the execution of routine activities such as data management and report production.

Cost allocation models: centralized vs. federated by business unit

A centralized delivery model provides opportunities for efficiency and consistency. Centralization streamlines the costing process and avoids duplicative activities that lead to reduction of the overall cost to serve. Additionally, current regulatory challenges (e.g., Dodd-Frank’s Living Will, CCAR’s requirement to model expenses under stress scenarios) are increasing the importance of consistency and transparency throughout the entire organization.

An allocation model that is federated by business allows for closer alignment of services to business specific requirements and preferences. Often, each business unit has different interpretations on what “good” looks like when it comes to defining services (e.g., brand activities). Federated models often can provide a better answer. Additionally, proximity of costs to the business allows for easier retention of transparency and cost control.

While many of our clients have mixed opinions on the ideal organizational model, based on our research, we think the centralized delivery model presents a better fit to address today’s need for enterprise-wide consistency. Additionally, this model increases production efficiency (through better supply chain optimization and economies of scale) while meeting the numerous use cases for cost insights such as allocations to legal entities and organizational layers, pricing of critical services, meeting tax requirements, transfer pricing, Regulation W and CCAR’s pre-provision net revenue (PPNR) reporting requirement. However, banks need to involve the business units and other service recipients from the outset, with the definition of the services and the allocation rules. This is key to maintaining transparency throughout the end-to-end allocation cycle.
Creation of a costing center of excellence to orchestrate efficiencies and enterprise-wide consistency

Banks have multiple costing change initiatives in flight simultaneously that typically lack overarching guidance. While the initiatives address the right questions, the lack of integration inhibits the opportunity to create consistent and effective costing practices throughout the entire organization.

From our experience, the above initiatives serve as different costing use cases based on common data sets. There is an opportunity to create a costing center of excellence that:

- Streamlines the costing process and avoids duplication of activities
- Applies consistent methodologies across the enterprise
- Allocates costs to legal entities and management in the same process
- Gathers data at the most granular level required and makes it available to all users

Key:
- Entire cost base
- Partial cost base
- Enterprise cost management line
- Transfer pricing line
- Living Will line
- Servicing costing line
Banks are investing in strategic cost allocation initiatives

Banks are investing in efforts to revamp their cost allocations with the objective of improving cost transparency while empowering a cost reduction agenda through the identification of new opportunities for efficiencies in the allocated cost base. Most survey respondents have an active or upcoming cost allocation program, or related improvements, and are investing significant amount of their budget.

“One-hundred percent of interviewed banks have ongoing or upcoming programs aimed at transforming cost allocations, with an average time frame of two to three years.”

Average budget available for transformation

- Less than US$1m: 36%
- US$1m–US$5m: 27%
- More than US$5m: 37%

Each of our respondents are at a different point of the evolution of improving their cost allocation process. This should be considered when evaluating these statistics.

Main drivers for strategic cost program

- Cost transparency and simplification: 100%
- Cost reduction: 92%
- Regulatory requirements: 54%
- Changes in tax policies: 38%
- Shareholder value: 31%

Totals do not add up to 100% due to participants selecting multiple answers.

“If we get transparency, cost reduction follows.”

CFO enterprise staff functions – large US bank
Improving cost transparency is a bank’s first priority

Banks across the Americas, EMEA and APAC are pursuing similar agendas to transform their cost allocations and achieve higher cost transparency.

Banks are focused on having a better understanding of their allocated cost base as a way to empower decision-making: in particular, to enable higher visibility into what drives costs and how they can influence them.

Transparency and better cost insights ...

Banks are trending toward assigning end-to-end cost accountability to cost recipients. Therefore, they are looking to enable better proactivity to reduce costs by gaining greater insight into the cost base, available management levers and the right time frame to act on those levers. In addition, some institutions are focused on understanding how service costs flow through the value chain and how it ultimately ends up in profitability dimensions, such as products and customers.

... delivered through more efficient processes ...

Banks want to simplify their allocation processes and methodologies. They aspire to increase the quality and speed of delivery, while at the same time reducing their process cost. Simplification, coupled with enterprise-wide improvements to consistency, is also expected to facilitate the opportunity for banks to further leverage international, lower-cost locations for recurrent activities.

... that lay the foundation for a sustainable culture that drives the right cost behavior

Banks ultimately aspire to create an environment where effective cost management is embedded within a sustainable and repeatable process, rather than functioning as a one-off exercise. Banks look to achieve this through changes in cost ownership, better alignment of controllable costs to cost accountability and cost analytics that increase transparency into the cost base.
While pursuing the cost management transformation, banks are looking to retain and extend their existing good practices

Retain costing talent and institutional knowledge

With the industry trending toward consolidating enterprise allocation activities within centralized teams and in some cases de-localizing part of the process to lower-cost locations, retaining costing talent and institutional knowledge is a key priority for banks.

Leverage existing technology platforms

While banks understand the key role that technology plays in the broader cost management framework, they are aiming at leveraging and evolving the existing technology platform whenever possible, instead of replacing it in order to contain the costs of the transformation.

Replicate areas of success

While all institutions are not satisfied with cost transparency at the enterprise level and are looking to simplify their cost allocations, they also recognize that there are cost areas within the bank that are more advanced and that are fit for purpose for effective cost management. These cost areas of success typically include the following:

• Cost allocation processes within technology and operations
• Cost granularity to be retained where deemed appropriate
• Business unit’s acceptance of overhead cost being included in the allocated cost base
• Ability to question and challenge allocated costs in dispute forums
Deconstructing cost allocation
Tools of the trade

69% of banks use service catalog-based models to allocate costs.

However, 53% of the allocated cost base is distributed through volume-based drivers.

23% of banks have adopted a consistent and holistic enterprise-wide service catalog.

Yet, only 40% of the cost base is distributed through volume-based drivers that reflect business activities.
To fully optimize costs at an enterprise level, a consistent taxonomy is essential. Almost 70% of banks use allocation models built from service catalogs. These service catalogs contain service level agreements used to help determine the level of service, priorities and responsibilities of service providers and recipients. Institutions are discovering that these models are an ideal compromise between costing models with excessive granularity, and simpler, yet weak, top-down approaches. Service catalogs are powerful tools in creating a unified understanding of what functions are provided, at what cost, while creating a unified taxonomy that lays the foundation for effective dialogue around cost and collaboration between providers of a service and its recipient.

Service catalog granularity is a key feature for balancing simplicity and influencing cost.

The granularity of a service catalog is a key factor in maintaining an effective balance between simplicity and the ability to act. In principle, a service catalog should be designed as simply as possible, and investment in additional granularity should be considered based on cost materiality, ability to influence costs (e.g., costs that are business-driven versus those tied to overhead), role in driving profitability and whether it facilitates compliance with regulatory requirements.

Most institutions currently perform very granular allocations across the cost base. However, with large and complex cost bases, it is often challenging and expensive to maintain this level of granularity. Banks have the opportunity to simplify their current catalogs and methodologies based on their evaluation of whether the investment in granularity is justified by any of the previously mentioned criteria, and, finally, they consider granularity as an enabler to effective cost management. This simplification should generate efficiency in the allocation process, increase the speed of delivery and help banks focus on what is most important, rather than being overwhelmed by extraneous details.

"It is difficult to be granular and effective with the size of our cost base."

Finance executive — global financial services firm

"We need the right details, not just details per se."

Corporate allocations executive — global financial services firm
Design a recipient-oriented catalog to improve cost awareness and drive changes in consumption behaviors

The industry is trending toward assigning end-to-end cost accountability to a service's recipients. To support this cultural shift, a service catalog needs to be designed to reflect how recipients manage their businesses. Too often, financial institutions adopt service catalogs that reflect how individual functions manage their own businesses rather than considering the recipient's viewpoint. This is typically a consequence of the function driving the definition of the services with limited engagement from the recipient side.

From our perspective, banks need to break free from this pattern to lay a foundation that incents better dialogue and collaboration between the service recipients and providers. This requires four steps:

1. Assignment of end-to-end cost accountability to service recipients
2. Development of cost insights that create transparency into which costs a service recipients can influence; this view provides guidance on where to focus efforts
3. Use of services into the cost management dialogue, shifting conversations away from defending current allocation practices to optimizing business conduct, through increasing cost transparency and cost awareness with the use of a service catalog that resonates with business fundamentals
4. Use of unit costing based on volume drivers that are aligned with business activities (e.g., loan transactions) whenever possible, as opposed to technical parameters (e.g., CPU usage time)

"We need to discuss business, not minutiae."
Finance executive – global financial services firm

"There are fewer excuses from divisions to say ‘this is not my cost.’ Divisions are held accountable and need to find ways to manage and drive down costs. But it all starts from making them accountable."
Finance controller – leading European bank

91% of institutions surveyed have updated their service catalogs within the last year. This was driven by an increased interest in cost transparency and changes in regulatory standards.
Tailor cost distribution methodologies based on the characteristics of the service and the availability of data

Based on our experience, there are four methodologies for distributing costs from service providers to recipients, and we advise our clients to assign the proper one to each service, based on the nature of the service and the characteristics of the underlying cost base.

In particular, materiality and ability to influence the cost base from a recipient perspective are the two most important criteria that should drive the selection, and evaluate the case for investing in the bank’s ability to improve the availability and quality of driver data.

Enterprise-wide service catalog

- Materiality
- Linkage of cost drivers to business activities
- Nature of the cost (transaction-driven vs. overhead)
- Ability to influence and reduce cost
- Availability of driver data

**Foundation of analysis**

**Criteria**

**Methodology**

- **Direct attribution**
  Costs have a clear relationship to the profitability dimensions (e.g., business units, products, customers, legal entities) and are incurred solely for the purpose of those dimensions
  - No calculation required

- **Volume-based allocation**
  Shared cost base material, influenceable from a recipient perspective, and for which system data is available covering accurate volume drivers (e.g., card transactions)
  - Rate x volumes

- **Blended-rate allocation**
  Shared cost base for which the investment of developing accurate unit costing is not justified by the expected benefit; blended rate typically includes FTE, RWA and revenue
  - Percentage-based allocation

- **Simple proxy**
  No relationship exists to cost objects, and allocations are based on management discretion and to be agreed up front as part of the financial planning process
  - Proxy and management discretion
Our view is that a service catalog should be as simple as possible, but not simpler. Investing in granularity in specific areas will add value through increased cost transparency and ability to influence without compromising simplicity.

- A stratification of services (i.e., more granular sub-services) according to their materiality and ability to influence can support a targeted approach to improving transparency, enhancing influence from a service consumer perspective, and enabling granular detail that is fundamental for the push-down of allocations.

- Investment in establishing up-front design principles for granularity and in gaining consensus on the methodology and allocation keys applied across the service catalog creates the foundation upon which an allocation methodology can be built in an aligned, consistent and scalable manner.

**Design principle:**
For material services that are primarily transaction-driven, a more detailed service catalog improves linkage with the business activity and, therefore, the understanding by businesses of how their actions could influence costs.

**Examples of cost differentiators:**
- Full cost absorption vs. direct costs
- Variable cost vs. fixed cost
- Discretionary costs vs. committed costs
- Run the bank vs. change the bank

**Enabler:**
Refresh driver data at an appropriate frequency, prioritizing cases where the business has greater ability to influence costs. This will incentivize the right behavior as the cost reduction efforts will be reflected in lower chargebacks.

**Examples**
- Most of operations, e.g., mortgage operations
- Brand marketing, group internal audit
- Real estate management, e.g., office management services
- HR policy and employment
The allocation waterfall needs to balance transparency with the need for fully loaded costs

Banks are using a wide variety of allocation waterfalls. Some institutions prioritize simplicity, while others focus on having a fully loaded cost view. Still others are leaning toward hybrid models. However, more than 60% of the respondents indicated that a partial waterfall methodology was their preferred methodology. The following sections provide additional insight on each model.

Direct waterfalls are simple and maintain transparency, but do not provide the fully loaded cost view of each service

The direct waterfall methodology is used by service providers when allocating to recipients only direct expenses. This is the simplest allocation methodology, providing the highest degree of cost transparency through the allocation process. While simplicity and transparency are at the forefront of a bank’s cost management aspirations, the lack of availability of fully loaded cost views may impair awareness by the service recipient of the entire cost behind the services they receive. Additionally, this methodology does not align with the ongoing industry trend that assigns end-to-end cost accountability to the service recipient.

Reciprocal waterfalls display the true cost of providing a service, but transparency is lost and ability to affect costs is impaired

The reciprocal waterfall methodology is the process where each service provider allocates their fully loaded service costs to each service recipient. This creates an inefficient allocation system where multiple steps are required. One institution has to perform nearly 20 steps to build a fully loaded allocation picture. Transparency is lost. While this methodology does help increase cost awareness, it often leads to political friction and an environment where the only conversation between providers and recipients of a service is focused on defending allocation charges rather than discussing how to improve cost management.

Reciprocal waterfalls display the true cost of providing a service, but transparency is lost and ability to affect costs is impaired

The partial waterfall is the ideal compromise between simplicity and actionable cost insights

The partial waterfall is a hybrid methodology where most material providers – typically real estate, technology and operations – allocate costs to each service recipient. Other providers allocate both direct expenses and their share of incoming allocations received from real estate, technology and operations to recipients. The industry is trending toward this waterfall methodology as it still offers a quasi-fully loaded cost without generating unnecessarily complex repetitive allocations. After all, as one finance executive put it, "Fully loaded costs are viewed as the person, the seat they sit in and the technology they consume."
Methodology

Adopt unit costing based on forecasting to increase cost awareness and ability to act

Use unit costing whenever possible to increase transparency

Unit costing increases transparency into allocated charges, as it links costs to volumes recognized by the service recipient.

EY research shows unit costing is a key enabler in assigning cost accountability based on actual control and influence over the cost base. In particular, service providers should be accountable for their unit costs and be responsible for optimizing their service value chain to reduce the cost to serve. Service recipients should be accountable for the accuracy of their volume forecast, as volume accuracy is a key input to the provider’s optimization tasks. Unit costing is also useful to analyze budget vs. actual variances and identify whether the difference is due to volume variances (i.e., different volume than planned) or to efficiency variances (i.e., higher unit cost than expected).

There are various methodologies for applying unit costing. They are based on using actual, budgeted or forecasted figures for both unit cost and volume.

Balance predictability against ability to act

Banks often use actual volumes coupled with either actual unit costs or standard unit costs, with quarterly, annual or semiannual true-ups performed.

In our view, using budgetary figures increases the stability and predictability of charges from a recipient perspective. Banks are using true-ups to help generate awareness on actual spending.

However, banks should consider using unit costs and volumes based on forecasts to allocate their costs. This methodology puts emphasis on forward-looking performance and cost cutting rather than discussion and defense of results recording.
Whenever possible, allocate cost directly to profitability dimensions, such as products, customers and legal entities

One-step allocation is the most effective way to retain transparency

The current industry trend is to directly allocate costs to the most granular profitability dimension and then aggregate and roll up similar cost groups to perform an analysis at a more material level. This methodology aligns costs to the most accurate drivers and makes sure that transparency is not lost due to multiple layers of allocations typically performed by different organizational units.

Two-step allocations

Historically, the majority of finance functions have performed two-step allocations where functions allocate costs to business units and the business units are then responsible to perform onward allocation to the more granular profitability objects.

This practice creates an additional layer of separation from where the cost originates and the ultimate recipient. Our clients indicate that this approach leads to loss of transparency as a result.

How are costs allocated to the profitability dimensions?

- One-step allocation: 46%
- Two-step allocation: 46%
- Both: 8%

60% of banks currently performing a two-step allocation claim that they lose transparency.

There is a growing appetite in the market to develop a centralized cost allocation center of excellence

About 80% of banks surveyed responded that they currently have or would be interested in creating a centralized cost allocation center of excellence that is tasked to perform every level of cost allocation within the bank.

This is representative of the desire to improve enterprise-wide consistency on methodology and taxonomy as an enabler to improve the dialogue between the providers and recipients of costs.

Would you consider the opportunity to develop a centralized allocation center of excellence?

- I might consider it: 23%
- Definitely yes: 77%
Allocation drivers should improve linkages to business fundamentals

Our clients use volume-based drivers for about 53% of their cost allocations ...

On average, survey respondents estimate that 53% of costs are allocated through volume-based drivers. This figure showcases the outcome of recent investments and the industry trend toward increasing the adoption of unit costing as standard methodology. Our analysis shows a significant disparity in usage of volume-based drivers, with some institutions distributing 20% of costs through this approach, and others more than 90%.

... however, there is room for improvement on the choice of the driver

Upon closer inspection of the volume drivers banks use to distribute costs, we noticed that as much as half of the cost base allocated through unit costing uses drivers that are highly technical and typically do not reflect a strong link with the business activities. Banks agree that these types of drivers, such as CPU usage time, contribute to losses in cost transparency and decrease the understanding of the charges from a recipient standpoint.

Based on our point of view, banks should adopt unit costing (volume-based drivers) to allocate costs when possible.

- Unit costing increases transparency over the allocated cost base and improves recipient understanding of charges.
- Unit costing allows for the alignment of cost accountability with the ability to influence the cost. Service providers should be responsible for optimizing the unit cost, while recipients are responsible for optimizing their consumption behavior and reducing costs.
- Unit costing should be based on volume drivers tied to business activities rather than technical parameters. This further increases the cost awareness from a recipient perspective.
Allocation volume drivers have a significant impact in incentivizing the right cost behavior

Example of good effect of using the right allocation driver

One institution improved its cost to serve for delivering trade-processing services by switching the driver from “number of transactions” to “number of exceptions.”

Upon the analysis of the delivery value chain, one of our clients identified that the main driver for costs was not the volume of transactions processed, but the time required to process exceptions. Following this change, the buyers (recipients) of these services were incentivized to improve the documentation quality and to gather the required information prior to submitting the trade for processing. Through this new focus, and effectively a change in consumption behavior, our client was able to record a reduction in the cost to serve due to a lower number of exceptions and, at the same time, recipients received lower charge-backs and achieved improvements in their business unit profit and loss statements.

Example of unintended behavior triggered by the use of a wrong driver

One institution invested millions of dollars to create a dedicated training facility for its employees. They decided to charge out the facility costs to each business unit based on the number of employees that attended training courses.

The result was that business units, pursuing a cost-reduction target, discouraged their employees from attending any non-mandatory training, thereby missing out on the advanced learning experience that the organization wanted to offer to its employees.

However, while there are minor pockets of variable costs such as on-site technical support, cleaning and maintenance, catering and other costs, the most material part of the cost for this facility has already been incurred by the bank. At this point, there would be no incentive in holding back employees’ participation.

Service recipients are likely to operate under the assumption of optimizing their individual profit and loss statements. The right allocation driver should keep that in consideration and use this knowledge as a leverage to incentivize the intended behavior. In this situation, the institution could have considered alternative charging drivers. One example might have been to charge out the cost of the facility to the business based on the percentage of employees, that although eligible to attend training, did not attend.
Allocation drivers should improve linkages to business fundamentals

Five common allocation drivers
The majority of our respondents indicate they use more than 200 different allocation drivers. However, when we analyze the drivers based on the cost materiality that are allocated through them, it emerges that five allocation drivers are commonly used across the industry.

Allocation is commonly based on:
• Full-time equivalent
• Time spent
• Volume
• Occupancy
• Revenue

Can you indicate the most used drivers?

In our view, banks should rationalize the number of allocation drivers they use. This increases the opportunity for efficiencies in data management and balances the cost of maintaining volume metrics with the actual benefits of cost management.

Banks should prioritize the use of unit costing and select volume drivers tied to business activities. However, when unit costing is not available, for example due to the nature of the service or the current data availability, banks should choose drivers that are easily obtainable and widely recognized by the service recipients.

An increase in the awareness of the most used drivers allows for the focus of data remediation and data quality activities on those drivers first.

Banks should also create a driver dictionary to provide single definitions across the enterprise. We often see our clients adopting multiple interpretations of drivers across the organization. For example, FTE is sometimes used as "Global FTE excluding contractors" or "Global FTE excluding contractors and long-term leave associates," etc. Inconsistent definitions harm cost transparency and impact the ability of the enterprise to optimize costs.

200+
58% of respondents use more than 200 allocation drivers.
Cost excellence success factors
Missed opportunity to integrate cost allocation and financial planning

While more than 85% of the respondents declare they are using consistent methodologies for cost allocations and financial planning, only about 15% of the respondents are leveraging common data sets and using standard, easily reconcilable drivers. This figure is only slightly higher, at 31%, for institutions that have adopted driver-based planning.

In our view, banks should improve the integration between cost allocation and financial planning.

The opportunity to adopt easily reconcilable drivers allows institutions to discuss and manage allocated costs during the budget cycle and position the organization to exploit cost optimization opportunities, as the discussion takes place before costs are committed or incurred.

Additionally, using common data sets reduces the organization’s effort to reconcile financial figures, and at the same time creates synergy on data remediation and data quality activities that can be performed once to serve both purposes.

Zero-based budgeting

Zero-based budgeting (ZBB) is a budget methodology in which the budget for every function starts at zero, and each incremental increase needs to be justified.

This is a powerful cost management tool, as it provides the opportunity to review every unit of expenses within each function. As a downside, this methodology is more time-consuming than the traditional budgeting methodologies.

This practice tends to be adopted by financial institutions less frequently than other industries and typically only when triggered by a market event, such as a merger or an acquisition. We asked our clients if they would consider ZBB as a one-time exercise upon improvements to cost transparency. About 54% of our respondents either would undertake the exercise or are willing to consider this upon understanding of the organizational impact.
Opportunities exist to improve the governance framework and achieve an immediate increase in cost transparency

62% of participants declare they do not have clearly defined roles and responsibilities for cost allocations.

Despite a lack of clarity in roles and responsibilities, most institutions feel there is sufficient sponsorship and oversight from senior management.

Institutions have implemented or are moving toward enabling dispute forums led by senior management to resolve allocation disputes.

31% of institutions are assigning end-to-end accountability to service recipients.

From our viewpoint, leading practice governance frameworks encompass:
- Clearly defined and well-documented roles and responsibilities across the allocation process
- Sufficient sponsorship and oversight by senior management
- Dispute forums, chaired by senior management, to rule on allocation disputes between service providers and recipients
- Service recipient end-to-end accountability on costs, including the allocated cost base
- Overarching enterprise-wide cost allocation policy supplemented, if needed, by more detailed federated policies

Where are new or updated cost allocation policies issued across the organization?

Totals do not add up to 100% due to participants selecting multiple answers

Overarching cost allocation policy as a tool to improve consistency at enterprise level

About 30% of respondents have one enterprise-wide cost allocation policy, and about 30% of participating institutions have at least an overarching policy or principles supplemented by more detailed policies per each business unit.
The use of analytics in cost management is increasing throughout the industry.

Seventy-seven percent of respondents indicate they have support from senior management to develop and utilize analytics to enhance cost management through increased insights into cost drivers and more accurate volume metrics to depict actual service usage.

Despite strong executive buy-in, some banks are still not adopting cost analytics across the entire cost base.

While 62% of respondents indicate they have sufficient resources to develop and execute cost analytics, and despite strong executive buy-in, only 42% of organizations surveyed actually use cost analytics across their entire cost base.

Our survey indicates that cost areas such as technology and operations are more likely to use cost analytics compared to traditional overhead cost areas like finance, risk, legal, marketing and compliance.

"We likely have enough resources, but we need to adjust their focus [to data analytics]."

_CFO enterprise staff functions – large US bank_

**Currently, does your organization have C-suite buy-in to develop analytics on cost transparency and cost management?**

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>77%</td>
<td>23%</td>
</tr>
</tbody>
</table>

**Does your organization use cost analytics to manage the allocated cost base?**

- Yes, cost analytics covers the entire cost base (42%)
- Yes, but cost analytics only covers a portion of the cost base (50%)
- No (8%)

**Currently, does your organization have enough resources to develop analytics on cost transparency and cost management?**

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>62%</td>
<td>38%</td>
</tr>
</tbody>
</table>
Opportunities exist to extend analytics to support cost takedown activities

While over 85% of respondents adopt cost analytics with the purpose of allocating cost in an equitable way, for example by improving the ability to measure the actual consumption of the service provided, over 50% of the institutions interviewed declare that they are not using analytics to empower their cost-reduction efforts.

Opportunities exist to improve the quality of cost analytics

Our survey indicates respondents present significant opportunities to improve the quality and insightfulness of their existing cost analytics. In particular, almost 75% of institutions declare they do not have a balanced mix of leading and lagging indicators, and about 60% of participating banks leverage analytics to forecast allocated charge-backs. This result indicates that most banks missed out on the opportunity to manage costs looking forward and gather useful insights on reduction levers and cost patterns before costs are committed. In our opinion, this is a major capability gap that banks should address in order to deliver against their cost-reduction targets. About 40% of institutions interviewed declare that they do not use advanced drill-down capabilities to analyze variances between actual and budget on the allocated costs. The inability to determine the root cause of this type of variance creates an impact on cost transparency and on the ability to increase accountability on carrying out the right cost behavior throughout the organization.

Q Which of the following statements best describes your organization’s current use of cost analytics for cost allocation?

- The goal is to allocate costs in an equitable manner.”

  – Global investment bank

Q Which of the following statements best describes your organization’s current use of cost analytics for cost allocation?

<table>
<thead>
<tr>
<th>Statement</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>We use cost analytics to allocate costs more fairly and transparently</td>
<td>85%</td>
</tr>
<tr>
<td>(e.g., drivers reflect actual usage).</td>
<td></td>
</tr>
<tr>
<td>We use cost analytics to drive down costs</td>
<td>46%</td>
</tr>
<tr>
<td>None of the above</td>
<td>0%</td>
</tr>
</tbody>
</table>

Q If your organization uses cost analytics, which of the following statements best describes your organization’s use?

<table>
<thead>
<tr>
<th>Statement</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our cost analytics provide an analysis through a balanced mix of lagging</td>
<td>25%</td>
</tr>
<tr>
<td>and leading indicators/metrics</td>
<td></td>
</tr>
<tr>
<td>Our cost analytics forecast allocated charge-backs</td>
<td>42%</td>
</tr>
<tr>
<td>Our cost analytics utilize drill-down capabilities to find root cause</td>
<td>58%</td>
</tr>
<tr>
<td>of actual vs. budget variances</td>
<td></td>
</tr>
<tr>
<td>None of the above</td>
<td>17%</td>
</tr>
</tbody>
</table>
Effective cost analytics will improve the transparency of the allocated cost base and the ability to drive down costs. There are three key value drivers needed to provide the path to cost excellence:

- **Transparency** – Enables the ability to better understand the costs
- **Influenceability** – Enables the ability to identify levers and changes in spending behavior required to drive down the costs
- **Sustainability** – Enables the ability to maintain transparency and influenceability in an efficient, repeatable and scalable manner

**Path to cost excellence**

**Spend analytics**
- Provide ability to track estimated cost savings into profit and loss statements
- Produce forward-looking analytics resulting in the ability to manage costs before they are incurred
- Integrate analytics within business reviews and use strategic tools to enable better decision-making in an efficient and scalable manner

**Cost takedown**

- Complementary lenses to:
  - Identify areas of focus (controllable vs. noncontrollable costs)
  - Tailor cost cutting to not harm growth (revenue-related vs. nonrevenue-related costs)
  - Identify short-term opportunities (discretionary vs. committed costs)

**Fair allocation**

- Recognize and identify the drivers of the cost
- Use business relevant drivers to distribute costs in an equitable manner and in a way that recipients can recognize
Increased cost transparency can be created by understanding the flow of costs through the delivery value chain and variance analysis through cost analytics covering four types of actual vs. budget variances.

- **Volume variance** – Difference between budgeted and actual consumption volume (controlled by recipient)
- **Efficiency variance** – Results from changes to unit cost (controlled by provider)
- **Foreign exchange (FX) variance** – Results from fluctuations in the FX currency rate
- **Error variance** – Results from use of wrong/outdated cost drivers

---

Cost analytics

Allocated cost base → Breakdown into cost areas → Breakdown by value chain → Breakdown by cost accountability

Allocated costs

<table>
<thead>
<tr>
<th>IT</th>
<th>Workspace and end-user services</th>
<th>Variance analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>$B</td>
<td>$B</td>
<td>$B</td>
</tr>
</tbody>
</table>

- **Risk**
- **Technology**
- **Finance**
- **Real estate**
- **Operations**
- **Applications**
- **Data storage & hosting**
- **Mgmt & control**
- **Security**
- **Workspace & end-user services**
- **IT Infrastructure**
- **Move, add & change**
- **Remote access**
- **IT Consumable**
- **Workstation**
- **Video conference**
- **Foreign exchange**
- **Efficiency**
- **Error**
- **Volume**
- **Focus area**

Allocated cost vs. budget

- **$B**

Costs
Our survey respondents are using multiple tools to perform allocations

Only 31% of participating institutions are using one dedicated allocation system across the enterprise. An additional 43% are using multiple dedicated systems to perform cost allocations, while the remaining institutions are either leveraging spreadsheets and non-audited systems to perform the calculation of unit costing and the distribution of costs, or they are pursuing additional options such as using non-dedicated systems (e.g., planning systems) to perform the allocation tasks.

The lack of one enterprise-wide cost allocation system presents many of our clients with the challenge of reconciling different, and often inconsistent (e.g., different update frequency) data sources to develop an enterprise view on the allocated costs. In particular, the use of spreadsheets and other end-user computing solutions negatively impacts the ability to leverage advanced cost analytics and makes it increasingly difficult to improve cost transparency. Additionally, this type of solution often presents itself with higher business continuity risks, as we have seen clients unable to reverse-engineer some parts of the allocation models due to poorly documented spreadsheets, especially when key individuals who develop the model have left the banks.

There is not a prevailing software of choice

The survey results indicate that there is not a prevailing trend toward a specific cost allocation technology solution. There is, however, a variety of software platforms used for developing unit costing and for distributing costs. From our conversations with the participating institutions, we gathered that the choice of cost allocation tools is driven primarily by the broader finance IT landscape rather than specific software features, and that there is a strong preference toward evolving existing technology platforms with the objective to contain the transformation costs, rather than buying new technology solutions.

62% of respondents utilize a custom-built system to calculate unit price and to distribute costs.

31% of organizations use one dedicated allocation system across the enterprise.
Transfer pricing, Regulation W and tax requirements are met but opportunities for efficiencies exist

About 75% of our respondents declare they are satisfied with their cost allocation support for compliance with transfer pricing, Regulation W and tax requirements, and, in particular, they say they have enough transparency to identify the underlying nature of the service cost and stand up to tax authority scrutiny, if necessary.

However, about 40% of participating institutions indicate that they are not performing transfer pricing and Regulation W activities leveraging a common data set and reconcilable methodologies and drivers with cost allocations.

While banks are effective in pursuing their tax requirements, there are additional opportunities to improve efficiencies on process activities and data management.

**Q** Are cost allocation and transfer pricing calculations based on a common set of data?

- 58% Yes
- 25% No
- 17% Partially

**Q** Do you have enough transparency to identify the underlying nature of the service cost and stand up to tax authorities’ scrutiny?

- 75% Yes
- 17% No
- 8% Partially

75% of respondents say they have enough transparency to identify the underlying nature of the service cost.
Jump-start your path toward your target state with immediate benefits
1 Set your path and journey toward the target state, leveraging EY’s view on leading practices and accelerators toolkit

For an accelerated delivery, we will utilize EY’s rapid diagnostic toolkit adopting a hypothesis-based approach.

We will propose our view on what your target state should look like, and through interactive discussions with key individuals in your organization, we will tailor our hypothesis to meet your specific priorities, context and objectives.

EY is able to offer this approach thanks to our experience in numerous recent and ongoing cost allocation transformation engagements delivered for your peers across the globe.

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**Hypothesis-based approach for a rapid jump-start**

- **Future state vision**
  - 4 weeks
- **Capability analysis**
  - 4 weeks
- **Road map**
  - 2 weeks

**Key activities**

**Future state vision**
- Validate hypotheses
- Develop and agree to design principles
- Define future state vision

**Capability gap analysis**
- Assess current state environment’s ability to produce future state vision
- Confirm capability gaps
- Identify remediations for capability gaps

**Road map**
- Assess priority and establish key milestones
- Develop implementation approach and road map

**Key deliverables**

<table>
<thead>
<tr>
<th>Key deliverables</th>
<th>Deliverable description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design principles</td>
<td>Guiding principles, agreed by senior stakeholders, that will lay the foundation of the cost transformation program</td>
</tr>
</tbody>
</table>
| Future state vision (enterprise cost management model) | Proposed outline of the target state enterprise cost management model including the vision on:  
  - Cost allocation framework  
  - Level 1 system architecture  
  - Level 1 and Level 2 cost allocation process taxonomy |
| Capabilities gap analysis         | Describes current gaps within the key cost management capabilities required to achieve the identified future state vision |
| Prioritized implementation road map | Identify the program work streams necessary to address capability gaps and indicates:  
  - Key milestones  
  - Work plan, reflecting priorities from lines of business (LOBs) and functions  
  - Key work products  
  - Key dependencies  
  - Resource and high-level cost estimates |

---

**Accelerators**

- Service catalog for financial services based on leading practices
- Implementation project plan including activities, resource estimates and description of key skills
- Templates for cost analyses
- Functional and technical requirements examples
- Cost analytics proof-of-concept and mock-ups

---

**Future state vision workshop**
**Remediation workshop**
**Capability analysis workshop**
**Road map workshop**
Jump-start your path toward your target state with immediate benefits

Generate immediate value to your organization through three tangible improvements

1. **Service catalog** (Pilot)
   
   **Description**
   List of services jointly defined by the providers and recipients of each service, yielding a transparent depiction of how a recipient will be charged and what work product will be delivered.

   **Benefits**
   - Improved transparency on allocated charges and service descriptions
   - Enhanced consistent dialogue based on a common taxonomy and terminology
   - Costs defined in a way easily understood by the service recipients (increase cost awareness)

   **Accelerators**
   - Service Catalog for financial service institutions based on leading practices.

2. **Cost transparency reporting** (Pilot)
   
   **Description**
   Tactical reports based on readily available data that improve the ability to identify cost drivers, cost reduction levers and root causes of variances between actual and budget.

   **Benefits**
   - Improved ability to drive down costs
   - Improved use of readily available data and identification of data remediation needs
   - Support to refine requirements for target state reporting through socialization and use of tactical reports.

   **Accelerators**
   - Cost analytics proof-of-concept and mock-ups
   - Library of costing performance metrics
   - Data dictionary

3. **Governance**
   
   **Description**
   Comprehensive governance framework clearly defining cost management roles and responsibilities, assigning cost ownership of creating a dispute forum to challenge allocation charges.

   **Benefits**
   - Clear accountability of end-to-end costs
   - Incentivized collaboration for cost takedown discussions
   - Increased understanding and awareness of opportunities for cost reduction

   **Accelerators**
   - Cost allocation process taxonomy including roles descriptions
   - Governance framework
3 Adopt a wave-based approach to generate continuous benefits without losing momentum

Typically, transformation programs use the marathon or sprint approach. With the marathon approach, requirements are defined in detail at the beginning of the program. While this helps in managing scope and helping the timeline, it usually yields stakeholder fatigue, budget consumption prior to final delivery and delayed benefit realization. Opposite to the marathon approach, the sprint approach realizes benefits in the short term, but projects are carried out in uncoordinated silos increasing program risks.

The marathon approach

The sprint approach

Our view is that there is a third approach merging the benefits of both approaches. The relay approach is a series of coordinated sprints with consistent feedback loops enabling business engagement throughout the delivery cycles (waves), and resulting in benefits being realized at the end of each wave.

The relay approach
Based on our experience in delivering strategic cost allocation programs, we believe that there are eight key capabilities that define cost excellence.

Achieving the full maturity stage in each of these is not necessary to achieve sufficient cost transparency. In particular, we believe that the combination highlighted below represents the right compromise between investment and improved transparency.

**Key capabilities essential to achieve cost transparency**

**Cost allocation maturity**

<table>
<thead>
<tr>
<th>Basic</th>
<th>Progressed</th>
<th>Mature</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allocations are not based on service catalogs (s)</td>
<td>Very granular allocations, even when there is no immediate value for such granularity</td>
<td>Service catalogs are in place, but multiple catalogs and conflicting taxonomies are used</td>
</tr>
<tr>
<td>Costs are allocated first to business units and cost transparency and granularity is lost between different steps</td>
<td>Different methodologies and different waterfalls are used across the enterprise creating inconsistent cost views</td>
<td>Granularity driven by materiality, ability to influence and regulatory requirements</td>
</tr>
<tr>
<td>Limited cost insight and typically just one line in the general ledger for allocated costs</td>
<td>Business unit profitability does not reconcile with total profitability of its individual products</td>
<td>Methodology, including waterfall, allocation methods and key drivers are consistently applied</td>
</tr>
<tr>
<td>Financial and volume data are sourced from multiple systems without overarching governance</td>
<td>Data sourcing and data flows are not fully documented and readily available within the organization</td>
<td>Cost breakdown is available by cost area (e.g., IT, real estate) and sub-service offering</td>
</tr>
<tr>
<td>Cost allocation is not part of an overarching finance architecture</td>
<td>Absence of dedicated cost allocation tools. Tactical spreadsheets are commonly used</td>
<td>Cost analyses on actual vs budget variance by volume, efficiency (e.g., unit costing), FX impact, error impact is available</td>
</tr>
<tr>
<td>Cost allocation architecture is integrated within the finance architecture</td>
<td>Cost allocation process is based on strong and continuous dialogue between services providers and recipients</td>
<td>Cost allocation tools are used for calculating unit costing and distributing costs</td>
</tr>
<tr>
<td>Cost allocation process is based on strong and continuous dialogue between services providers and recipients</td>
<td>A formal dispute resolution forum is in place and chaired by a senior finance executive</td>
<td>Cost allocation processes are integrated within other key finance and business processes</td>
</tr>
<tr>
<td>Cost allocation is managed by different organizational units</td>
<td>Lower-cost locations are used but they are limited to manage a small portion of the process</td>
<td>Centralized unit managing cost allocation across purposes (management and regulatory)</td>
</tr>
<tr>
<td>There is a perception that some costs are fixed and not “influencable”</td>
<td>Service owners, driver data owners and business contacts are assigned to each service</td>
<td>Cost accountability is aligned with the ability to influence the costs</td>
</tr>
</tbody>
</table>

**Minimum capability to unlock cost transparency**

- Enterprise-wide service catalog covering all allocation purposes
- Clear identification of cost reduction levers and cost management tips
- Costs allocated to the most granular level whenever possible, then rolled up
- Multidimensional reporting provides actionable cost insight across complementary lenses, using drill-down capabilities
- Business unit profitability reconciles with total profitability of business unit individual products
- Fully integrated data model enabling consistent multidimensional analyses
- Dedicated cost allocation tools are fully integrated with other key finance processes
- Governance exists, including escalation mechanisms and official touch points between functions and businesses
- Leveraging of lower-cost location for a significant portion of the cost allocation process

Cost transparency is maintained throughout the end-to-end allocation process
About the survey
Survey methodology

The purpose of EY’s Global Cost Allocation Survey is to document the views, insights and observations of banking senior financial officers around the world, as well as our view on cost allocation and cost management leading practices.

This publication was developed leveraging insights gathered through:

• A series of interviews conducted from March 2016 through June 2016 with about 30 senior financial officers representing 13 global financial institutions across the Americas, EMEA and APAC
• Responses to a 50-question survey for each participating institution
• EY’s view on leading practices and global experience in designing and delivering cost allocation and cost management transformation programs

For several of the questions, multiple answers were allowed, resulting in responses that do not add up to 100%.

A version of this report was published on July 2016 and distributed exclusively to the participating institutions as a recognition for the time and enthusiasm they invested in sharing their views and insights with our team.
Participating institutions

Number of participating institutions

Average total assets per institution

Average cost base per institution

North America

US$1.6t

US$41b

EMEA

US$1.4t

US$31b

APAC

US$0.6t

US$13b
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Key contributors and subject-matter resources

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Steve Krueger and Matt Polvara have recently co-authored another EY publication on cost management:

*The allocation game: managing cost before money is spent*
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SCORE No. 03984-171Gbl
BSC No. 1706-2330632
ED None

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