Riding out the storm
How to make enterprise cost management sustainable

Hopeful signs and lingering worries are sharing the stage as businesses chart their course for 2012. Corporate earnings and capital spending are rising, yet unemployment remains high and consumer demand weak. While fears of a double-dip U.S. recession are abating, housing markets continue to struggle, and European sovereign debt and euro issues persist.

What does this mélange of factors mean for global markets and marketplaces? Simply put: uncertainty. Not as a short-term condition, but as an ongoing feature of a restructured economic order. Leverage is carrying higher risk premiums, and companies are taking on less of it. Consumers are keeping their belts tighter. Currency, regulatory, and employment issues continue to loom over governments, businesses, and jobseekers.

These conditions may make it difficult for businesses to maintain short-term viability while laying the groundwork for growth. Achieving both those goals could require additional cost management and reduction initiatives, productivity improvements beyond those made in the downturn, and more and better use of technology — which may not be easy.

Nonetheless, most businesses appear to view pursuing growth and tackling cost reduction side by side as inescapable. Ninety percent of business leaders in a 2011 Deloitte survey expect to maintain or grow revenue through 2013, while 80 percent plan to implement cost reduction strategies and programs.[1]

With little low-hanging fruit left for efficiency improvement, executing this combination may require more strategic, aggressive cost management and performance improvement initiatives, with the attendant risk. The Deloitte survey found a 37 percent failure rate for such efforts in 2011, compared to rates in the teens in the previous few years,[2] evidence that easy efficiency opportunities may have dried up.

This article discusses how setting priorities and objectives based on your company's competitive situation and conducting a structured assessment of your performance improvement needs and capabilities can provide the foundation for sustainable business growth and cost containment.

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[1] What's Next? Deloitte Consulting's Biennial Cost Survey, 2011.

[2] Ibid.

Different conditions, different levers

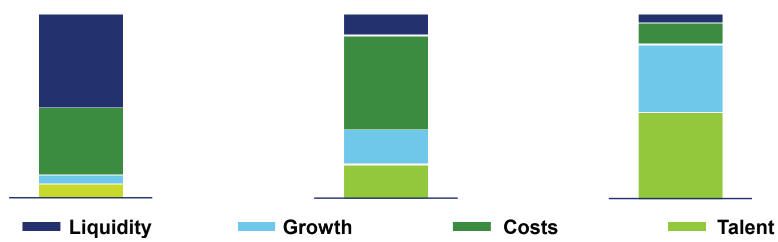
An individual company's competitive situation, which provides the context for its performance improvement initiatives, is likely to fall into one of three categories: distressed or turnaround, prolonged uncertainty, or growth (Figure 1). Most reasonably healthy businesses fall into the prolonged uncertainty category today. However, some companies may find themselves straddling categories amid continuing global economic uncertainty, a U.S. economy still in recovery, and the imperative to develop growth strategies.

Figure 1. Competitive situations guide priorities and actions

A company's competitive situation determines its priorities, primary objectives, and actions

	Distressed/Turnaround	Prolonged uncertainty	Growth
Competitive situation	• Losing market share • Structural operating flaws • Liquidity concerns	• Recovering from recession • Adjusting to demand levels • Growth concerns	• Healthy balance sheet • Excess cash flow • High growth potential

Priority Balance



	Distressed/Turnaround	Prolonged uncertainty	Growth
Primary Objectives	• Conserve cash • Renegotiate costs • Restructure debt	• Transform operating model • Optimize business processes • Right-size FTE structure	• Focus on investment and M&A • Optimize and align customer and product portfolios • Focus on efficient delivery

Source: Deloitte.

For companies developing performance improvement programs in any of these categories, it is important to strike a balance between controlling costs, meeting liquidity needs, pursuing profitable growth, and securing the talent required to meet business objectives.

Distressed or turnaround situations

A distressed business needs to be stabilized to survive in the short-term. Demonstrating control over the situation, reintroducing predictability, potentially fixing its capital structure, and attaining legal and fiduciary compliance are critical to recovery. Once the business attains stability, it can address operational and cost issues. After that, it can work to focus on strategy matters.

One potential avenue for attaining business stability is to emphasize cash management, cash generation, and cash conservation, supported by a substantial cost-reduction drive. For a distressed company, renegotiating the cost structure and completing a debt restructuring often go hand in hand. Conserving cash can provide the means to achieve these aims.

Distressed companies often have not forecasted ranges of cash and earnings or developed liquidity contingency plans. In contrast, cash-efficient organizations generally stress cash management, producing weekly and in some cases daily cash forecasts.

The cost reduction efforts of distressed companies typically focus on sales, general, and administrative (SG&A) expense, emphasizing obvious and immediate targets, such as headcount reductions. Thus, if there isn't any low-hanging fruit, the process can stagnate.

Firm leadership and a bias toward action are critical in distressed situations. Consensus building can be an impediment, especially in the initial phases.

Prolonged uncertainty

Encouragingly, fewer businesses appear to be in a liquidity crisis than in the depths of the downturn. But the majority of companies are still contending with what are now ever-changing marketplace and financial market conditions. In this state of prolonged uncertainty, companies should consider undertaking structural improvements designed to leapfrog competitors, increase revenues, and reduce costs. Focus areas may include improving sales force effectiveness, rationalizing sales and marketing channels, centralizing support functions, standardizing business processes, and establishing strong governance.

A priority for many of these companies is to achieve better margins through initiatives such as direct cost reduction, SG&A management, and supply chain improvement, as well as better execution of business plans and roles. Amid prolonged uncertainty, companies can benefit from repositioning operations for efficiency and improving business processes. Right-sizing the organizational structure can potentially deliver significant performance and profitability improvements. Generally, strategy is not as strong a focus for these companies as it is for companies in a growth mode, although strategic elements such as business portfolio optimization may come into play.

Growth

Companies in a growth state can benefit from identifying where growth is likely to come from, and then targeting customers with similar wants or needs. Growing companies will want to understand their competitive strengths and weaknesses, and many may seek growth abroad as U.S. consumption continues to moderate with the peaking of baby boomers' spending years.

Revenue growth is a focus for these companies, which can be achieved through pricing realization, marketing and sales effectiveness, product portfolio innovation and rationalization, and delivering a favorable customer experience. Product portfolios and customer alignment and investment are also priorities of growing businesses.

Focus areas for these companies include developing scenario planning capabilities, executing market expansion strategies, investing in R&D, maintaining growth through acquisitions, and establishing a scalable, cost-efficient operating model through partnerships and outsourcing relationships.

Attention to strategy can be critical for these companies in various areas, including mergers and acquisitions, establishment of partnerships, and tax planning. As with distressed and uncertain companies, goal achievement for growth companies will likely hinge largely on executing business strategies and plans.

Developing and executing a performance improvement strategy

Beginning performance improvement initiatives with a structured assessment can help improve the prospects of meaningful transformation and goal attainment, whether a company is in distressed, uncertain, or growth mode. A four-step process can be used to identify strategic, operational, and capabilities requirements, as well as lay out a program road map.

Strategic assessment

Any performance improvement process can begin by evaluating current costs, liquidity, growth prospects, and available talent. An important consideration is how costs will scale under different economic conditions. This factor can be explored through scenario analysis and cost and profitability benchmarking.

Among mistakes companies sometimes make is assuming that they are on track and only need to tweak strategy. Or, they may overemphasize cost reduction. Strategic decisions can be improved by examining industry and competitor benchmarks and realistically assessing the organization's current condition and desired future state. While leadership may want to execute a game-changing play, the company's strategic and financial position may dictate more modest goals.

Operational assessment

With an understanding of the industry, the competition, and the company's strategy, the next step should be to decide what operational changes may be needed and how prepared the organization is to make them. One of the main drivers of structural cost in a company is the type of business model it uses. Many companies may not explicitly establish a business model but instead see it evolve over time, such as through acquisitions.

Operating models cover a spectrum from decentralized to centralized. Companies that have decentralized models, such as a holding company structure, may enjoy greater flexibility at the expense of a higher cost structure. More-centralized models may be appropriate for companies that are experiencing low growth and have similar product and service lines.

An operational assessment can help determine the alignment between a company's business model and its cost structure. Because organizational complexity can be a significant impediment to cost reduction and efficiency improvement, it may be valuable to break down business priorities along different dimensions such as portfolio, customer channel, or cost. Cost can often be reduced further in organizations where they have already been rationalized.

Reducing complexity by examining specific dimensions can begin to simplify the business structure and identify complementary processes and systems. For example, looking at customers and profitability together can reveal unprofitable customers and drive changes to product offerings and fulfillment. Understanding complexity drivers and then evaluating complexity's effect on operating effectiveness, efficiency, and production cycles can lead to meaningful changes. Reviewing key areas is critical, so there should be no sacred cows in this process.

Capability assessment

Companies have gone through restructuring and cost reduction programs, only to discover that they don't have the people or capabilities they need. Too much may have been invested in transactional capabilities, rather than those that are critical to success and can help take the organization to the next level.

Some key steps in making effective decisions include defining key performance measures, identifying leading practices, assessing in-house capabilities across both technical and change management dimensions, and understanding the economics of internal and external changes.

Ultimately the success of an enterprise transformation process may depend on whether the right resources are in place and plans have been fully developed. Having a process leader and an aligned leadership team that can mobilize the organization is another prerequisite to achieving transformation goals.

The program road map

The outcome of an effective transformation and turnaround plan depends on a detailed road map to the desired future state. The road map lays out the opportunity, processes, timelines, and guidelines for execution, communication, and control.

Prioritizing opportunities based on the size of the benefit, the complexity involved, and the time needed to achieve the desired outcome is critical (Figure 2).

Communication is an important, often overlooked dimension of performance improvement initiatives. Information may not be shared broadly enough or in sufficient detail. Communicating fully with stakeholders in the process — particularly employees — is key to achieving the desired results. Prioritizing opportunities based on size and value proposition and then establishing dedicated leadership for the effort can enhance the potential for success.

Grouping opportunities into initiatives and then combining initiatives that have similar timing and programs can also aid in managing strategic improvement. Empowering leaders and managers to execute the program and then holding them accountable for outcomes are also integral to the process.

The road map provides an effective way to track savings realized from the process changes. And, it can support establishing a process to mobilize the organization around performance objectives and build support from stakeholders.

Positioning for transformation success

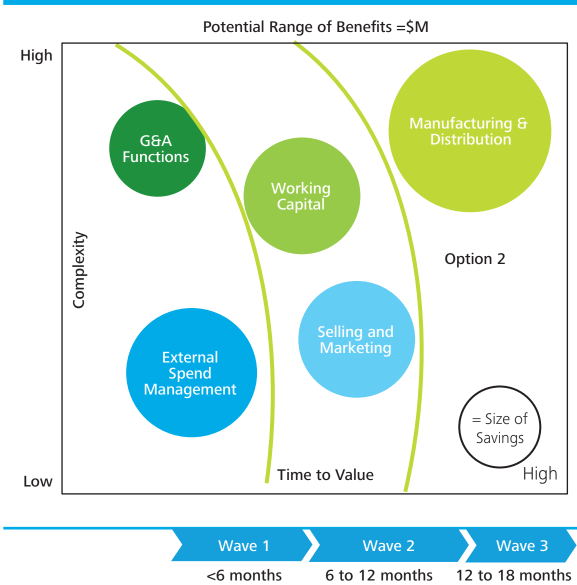
Consumer demand, employment, capital investment and other economic factors may improve or deteriorate in the months and years ahead, and surprises are inevitable. Whatever developments unfold, uncertainty is likely to maintain a prominent place in the minds of business leaders.

Companies can increase their potential for success in this environment by making structural improvements and forming sustainable cost structures. While the blueprint for cost reduction will be different for each organization, companies can increase the potential for transformational success by taking a structured approach to assessing their strategy, operations, and capabilities.

Figure 2. Performance improvement road map

A program roadmap can provide a structured approach to implementing strategic and operational initiatives

Prioritization of Initiatives



Key Steps

- Quantify the incremental benefits of all cost management opportunities
- Assess the level of complexity of all opportunities – including level of effort and potential for disruption
- Assess the time to value (whether the benefits can be realized in months or years)
- Prioritize opportunities based on:
  - Size of benefits
  - Time
  - Ease of implementation and complexity.
- Combine similar opportunities into initiatives; combine initiatives with similar timing into programs
- Develop a program-level roadmap for execution and management of identified opportunities
- Establish plans for execution and control

Source: Deloitte.

Note:

- Bubble size illustrates potential benefits
- Each bubble encompasses multiple activities identified for cost management

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