Advisory Outlook

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The Truth about Costs

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Stagnating revenue growth, intense competition, pressure on pricing, and the list of challenges facing businesses goes on.

With vigilance on cost leading the agenda every year since the 2008 financial crises, it's easy to think that every possible inefficiency has already been driven out, cost-saving targets have been met and headcounts have been sufficiently cut. But the data tell a different story. Costs are eating into profit margins. Many companies' financial results are lackluster. The fact that cost reduction remains a primary concern confirms that the task is incomplete. The job isn't done.

Change is hard – and difficult to execute. Cost initiatives are often poorly designed and badly implemented. Many business leaders don't recognise the underlying challenge and are over reliant on the organisation to deliver the results.

Cost savings tend to be short term in nature, and leak away once the organisation goes back to its old ways of working. Managers focus mainly on the most visible costs, such as reducing staff numbers in support functions – and not by addressing the true nature and structure of costs.

Operational complexity built up during extended periods of growth is difficult to unpack and simplify. Organisational politics, vested interests and individual behaviours impede objectivity and effective decision-making; whilst a lack of skills and experience of having done this before limits meaningful progress.

Businesses need to put together a programme which will bring more significant cost savings by 'doing with less' and 'doing things differently'. Focusing in this way, will help you move beyond cutting costs to restructuring them to achieve larger savings with lasting results.

Before starting on cost reduction initiatives, take the time to understand why programmes don't always deliver their full potential.

Consider the common pitfalls:

- It's not enough to set targets - Behaviours and structures need to be changed to deliver long-term results.
- Budget owners can't be relied on to meet savings goals - No one wants to reduce their influence or undo their own work.
- A failure to deliver sufficient cost reductions doesn't mean new or more ideas are needed - Execution is often at fault.
- Benchmarks won't produce savings - They only give an insight into whether progress is being made.
- Responsibility for cost can't be delegated - Cost reduction requires a fundamental change that must be visibly led from the top through executive leadership.
- Savings initiatives mustn't be delivered by 'gifted amateurs' while they continue in their day jobs - They need experience and total commitment.

A new way of looking at costs

Maybe you've just finished a cost reduction or restructuring programme, you're about to start or know that you have to address this again if the market doesn't improve quickly. We've found that no matter how hard you and your teams have looked at this, there are still costs that are missed.

From our work with various organisations, we've found that cost savings fall broadly into four categories. Tackling costs in this way will bring different levels of savings. Businesses have already worked hard on 'doing without' and 'doing better' but what about making more significant and sustainable savings by 'doing with less' and 'doing things differently'.

We call this the Opportunity Accelerator Approach.

While the Opportunity Accelerator identifies immediate savings, it's a longer-term approach. It involves targeting both tactical and strategic cost reduction initiatives that produce a range of savings over the near term (three to six months), medium term (six to twelve months) and longer term (twelve to eighteen months).

This balanced approach allows you to release immediate cash savings to fund a longer-term programme to deliver broader, strategic structural change, such as IT and data centre consolidation, shared services or outsourcing arrangements.

Doing with less

Do with less by reducing infrastructure and save up to 20%.

Property related spend is normally the second largest category for a business, after staff. However, cost reduction initiatives focused on real estate often take a narrow and non-strategic view of assets that fails to deliver real long-term value. They can leave property and corporate strategy misaligned and destroy value by focusing on cost and liability minimisation. Businesses should focus on maximising the value of their assets instead.

Doing things differently

Do things differently by restructuring the cost base and save 20% or more.

Companies can consider closing or selling underperforming/non-critical parts of the business, customer types and/or product offerings, which could also free up funds and investment/growth opportunities. You can also consolidate sourcing and vendor activity, create shared services, and outsource non-core processes.

Traditionally, cost reductions in procurement have come from aggregating local spend, reducing unit costs and squeezing suppliers. A more strategic and collaborative approach towards total third-party spend that aligns its objectives and incentives with the rest of the business is needed and can produce huge savings and create benefits instead of just controlling costs. Rather than focusing exclusively on supply, sources of demand within the organisation must be included in procurement cost-cutting programmes. Procurement needs to use its uniquely broad view of spend categories to identify potential synergies.

Creating Accountability

An office of cost control fulfils a crucial function in cost reduction programmes by linking the driving force of change – executive management – with the rest of the business.

Only about 30% of cost programmes hit their original targets; and very few organisations sustain results after three years.

In our experience, having a well-structured programme office can make all the difference to the success of a cost reduction initiative. Its role is to create a mindset of cost consciousness amongst all your people resulting in savings and improvements over the longer term.

We believe the office of cost control should be part of the finance function but it must have key responsibilities and interactions across the business. It typically consists of four parts.

1. Providing relevant business information. This is done by finding ways to simplify cost allocation, agreeing useful cost reporting and management information, standardising definitions and ensuring robust budgeting and forecasting processes up front.
2. Assigning ownership for all cost decisions. The office of cost control will set up processes with the right control points and ensure your leadership and your people take responsibility for both regular and discretionary spend.
3. Delivering the methodology for achieving the targeted savings. The office of cost control sets up programme disciplines and methodologies across the programme. The office is also responsible for reviewing and prioritising cost initiatives as they arise and builds them into the longer-term plan, tracks duplication and dependencies with other initiatives and pinpoints any risks to achieving the planned benefits.
4. Monitoring and reporting actual savings. The office designs the right measurement and reporting frameworks to monitor the actual savings. A consistent methodology is applied to track all the saving and monitor each cost initiative. The office also develops metrics and score cards across the project, business unit and the whole organization and highlights any shortfalls.

Seeing the benefits

Achieving long-term cost reduction which lasts in the business rather than repeating the same cost cutting tactics, requires being open to possibilities you may not have considered or attempted.

About the author
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