These are unprecedented times; confronting many leaders with challenges and questions they never faced before. How can strategic cost management play a crucial role in defining the right actions to thrive and win in these uncertain times?

For many companies, cost management has been a strong, annually recurring imperative. However, as companies continued to have positive expectations for revenue growth, many didn’t focus on cost performance structurally. Consequently, cost, operating and business models have drifted away from each other. During such crises, the unprepared are quickly confronted with a plummeting top-line and are struggling to adjust their cost model. Immediate action is often tactical: cash flows and working capital are being optimized, whilst more radical cost measures start to be considered. Within Deloitte, we strongly believe a more structured approach, going beyond cost-cutting, is required to safeguard your competitive position and future growth potential. To help you navigate through these times, we gathered our experience into this point of view, including the key elements to consider when strategically reflecting on the cost measures to take during and after the COVID-19 crisis.
Mind the gap!

History has favoured the prepared

There is no question that the COVID-19 situation has or will result into a cost optimization exercise for many companies. Temporary freezes on new hires, renegotiation of key contracts, review or delay of CAPEX investments, optimisation of inventory levels or cut of performance rewards: here is a snapshot of some measures that organizations have already taken to respond to the situation.

These are examples of typical tactical short-term oriented cost-savings actions. Nevertheless, there is more to tell about the cost story: whilst short-term initiatives are necessary to cope with the current situation, a more structured and strategic reflection on cost models is required to boost recovery and prepare your business to thrive during these uncertain times.

Mind the gap

Let’s start by taking a step back to better understand where we come from. The situation many organisations are confronted with today is the consequence of a limited, structural focus on costs prior the virus outbreak. With no real burning platform such as COVID-19, costs have been approached in a very opportunistic way. Whilst time and effort were mainly spent modelling future revenues, little attention was given to the supporting cost model.

Illustration 1: costs and revenues management over time
A lack of cost transparency preventing a central steering, a structural control and a strategic reorientation of the bottom line.

Business and finance working as stand-alone departments resulting in a lack of mutual understanding.

As a consequence, organizations’ cost, operating and business models have drifted away from each other, with cost models no longer funded by business and many losing track of where costs reside, their origin, their nature. (see illustration 1)

History has favoured the prepared

There can be never-ending debates about when the world goes back to normal and even what new normal will be. It is also difficult to assess today the long term impact that this virus outbreak will have on the economy. However, what is clear is that being prepared for new lockdowns or outbreaks will be a prerequisite to thrive.

Moreover, history shows that those organisation that prepare themselves, are better equipped to outperform the unprepared during those turbulent time. As visualized in illustration 2, prepared companies are able to grow both revenues and margins (costs). But what does “being prepared” exactly means from a cost point of view? What are the checks you should have in place to be responsive and thrive in these uncertain COVID-19 times?

Illustration 2: history favours the prepared*

Setting-up for a cost reboot

To be prepared facing a new crisis such as the COVID-19 pandemic, companies have to swiftly adjust their cost models relying upon a truly agile and scalable business, including:

- Improved flow of resources to areas of strategic importance
- Minimized effects of organizational weakness
- Reduced level of inefficiencies
- Decreased amount of effort and costs dedicated to non-strategic activities

Only 14% of organisations manage to increase their revenues and expand their margin but they significantly outperform competition having, on average revenues and margins respectively higher by 14% and 7%.

Source: BHI, based on S&P Compustat and Capital IQ data
Following a pragmatic and efficient approach, this viewpoint will walk you through three steps we advise you to follow to reboot your costs:

1. Determine your total – addressable – baseline
2. Explore the different cost levers
3. Don’t over-promise but ensure successful delivery

1. Determine your total baseline

The first step of our recommended approach is to determine your baseline. This baseline will be the starting point to identify your cost improvement and saving initiatives. It is made of:

- **Indirect spend**
  Costs related to the purchase of goods and services allowing the organisation to operated but not directly linked to the manufacturing of its goods or delivery of its services (typical examples are travels and expenses, office supply, trainings, hiring fees, ...)

- **Extended workforce**
  Costs related to off-balance sheet workforce including contingent workers (individuals working for the organisation with clear job descriptions and reporting lines but their salary is not processed through the company’s payroll) and external providers (third-party organisation hired for a specific mission/activity)

- **Labour**
  Costs directly linked to the compensation of on-balance sheet employees (permanent and fixed-term); including salary, performance rewards and other on-cost (taxes, welfare plans, pension accounts, ...)

Important element to note: you can only manage those costs that you can control directly. Therefore, focus on addressable costs when determining your baseline, leaving behind for now non-addressable costs such as taxes or depreciations.

2. Explore the different cost levers

The second step of our approach aims to assess the cost baseline by exploring different costs levers to identify cost improvement initiatives. Six cost levers can be considered, resulting in both tactical and strategic transformative improvement initiatives resulting in long-term benefits:

- **Demand management:** Reducing level of effort through elimination of work (i.e., rationalizing management reports, standardizing master data, harmonizing policies)
  Typical initiatives: re-evaluate (internal) service levels according to demand, rationalise reporting needs and standards

- **External spend management:** Aggressively sourcing and managing indirect external spend; applying deep category-specific insights to develop the right program to manage each major spend category
  Typical initiatives: review (travel) and expense policy, consolidate sourcing (office supply, health insurance, ...), renegotiate/reduce contingent workforce

- **Business process optimisation:** Simplifying, standardizing, re-engineering and automating end-to-end processes (e.g., order-to-cash, procure-to-pay) across business units and geographies (including enabling technologies)
  Typical initiatives: eliminate process duplication (data quality check, ...), automate processes, maximize value of ERP enabled processes
Business and operating model: The Operating Model determines how a company will be structured and governed to achieve its strategic intent.

Typical initiatives: review return on investment of key programs, real estate rationalization, manufacturing footprint & supply chain network.

Service delivery model: Clearly defining and optimizing what work is performed, where, with how many resources and at what cost, resulting in optimal realignment of functional staff.

Typical initiatives: re-balance delivery models (offshoring, near shoring, ...).

Organisation design: Aligning the organisational structure with overall business and operating models; defining required functional capabilities and roles / responsibilities and reducing layers and broadening spans of control.

Typical initiatives: review performance management and incentive structure, review spans & layers, eliminate/relocate low-added value activities.

3. Make your cost saving program a success

Success of a cost transformation program, however, goes beyond a structured approach and methodology. It is easy to set targets, but the implementation of your initiatives will ultimately define your success.

Based on our long-standing experience of strategic cost transformation programs, we strongly recommend you to consider four key success factors that will help you implement your cost savings initiatives successfully:

**Stakeholder ownership**
- Designated stakeholder need to become owner of cost saving initiatives
- Emphasis on the benefits to the business from day 1 to the broader audience

**Fact base, data-drive approach**
- Define a clear current state cost base that is detailed enough to withstand challenges
- Set clear targets and timelines – what outcomes need to be delivered and who is accountable

**Actionable initiatives**
- Identify actionable initiatives; no “theory talks”
- Take into account the “agility” of your organisation, focus on bite-sized initiatives
- On the longer term, consider cross-functional initiatives

**Cost Program Command Centre**
- Establish a dedicated cost reduction team to monitor costs, benefit realization and initiate corrective measures
Are you prepared for the next crisis?

With our recommended three step approach, we are confident that you have the right toolkit to look at rebooting your cost structure and are prepared to thrive in these uncertain times.

Following this approach, your cost model will be: transparent, scalable and flexible:

- **Your cost baseline is transparent**
  - You have consistent and aligned data on your addressable cost categories
  - You have a clear view on cost kinds (e.g., personnel, supplier spend, etc.), cost nature (fixed, variable, etc.), cost drivers (e.g. activity volume asset size, #FTE), and cost origin (e.g. transfer pricing, cost re-charges)

- **Your cost baseline is scalable**
  - The impact of an increase/decrease in sales is proportionally that the impact on your cost
  - You can predict profit margin throughout business cycles and seasonality

- **Your cost baseline is flexible**
  - You can reallocate resources and shift priorities across your business
  - You have an adaptable cost baseline through outsourcing and contingent labour

Moreover, your organization will have: cost-saving initiatives, the ability to monitor cost performance and a cost governance structure:

- **You have identified pro-active and realizable cost-saving initiatives**
  - You know what to do to optimise your cost on the short-term, mid-term and long-term
  - You have an execution plan for each initiative: business case, owners and KPI

- **You monitor your cost performance**
  - You benchmark your cost against your peers and track evolution
  - You track the cost and profitability for each of your business activities

- **You have a cost governance structure in place**
  - Your cost savings initiatives are endorsed by your leadership team
  - There are processes, skills and tools available to deliver and monitor these initiatives

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Summary

There is no question that the COVID-19 outbreak has substantially impacted business performance, requiring the swift implementation of measures to respond to the crisis. It is our recommendation to leverage strategic cost transformation as a key lever not only to mitigate the impact of the pandemic on the short term but also, and more importantly, to recover and thrive in the longer term.

As the economic environment has been favorable over the past years, time and effort was mainly spent modelling future revenues, whilst little attention was given to the supporting cost model. As a consequence, the cost management and governance of many businesses lack transparency, central steering and structural control.

This burden of the past has caught up with us today, slowing companies down in their cost decision making process. As history proves that prepared companies are thriving in uncertain times, we suggest you to follow a three step approach to reboot your costs and get prepared to thrive these uncertain times.

1. **Determine your addressable baseline**

The first step is to consolidate a baseline, starting point of your cost reboot exercise. This baseline is made of three cost categories:

- **Indirect spend**: Costs related to the purchase of goods and services allowing the organisation to operate but not directly linked to the manufacturing of its goods or delivery of its services.
- **Extended workforce**: Costs related to off-balance sheet workforce including contingent workers and external providers.
- **Labour**: Costs directly linked to the compensation of on-balance sheet employees (permanent and fixed-term).

2. **Explore the different cost levers**

The second step aims at identifying cost improvement initiatives scanning the baseline through six different cost levers. This will result in in both tactical and strategic transformative improvement initiatives bringing long-term benefits:

- **Demand management**
- **External spend management**
- **Business process optimisation**
- **Organisation design**
- **Service delivery model**
- **Business & operating model**

3. **Make your cost saving program a success**

Based on our long-standing experience of strategic cost transformation programs, we strongly recommend you to consider four key success factors that will help you implement your cost savings initiatives successfully:

- **Stakeholder ownership**
- **Fact base, data-drive approach**
- **Actionable initiatives**
- **Cost Program Command Centre**

Following this three step approach, we are confident that you have the right toolkit to reboot your cost management and thrive these uncertain times:

- **Your cost baseline is transparent**
- **Your cost baseline is scalable**
- **Your cost baseline is flexible**
- **You have identified pro-active and realizable cost-savings initiatives**
- **You monitor your cost performance**
- **You have a cost governance structure in place**
Contact

If you want to learn more about the Strategic Cost Transformation practice within Monitor Deloitte and how our reboot program can help you, please contact the authors.

Catherine Hannosset
Partner - Brussels office
Deloitte Belgium Consulting
channosset@deloitte.com
+32 494 56 68 55

Catherine leads the Strategy, Business Design and M&A consulting practices for Deloitte Belgium. She is also the North South Europe M&A Consulting Lead. She has more than eighteen years' experience providing advice and challenge to senior management in planning and delivering complex cross-border integrations and cost transformations program.

Ben Desmet
Director - Brussels office
Deloitte Belgium Consulting
bdesmet@deloitte.com
+32 496 72 77 42

Ben has 12 years of experience in various business and commercial transformation topics. He is a leading the Strategic Cost Transformation (SCT) practice in Belgium and active member of Deloitte's global SCT Centre of Excellence.