

The new Paradox in Cost Reduction: “Save to Grow”

Growth under cost constraints and in an uncertain business environment



Many companies are using cost reduction as a way to drive growth and not just as a survival technique or as a means to avoid insolvency. But here in Japan trends are less obvious, with the overarching question “Is Abenomics the starting point for real growth or just a bush fire that will be over before fall?”

Agenda

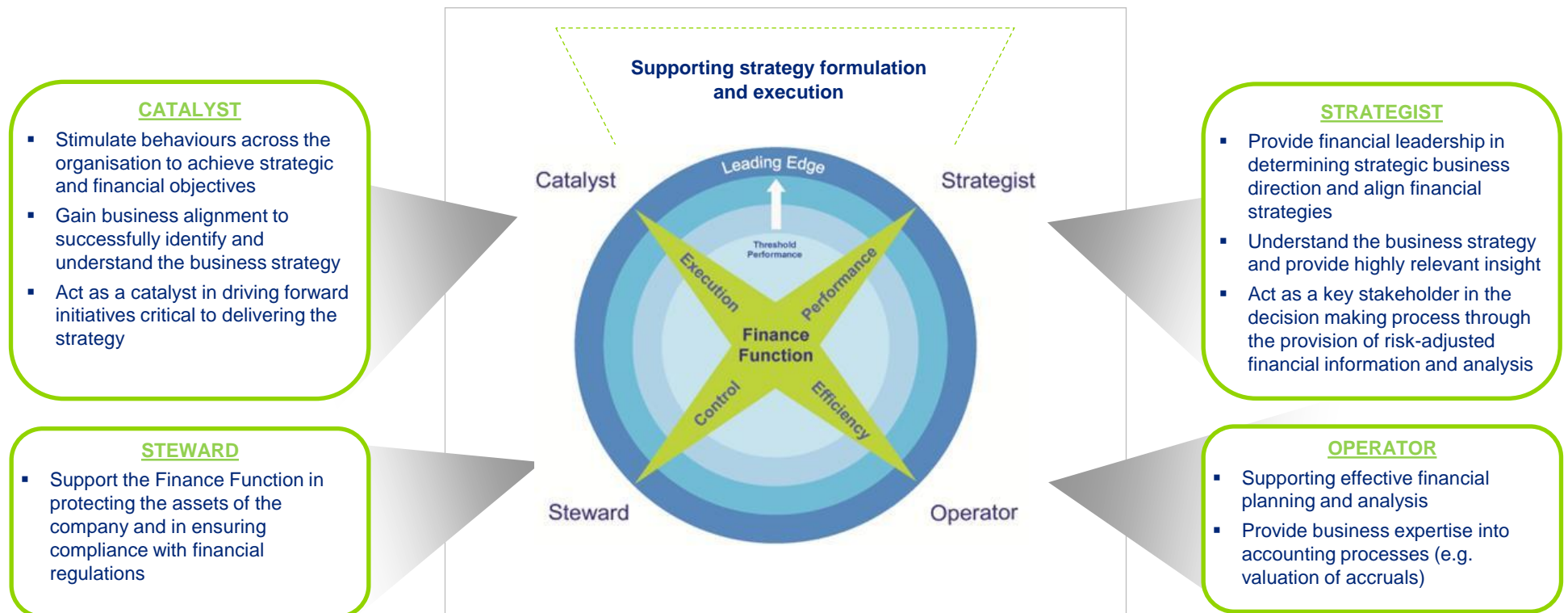


A word cloud of business and economic terms. The most prominent words are 'Save to grow', 'Cost', and 'Abenomics'. Other significant words include 'Growth', 'Sales growth', 'Cost reduction', 'Targets', 'External risks', 'Strategic priorities', 'Regulation', 'Investments', 'Customer demand', 'Net income', 'GDP', 'Liquidity', 'Positioned for growth', 'Revitalization', 'Deflation', 'Goals', 'Collaboration', 'Profitability', 'Strategy', 'Concerns', and 'Execution'. The words are arranged in a dense, overlapping manner, with colors ranging from light blue to dark blue and green.

Investments Regulation Cost reduction
Strategic priorities Targets Concerns
Customer demand Profitability Growth
Sales growth Collaboration Strategy Net income External risks
Goals GDP
Deflation Save to grow
Revitalization Cost Abenomics
Execution Liquidity Positioned for growth

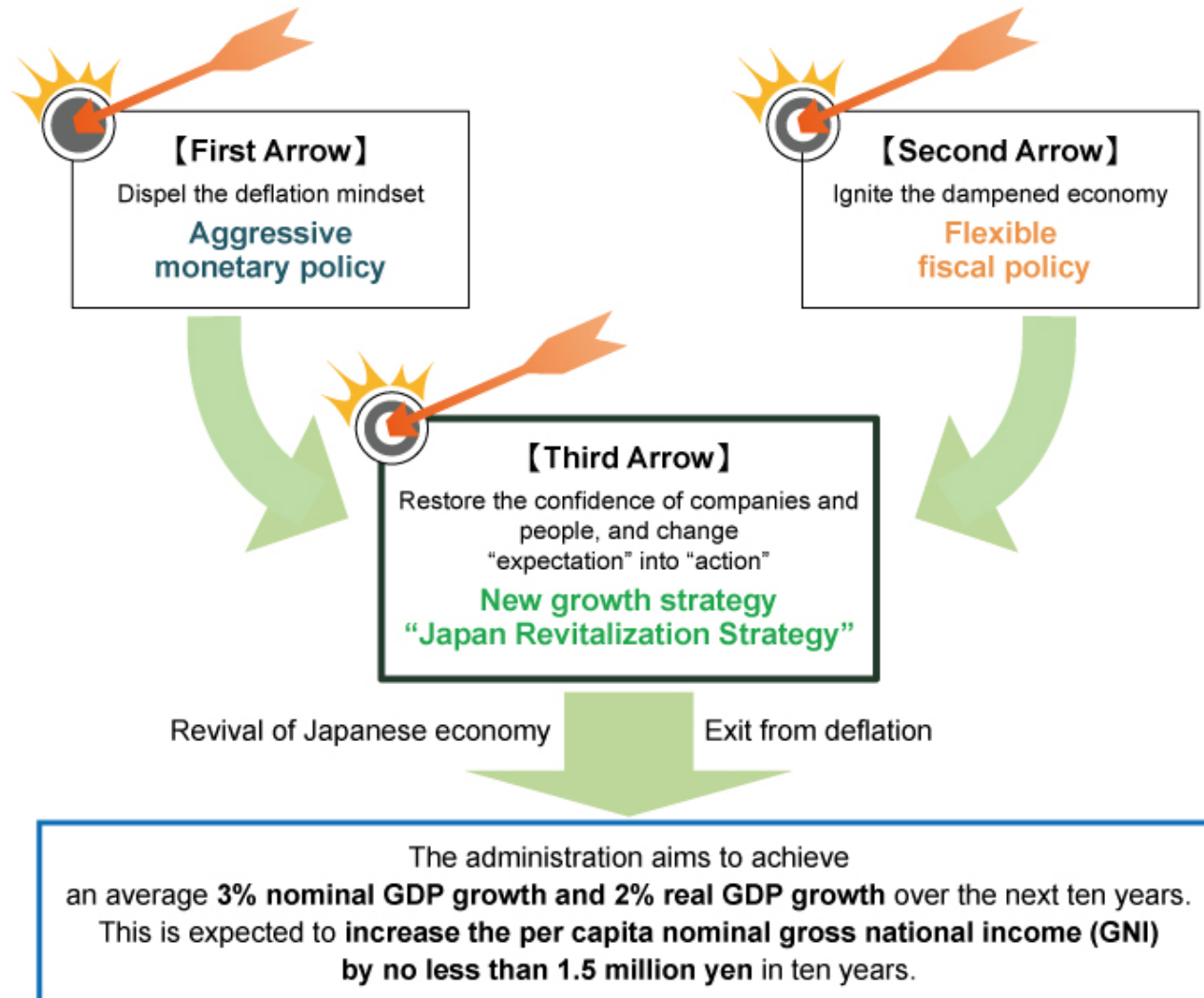
The CFO has a strong role in both cost reduction and growth initiatives

Finance should support and challenge the business to ensure that a chosen business strategy delivers the highest financial value at an acceptable level of risk. Finance can create significant value by improving the quality of decisions geared towards growth (e.g. investment appraisal, pricing strategy) and through leadership in cost reduction efforts.



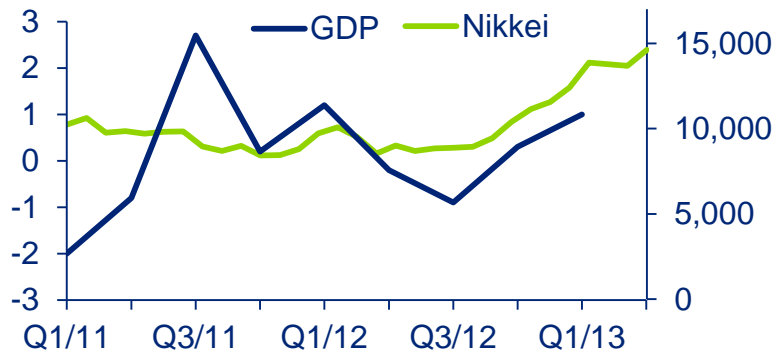
Deloitte's Four Faces of the CFO model

Abenomics – revitalizing Japan through targeted initiatives stimulating growth



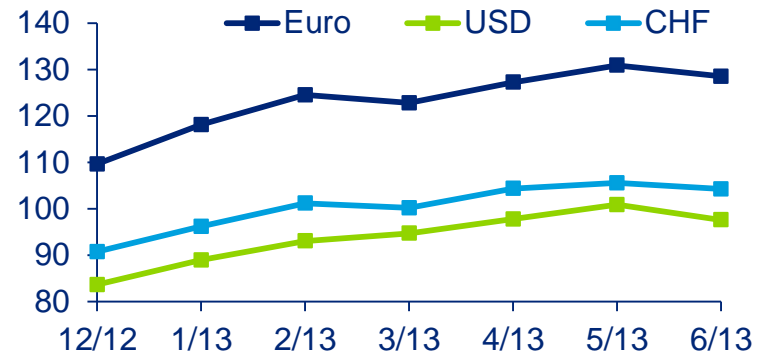
The first months show that Abenomics made a change (1/2)

Annualized GDP growth* in Q1/13 of 4.1%
Nikkei gained >40% since Abe's election

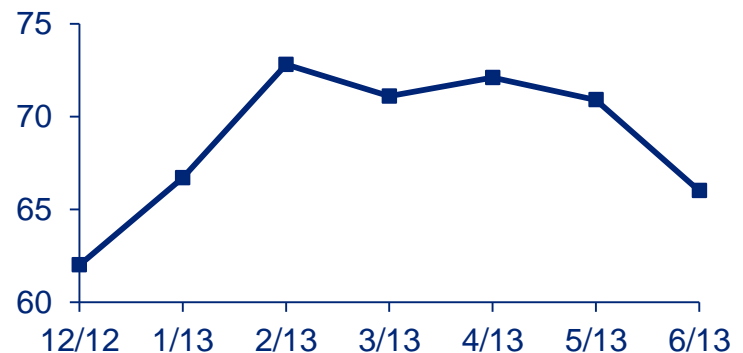


*Growth rates of real GDP, change over previous quarter, seasonally adjusted

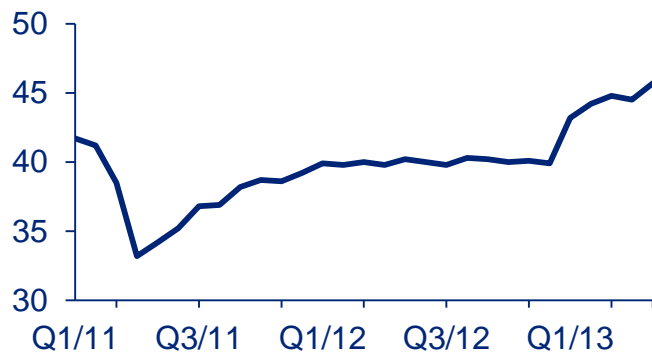
Yen significantly depreciated against major currencies



Support for Abe constantly >60%

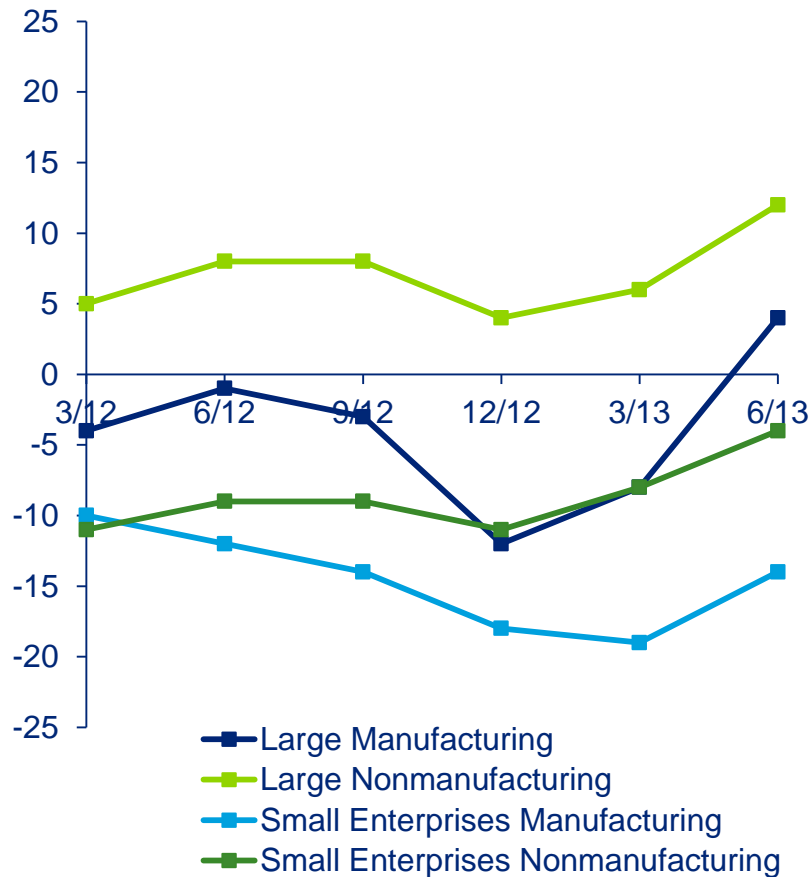


Consumer confidence reaching highest level since 2007

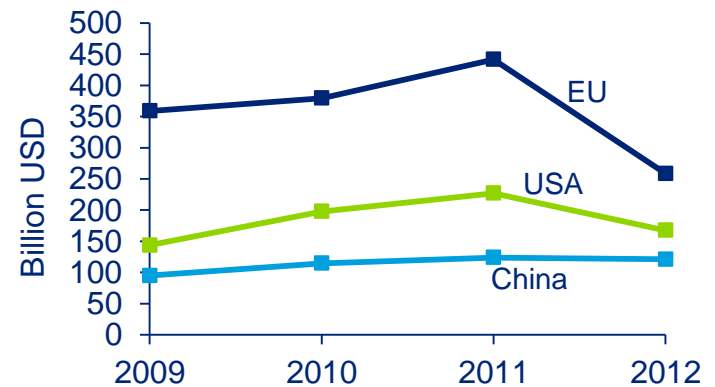
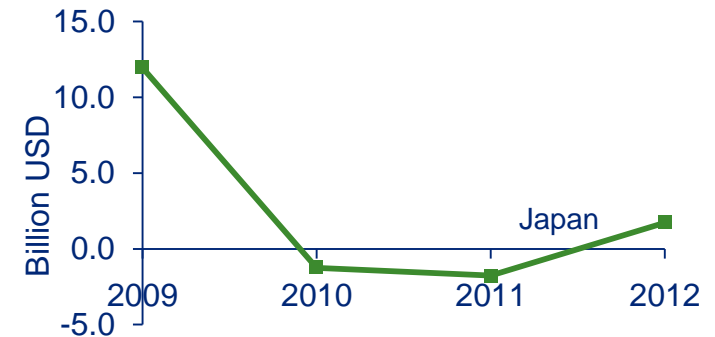


The first months show that Abenomics made a change (2/2)

The Bank of Japan Tankan economic survey shows a **positive trend**



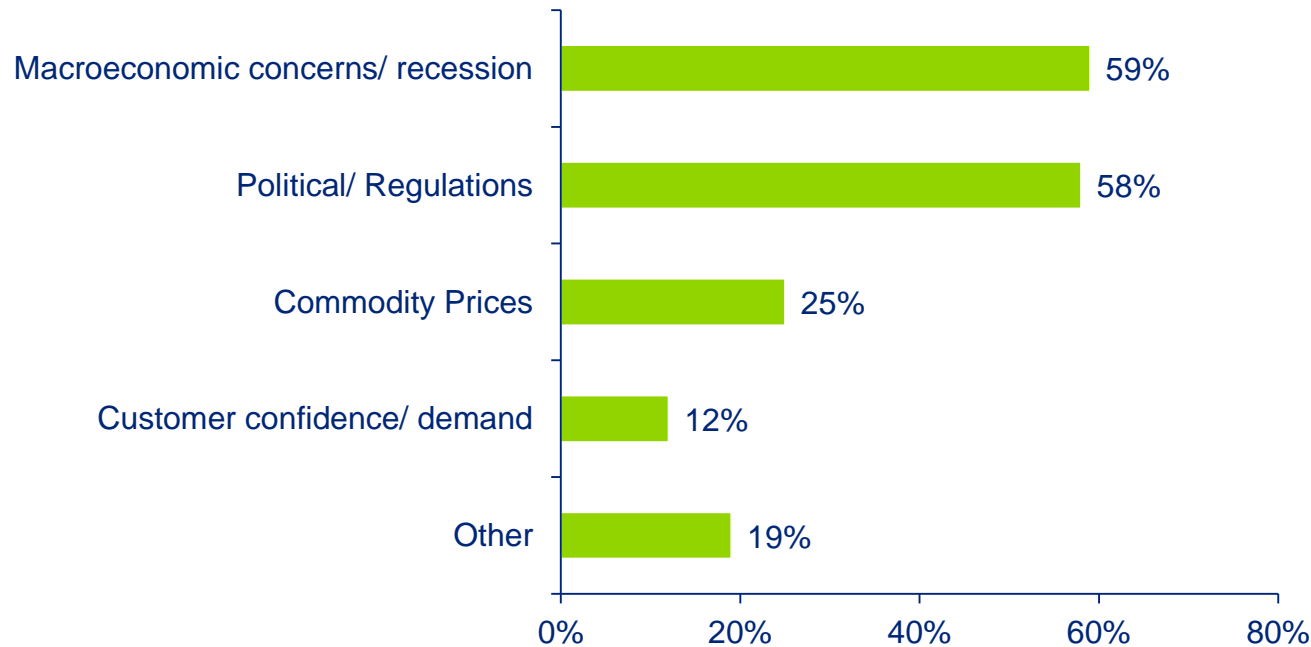
Japan's FDI inward flows **improved from 2011 to 2012**



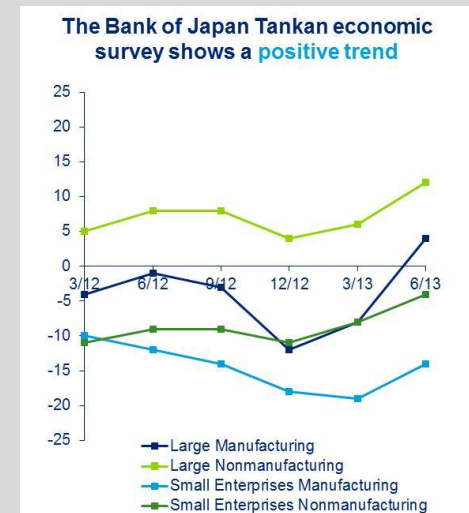
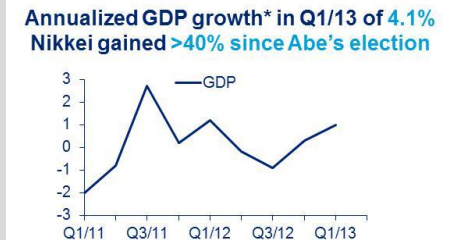
How does Abenomics affect foreign companies in Japan?

Top external risks in the next 24 months

- Recession is the top external risk feared by executives around the globe and also in Japan
- Despite short-term sentiment improvements achieved by Abe's bold measures, sustainable effects not guaranteed

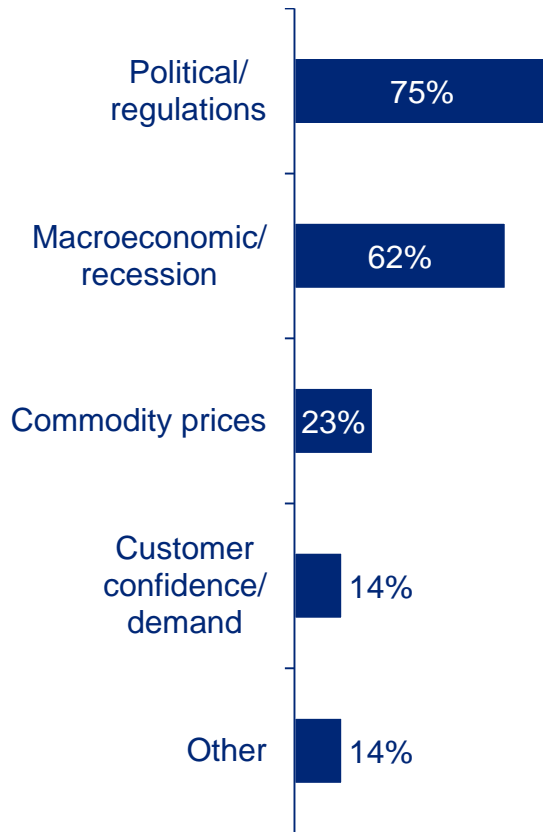


Recap

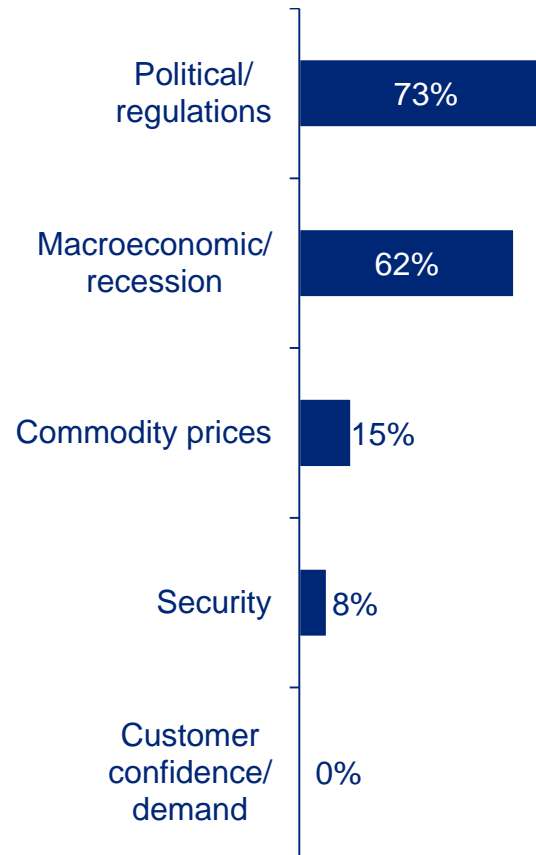


Top external risks in the next 24 months – industry specific

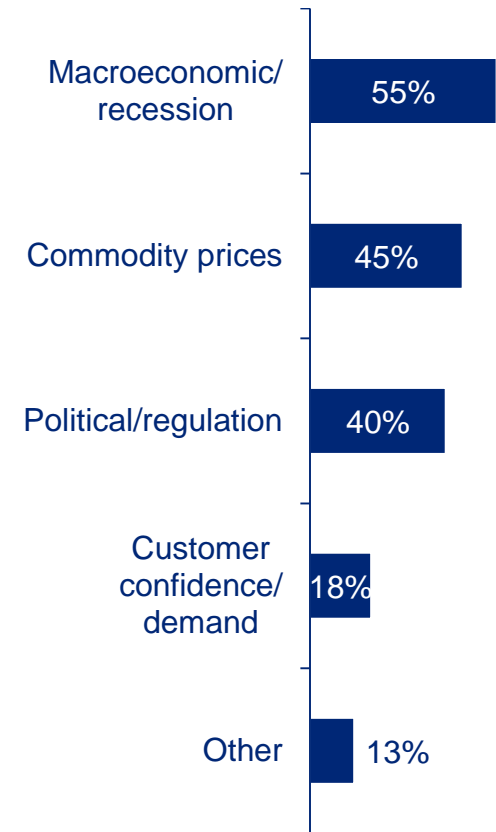
Financial Services



Life Sciences & Health Care



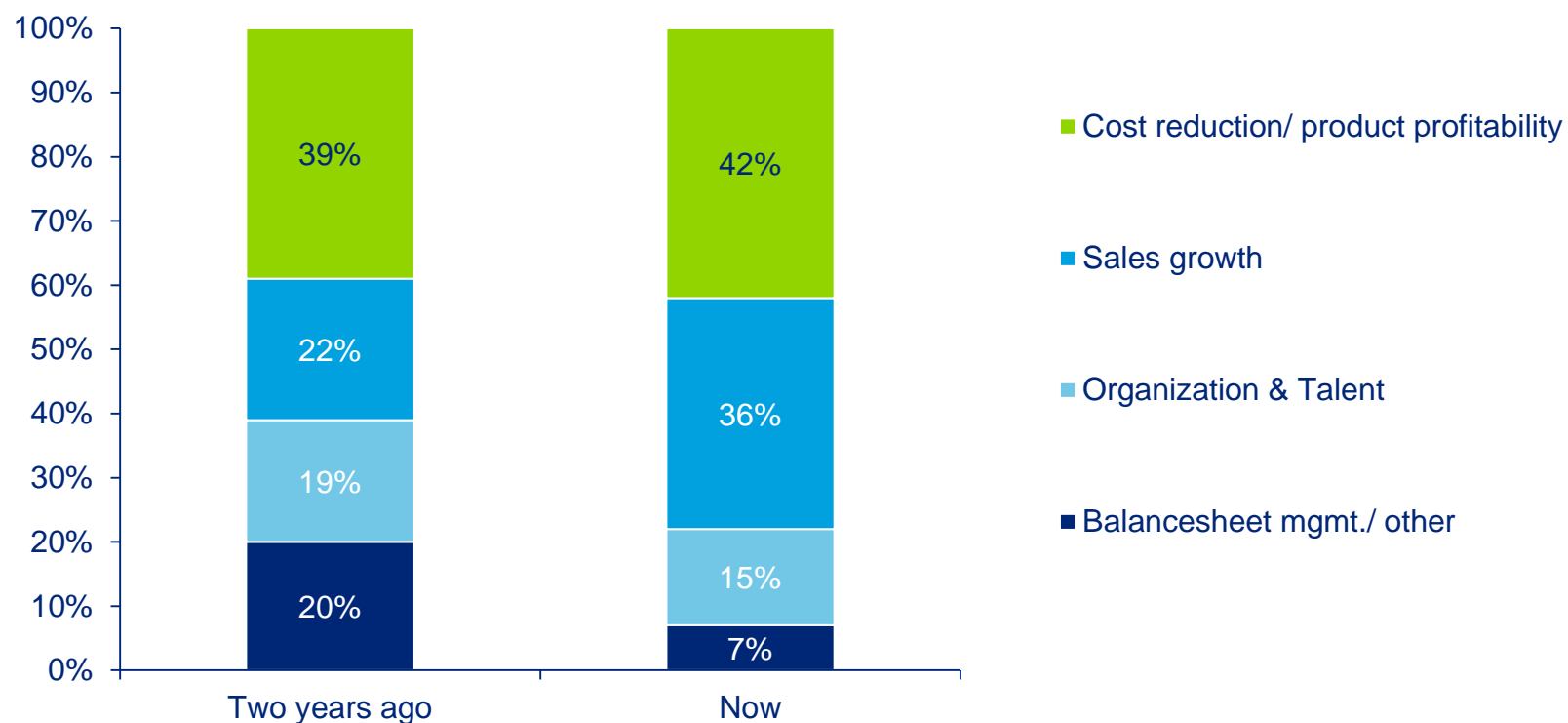
Consumer & Industrial Products



In light of external risks, what is the most crucial adjustment your organization is considering over the next 24 months?

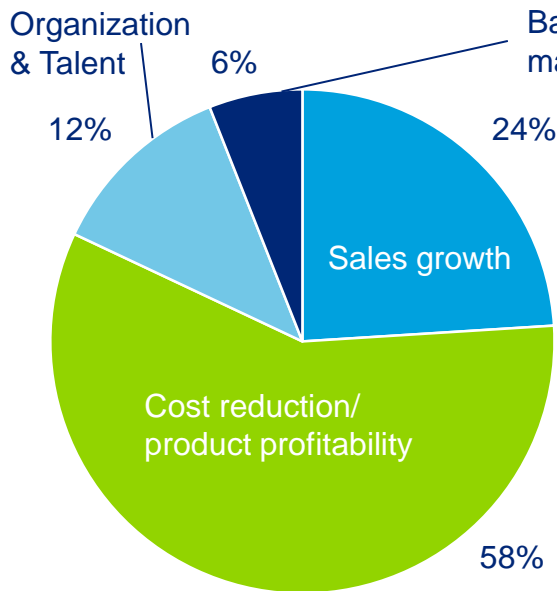
Strategic priorities in the next 24 months – dual focus on cost reduction and sales growth

- Many companies are using cost reduction as a way to drive growth
- In this year's survey, 36% of executives cited sales growth as their top strategic priority, compared to only 22% two years ago
- The number of respondents focusing on cost reduction and product profitability increased from 39% two years ago to 42% this year

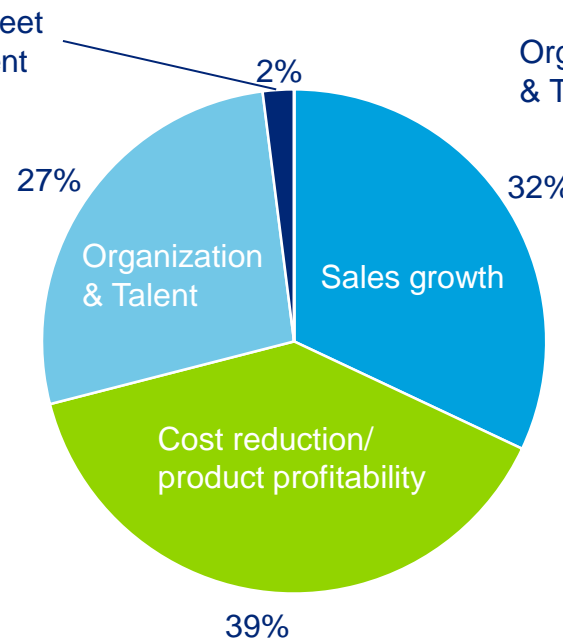


Strategic priorities – industry specific

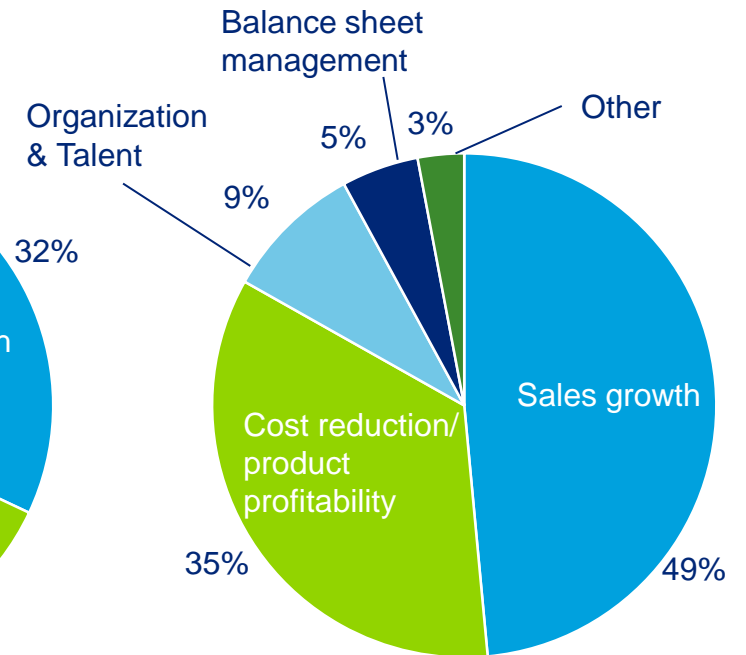
Financial Services



Life Sciences & Health Care



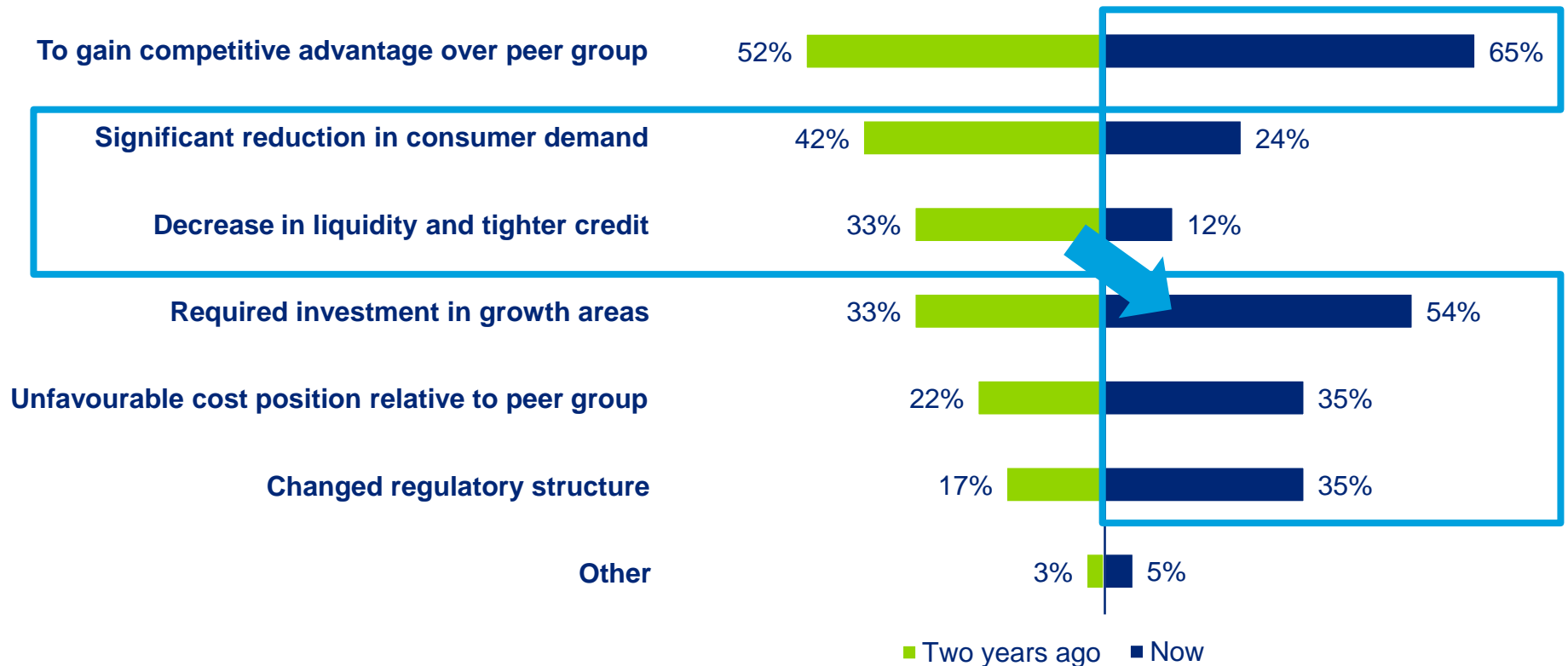
Consumer & Industrial Products



What is the primary reason why your company is driving cost management measures?

The current intent is “save to grow” versus the “save to survive” focus post recession

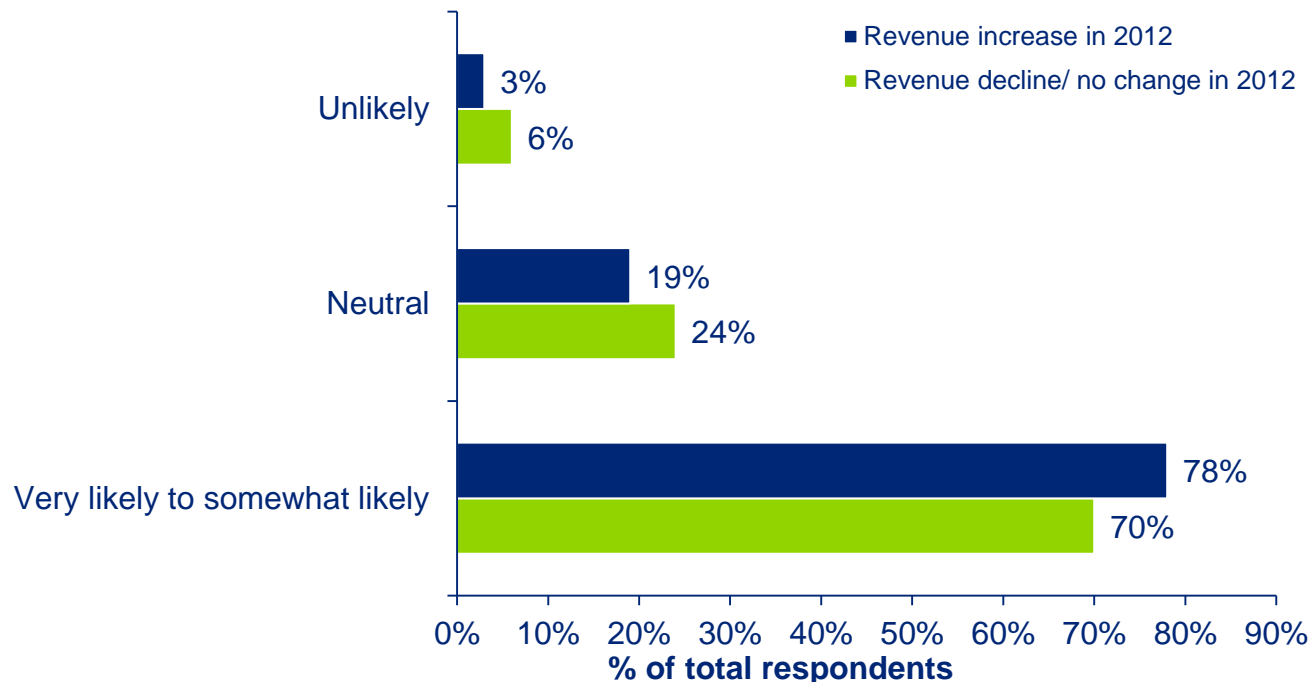
- 65% of respondents want to reduce cost to gain a competitive advantage over peer group and 35% think their own cost position is unfavorable compared to their peers
- Cost containment is always on the agenda of a CFO, but in the most recent survey we can see a shift towards cost reduction to free up funding for investment in growth areas



Cost management initiatives planned despite revenue increase

- Companies that saw their revenue increase over the past two years are even more likely to pursue cost reduction than their less fortunate counterparts (78%, compared to 70% of companies with flat or declining revenue)

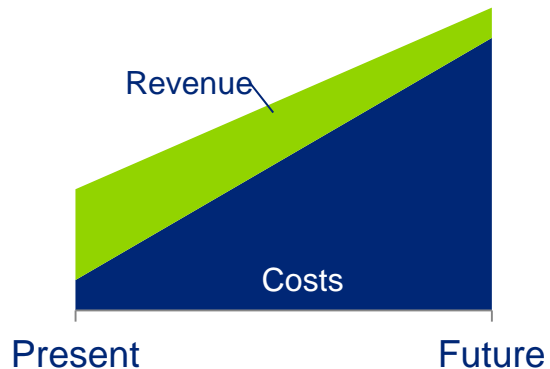
Likelihood of cost reduction in next 24 months



Effective cost management required to avoid an over proportional increase in costs

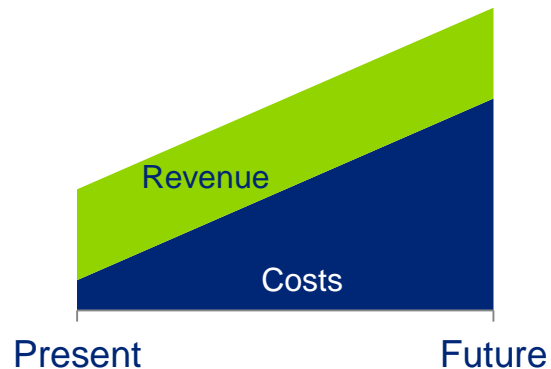
Blinded by Growth

Costs are rising faster than revenue is increasing



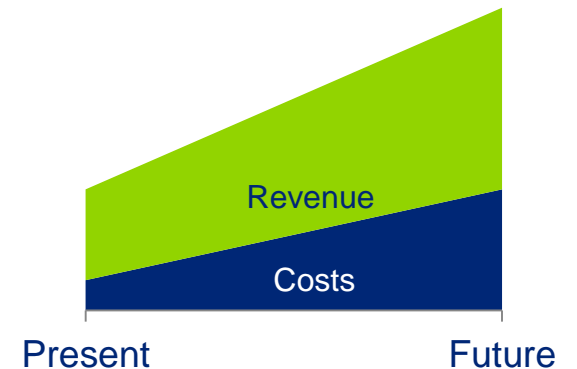
Scale to Scale

Costs are rising simultaneously with the revenue



Save to Grow

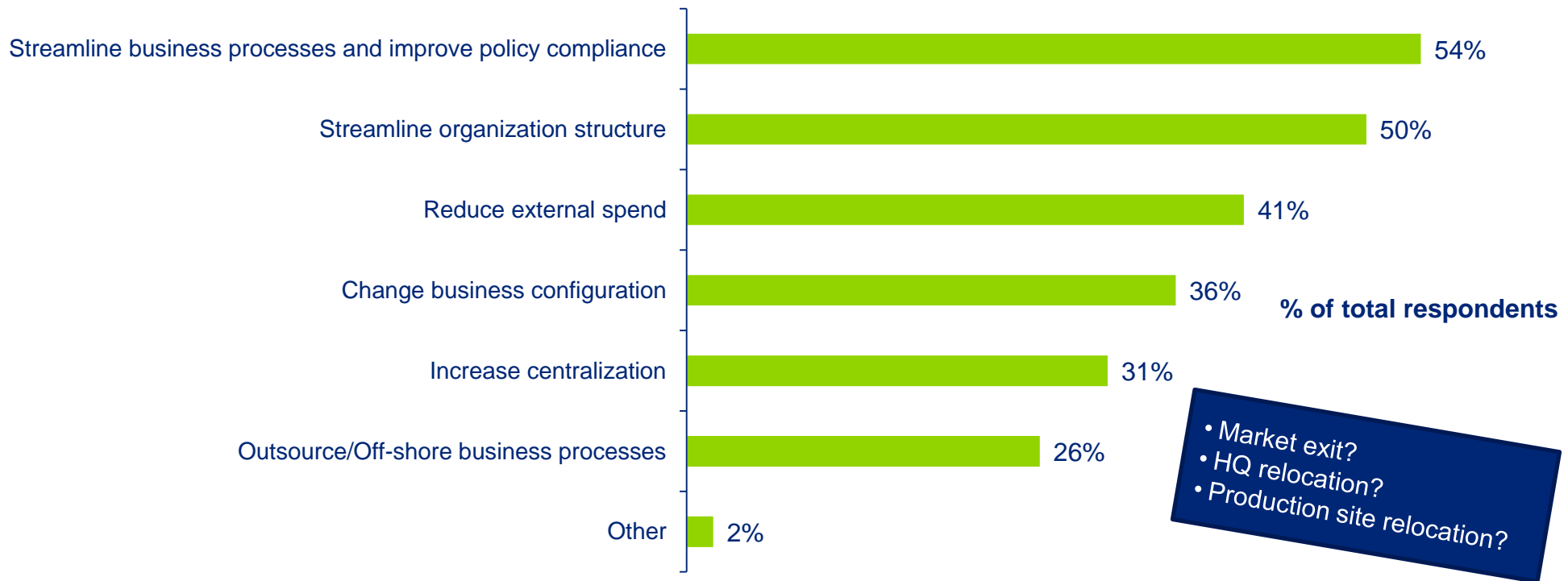
Costs are rising slower than revenue is increasing



What primary area is your company targeting to drive cost management measures?

Cost actions viewed as most likely in the next 24 months

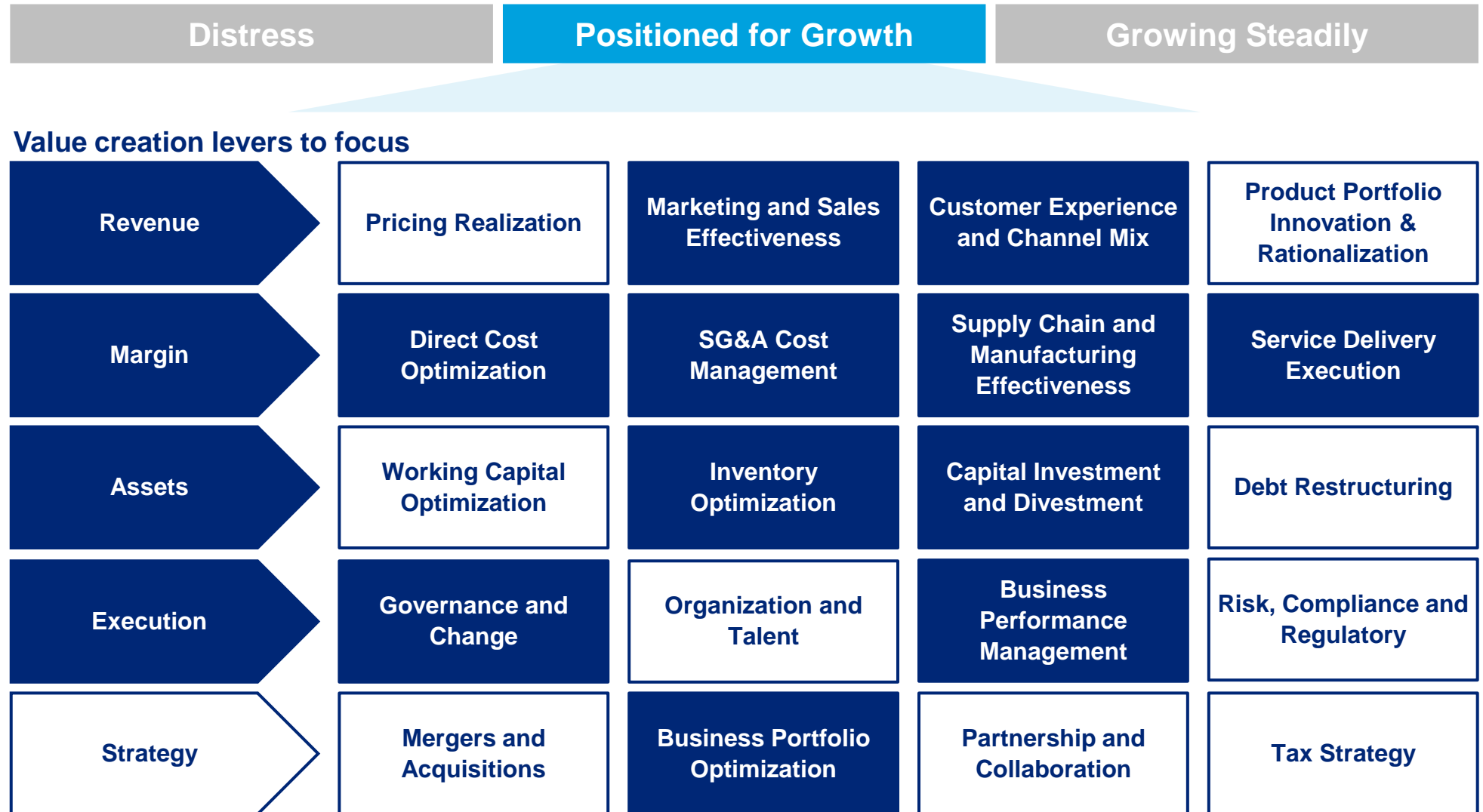
- Companies intend to continue to focus on incremental tactical cost reduction approaches, as opposed to more strategic initiatives
- Many respondents say their companies tend to focus on the same cost reduction areas year after year, especially administrative costs (75%) and operational costs (67%), using the same old approaches



A company's marketplace position helps determine its primary objectives to creating value

	Most companies fall here		
	Distressed	Positioned for Growth	Growing Steadily
State of the organization	<ul style="list-style-type: none"> • Losing market share • Structural operating flaws • Liquidity concerns • No clear growth options 	<ul style="list-style-type: none"> • Recovering from recession • Adjusting to demand • Growth concerns • Conditional growth option 	<ul style="list-style-type: none"> • Healthy balance sheet • Excess cash flow • High growth potential • Unconstrained options
Primary objectives	<ul style="list-style-type: none"> • Conserve cash • Renegotiate costs • Restructure debt • Downscale business model 	<ul style="list-style-type: none"> • Transform operating model • Optimize business processes • Right-size FTE structure • Fuel growth through savings (capital efficiency) 	<ul style="list-style-type: none"> • Focus on investment and M&A • Optimize and align customers and products • Focus on efficient execution and delivery

Companies that are “Positioned for Growth” should focus on structural improvements and cost savings



 Indicates levers that Deloitte identified as potential focus areas for companies positioned for growth

Lessons learned – most crucial elements to achieve cost reduction objectives

- A focus on change management, communication and setting realistic goals and objectives are important lessons learned - especially to help employees and managers better understand the cost reduction program

Lessons learned past 24 months



Failure rates of cost programs have increased in recent years: Ineffective scope, wrong approach or bad execution?



Typical cost action from survey results

Companies focused on continuous improvement programs before the downturn

Companies focused on costs aimed at low hanging fruit to recover from demand reduction

Companies still focused on tactical changes mostly by targeting processes and organization streaming

Actual response needed

Broad restructuring and liquidity improvements

Structural costs and business model changes to gain efficiency

Structural cost and business model changes to fuel growth

Meeting cost reduction goals

Did not meet goals

17%

37%

48%

Met goals

54%

35%

33%

Exceeded goals

30%

29%

19%

Takeaways – summary of cost survey

- ✓ Recession is the top external risk feared by executives around the globe and also in Japan. Business leaders expect the current business environment to stay uncertain and volatile in the near future
- ✓ Despite short-term sentiment improvements achieved by Abe's bold measures, sustainable effects are not guaranteed for companies operating in Japan
- ✓ In this environment, companies have a dual focus on revenue and costs and most companies now are reducing costs to fuel growth in their businesses
- ✓ Unfortunately, the failure rates of cost programs have continued to increase over the past few years, in particular due to technical implementation issues
- ✓ Companies intend to continue to focus on incremental tactical cost reduction approaches, as opposed to more strategic initiatives
- ✓ In order to be successful in their “save to grow” strategy, companies should set realistic goals, and focus on teamwork and effective communications, in addition to defining more structural and transformational programs

Self Assessment (1/2)

Where will cost reduction have the most impact on your company's overall performance? The right scope and approach can put your company on track to sustained competitiveness. Focusing on the cost reduction approach and levers that are most relevant to your company's situation can deliver greater cost savings while requiring less time, money and effort than an across-the-board approach.

Revenue

- Are we getting the most out of our sales and marketing spend by attaining a high ROI?
- Do trade and promotions spend result in measurable "revenue lift" or results?
- Do we make the most of service revenue potential with our customer base?

Margin

- Are all major channels, customers or categories profitable and do we know the unprofitable ones?
- Are our costs-of-goods-sold or costs-of-operation competitive with the industry?
- Do we have appropriate procurement and sourcing strategies to ensure competitive unit cost?
- Do we have the right demand management programs to ensure efficient utilization of resources?
- Do we get the appropriate value-add from G&A expenses and is our G&A cost structure scalable?
- Have we fully embraced shared services, outsourcing, and centers of expertise in administration?
- Do our distribution and network systems increase efficiency?

Self Assessment (2/2)

Assets

- Is our inventory supporting superior working capital performance?
- Is inventory tied to financial and efficiency metrics?
- Do we have the right systems in place for proper visibility over inventory?
- Have we integrated our supply chain with suppliers and clients?

Execution

- Do we have effective processes to rationalize and prioritize investments?
- Do we track results from investments?
- Is our company's decision making efficient and effective?
- Do we have leading governance practices to support effective and efficient decision making?
- Do we have the right tools, systems and technology to support analytics and decision making?

Strategy

- Do we provide consistent guidance to the business over investments or divestments?
- Do we have the right portfolio of businesses and services to compete and grow in the market?

Session Summary

The concept of Abenomics still has to be proven

CFOs commented:

(abridged and edited for clarity)

“We see **double effects**: we don’t export so much directly but we sell to Japanese OEMs and they export, so there is a **time lag effect**. But we expect there **will come a point where our customers can leverage on the Japanese Yen to export more.**”

“Short term Abenomics is **not very good.**”

“Currently, **Abenomics is based on expectations**. Now after the upper house election I would rather wait to see **what’s the concrete decision making by the government**. Otherwise, further disappointment may happen.”

Abenomics is linked with great expectations

CFOs commented:

(abridged and edited for clarity)

“If Abe doesn’t deliver its going to be pretty bad.”

“We are trying to push consumption but at the same time we are slowing it down by a consumption tax increase.”

“The Japanese Sales Tax is only 5% so there is a lot of room to raise it up to European Sales Tax levels.”

“A raise in sales tax is a huge challenge for us, especially as an importer.”

Strategic priorities and measures vary across industries

CFOs commented:

(abridged and edited for clarity)

“Our company has **SG&A costs** as a **very, very high priority.**”

“It’s really about how to **funnel cash into our pipeline.** We had to make some difficult decisions about a decade ago when we lost patents and **cut investment in R&D to keep our profit margins stable.** Now we are **paying a high price with a gap in the R&D pipeline.**”

“We have permanent employees, fixed duration employees and temporary employees. This setup **allows us to actually fluctuate staff levels with the business cycle** and maintain a stable core.”

“We see a lot of companies redefining growth because **the traditional types of growth are no longer valid.** The models need to be adjusted, but **people are scared to walk away from the traditional models.**”

Cost reductions remains on the CFO's agenda

CFOs commented:

(abridged and edited for clarity)

“We are not only paying attention to the **absolute value but also to the structure of the costs.** We are constantly working on our cost structure to **gain a competitive advantage.**”

“Cost reduction is **not a project, it is an ongoing activity.**”

“We have done a lot **locally in cost reduction** and now we are looking more on the **international opportunities with shared service centers.**”

“A lot of the benefits from shared service centers came **from standardization, not labor cost arbitrage.**”

“One way for the **sales growth and cost reduction is better alignment with your business partners in an arrangement to share certain costs with them.**”

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