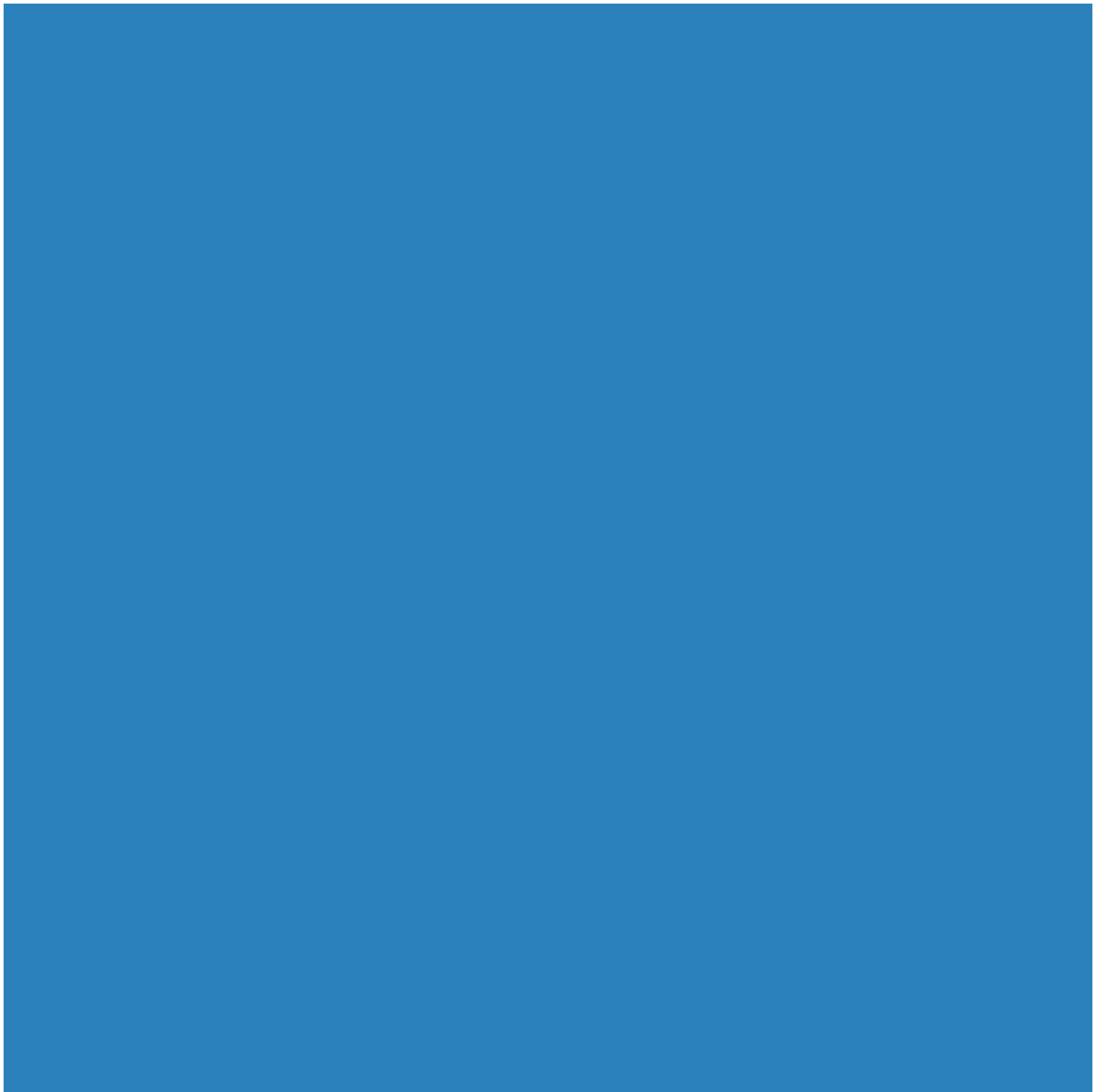


# On top of the costs: A leading role for finance in cost reduction



# Introduction

Many financial services organisations have found that their attempts to cut costs in the wake of the financial crisis have been far less successful than hoped and are already proving very difficult to sustain.

With its firm-wide view of cost, risk and profitability, the finance function could provide the decisive insights that would enable companies to make significant and lasting cost savings. Yet, in many organisations finance is not making the telling contribution to cost management that it could and should.

Drawing on the practical insights and recent experience of cost management experts from PricewaterhouseCoopers<sup>1</sup>, this flyer outlines where and how finance teams can play a stronger role in enabling organisations to emerge leaner and more competitive from the crisis.

<sup>1</sup> 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

# Overview

Many firms are finding it difficult to bring costs down to competitive levels as they are unclear about the true extent and nature of their expenses and even whether certain products are genuinely profitable. The finance function could provide the critical insight and direction to help them get on top of their costs.

Amid the surge in profitability in the earlier part of the decade, it was all too easy for many financial services organisations to take their eye off cost. Now, matching expenses to sharply falling demand has become critical to survival and success once again. The importance of controlling expenses can only grow as capital remains constrained and compliance costs continue to increase.

Yet, a lack of transparency over where expenses are incurred and who has responsibility over their management means that many companies do not know enough about their delivery costs, how they change in relation to fluctuating demand and how they could be better controlled. In particular, centralised IT, marketing and other support costs may not be adequately allocated to specific products or services. Some incidental expenses may also be ignored, even though their

cumulative impact could be significant. As a result, returns could be considerably overestimated, especially if a dip in sales leads to an increase in unit costs. Many companies may also lack the comparative cost and efficiency measures to enable them to identify and track potential savings. Even if they do have the required information, some firms may find it difficult to cut expenses because of poor flexibility in their operational planning and contractual arrangements.

By being able to measure expenses from across the business, then drill these calculations down to a specific product or service and equate them to cost/income ratio and other appropriate key performance indicators (KPI), the finance function is ideally positioned to enhance management's understanding and control of costs. This includes: providing a clear indication of how costs per

transaction, product or settlement move over time; how much of these expenses are fixed and variable (ie the extent of flexibility); and how costs are governed through the supply chain. Finance's bird's-eye view of the enterprise can also help to identify the key revenue drivers upon which spending should be focused to help realise business objectives and the sources of inefficiency and needless complexity that may impede delivery.

The key business benefits include enabling management to develop a more accurate picture of the true returns from a specific product, service or business operation. Our recent work with clients indicates that input from finance can be particularly useful in enabling management to measure cost/income at a granular rather than vague aggregate level and develop KPI benchmarks for cost efficiency against which they can gauge progress over time. Analysis from finance can also inform the business case for strategic decisions such as operational rationalisation or the possible withdrawal of a particular product. Ultimately, more active financial insight can help organisations to create lasting cost savings and so emerge leaner and more competitive from today's tough environment.

Providing improved insight and direction will nonetheless be a challenge for many finance teams, requiring them to look beyond the long-term financing and structuring of the business at the nitty-gritty of delivery and operational support. Their analysis needs to be underpinned by sound data and a thorough understanding of cost patterns, value drivers and what influences them. To make their insights count, finance teams will need to work closely with business teams to win their trust and foster a strong steering role within cost management. They also need to be able to communicate their analysis in a compelling and actionable way.

# Finance and cost reduction:

## Strengthening insight and direction

**Finance can help management to make more informed cost decisions; help define rules for cost approval and accountability; and strengthen the firm-wide commitment to cost reduction and financial discipline. Indeed, if in the past the role of finance could be described as helping the business to understand the financial implications of operational decisions, it is now just as important that it helps the enterprise to understand the operational decisions required to improve its financial position.**

### Transparency

After initial success in reducing spending, many companies' cost control initiatives have foundered through lack of transparency and precise targeting. Finance could help to provide clearer understanding, comparison and communication of costs. This includes developing consistent firm-wide cost definitions and a baseline against which future changes are measured and tracked. The firm-wide perspective of finance could prove especially valuable in mapping cost flows and operational processes.

### Accountability

Many business units lack sufficient responsibility and accountability for the costs they incur. Poor understanding and control at product and business unit level can be compounded by the centralisation of support services. Finance can play a key role in developing expense and delivery measures such as cost per settlement, which can be applied to particular product or help to compare the efficiency of sourcing.

### Flexibility

Many firms are operating at pre-crisis cost levels because of inflexible long-term agreements with contractors. Finance can advise on how sourcing arrangements and the employment of contract staff could be better matched with fluctuating demand. It could also help to strengthen monitoring and evaluation of contract delivery.

### Equating cost and value

The priority in the short-term is for the finance team to help management understand its return on spending and investment, including the relationship between the company's cost structure and cost drivers, its value chain and value drivers. For example, travel expenses are a

variable cost that can be easily targeted for cost containment. However, a sales force that cannot travel is of little use, while in contrast, fewer internal face-to-face meetings may actually improve productivity. Similarly, shedding support staff may impede the company's ability to meet customer demands, come the eventual upturn.

### Tackling complexity

Sustainable long-term cost reduction requires the elimination of unnecessary complexity that adds cost, but no value. Finance can play a key role in advising on how to simplify legal structures and streamline operations, for example moving from a subsidiary to a branch network. It can also look at how to rationalise and consolidate support processes to reduce costs without impeding delivery.

### Stronger business case

Products that may have been profitable in the pre-crisis boom may no longer be making a sufficient return. The scale of certain IT, marketing and other support spending may also fail to reflect changes in current and long-term demand. Finance can help management to make a clear evaluation and business case for strategic and operational changes ranging from the consolidation of support

services to product redesign and withdrawal. Input from finance can also help to communicate the rationale for decisions to staff, investors and other key stakeholders.

### Managing realisation

Gains from cost management initiatives can often prove short-lived through lack of appropriate tracking and evaluation. Finance can help to monitor delivery against plans/targets and advise on further improvements. It can also help to integrate cost reduction with other KPI.

### Governance

Lasting cost reduction also demands clearly defined and understood rules on cost approval, monitoring and accountability. Finance is well-placed to help set and oversee appropriate guidelines as part of stronger overall governance structures.

# Making it happen

**A stronger role for finance in cost control is likely to require a change of focus and culture within many organisations.**

## Win business trust

The development of a close working relationship between the finance function and frontline business teams is essential. Partnership can help to ensure a good supply of timely, reliable and relevant data for finance and convince the business that analysis of this information can enhance their decisions rather than result in arbitrary cuts.

## Earn the mandate

For the finance function to gain the credibility it needs to take the lead in cost management, it should itself be able to deliver good service and advice at a reasonable cost.

## Provide clear insights

Finance teams need a clear overview of where costs are being incurred and who controls spending, which can be evaluated against cost/income and other profit and efficiency indicators. The key is a baseline from which to determine what is fixed and what is variable; what are the

major cost categories; what contracts are due for renewal and what costs are most addressable.

## Competencies

Finance professionals need a clear understanding of the operations and priorities of the business. This includes the process flows and demand factors that have the most affect on costs.

## Communication

Finance teams need to be able to define and communicate cost patterns and the behaviour that underpins this. To do this effectively, they should provide information that is clear and directly actionable by management.

## Culture

Finance teams need to take the lead in creating a firm-wide commitment to financial discipline. Active input from the CEO and other senior executives will also be essential in ensuring that lasting cost reduction becomes a sustainable priority within the business.

# Giving businesses the edge:

## The role of PricewaterhouseCoopers in supporting sustainable cost management

Is your business having difficulties in judging where and how to make savings?

Are you finding it difficult to make a convincing business case for strategic cost savings such as rationalisation or product withdrawal?

Are you finding the savings to sustain, for example through falling away of commitment or difficulties in responding to changing customer demand?

PricewaterhouseCoopers has a team of dedicated financial services cost management and performance improvement experts who can help your organisation and its finance team to make more informed decisions and give your business a critical cost-competitive edge.

PricewaterhouseCoopers is helping a range of institutions to reduce their expenses and develop a sustainable low-cost delivery model. PricewaterhouseCoopers offers well-developed control tools that give clients clear insights into their costs and a practical and pragmatic approach to cost reduction. Our support benefits from our close understanding of the business developments and the cost patterns in the various financial services sectors.

If you would like to discuss any aspect of the issues raised in this paper, please speak to your usual contact within PricewaterhouseCoopers or one of those listed below.

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