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Thriving in Uncertainty
Deloitte's first biennial cost survey: cost improvement practices and trends in Latin America

May 2016

Executive summary

Macroeconomic factors are having a major impact on cost improvement priorities and actions for companies in Latin America. To learn more about what Latin American companies are doing to manage costs, Deloitte recently surveyed more than 150 CXOs, executives, and senior managers from large and mid-size companies in Brazil and Mexico – two countries that together represent 63% of the Latin American economy based on gross domestic product (GDP)[1]. We also conducted a review of the macroeconomic factors in Brazil and Mexico in order to establish a broader context for the survey results.

What we found is that from an economic standpoint Brazil and Mexico face very different challenges. In Brazil, the economic conditions are much more challenging, with negative GDP growth, accelerating unemployment, a high inflation rate, and political uncertainty combining to create a potential near-crisis business environment[2]. In Mexico, economic conditions are less severe: GDP growth is lower than usual, but still positive, and while exchange rate fluctuations and commodity price volatility are creating some challenges, the overall situation seems to be improving – in part due to the relatively strong US economy, which is Mexico's largest trading partner[3].

Despite their different economic circumstances, survey respondents from Brazil and Mexico provided similar answers about their past and future cost reduction activities.

[1] International Monetary Fund (IMF)
[2] "Brazil Heads for Worst Recession Since 1901, Economists Forecast", Bloomberg, January 4, 2016
[3] Economist Intelligence Unit (EIU)

Key findings from the survey:

- Factors related to the global economy -- including "macroeconomic concerns / recession" and fluctuations in both "global exchange rates" and "commodity prices" -- were rated as the top external risks for both Brazil and Mexico.

- Although they face challenging economic conditions, the vast majority of surveyed companies in both Brazil and Mexico saw their revenues grow over the past 24 months, and even more companies expect their revenues to grow over the next 24 months.

- Despite their growth expectations, nearly all organizations surveyed in Brazil and Mexico say they are likely to pursue cost reduction over the next 24 months -- regardless of whether their revenues are increasing or decreasing.

- Consistent with their positive expectations about growth and cost reduction, the companies we surveyed cite sales growth and cost reduction as their top strategic priorities. The simultaneous pursuit of these two seemingly conflicting priorities creates a paradox we call "save to grow."

- Balance sheet management appears to be another high priority for our respondents, and given the high level of economic stress Latin American companies currently face, it is possible that many are focusing on all aspects of balance sheet management, from credit and working capital to liquidity and foreign exchange issues. The result is a new cost management scenario that we call "thriving in uncertainty," which extends the cost / growth paradox of "save to grow" by adding in a strong focus on balance sheet items – a focus typically associated with businesses in distress.

- Companies are setting aggressive cost reduction targets, with 63% of Brazilian respondents and 69% of Mexican respondents reporting annual cost reduction targets of 10% or more. At the same time, roughly two out of three companies in both countries say they did not meet their targets. These high cost program failure rates could climb even higher if economic conditions remain challenging, since companies may be under increasing pressure to reduce costs. Unless companies adopt new cost management approaches that are capable of achieving a higher level of savings than their existing approaches can deliver, rising targets could lead to rising failure rates.

- Survey respondents see implementation issues as the main barriers to effective cost management, with four of the top five barriers directly related to implementation. These include not only the general issue of "challenges in implementing initiatives," but also more specific implementation-related issues: erosion of savings, weak business case, and poor design and tracking. The only barrier in the top five not directly tied to implementation is "lack of understanding."

- Companies in both Brazil and Mexico are actively developing a wide range of cost management capabilities; however, adoption rates for zero-based budgeting (ZBB) seem to be declining, despite the fact that it first came to prominence in Brazil.

- The cost actions that companies expect to implement over the next 24 months tend to be more tactical than strategic. Popular tactical actions -- such as reducing external spend and streamlining business processes --may not be capable of delivering the aggressive savings most companies are seeking, which may be why so many cost management programs are failing to meet their goals. To achieve aggressive cost reduction targets, companies could apply approaches that are more strategic in nature, such as increasing centralization, reconfiguring the business, and outsourcing / offshoring business processes. Those are the kinds of actions that can potentially deliver the 10%+ cost reductions most companies seem to be seeking.

Choosing the right cost management approach:

- Businesses generally fall into one of three traditional cost management scenarios: (1) distressed, (2) positioned for growth, or (3) growing steadily. However, today's volatile and complex global business environment seems to be giving rise to a fourth category that we call "thriving in uncertainty" -- a scenario that straddles the line between "distressed" and "positioned for growth" and involves organizations simultaneously pursuing the goals of growth, cost improvement, and balance sheet management.

- It remains to be seen whether this fourth category is a new and permanent feature of the business landscape, or simply a stepping stone to one of the traditional cost management categories. However, in the case of Brazil and Mexico, their current state of "thriving in uncertainty" could eventually transition to a traditional cost management scenario – although their destinations could be different and may require different playbooks.

- Given the severe economic conditions in Brazil, many Brazilian companies will likely need to shift their focus to a specific set of value creation levers that are appropriate for "distressed" businesses. By contrast, companies in Mexico may find themselves pulled toward the growth side, prompting them to focus on value creation levers more appropriate for businesses "thriving in uncertainty" or "positioned for growth."

About the survey

In February 2016 Deloitte Consulting LLP conducted its first biennial Latin American cost survey on current and future cost reduction initiatives at large and mid-size companies in Brazil and Mexico -- two markets that together represent 63% of the Latin American economy based on GDP[1]. We have been conducting similar surveys of large US companies since 2007, and are now expanding our studies to include key global regions in order to provide detailed regional insights and a more global perspective.

This initial survey of executives and senior management included 77 respondents from Brazil and 78 respondents from Mexico.

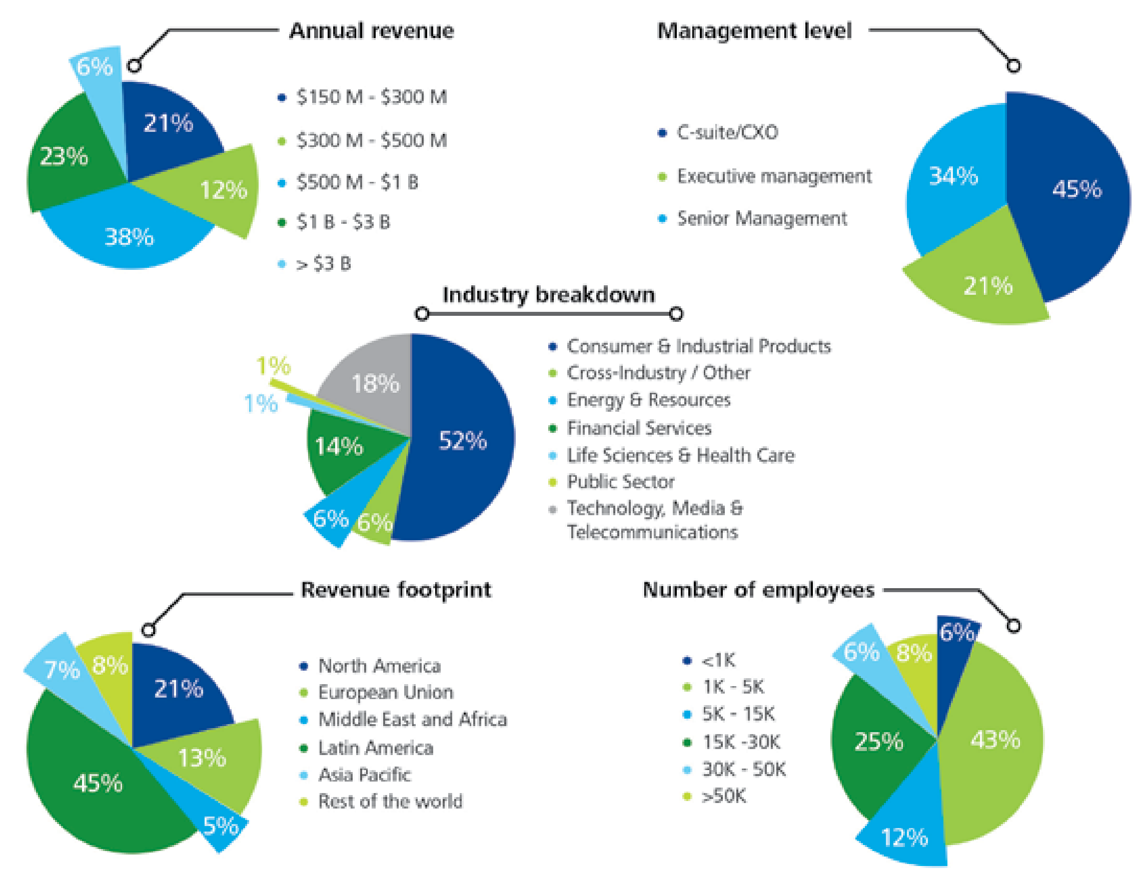
Key objectives:

- Understand factors, approaches, actions and targets related to cost initiatives
- Assess the effectiveness of cost initiatives, including lessons learned from previous efforts
- Understand the drivers and scope of future cost initiatives

Qualification criteria:

- C-suite level executive (CEO, CFO, COO, CIO, Board of Directors, etc.), executive management level (Division / Business Unit / Regional President, Controller, Treasurer, or other company officers), or senior management level (SVP / VP of a Business Group, or SVP / VP of an enabling function such as Finance, HR, or IT)
- Annual company revenue of at least $150 million (USD)
- Personal involvement in managing cost reduction initiatives within the company

Fig 1. Filmographics summary for Brazil (77 Responses)



[1] International Monetary Fund (IMF)

Fig 2. Filmographics summary for Mexico (78 Responses)

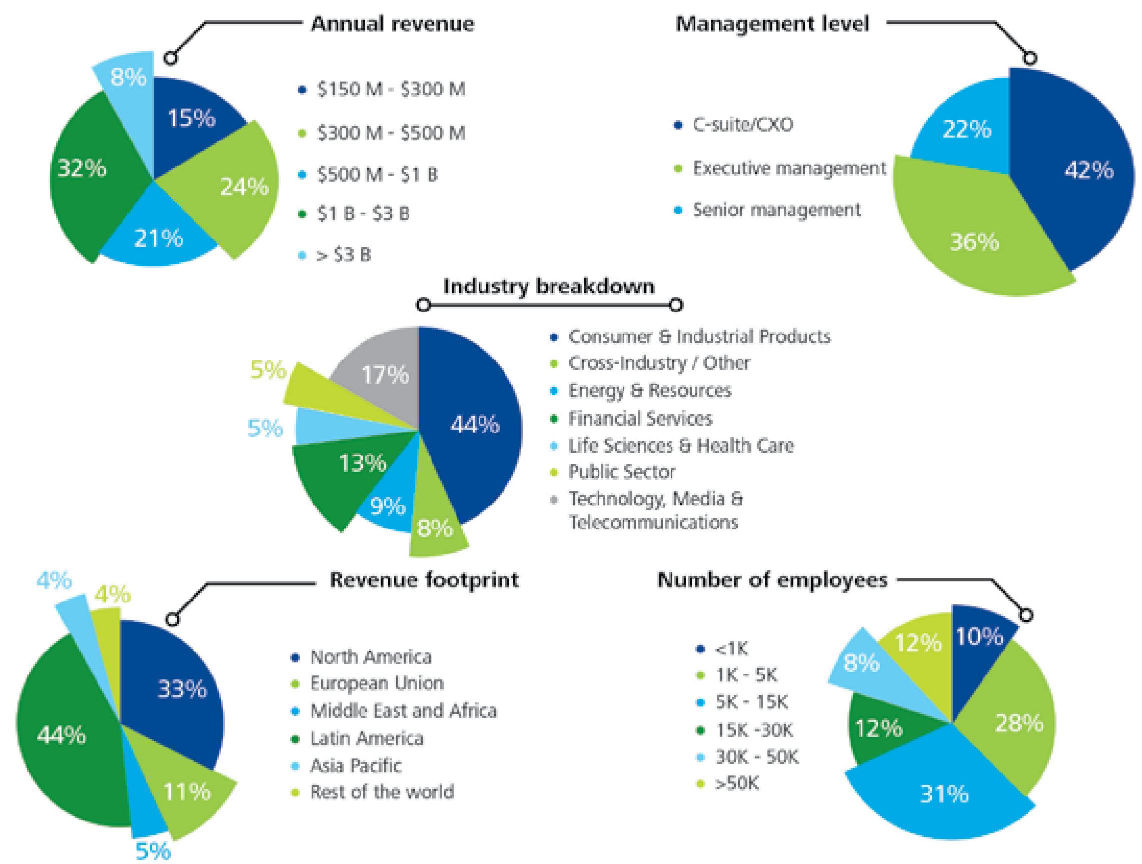
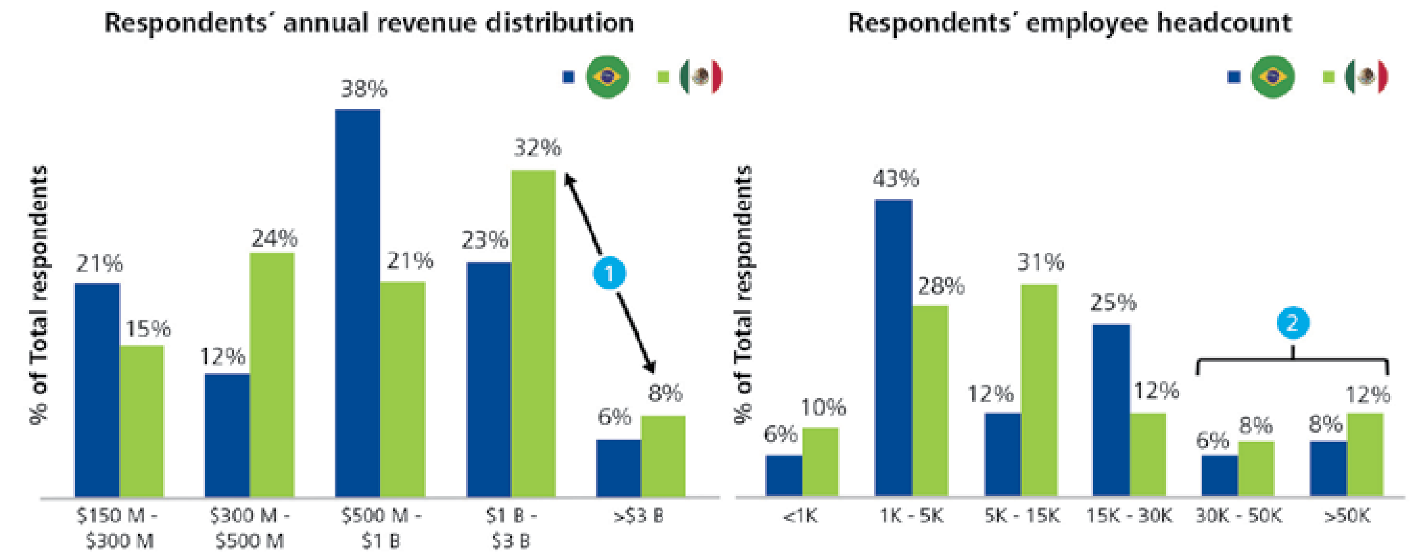


Fig 3. Filmographics details: annual revenue and number of employees



Demographic comparisons

1. In general, respondents from organizations in Mexico were from larger firms; 40% of respondents from Mexico were from firms with greater than $1B in revenue as compared to 29% for respondents from Brazil

2. In general, respondents from organizations in Mexico were from larger firms; 20% of respondents from Mexico were from firms with 30,000 employees or more as compared to 14% of respondents from Brazil

C-suite participation in our survey was similar for both Brazil (45%) and Mexico (42%)

The percentage of participants at the executive management level is higher for Mexico (36%) than Brazil (21%), while the percentage of participants at the senior management level is higher for Brazil (34%) than Mexico (22%).

In general, participating companies from Mexico were larger than those from Brazil. Among Mexican participants, 40% were from companies with greater than $1B in revenue, and 20% were from companies with 30,000 employees or more. Among Brazilian participants, 29% were from companies with greater than $1B in revenue, and 14% were from companies with 30,000 employees or more.

Distribution of respondents across industries is very similar between Mexico and Brazil. The consumer & industrial products industry (C&IP) had the most respondents, with 52% of Brazilian respondents and 44% of Mexican respondents representing C&IP.

Less than half of respondents' revenues come from Latin America, inferring they are heavily dependent on exporting goods and services. Mexican companies generate a much higher percentage of their revenue (33%) from within North America than does Brazil (21%).

Fig 4. Filmographics details: industry breakdown

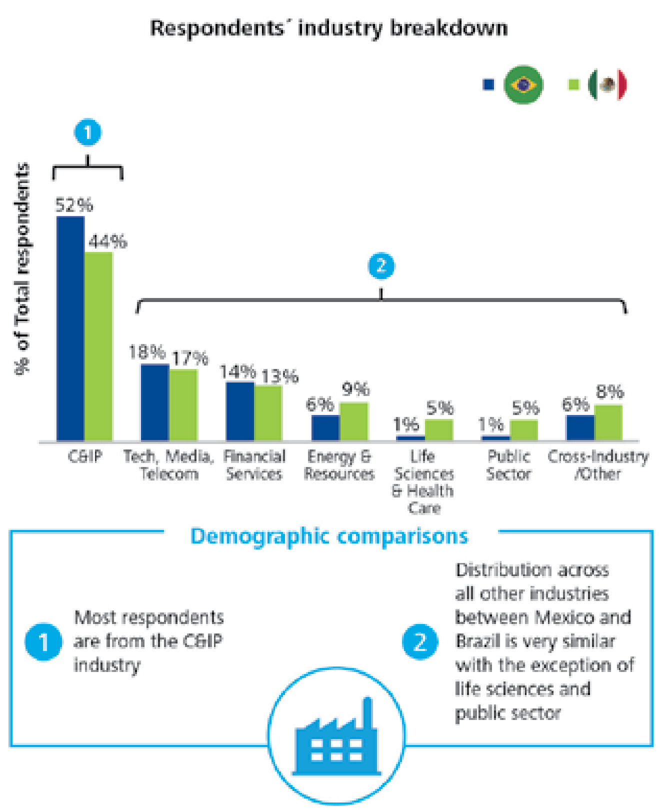
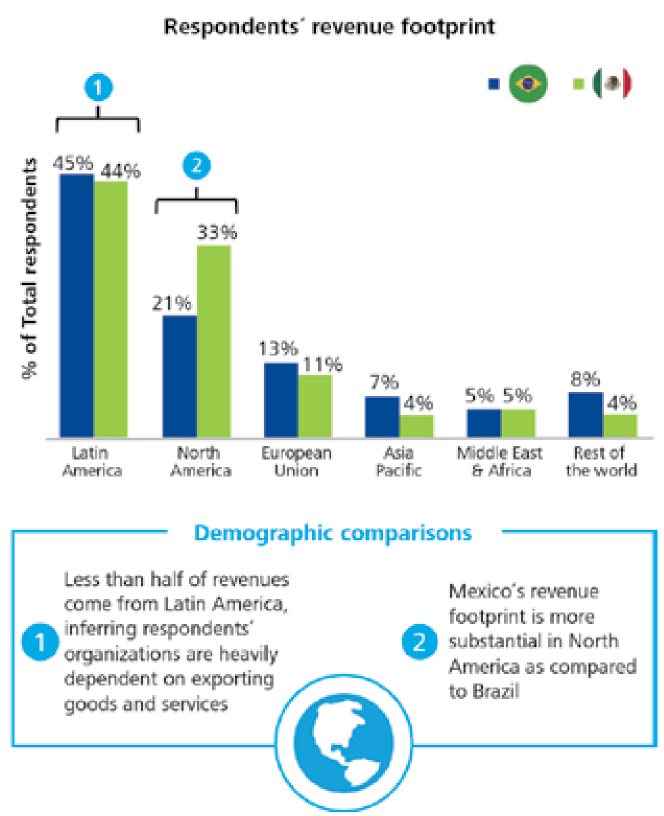


Fig 5. Filmographics details: revenue footprint

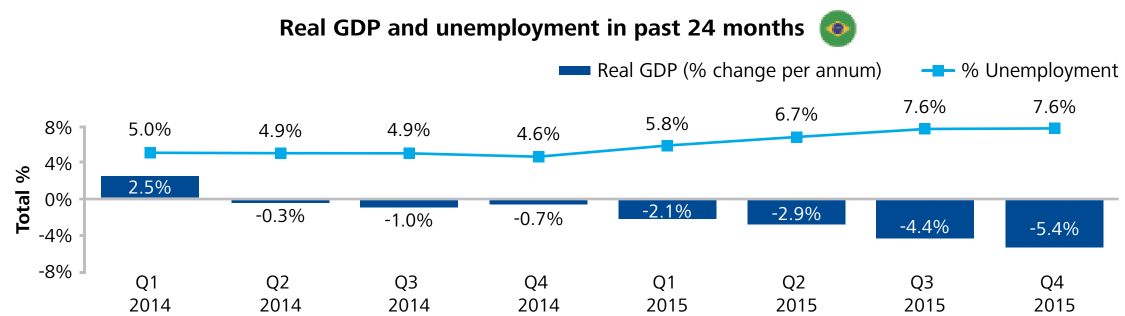


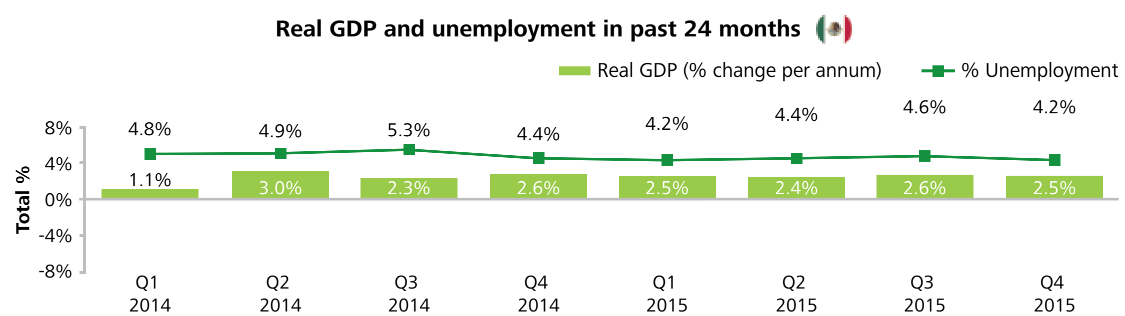
Macroeconomic trends

GDP growth, inflation, and unemployment rates appear more favorable in Mexico than Brazil during the 24 months preceding our survey. In addition, economic conditions seem to be stabilizing in Mexico. If forecasts are correct, Brazil could be facing its worst recession in more than a hundred years[2].

In the last quarter of 2015, Brazil's GDP was contracting with an annualized growth rate of -5.4%, and unemployment had climbed to 7.6% from 4.6% a year earlier. Meanwhile, Mexico's GDP growth was roughly holding steady at an annual rate of +2.5%, and unemployment had fallen to 4.2%.

Fig 6. Real GDP and unemployment in past 24 months (Brazil & Mexico)



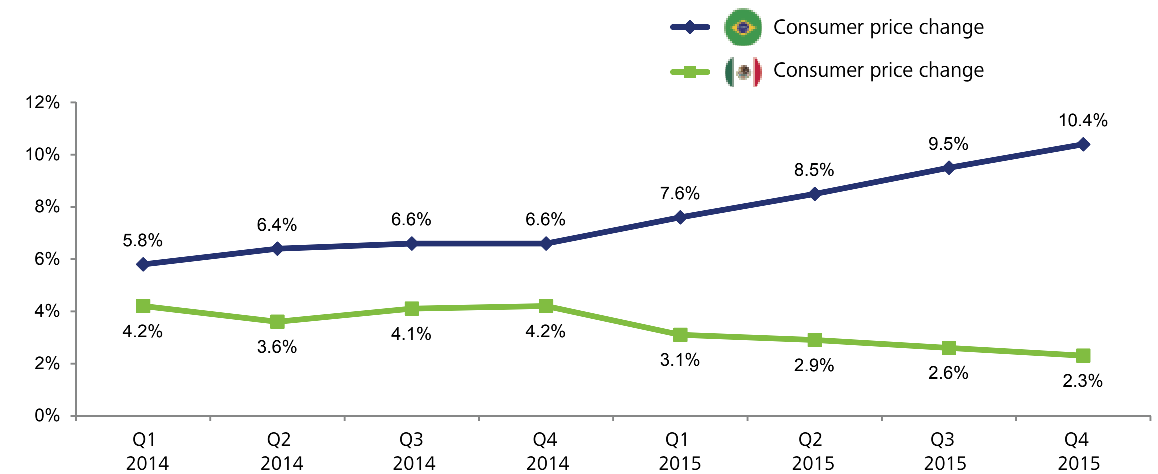


Source: EIU

Inflation remains a significant issue in Brazil, where consumer prices rose by 10.4% from Q4 2014 to Q4 2015. Meanwhile, in Mexico the annual rate of inflation has been steadily declining and was down to 2.3% in Q4 2015.

[2] "Brazil Heads for Worst Recession Since 1901, Economists Forecast", Bloomberg, January 4, 2016

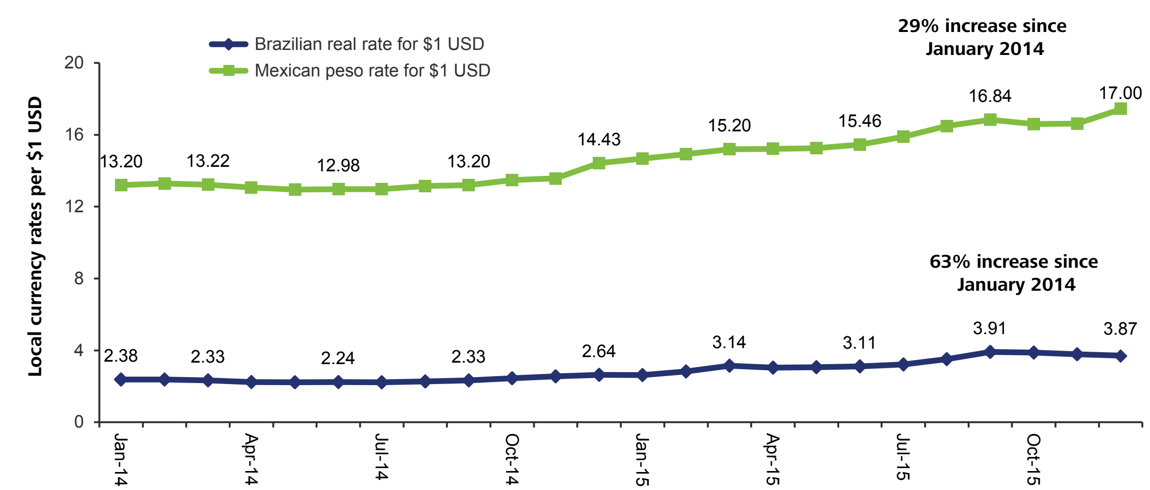
Fig 7. Consumer prices (% change, year on year) in past 24 months



Source: EIU

Mexico and Brazil both potentially face significant currency devaluation relative to the strong US dollar. Over the course of 2014 and 2015, the Mexican Peso declined in value by 29%; however, the Brazilian Real's decline was larger at 63%.

Fig 8. Exchange rates in past 24 months



Source: EIU

Over the long term, inflation and currency devaluation can impact a country's economy; however, in the near term those problems may increase demand for a country's products and services by effectively making them cheaper to foreign buyers. This complexity may be contributing both to uncertainty and to many companies' focus on cost reduction, growth, and balance sheet management during this time of market volatility.

Survey findings

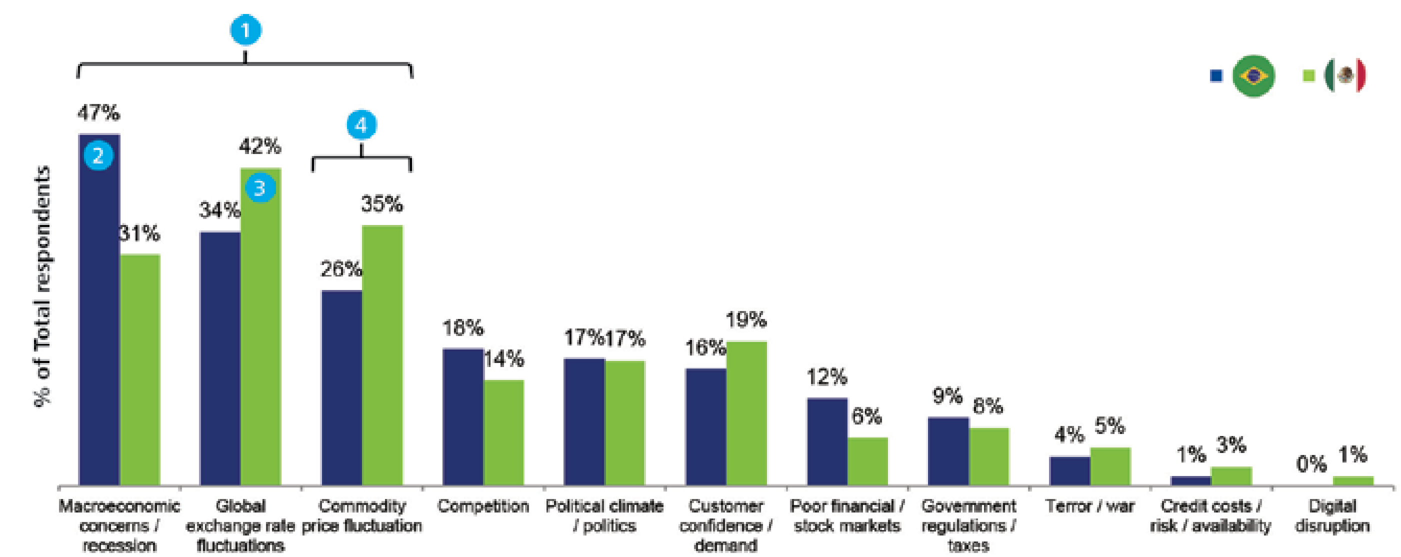
Despite the different economic circumstances they are facing, survey respondents from Brazil and Mexico provided similar answers about their past and future cost reduction activities.

Global macroeconomic factors are the top external risks

Given the macroeconomic trends highlighted above, factors related to the global economy -- including "macroeconomic concerns / recession" and fluctuations in both "global exchange rates" and "commodity prices" -- were rated by respondents as the top external risks for both countries.

In Brazil, the #1 external risk cited by respondents is "macroeconomic concerns / recession," whereas in Mexico, the #1 external risk cited is "global exchange rate fluctuation." "Commodity price fluctuation" is also viewed as a risk in Mexico and Brazil.

Fig 9. Top external risks in next 24 months



Survey findings

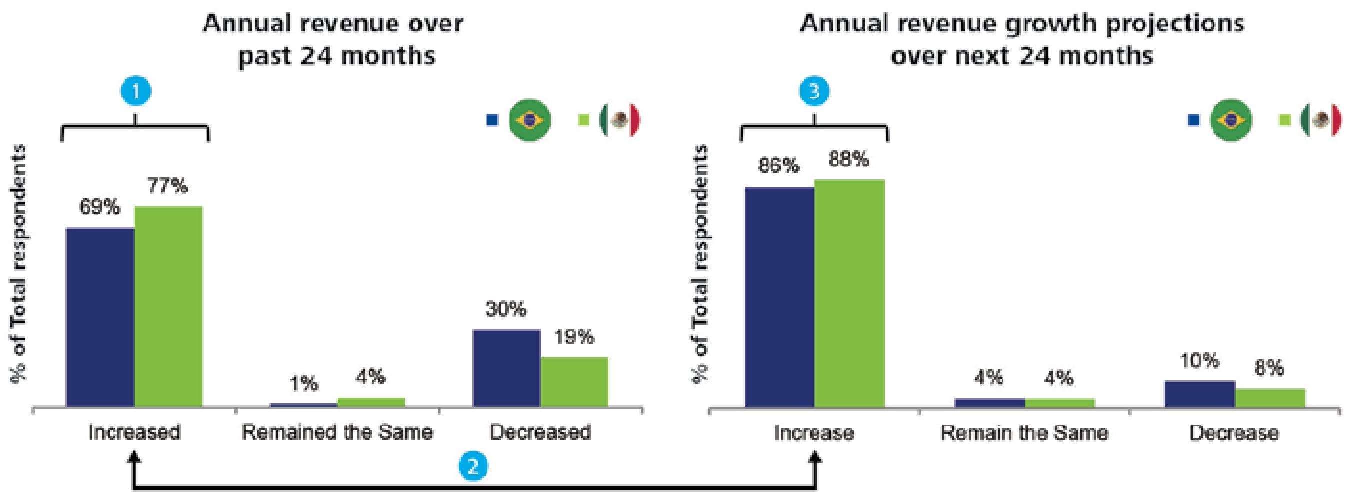
1. Macroeconomic concerns and fluctuations in global exchange rates / commodity prices represent top external risks
2. In Brazil, macroeconomic concerns / recession is the top-ranked external risk among survey respondents
3. In Mexico, global exchange rate fluctuation is the top-ranked external risk among survey respondents
4. Commodity price fluctuation is cited more frequently by respondents from Mexico

Source: EIU

Revenue growth is a high priority

Although they face challenging economic conditions, the majority of surveyed companies in both Brazil and Mexico saw their revenues grow over the past 24 months, and more companies expect their revenues to grow over the next 24 months.

Fig 10. Annual revenue growth projections



Survey findings

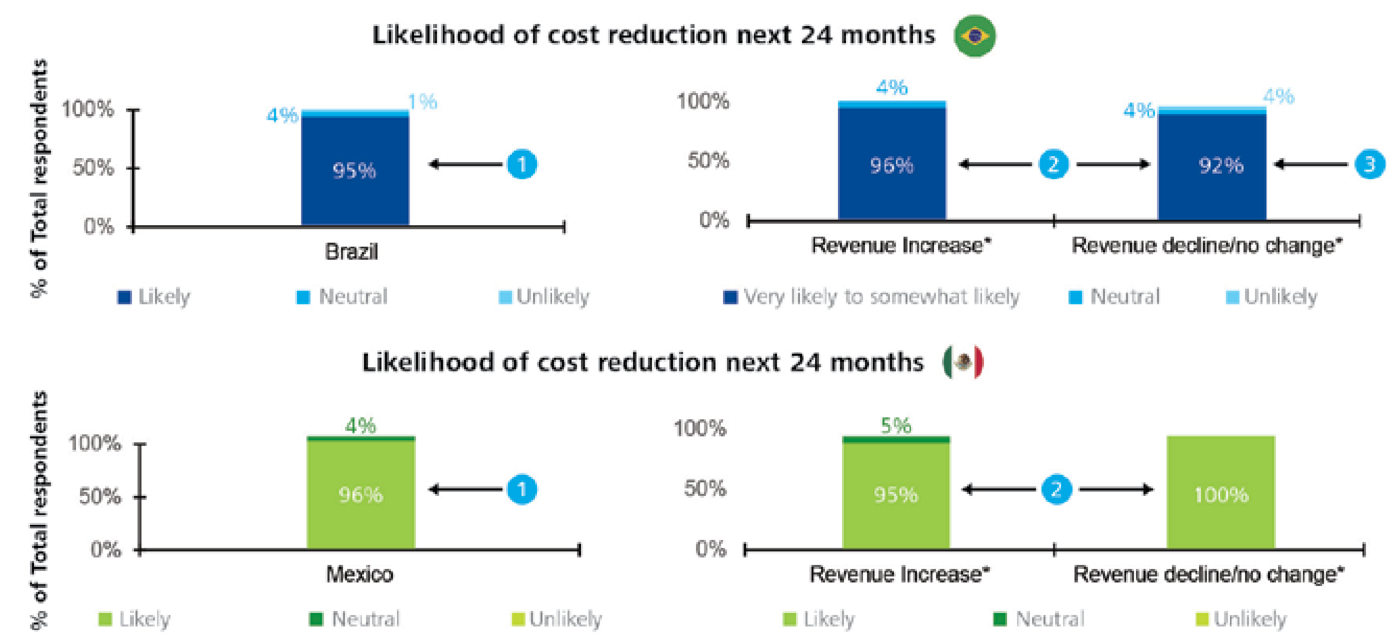
1. Respondents from Mexico cited a higher frequency of nominal revenue growth over the past 24 months as compared to respondents from Brazil; this gap would widen further if revenue growth were to be measured on a real basis – for example, in order to achieve the equivalent of 10% nominal revenue growth in Mexico, a Brazilian organization would need to realize nominal growth of 17.2% to achieve equivalent growth after adjusting for inflation
2. Respondents believe the revenue growth outlook for the next 24 months will be more favorable than for the past 24 months
3. Despite the recent challenging economic environment in Brazil and Mexico, respondents from both economies are confident their businesses will keep growing on a nominal basis

Respondents from Mexico cited a higher frequency of nominal revenue growth over the past 24 months than did their counterparts from Brazil, and the gap could have been even larger if revenue growth were measured on a real basis, since Brazil's inflation rate is higher. For example, taking inflation into account, an organization in Brazil would theoretically need to achieve nominal growth of 17.2% in order to achieve the equivalent of 10% nominal growth in Mexico. That being said, the negative impact of inflation and currency devaluation may be offset in the near term by an increase in exports, since those problems can potentially lower the price of a country's products in foreign markets.

Cost reduction is nearly universal

Nearly all surveyed companies in Brazil and Mexico say they are likely to pursue cost reduction over the next 24 months -- regardless of whether their revenues are increasing or decreasing.

Fig 11. Likelihood of cost reduction next 24 months



Survey findings

1. Virtually all respondents indicated their organizations are likely to undertake cost reduction activities over the next 24 months
2. Organizations in Brazil and Mexico are highly likely to undertake cost reduction initiatives, regardless of whether or not revenues are increasing or decreasing
3. Not all respondents from organizations in Brazil with revenue declines over the past 24 months are planning to undertake cost reduction activities

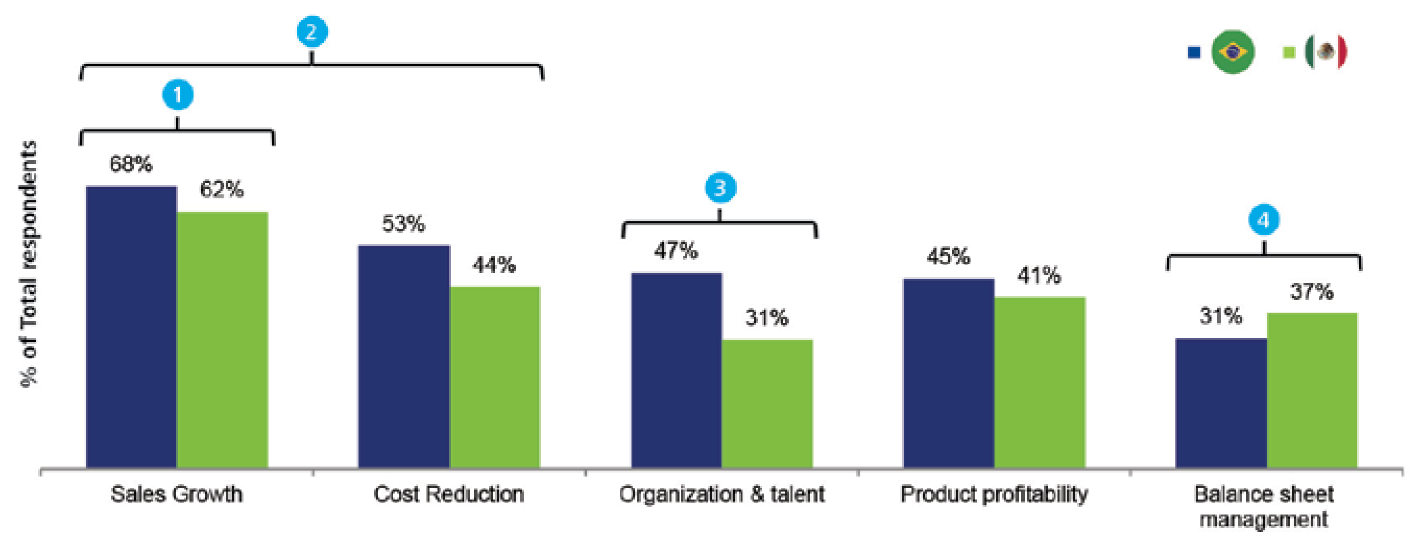
*Revenue changes refer to change in revenue over the past 24 months

The cost / growth paradox

Consistent with their expectations about growth and cost reduction, the companies we surveyed from both Brazil and Mexico cite sales growth and cost reduction as their top strategic priorities. The simultaneous pursuit of these two priorities creates a paradox we call “save to grow.”

In a tough economy, businesses typically focus on defensive strategies – yet sales growth remains the top strategic priority cited by companies in both Brazil and Mexico. The companies also cite “organization and talent” as a top strategic priority, which is consistent with a growth mindset since achieving positive growth requires a sufficient quantity and quality of well managed talent.

Fig 12. Strategic priority in next 24 months



Survey findings

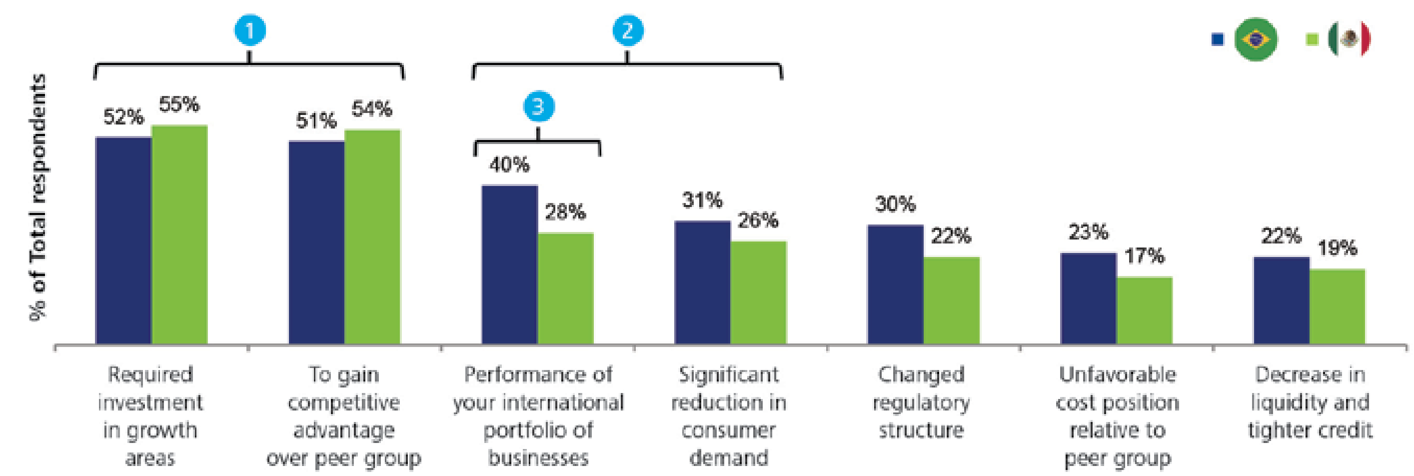
1. Typically, we would expect organizations to prioritize more defensive actions when in crisis-mode, but despite challenging economic environments, respondents from Brazil and Mexico are still focused on growth
2. Sales growth and cost reduction represent the top strategic priorities for Brazil and Mexico
3. Talent represents a more frequently cited strategic priority for respondents from Brazil compared to Mexico
4. Despite strong growth priorities, balance sheet management is also viewed as a high priority

At the same time, balance sheet management is also cited by respondents as a high priority -- especially by companies in Mexico -- and given the current high levels of economic stress in Latin America, it is likely that many companies are focusing on all aspects of balance sheet management, from credit and working capital to liquidity and foreign exchange issues. The result is a new cost management scenario that we call “thriving in uncertainty,” which extends the cost / growth paradox of “save to grow” by adding in a strong focus on balance sheet items – a focus typically associated with businesses in distress.

Cost reduction is being driven by a mix of growth-oriented and defensive factors

Cost reduction drivers related to growth, such as “required investment in growth areas” and “to gain competitive advantage over peer group,” are top of mind for companies we surveyed in Brazil and Mexico. However, consistent with the cost / growth paradox, those growth-oriented factors are closely followed by other cost reduction drivers that are more defensive in nature, such as “significant reduction in consumer demand” and “performance of your international portfolio of businesses” -- the latter being rated as particularly significant by companies in Brazil.

Fig 13. Drivers of cost reduction



Survey findings

1. Top drivers are related to growth, focusing on cost reduction as a mechanism to fuel growth; The majority of revenue for both Brazil and Mexico comes from outside of Latin America, and while growing inflationary / exchange rate pressure builds, it actually makes products and services from Brazil and Mexico more attractive to foreign buyers, increasing demand – these dynamics likely contribute to the paradoxical focus on growth during this time of market distress
2. Secondary drivers of cost reduction are defensive in nature and suggest uncertainty about near-term business performance
3. The performance of the international portfolio of businesses is a comparatively more significant driver of cost reduction in Brazil vs. Mexico

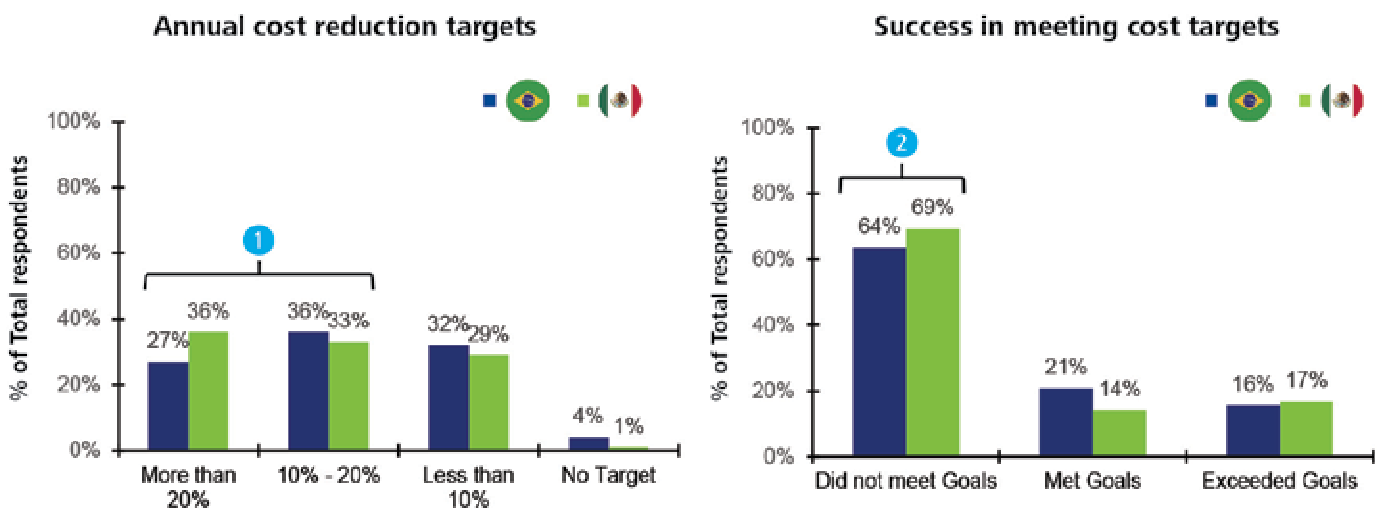
This conflicting mix of defensive and growth-oriented cost reduction drivers may be a reflection of the surveyed companies’ uncertainty about macroeconomic factors and near-term business performance.

Cost reduction targets and failure rates are both high

Companies are setting aggressive cost reduction targets, with 63% of Brazilian respondents and 69% of Mexican respondents reporting annual cost reduction targets of 10% or more. At the same time, roughly two out of three companies in both countries say they did not meet their targets.

These high numbers could climb higher if economic conditions remain challenging, since companies may be under increasing pressure to reduce costs.

Fig 14. Annual cost reduction targets and success in meeting cost targets



Survey findings

1. 63% of respondents from Brazil and 69% of respondents from Mexico state annual cost reduction targets of 10% or more
2. Roughly two thirds of respondents from Brazil and Mexico did not meet their cost reduction targets

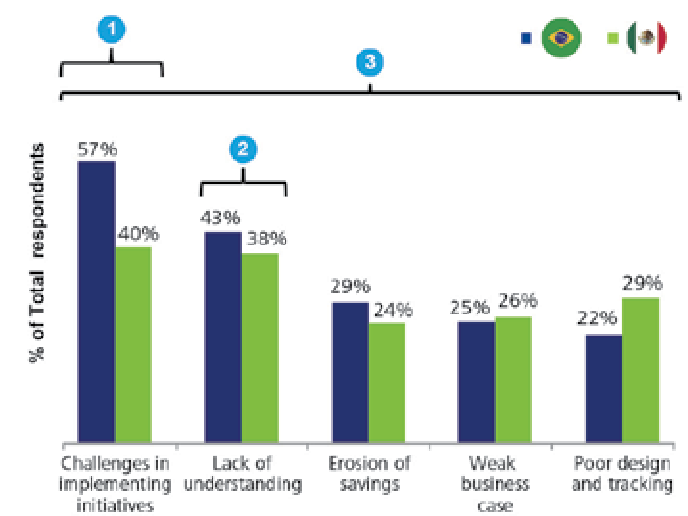
Unless companies adopt new cost management approaches that are capable of achieving a higher level of savings than their existing approaches can deliver, their rising targets could potentially lead to rising failure rates.

Implementation issues are the main barriers to effective cost management

According to the survey results, implementation-related issues are the biggest barriers to effective cost management in both Brazil and Mexico. In fact, four of the top five barriers are directly related to implementation. These include not only the general issue of "challenges in implementing initiatives," but also more specific implementation-related issues: Erosion of savings, weak business case, and poor design and tracking.

Similarly, implementation strategy and change management are the most commonly cited categories of lessons learned, outranking other categories such as continuous improvement and budget management.

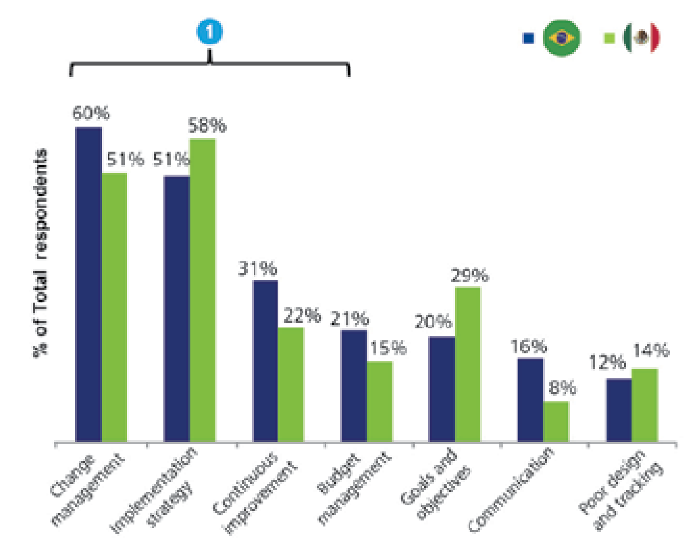
Fig 15. Barriers to effective cost management



Survey findings

1. Implementation challenges represent the top barrier to effective cost management for both Brazil and Mexico, and response rates are higher in Brazil compared to Mexico
2. Only "lack of understanding" is related to change management
3. Four of the top five barriers to effective cost management are related to implementation challenges

Fig 16. Lessons learned - past 24 months



Survey findings

1. Change management and implementation strategy are the most commonly cited categories of lessons learned by respondents from both Brazil and Mexico

The only barrier in the top five not directly tied to implementation is "lack of understanding."

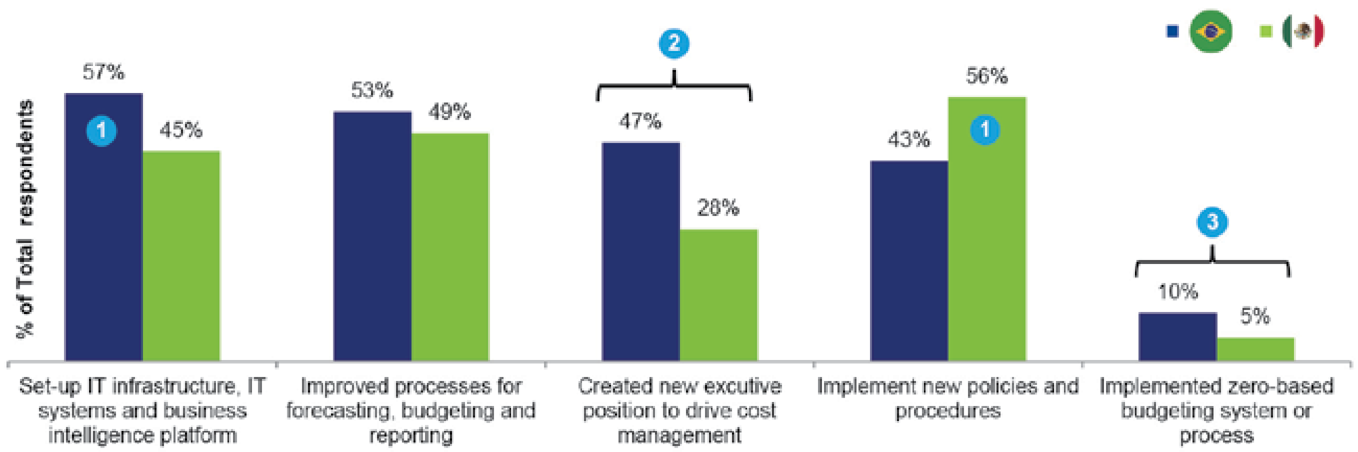
In Brazil, change management ranks somewhat higher than implementation strategy (60% versus 51%). However, in Mexico the reverse is true, with implementation strategy ranking somewhat higher than change management (58% versus 51%).

Companies are actively developing their cost management capabilities

Over the past 24 months, the companies we surveyed developed a broad range of cost management capabilities. For Brazil, "setting up IT infrastructure" was the most frequently cited capability, while "implementing new policies and procedures" was the most frequently cited capability for Mexico.

The biggest variation in this area was on the subject of creating a new executive position to drive cost management, which was cited by 47% of Brazilian companies but only 28% of Mexican companies.

Fig 17. Capabilities developed over past 24 months



Survey findings

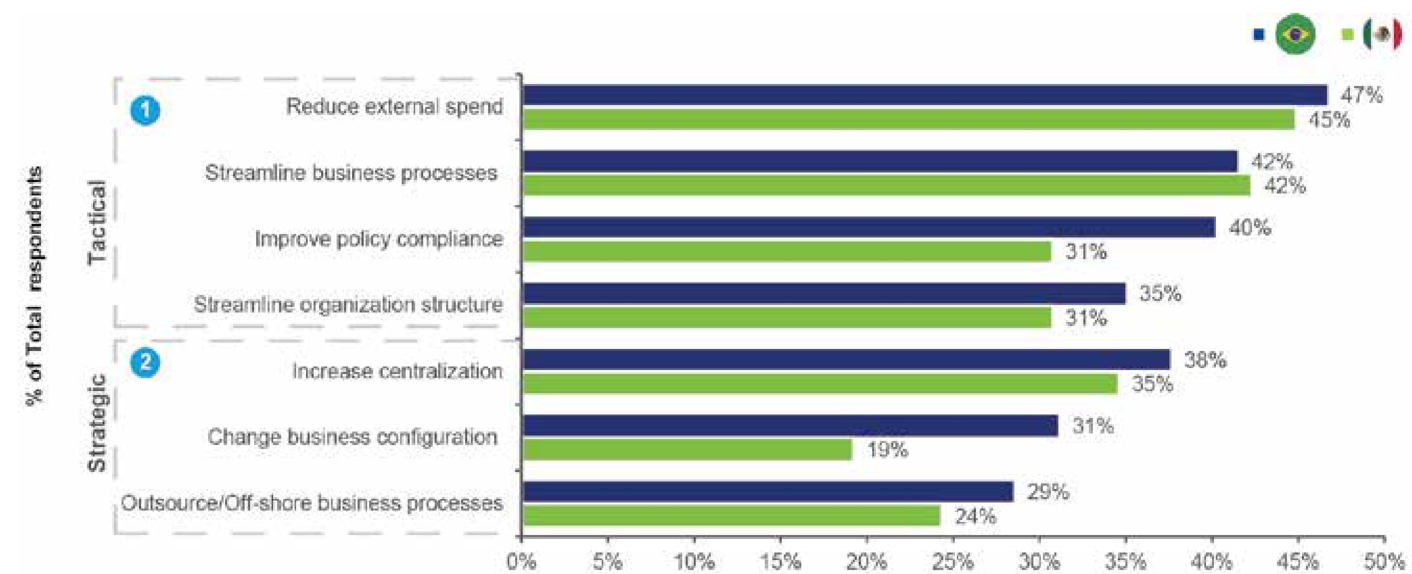
1. Setting up IT infrastructure and implementing new policies and procedures were the most frequently cited capabilities developed over the past 24 months by Brazil and Mexico respectively
2. Creating a new executive position to drive cost management represented a more frequently developed capability by respondents from organizations in Brazil as compared to respondents from organizations in Mexico
3. While twice as many respondents from organizations in Brazil implemented ZBB systems or processes over the past 24 months as compared to respondents from organizations in Mexico, ZBB still represents a relatively underdeveloped capability within the past 24 months

Zero-based budgeting (ZBB) was implemented by 10% of companies in Brazil, twice as many as in Mexico (5%). However, both of those numbers are much smaller than the adoption rates for other cost management capabilities (For more information on ZBB, see the sidebar: "Zero-based budgeting: breakthrough or passing fad?").

Tactical versus strategic cost actions and improvements

The cost actions that companies expect to implement over the next 24 months tend to be more tactical than strategic. These tactical actions -- such as reducing external spend and streamlining business processes -- may not be capable of delivering the aggressive savings most companies are seeking.

Fig 18. Cost actions viewed as most likely in next 24 months



Survey findings

1. The most frequently cited cost actions in the next 24 months are tactical in nature
2. The least likely actions to be implemented in the next 24 months are strategic in nature

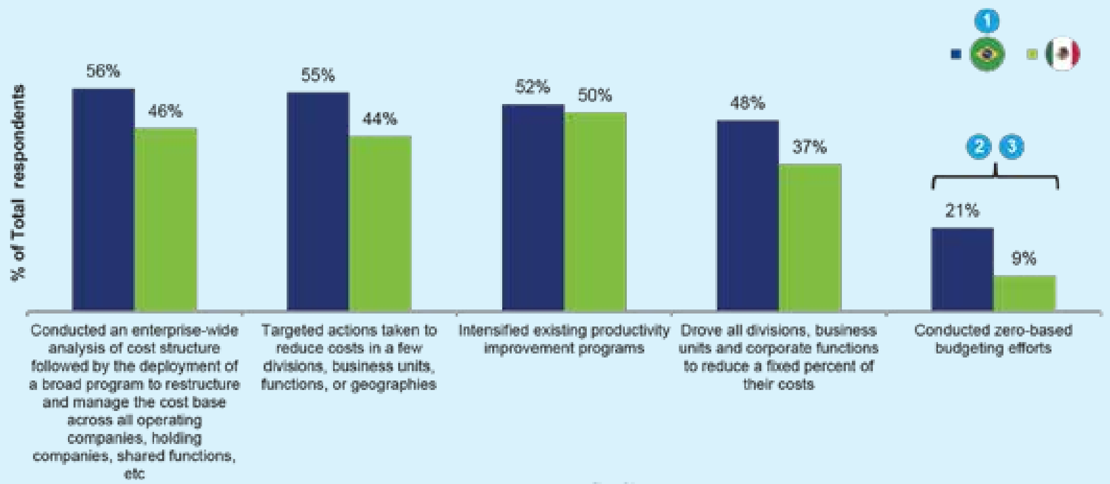
To achieve aggressive cost reduction targets, companies could apply approaches that are more strategic in nature, such as increasing centralization, reconfiguring the business, and outsourcing / offshoring business processes. Those are the kinds of actions that can potentially deliver the 10%+ cost reductions.

Zero-based budgeting: breakthrough or passing fad?

The traditional approach for developing a budget is to start with the previous period's budget and make adjustments as needed. Zero-based budgeting (ZBB) is a fundamentally different approach that involves developing a new budget from scratch every time (i.e., starting from zero). The theory is that ZBB prompts decision-makers to constantly look at the business with fresh eyes, free from the limitations of past assumptions and targets. But how well does the theory translate into practice?

Although the latest resurgence in zero-based budgeting has its roots in Brazil, surveyed organizations in both Brazil and Mexico did not cite ZBB as a priority approach for managing costs over the past 24 months.

Fig 19. Approaches to manage costs over the past 24 months



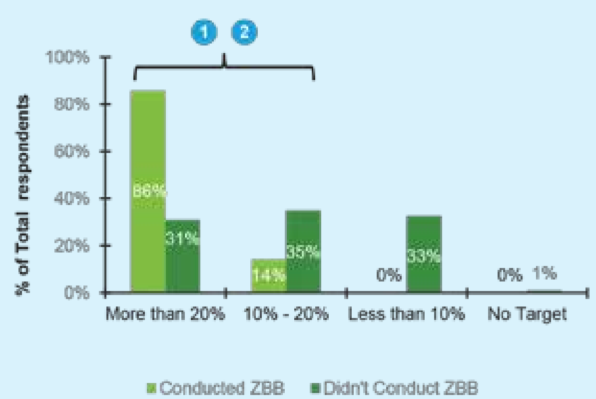
Survey findings

1. Respondents from organizations in Brazil employed cost reduction approaches over the past 24 months more frequently than respondents from organizations in Mexico
2. More than twice as many respondents from organizations in Brazil conducted ZBB efforts over the past 24 months as compared to respondents from organizations in Mexico
3. Overall utilization of ZBB is low on a relative basis for respondents from organizations in both Brazil and Mexico

Although ZBB is more than twice as popular in Brazil than in Mexico, in both countries the adoption rate for ZBB is lower than for other cost management approaches.

In Mexico, a major issue is that many businesses may have unrealistic expectations about the level of cost savings ZBB can deliver. According to the survey, 100% of Mexican companies surveyed that use ZBB have cost reduction targets of 10% or more, and 86% have cost reduction targets that exceed 20% -- higher than for non-ZBB users, and higher than ZBB is capable of delivering.

Fig 20. Annual cost reduction targets (Mexico)

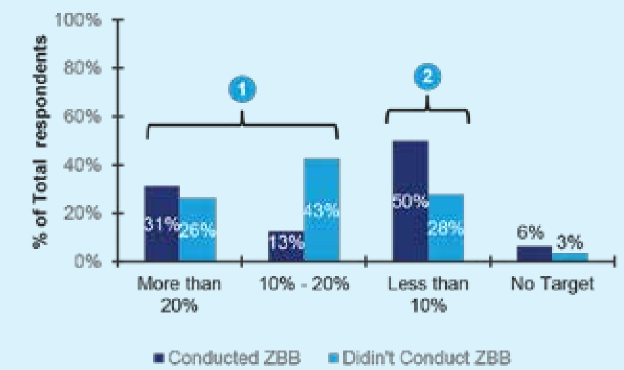


Survey findings

1. Cost reduction targets are reported as being more aggressive for organizations that conducted ZBB (100% of respondents from Mexico that conducted ZBB cited annual cost reduction targets of 10% or greater vs. 66% for respondents that did not conduct ZBB); overall, targets are extremely aggressive
2. Respondents from organizations in Mexico had unrealistic expectations as to the level of cost savings ZBB is capable of delivering; ZBB is not capable of delivering more than 20% cost savings

Brazilian ZBB-users we surveyed appear to consider ZBB as a tactical tool, and their cost reduction targets tend to be lower than those of their Mexican counterparts. Half of the Brazilian companies we surveyed that use ZBB have annual cost reduction targets of less than 10%.

Fig 21. Annual cost reduction targets (Brazil)

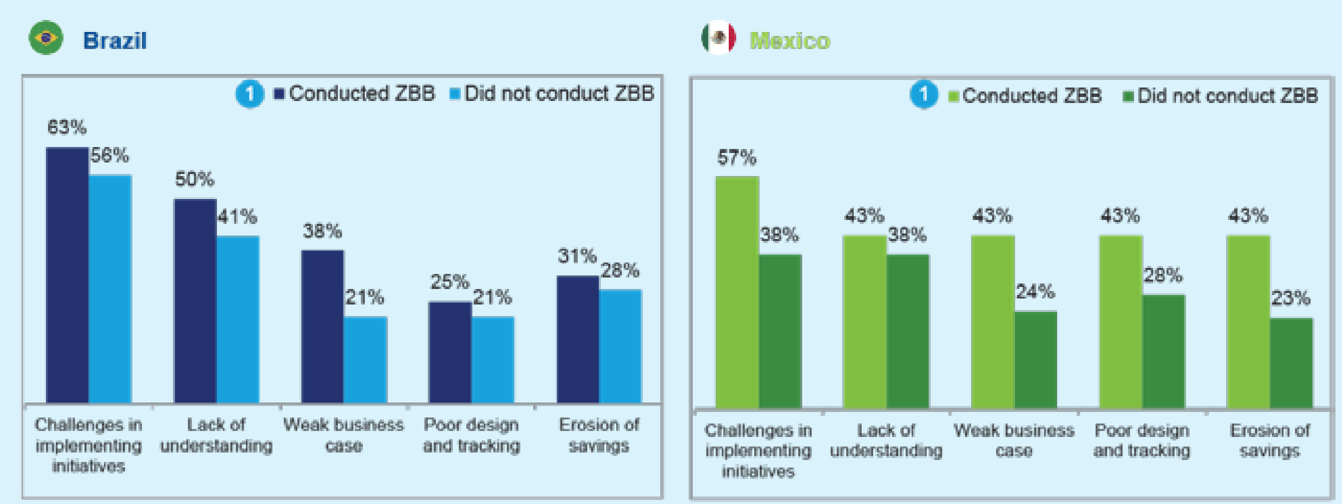


Survey findings

1. Cost reduction targets are reported as being more aggressive for organizations that did not conduct ZBB (69% of respondents from Brazil that did not conduct ZBB cited annual cost reduction targets of 10% or greater vs. only 44% for respondents that conducted ZBB)
2. Respondents from organizations in Brazil had relatively realistic expectations as to the level of cost savings ZBB is capable of delivering – they understand it is a tactical tool

Companies surveyed in both Brazil and Mexico that use ZBB encountered more barriers to effective cost management across-the-board than did companies surveyed that do not use ZBB – and the failure rate of cost reduction programs for ZBB users surveyed remains high.

Fig 22. Barriers to effective cost management

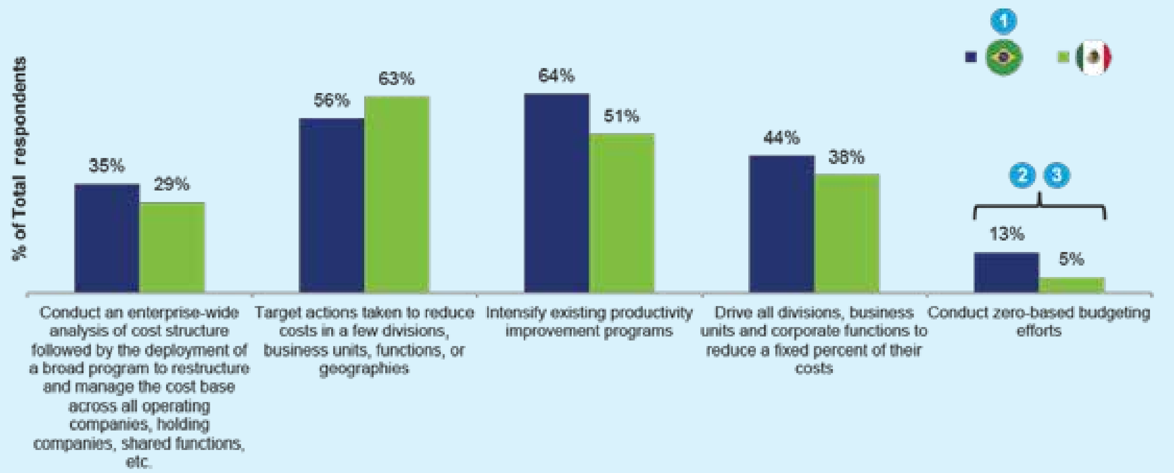


Survey findings

1. Respondents from organizations conducting ZBB over the past 24 months reported a higher frequency of barriers to effective cost management across the board in both Brazil and Mexico

Given these challenges, few organizations surveyed in Brazil and Mexico plan to use ZBB over the next 24 months. Respondents expect ZBB use to decline during the next two years -- from 21% to 13% in Brazil, and from 9% to 5% in Mexico. This sharp decline suggests that ZBB may be a fad that is already past its prime.

Fig 23. Planned cost improvement initiatives in next 24 months



Survey findings

1. Respondents from organizations in Brazil plan to employ cost reduction approaches over the next 24 months more frequently than respondents from organizations in Mexico
2. More than twice as many respondents from organizations in Brazil plan to conduct ZBB efforts over the next 24 months as compared to respondents from organizations in Mexico
3. Overall planned utilization of ZBB over the next 24 months is low on a relative basis for respondents from organizations in both Brazil and Mexico

Choosing the right cost management approach

The most effective approach to managing costs is different for every business, depending on its situation, priorities, and objectives. However, businesses typically fall into one of three traditional cost management scenarios: (1) distressed, (2) positioned for growth, or (3) growing steadily.

Fig 24. Traditional cost management scenarios

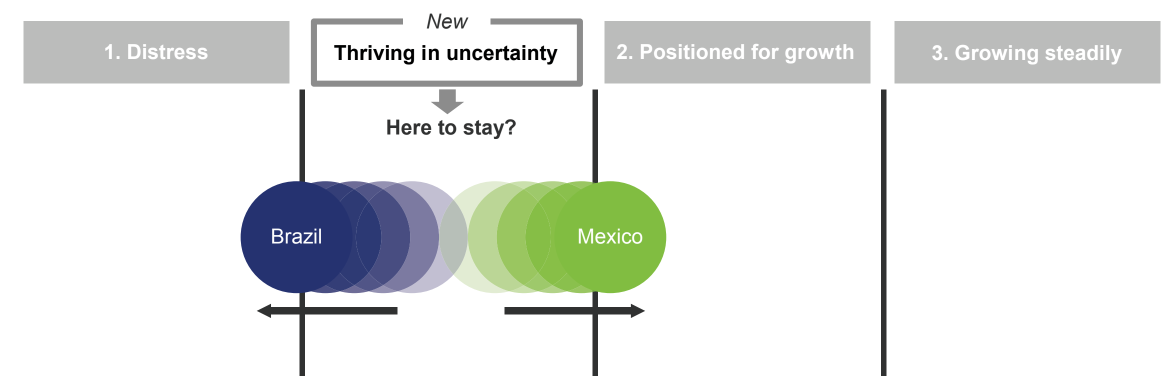
	1. Distressed	2. Positioned for growth	3. Growing steadily
Competitive situation	• Losing market share • Structural operating flaws • Liquidity concerns • No clear growth options	• Recovering from recession • Adjusting to demand levels • Growth concerns • Conditional options for growth	• Healthy balance sheet • Excess cash flow / reserves • High growth potential • Unconstrained options
Priority balance	Costs Liquidity Growth Talent	Growth Costs Liquidity Talent	Growth Talent Liquidity Costs
Primary objectives	• Conserve cash • Renegotiate costs • Restructure debt • Downscale business model	• Transform operating model • Optimize business processes • Right-size FTE structure • Fuel growth through savings (capital efficiency)	• Focus on investment and M&A • Optimize and align customer and product portfolios • Focus on efficient execution and delivery

Low Focus
High Focus

A “distressed” business typically focuses on short-term survival and balance sheet improvement -- looking for any cost and liquidity improvements that can help stabilize the business. A business that is “positioned for growth” typically starts by focusing on structural improvements, such as choosing the right operating model; it can then look for additional cost reduction opportunities to help fund its growth initiatives. A company that is “growing steadily” typically focuses on achieving profitable and sustainable growth through structural cost efficiencies and improvements – such as smart investments, M&A, and management of customer and product portfolios – actions that may strengthen its performance and competitive position.

Until recently, many companies fell into one of these three traditional categories; however, as noted earlier, today’s volatile and complex global business environment seems to be giving rise to a fourth category that we call “thriving in uncertainty” -- a scenario that straddles the line between “distressed” and “positioned for growth” and involves organizations simultaneously pursuing the goals of growth, cost improvement, and balance sheet management. It remains to be seen whether this fourth category is a new and permanent feature of the business landscape, or simply a stepping stone to one of the traditional categories. However, in the case of companies surveyed in Brazil and Mexico, their current state of “thriving in uncertainty” may eventually transition to a traditional cost management scenario.

Fig 25. Thriving in uncertainty



Brazil Competitive Situation

Brazil faces a more distressed business environment where negative GDP growth, accelerating unemployment and high inflation rates have combined to create a near-crisis economic scenario; despite these conditions, respondents from Brazil are more concerned with growth and talent than with cost and liquidity, suggesting a potential disconnect between planned cost reduction actions and economic reality – Brazil may be entering the “distress” stage.

Mexico Competitive Situation

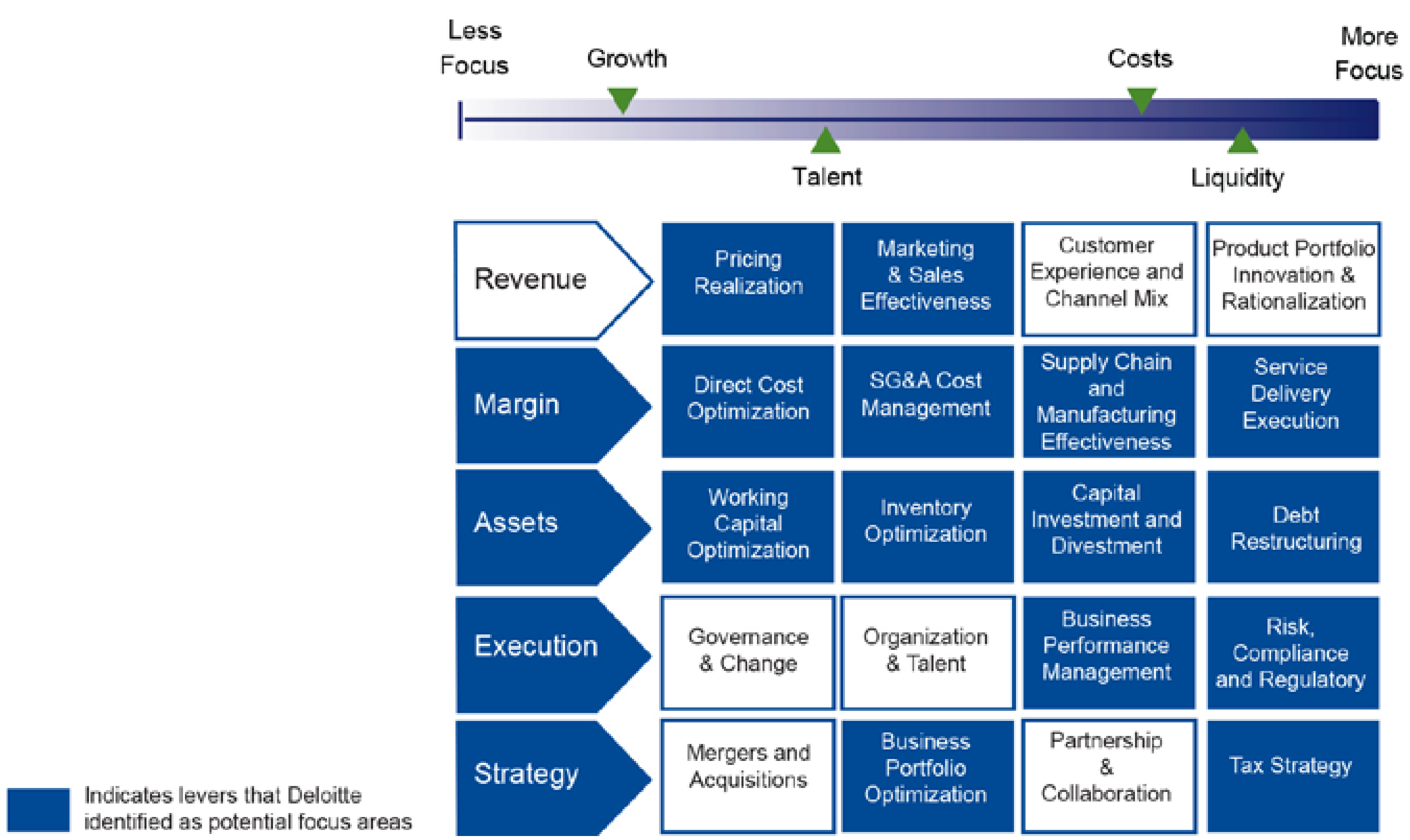
The economic situation in Mexico is less severe and improving, although still distressed. GDP growth is positive, but lower than usual, and inflation has created challenges relating to fluctuating exchange rates; survey responses indicate Mexican businesses are dealing with a “thriving in uncertainty” competitive situation where they plan to simultaneously pursue the seemingly conflicting goals of aggressive growth and aggressive cost improvement.

Economic conditions in Brazil such as negative GDP growth, accelerating unemployment, and a high inflation rate combine to create a potential near-crisis business environment[2] that could push some Brazilian companies into the “distressed” category. Respondents from Brazil currently seem more concerned with growth and talent than with cost and liquidity, suggesting that their planned cost reduction actions may not align with the economic reality they are facing.

[2] “Brazil Heads for Worst Recession Since 1901, Economists Forecast”, Bloomberg, January 4, 2016

To operate effectively in this challenging environment, many companies in Brazil may need to shift their focus to a specific set of value creation levers.

Fig 26. Key value creation levers for brazilian companies in distress

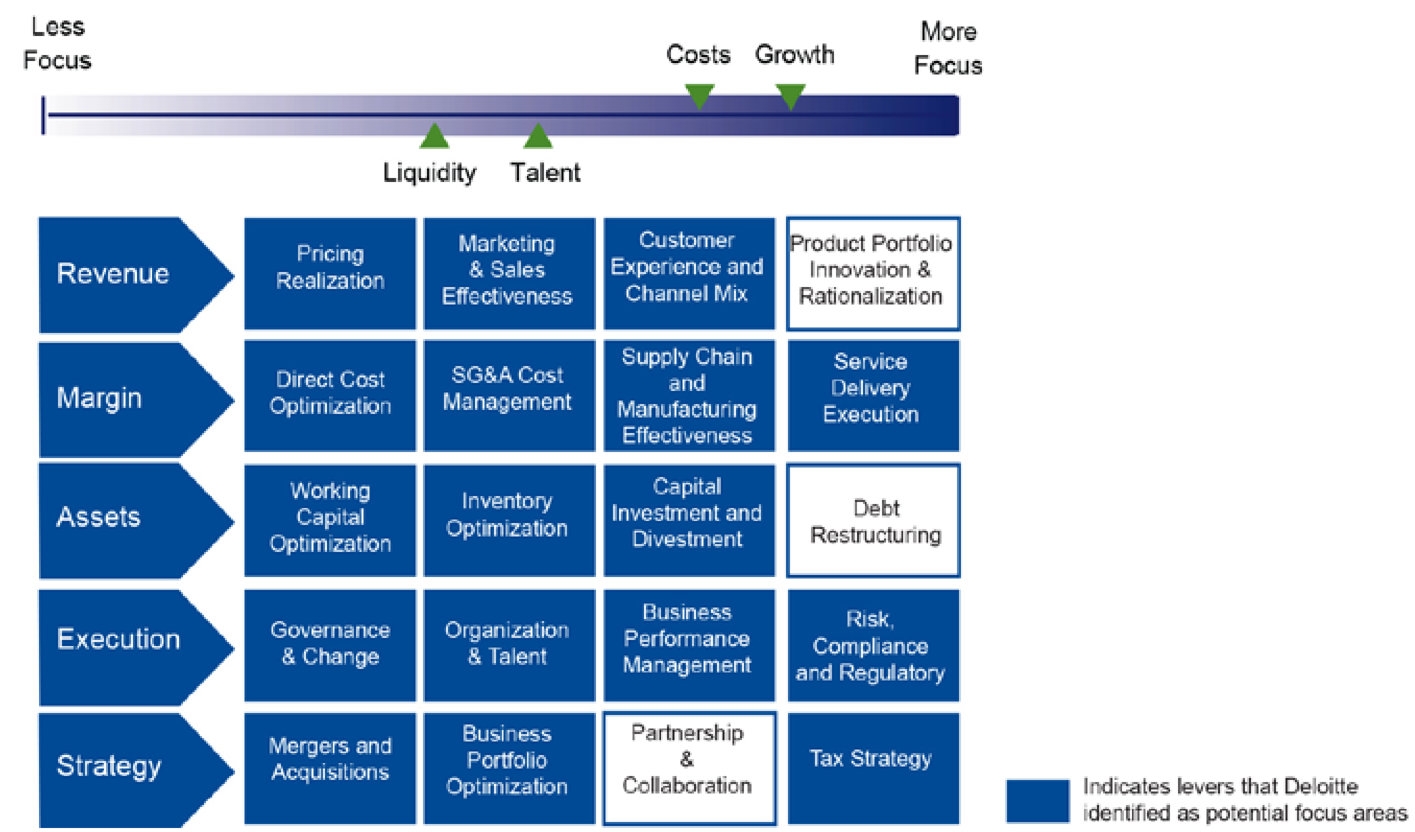


Economic conditions in Mexico are challenging and may be improving. GDP growth is positive (albeit lower than usual), and while exchange rate fluctuations and commodity price volatility are creating some challenges, inflation is declining and is much lower than in Brazil[1]. Survey responses indicate Mexican businesses in general are currently operating in the mode of "thriving in uncertainty" -- simultaneously pursuing growth, cost improvement, and balance sheet management – but they could find themselves pulled toward the growth side by the relatively strong economy in the USA, which is Mexico's largest trading partner.

[1] International Monetary Fund (IMF)

To operate effectively, businesses in Mexico could focus on a different set of value creation levers than their Brazilian counterparts.

Fig 27. Key value creation levers for mexican companies that are "thriving in uncertainty" or "positioned for growth"



Looking ahead

Companies surveyed in Brazil and Mexico potentially face similar challenges, including slow or negative GDP growth, volatile commodity prices, unfavorable exchange rates, and political instability, among others. However, the severity and expected duration of these challenges varies widely, which has a major impact on the value creation levers companies surveyed in each country need to focus on. In Brazil, which is facing a downturn, companies in distress could follow a cost management playbook typically associated with "distressed" businesses. This includes a highly defensive posture that focuses not only on cost reduction but also on liquidity and other balance sheet issues. By contrast, the economic conditions in Mexico could lead companies to follow a more growth-oriented playbook designed for businesses that are "thriving in uncertainty" or "positioned for growth."

Regardless of economic conditions, companies with aggressive cost targets will likely need to change their overall cost management approach, shifting from tactical actions to actions that are more strategic in nature, such as increasing centralization, reconfiguring the business, and outsourcing / offshoring business processes. Traditional cost reduction tactics by themselves may not be capable of delivering the high level of cost savings most companies are currently seeking.

In addition, companies with business results denominated in a relatively strong currency such as US dollars or Euros – whether they are based in Latin America or abroad -- may want to capitalize on favorable exchange rates by acquiring or investing in local Latin American companies.

During times of economic uncertainty, companies that take bold action may recover more quickly and could gain potential competitive advantages that boost performance both during the recovery and in the growth phase that follows. For companies with the resources to make significant moves, the current economic environment may present a prime opportunity to position themselves for long-term success.

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