Is your corporate footprint stuck in the mud?

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> ILLUSTRATION BY ALEX NABAUM
IS YOUR CORPORATE FOOTPRINT STUCK IN THE MUD?
When Ken was asked by his CEO to attend a meeting about the company’s global footprint strategy, he wasn’t sure what to expect. Hadn’t they just finished moving the last labor-intensive production line to Suzhou? As director of operations, Ken felt like he had a pretty good handle on how the company was doing in terms of facilities utilization—it seemed unlikely that they could squeeze more out of any of their sites.

Upon his arrival, Ken was ushered into a darkened conference room where he greeted the other members of the leadership team who were getting settled. A few moments later, the CEO welcomed them.

“I hope you had a good trip in. Today is all about learning, exploring possibilities, and generating ideas to create significant value for our company.”

Ken watched as the facilitator further dimmed the lights and tapped his keyboard. Several large computer screens on the wall of the conference room glowed, showing a world map with a constellation of about 30 colored indicators. Ken recognized the locations of their manufacturing and distribution sites but noticed the headquarters, back office, contact centers, data center and R&D hubs were shown as well.
The facilitator pressed a few more buttons and a number of charts and tables popped up across the map depicting the company’s financials for last year, employee headcounts, operating costs and more. The head of HR answered a few questions about talent issues in some of the back office and R&D sites.

“Let’s run a few hypotheticals,” the facilitator said. He double-tapped the indicator for one of the R&D sites. It blinked slowly. “What if we were to redeploy this to a market that had better industry presence, a growing base of engineering talent and also offered R&D tax credits?”

He dragged the blinking site across the screen to a Southeast Asian country and released it. Ken immediately noticed a new column on one of the tables that showed an improvement in financial performance.

His mind raced. One of his production sites was getting hammered with an electricity rate increase that he was going to have a hard time dealing with. Ken began to realize that the company’s footprint strategy hinged on much more than just the utilization of their facilities.

**WHY DO COMPANIES GET STUCK?**

Many organizations recognize that geography is a key driver of corporate performance. Yet many maintain ineffective and inefficient footprints that can hamper talent attraction and retention, increase operating costs, overexpose them to risk and depress shareholder value. Why do companies leave value on the table by suboptimizing their geographic deployment, and how can they better capture that benefit?

During good economic times, many companies expand rapidly and deploy enterprise assets in pursuit of singular objectives—to increase revenue, reduce costs or source new talent. In times of hardship, companies in search of immediate solutions may take an unsophisticated approach to disposing of high-cost or underperforming operations.

Fewer companies are deliberate and proactive in assessing their overall corporate footprint and the degree to which it supports and contributes to the business strategy. Geographic variables such as talent availability, operating costs, risk or tax regulations can change quickly. Mergers and acquisitions generate additional footprint complexity, often yielding overlap in some geographies and underrepresentation in others.

Yet many companies lack mechanisms to effectively evaluate and react to these changes. Some make footprint decisions at the subenterprise (e.g. business unit or regional) level. Others, through sheer inertia, continue to perform the same functions in the same geographies while the world changes around them. Still
others regard footprint decisions primarily in terms of real estate rather than a more expansive view that considers the proper location for every corporate function and asset.

By enhancing “locational awareness” and evaluating the corporate footprint with a more holistic perspective, companies can more efficiently and effectively position assets and strike a balance between market access, talent availability, risk mitigation and cost containment.

**WHAT IS A “FOOTPRINT”?**

A company’s footprint is more than just the real estate it occupies. It includes the people it employs; customer access and speed to market it experiences; operating costs it incurs, and the risk it undertakes. Where companies locate their assets helps dictate the potential value they can achieve as an organization. This configuration of attributes—the “footprint”—includes a wide array of corporate assets such as:

- Capital
- Talent
- Machinery and equipment
- Inventory
- Contract manufacturers
- Facilities
- Intellectual property

**DYNAMIC CHALLENGES**

Extraordinary events of the past few years have presented significant challenges for many companies. Though global organizations have faced location and footprint decisions for decades, these circumstances, and the continuation
of longer-term business trends, have altered the cost and conditions that companies enjoyed—sometimes profoundly. Beyond these events and trends, there are traditional triggers for footprint realignment that can create more urgency around such decisions.

**Disruptive events**

Companies are occasionally jolted into location awareness by disruptive political, natural or economic events. Prior to the 2011 Arab Spring upheaval in the Middle East, Egypt had been considered a budding global technology destination where many global IT companies have tapped an abundant, low-cost supply of programming talent to create tens of thousands of jobs.1 Foreign companies are undoubtedly taking a more cautious view of Egypt, and the Middle East in general, in light of the recent and predominantly unpredicted uprisings.

Escalation of drug-related violence in northern Mexico has also influenced the footprint strategy of many leading organizations. One major global retailer cancelled plans to deploy a new several hundred person back-office support center in Monterrey after a wave of crime—which was historically focused along Mexico’s border with the United States—threatened to sweep through northern Mexico’s hub city as well. Validating the company’s concerns, conditions did subsequently deteriorate to the point that Monterrey’s violence levels are as extreme as anywhere in the country.2 Global manufacturers, who operate thousands of maquiladora facilities along Mexico’s northern border, are also exercising increasing caution.3

Other globally felt events, such as the Japan earthquake and tsunami of 2011, and recent terrorist activity in locations ranging from Mumbai to Norway, can have similar ramifications. For companies directly affected—and even those that were not—global events often serve as triggers to reevaluate location and supply chain risk within the portfolio. The aftermath of these shocks can range from companies taking a renewed organizational focus on risk mitigation strategies and contingency planning, to delaying or revisiting investment plans, or potentially to redeploying existing operations to lower-risk locations.

**The economy**

Possibly nothing impacts companies’ global footprint decisions more than their outlook on the economy. During good economic times, companies eagerly invest in new production sites, R&D operations or other expansion initiatives. The recent global recession and concerns of a “double dip” have pushed companies to try to do more with less. Many organizations have been forced to cut costs to remain competitive throughout the turmoil. Many large-scale capital investments have been
put on hold, replaced on the corporate “to-do” list by initiatives aimed at reducing real estate, labor or other costs.

While priorities often shift toward consolidation in this economic landscape, footprint optimization is equally important in good economic times as in bad. Mergers and acquisitions, for example, present an opportune time to reduce redundancy. Many companies, however, address redundancy at the business unit level, and few take the opportunity not only to review where the new combined footprint is, but also where it is not.

Forward thinking companies are constantly working to right-size their footprint and deployment of assets for both current and future economic conditions, understanding that the legacy footprint that was suitable for the last economic period is unlikely to be optimal for the next.

**Going green**

Increasing volatility in energy costs is another trend significantly influencing footprint decisions. When fuel prices soared late in the ’00s, some companies brought manufacturing back from distant low-cost countries, while others increased their distribution capacity to get closer to customers. But the fuel effect has transcended costs, as a growing emphasis on sustainability further enhances the importance of energy in the footprint equation. Increasingly, companies are seeking to identify renewable energy sources as production inputs—not only for cost containment reasons, but for corporate social responsibility as well. This has led to the emergence of several new industrial hubs that feature hydroelectric or geothermal power. Executives in energy-intensive manufacturing industries are turning their attention to locations such as East Malaysia, where demand for developed industrial land in Sarawak has far outpaced supply; Quebec, Canada; and, although less so in the wake of the financial and natural disasters that have befallen it lately, Iceland.

**Long-term benefits of a properly aligned footprint can greatly exceed the cost of implementation.** Present value cost savings over a 10-year period can range from 5 to 25 percent, with headquarter re-deployments representing the lower end and realignment of distribution operations typically nearer the upper end of the range.
MEGATRENDS

A number of ongoing trends have dramatically impacted companies both home and abroad and are showing no signs of reversing any time soon. These trends will likely continue to influence location decisions and may require companies to anticipate the impact on their operations and therefore on their global footprint.

China’s continued evolution

The decisions that led many global companies to China a decade ago cannot be automatically assumed to hold valid today. China’s coastal wage rates are escalating at double-digit rates; this combined with the potential risk for revaluation of the Chinese yuan has led to more companies considering other Asian candidate countries for low-cost, export-oriented manufacturing. At the same time, China is producing a massive, growing and increasingly talented pool of engineers, computer scientists and IT graduates (estimated at over 500,000 per year). While many companies are exiting—or bypassing—China for low-skilled manufacturing, savvy companies are seeking to backfill those positions by growing and diversifying in-country research and development or high-tech manufacturing capabilities.

Increasing share of demand coming from emerging markets

Global economics are constantly evolving, as illustrated by changes in cross-border investment. A more diverse group of countries draws foreign direct investment (FDI) each year, and emerging economies such as India, Turkey, Brazil and several Southeast Asian nations are attracting a growing share. (See figure 1.) For businesses, this means the environments in which they operate—or those in which they could potentially operate—are experiencing perpetual changes in talent, technology, infrastructure and operating costs that can further increase (or in some cases, decrease) their attractiveness for future investment.

The influx of capital and jobs has helped increase consumer spending in many emerging economies. Spending power in 35 top emerging market countries grew by an average of 83 percent from 2001 to 2009, contributing to a cycle of growth and expansion that often leads to more foreign investment. As demand stagnates in many developed countries and companies increasingly turn to burgeoning markets for revenue, they are positioning footprints to build market presence and brand reputation for long-term sales growth.

Skill migration and competition for talent

The specter of the Baby Boomer generation’s retirement from the U.S.
Figure 1. Foreign Direct Investment inflow

2005

2014 (projected)

Source: Economic Intelligence Unit, September 2011
workforce has made media headlines for the last few years, but the aging of the workforce is not limited to the U.S. In fact, the trend is impacting countries such as Japan and Germany far more severely. Though the economic recession has dampened news of it, a competition for talent to replace those exiting the workforce looms, forcing companies to be more creative about where they find skilled personnel. Similarly, these trends will likely require companies to give more thought to other talent strategies, such as utilizing mobile technology to engage professionals remotely.

**Narrowing gap in educational quality**

Many emerging countries have invested heavily in their education systems over the years, recognizing its value to enhance their position in the global economy. This educational development has closed the gap between top-tier developed markets and some emerging countries, such as Romania and Chile, particularly at the university level. These developments may present opportunities to get ahead of the curve by gradually shifting the work done at existing locations to the types of activities aligned with the emerging skills and education levels. For example, it is becoming more common for companies to consider R&D placement in markets that may have been more focused on low-skill manufacturing—or would not have even come to mind—10 years ago.

**Continued manufacturing automation**

A long-running debate concerns the relative benefits of labor arbitrage in offshore manufacturing versus cost reduction and efficiency enhancement through automation. As technology continues to improve and arbitrage opportunities decline in many growing markets, automation is again gaining traction. This, in turn, has led to what some call the “Talent Paradox”: high unemployment levels in areas with protracted shortages of skilled workers. Many companies from Cleveland to Cincinnati, for example, struggle to find R&D and innovation talent, although...
Ohio’s unemployment rate continues to exceed 9 percent. This phenomenon is not limited to North America and Europe, but is also extending to other countries throughout the world as companies replace man-hours with kilowatt hours. For some industries and manufacturing processes, automation advancements are reshaping location and footprint decisions as companies suffer from skill and talent shortages in legacy locations.

China’s recent discouragement of low-skilled manufacturing (through reduced incentives and increased legislative restrictions), an evolving immigration policy in the United States that may incorporate potentially restrictive provisions being debated in state and federal legislation, and the enactment of treaties in South America and Asia that could result in trade protections for regional economies are all policy trends that can have a profound impact on companies’ existing footprint and the decisions they make for the future. Restrictive measures enacted by one country can have a ripple effect on others; Canada, whose immigration slogan is “Canada Wants You!,” has used policy to welcome top-skilled talent shut out by restrictions in the United States. South American countries, particularly Brazil and Argentina, have started implementing policies to restrict some labor-intensive manufacturing imports, particularly from China, to protect a domestic industry described as “under siege” by Brazil’s finance minister. Other Asian countries such as Vietnam, Cambodia and Bangladesh have benefitted from China’s dissuasive stance toward lower-end manufacturing. These legislative maneuvers should not be viewed in isolation, but rather should be regarded as interconnected forces.

A POTENTIALLY GAME-CHANGING SHIFT IN ENTERPRISE VALUE

Assessing the enterprise footprint and executing the recommended realignments are not small endeavors. Footprint optimization can be costly and time consuming. But companies able to do so are realizing short-term financial benefits and likely better positioning themselves for long-term success.

Aligning an enterprise footprint primarily creates value through infrastructural and operational economies of scale and flexibility. Real estate expenditure decreases and the reduction of redundant positions are fundamental value drivers; however, other geographically variable operating conditions and costs can also contribute additional ongoing value. Companies can materially improve deployment performance by enhancing their access to appropriate labor skills and leveraging cost arbitrage, as well as managing other operational costs such as taxes, utilities and logistics. The characteristics of a company’s specific footprint determine the relative
impact of these factors which, when balanced for both existing and new locations, are essential to realizing sustainable benefits.

Realizing the benefits of a realigned footprint requires material investments and implementation planning. The primary investments include costs associated with exiting existing facilities, capital expenditures for new facilities, equipment relocation, employee severance and stay bonuses, relocation of key personnel, and incremental recruiting and training. The required expenditures can be significant and can reach $50 million for large-scale redeployments. In addition, detailed implementation and communications planning is essential to retain key talent and mitigate potential impacts to productivity during the transition. A detailed evaluation of organizational design and operational processes should also be utilized to provide the foundation for change and facilitate redeployment decisions. Absent this perspective, changes to the footprint may not yield the expected results.

Long-term benefits of a properly aligned footprint can greatly exceed the cost of implementation. Present value cost savings over a 10-year period can range from 5 to 25 percent, with headquarter redeployments representing the lower end and realignment of distribution operations typically nearer the upper end of the range. Deployment of shared service operations and realignment of commercial operations typically yield present value savings of 10–15 percent. Payback periods and return on investment also vary but generally are two to five years and two to five times investment levels on a present value basis, respectively. Even though a significant effort and cost are required to align a footprint, the financial and operational return to an enterprise can be sustaining, as shown in the following examples.

“ONE SIZE DOESN’T FIT ALL”

A leading global nutrition company has experienced rapid organic growth over the past decade, putting a strain on all facets of the business. As a result of uncoordinated growth, the company had adopted divergent footprints in key regions of the world. European operations had become highly dispersed across countries, leading to redundant people, processes and space. Conversely, its U.S. footprint had grown overly centralized in a single metropolitan area with a high cost of living, which inflated wages for skill sets that could be efficiently sourced in other lower-cost locations and exposed the company to elevated levels of business disruption risk associated with centralization in a city susceptible to natural disasters. With growth projections approaching double digits annually, the existing footprints were no longer sustainable.

With a mandate from top executives, the company set out to systematically define a configuration and locations conducive to future business growth.
The solution, in this case, lay somewhere between the legacy U.S. and European models. Extracting selected functions from the countries in Europe and consolidating them in a low-cost, in-region “center of excellence” is expected to yield present value cost savings of 10–15 percent, generate returns of three to five times the costs of implementation, and create economies of scale in Europe. In the United States, deployment of a second “hub” is anticipated to reduce operating costs for the enterprise by 5 percent, yield a return of twice the cost of implementation, provide access to new talent, and offer risk diversification.

The new footprint strategy is not without obstacles; moves to the new locations will be costly, transitions are likely to be challenging to manage and key personnel may be lost in the process. However, those issues can be anticipated and mitigation plans implemented. With manageable challenges and payback periods of approximately three to five years, the implementation costs proved to be a beneficial investment for a footprint that offers a flexible, cost effective and sustainable platform to support future growth.

“ROOM TO GROW”

With an increasing number of drugs in the pipeline, this highly profitable developer and manufacturer of pharmaceuticals anticipated rapid growth that would require additional staff and facilities. As a reaction to its growth expectations and dispersed footprint, company executives sponsored an initiative to evaluate deployment options across the entire enterprise, including headquarters, R&D, manufacturing and commercial activities. The objectives of the program included not only supporting growth and the development of commercial capabilities but also reinvigorating R&D and innovation within the organization and redefining the company culture to be more collaborative.

Through a structured and disciplined process, the company developed guiding principles based on the strategic goals to evaluate potential deployment scenarios that could support consolidation and future growth. These principles, which focused on the retention and attraction of specialized highly skilled talent, and a broad financial analysis were used to analyze the trade-offs between five distinct deployment scenarios ranging from partial consolidation to full co-location of operations. The company selected a deployment scenario calling for consolidation of operations into a single location. In addition to facilitating the company’s cultural and operations goals, the deployment strategy offered present value operating cost savings of 15–20 percent, a return of approximately three times the costs of implementation, and a payback period under three years. Also as a result of broad planning, employee turnover has been minor and research collaboration has measurably increased.
**THE WAY FORWARD**

Through work with a variety of leading companies supporting enterprise footprint optimization initiatives, we have identified a number of key insights, described in the accompanying table.

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<td><strong>Set the tone at the top.</strong> Leadership buy-in and communication up front is critical to encouraging supportive contributions among key stakeholders and mitigating organizational uncertainty. Identify a senior leader to take responsibility for design and execution of changes, and clearly communicate the importance of positive participation early in the process.</td>
<td><strong>Don’t wait for a crisis.</strong> When crises strike, companies tend to favor decisive action over rigorous analysis. Enterprise footprint optimization presents the opportunity to take a step back to proactively align location footprint and strategic planning to make urgent reactions to crises either unnecessary or at least more efficient.</td>
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<td><strong>Take a holistic view.</strong> To be effective, the optimization process should consider everything from key strategic objectives, such as enterprise sustainability and market growth, to operating requirements, such as talent availability, risk management and cost containment.</td>
<td><strong>Don’t undercommit.</strong> The potential for a transformative impact on the business in terms of positioning it for the future and developing a source for sustainable competitive advantage justifies the expenditure of time and resources. Insufficient leadership communication or dedication of resources could lead to transition costs without realization of the full benefit of footprint optimization.</td>
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<td><strong>Start with quick wins.</strong> In many cases, there are immediate improvement opportunities that can start delivering benefits in less than three months. These “quick wins” not only can make the overall effort self-funding, they can help build momentum and credibility, which are essential to sustained improvement and gradual pursuit of a target footprint.</td>
<td><strong>Don’t forget about tax.</strong> The intricacies of international tax law often present a prime opportunity for a footprint assessment. In fact, for some companies, the tax incentives offered by particular jurisdictions can justify the entire effort.</td>
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<td><strong>Consider long-term objectives.</strong> A key component of enterprise footprint optimization is literally mapping the future of the organization. With that in mind, it is important to align the footprint with strategic objectives, include scenario analysis as part of the initiative to identify key factors that could impact plans, and build in footprint flexibility to quickly respond to change.</td>
<td><strong>Don’t ignore change management.</strong> Integrating effective organizational design adjustments, aligning talent management and incentives with changes, and identifying and addressing the impact on corporate culture are essential to long-term success.</td>
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<td>Challenge traditional assumptions. Sophisticated tools such as advanced analytics can allow organizations to test assumptions and model profitability at a depth not previously feasible. These initiatives offer the opportunity to validate or refute standard assumptions using these resources as part of footprint modeling.</td>
<td>Don’t view the exercise solely as one in cost reduction. While cost reduction is a potentially significant component, organizations that focus exclusively on that objective miss the true benefits of balancing a wide range of critical factors, from cost efficiency and operating requirements to talent availability, tax impacts and access to new markets.</td>
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<td><strong>Align incentives.</strong> Traditional incentive programs tend to reinforce the status quo and encourage optimization within individual functions rather than for the enterprise as a whole. To address the issue, incentives should be realigned so that managers and employees are motivated to both support changes and focus on overall margins rather than focusing on increasing performance within their particular function.</td>
<td>Don’t let groups opt out. There may be legitimate reasons to exclude certain groups, functions or geographies, but each group that opts out erodes the benefits of a holistic review. Many times, individual groups perceive the exercise as a threat rather than an opportunity, further emphasizing the need for strong, early and consistent communication.</td>
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<td><strong>Repeat as needed.</strong> Plan to periodically repeat the analysis as the business environment changes and your footprint evolves. The good news is that subsequent analyses will likely take only a fraction of the time and effort that was required initially.</td>
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For leading companies, internationalization is starting to give way to true globalization as these organizations extend their reach to all corners of the habitable world in search of new markets, resources, talent pools and cost advantages. Yet this path can be challenging to navigate as the business environment is constantly evolving, from gradual changes in costs and talent markets to political and natural events impacting economies.

Companies not focused on these dynamics can be quickly left behind, encumbered by locations that no longer suit their needs, unnecessary redundancy in their operations, elevated risk levels, and footprints that do not position them to anticipate and address change quickly. On the other hand, companies that proactively manage their global footprint can gain a competitive advantage that would be difficult to replicate, literally positioning the organization globally to achieve its strategic objectives, both in the short term and for the future. DR

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Endnotes


6. Economist Intelligence Unit, September 2011

7. World Bank, per capita incomes at purchasing power parity, 2011 (countries are emerging market economies and include Algeria, Argentina, Belarus, Brazil, Bulgaria, Chile, China, Colombia, Costa Rica, Croatia, Dominican Republic, Equatorial Guinea, Estonia, Hungary, Latvia, Lithuania, Malaysia, Mauritius, Mexico, Oman, Panama, Peru, Poland, Romania, Russia, Saudi Arabia, Slovak Republic, Slovenia, Suriname, Thailand, Tunisia, Turkey, Turkmenistan, Ukraine, and Uruguay)

8. US Census Bureau International Database, 2011 Estimates

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