

# Attacking Overhead Costs from Both Sides

## Optimizing the Supply and Demand for G&A Services

“Business is flat. I need to cut overhead costs quickly to meet my earnings forecast. At the same time, I have to launch an even bolder round of restructuring to bring costs down 30 to 40 percent over the next three to five years. And I need to achieve these goals without undermining the core functional capabilities needed to keep my business moving and, ultimately, achieve above-market growth.”

### Sound familiar? Seem impossible?

Having weathered a series of numbing blows recently, companies the world over are reassessing their business models and fundamentally redesigning them from within. With top-line growth stalled in many industries, overhead costs are a primary and persistent target of these reviews.

Over the past decade, most global 500 companies have implemented several waves of restructuring programs to cut general and administrative costs, including business process reengineering, shared services, ERP, and strategic outsourcing. While these traditional initiatives have often been effective in improving the bottom line and enhancing shareholder value, they have largely run their course. Companies just cannot keep squeezing the same functional service areas in the same way without compromising the value these services provide. So exactly how are companies supposed to wring additional and significant savings from their overhead functions?

Standout companies are stepping back and adopting a new and broader perspective on this age-old problem, one that encompasses not only supply-side cost restructuring but also demand-side optimization

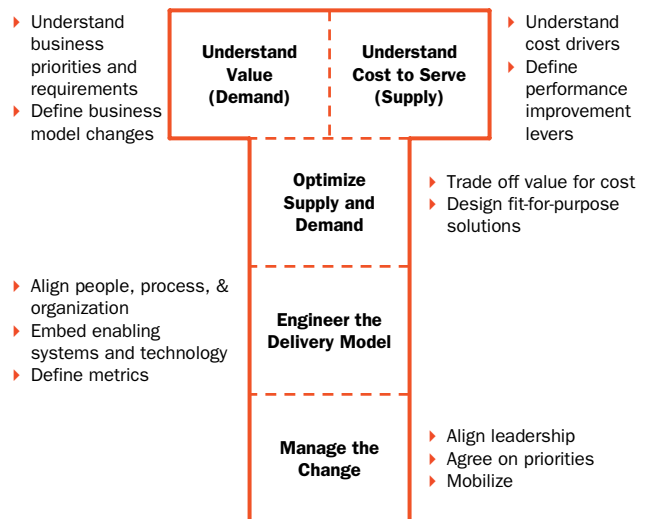
strategies (see Exhibit 1). Approaching the cost reduction challenge from both sides has unlocked major benefits and savings for such companies. The notion is grounded in basic microeconomics: By aligning supply with demand, companies can achieve a value-based equilibrium in their G&A cost structure. It's this alignment of supply and demand that distinguishes next-generation overhead cost reduction strategies.

### Blowing Up and Rebuilding Overheads

Traditional approaches to cutting overhead costs usually lead from the *supply* side. Companies challenge how overhead functions are organized and delivery processes are designed by applying classic reengineering techniques to increase efficiency and productivity. Our recent client experience, however,

#### Exhibit 1

Booz Allen's Approach to Attacking Overhead Costs from Both Sides



Source: Booz Allen Hamilton

suggests that managing the *demand* for such overhead services yields as much, if not more, in terms of benefits.

Managing demand is not simply a matter of assessing the overall appetite for overhead services and lopping off 10 percent across the board. When done right, it is a careful, systematic, and business-specific assessment of what services are needed at what level of performance and why. This assessment measures the relative criticality of various functions and services to determine the need for excellence versus adequacy. To make this determination, executives need to understand and openly question fundamental business drivers on a unit-by-unit basis, including decades-old standards and policies, strategy-based business model requirements, customer-driven market priorities, and economic and competitor-driven affordability levels.

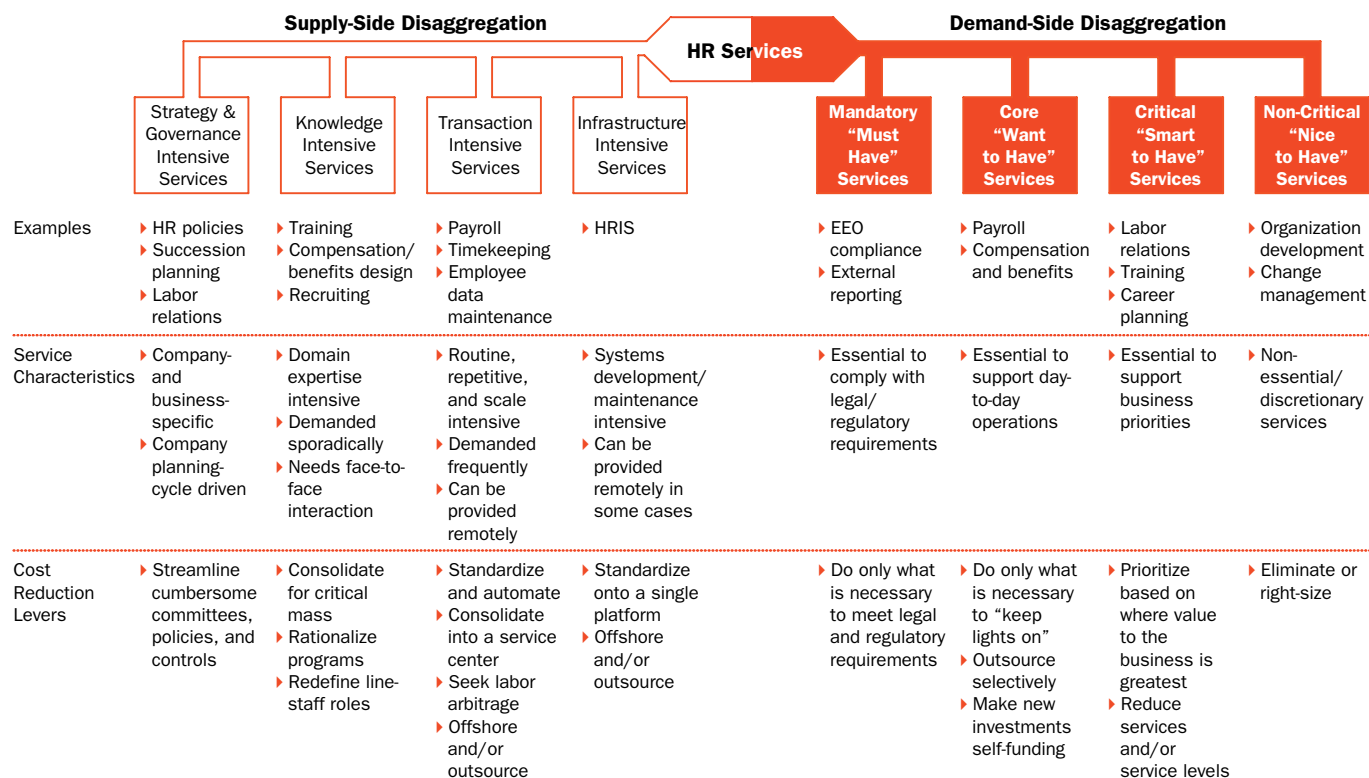
Supply and demand cost reduction strategies are by no means mutually exclusive. In fact, an organization can achieve maximum efficiencies only by exploiting both and discovering the supply-demand “sweet spot” – the strategic equilibrium where supply and demand for services are aligned. To locate this sweet spot,

companies must disaggregate overhead services from both a supply and a demand perspective (see Exhibit 2).

Supply-side disaggregation involves breaking up services into their component activities and then reassembling them based on 1) the inherent nature of the service (e.g., routine versus highly knowledge intensive), 2) the frequency of service usage (e.g., daily versus semiannually), and 3) the channel through which the service is accessed (e.g., on-site staff versus call centers). In HR, for example, such a tear-down and build-up exercise results in four broad overhead service groupings, each with its own unique set of economics and cost reduction levers (see Exhibit 2).

Demand-side disaggregation focuses on breaking down the appetites for various services among business unit customers. What results are categories of “must have,” “want to have,” “smart to have,” and “nice to have” services based on why customers need them, where they access them, and how they apply them to support specific business decisions, operations, and processes. The resulting disaggregation provides a view on the service breadth and levels currently being consumed across the organization as well as the business case

**Exhibit 2**  
Disaggregation of Supply and Demand for HR Services



for that breadth and level of consumption – good and/or bad.

**Next Generation Supply and Demand Levers**

Having segmented its range of services from both a supply and a demand perspective, a company can “build” a conceptual and analytical view of its overhead cost structure. More importantly, it can readily identify which supply and demand levers would be most effective and nondisruptive in reducing costs. Our work with clients around the world suggests there are ten basic levers companies can use to identify and exploit the supply-demand sweet spot and achieve next-generation cost reduction (see Exhibit 3). Many of these levers are familiar; however, we’re suggesting turbo-charging these techniques and taking them to the next level as part of an aggressive program to balance both supply-side and demand-side drivers.

For instance, on the supply side, many companies have taken outsourcing to the next level by cleaving off their utility services and relocating them offshore in low factor-cost locations. Some are handing over entire functions to third-party providers. Others are aggressively implementing best practice transfer in core strategic services such as engineering, marketing, quality, and IT applications development.

On the demand side, companies are becoming far more rigorous in “doing the right things with less,” particularly in capital-intensive overhead areas such as IT. Newly empowered executive committees and governance boards are vetting capital investment projects, applying disciplined business case and ROI criteria before approving significant expenditures. Sophisticated customer segmentation is another demand-side lever. Some of the same techniques used to segment and target external customers are now being used to manage internal customer demand for overhead services.

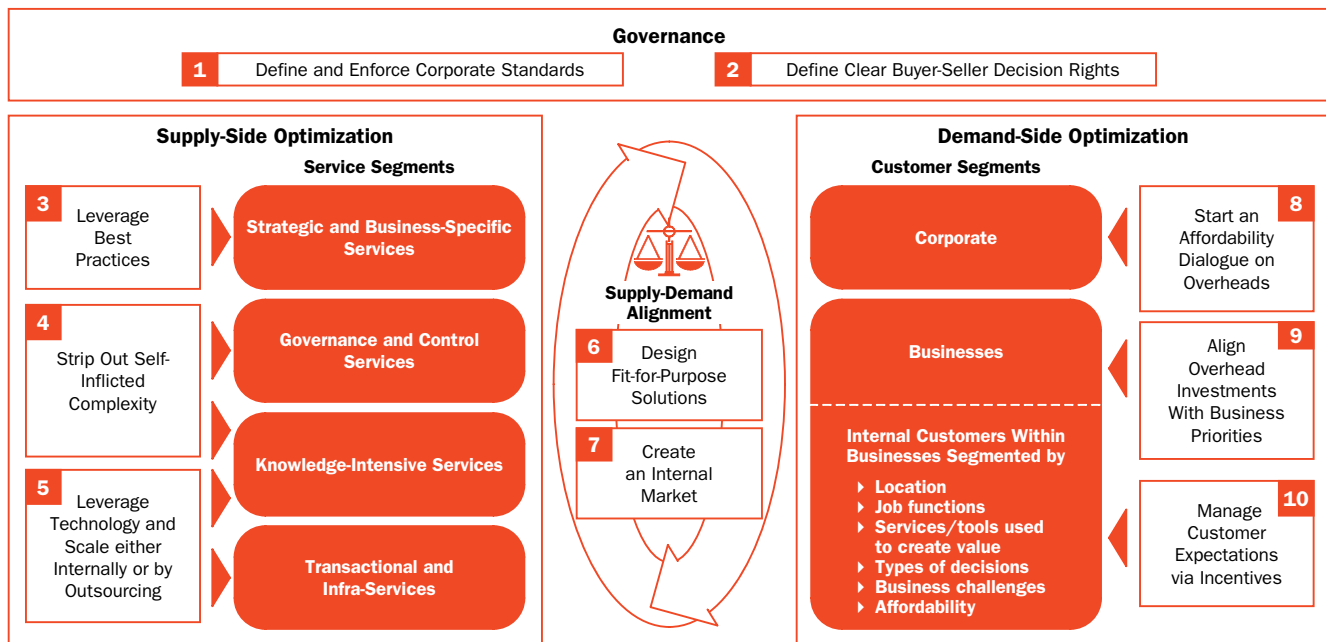
In the next section, we look more closely at fit-for-purpose solutions, a hybrid cost reduction lever that combines demand-side customer segmentation techniques with supply-side service delivery tools.

**Fit-for-Purpose Solutions**

Conventional wisdom has long held that one-size-fits-all solutions result in the lowest overall costs, but our recent client work suggests that logic is faulty. Standardized solutions actually overserve many business users while underserving others. The result is higher than necessary costs, and dissatisfied users who are not receiving an appropriate level of service. Conversely, if service providers offer too many options

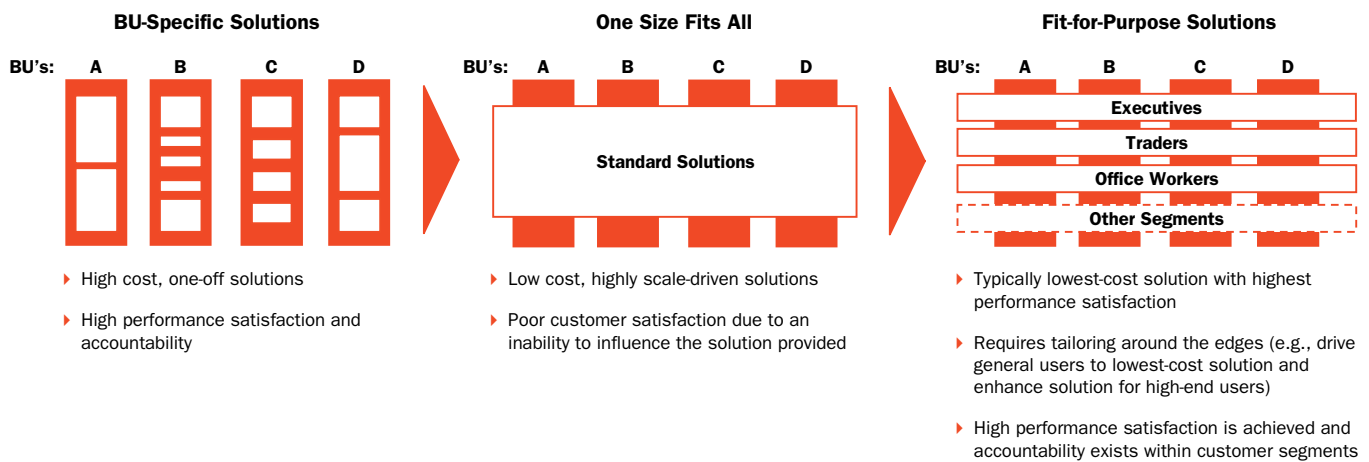
**Exhibit 3**

Next Generation Supply and Demand Levers for Overhead Cost Reduction



Source: Booz Allen Hamilton

## Exhibit 4 What Are Fit-for-Purpose Solutions?



Source: Booz Allen Hamilton

(e.g., supplying each business unit a customized menu of services) without establishing sufficient scale or standards, costs quickly and predictably escalate (see Exhibit 4).

Fit-for-purpose solutions represent the happy medium in the enduring tug-of-war between one-size-fits-all and custom-tailored service offerings. They are tailored but efficient service delivery solutions that align supply and demand. By assessing the economics of service delivery from a cost-to-serve and ability-to-serve perspective, and by segmenting customer needs and priorities, companies can radically restructure overhead services, resulting in a set of affordable yet responsive solutions.

Take IT desktop services as an example. To design fit-for-purpose solutions, start with the customer, defining distinct segments in the IT user population using classic market segmentation concepts. Segmentation criteria might include:

- ▶ Where are customers located?
- ▶ How do they access their data?
- ▶ What job functions do they perform?
- ▶ How critical are the business decisions they make?
- ▶ What applications and tools do they need to support these business decisions?

Such a demand-side approach to IT desktop illuminates those customers across business units with similar needs, and draws distinctions where

there are meaningful differences. Segments are defined not simply by location or function, but by a more sophisticated characterization of the nature of their demand. Those with similar needs are grouped together to create a critical mass that can be profitably served. It's not unusual to see segments of service users cut across multiple business units, locations, and organization functions.

Once segments are defined and customer needs prioritized into "musts," "wants," and "nice-to-haves," IT professionals can then rationalize and reconfigure their existing portfolio of desktop services into fit-for-purpose service bundles that combine the requisite criteria (e.g., service levels, access methods, support levels, reliability) for each segment. The trick in this process is to design service bundles that optimize the trade-off between being responsive to individual customer segments and being mindful of controlling complexity by minimizing the number of segments and constraining variations.

The next challenge is delivering these fit-for-purpose solutions through the right channels to desktop users. Service delivery channels include the people, the processes, and the systems involved in bringing a service to the customer. A particular channel need not be exclusive to a particular customer segment or service bundle. Once again, the challenge is to find an optimal balance between an over-proliferation of delivery channels and too few. Companies that get this right usually organize the delivery infrastructure around stability, predictability or difficulty.

**Exhibit 5**

Fit-for-Purpose in Action for IT Desktop Services

Customer Segmentation			
Service Levers	Large Office Business Critical	Office Worker	Remote Business Critical
Support Ratio	100:1	250:1	150:1
Seats per User	1.2	1.0	1.5
Refresh Rate	33%	33%	50%
Hours of Operation	24x7	9-5	24x7
Response Time	< 20 min.	< 4 hrs.	< 1 hour

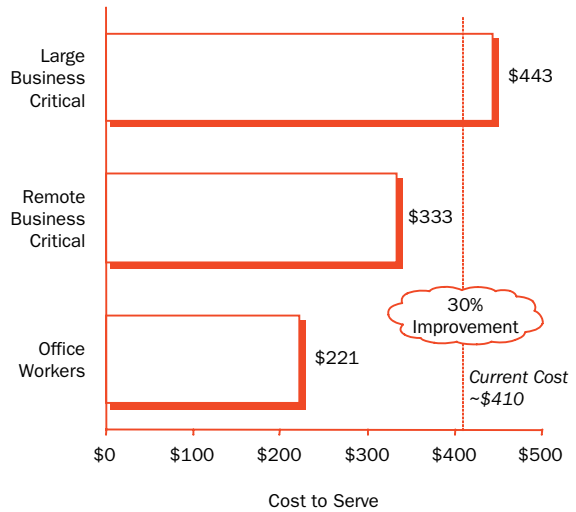
User Segments	Large Office Business Critical	Office Worker	Remote Business Critical
	<ul style="list-style-type: none"> <li>A large office (&gt;100 staff at location)</li> <li>Professional/publishing</li> <li>Entry/mid-level sales/publishing</li> </ul>	<ul style="list-style-type: none"> <li>Entry/mid-level office and clerical</li> <li>Mid-management Finance, Marketing and Admin.</li> </ul>	<ul style="list-style-type: none"> <li>Same as Large Office Business Critical, but located at small or home offices</li> </ul>

Delivery Models	Large Office Business Critical	Office Worker	Remote Business Critical
	<ul style="list-style-type: none"> <li>Service desk</li> <li>Dedicated onsite</li> </ul>	<ul style="list-style-type: none"> <li>Shared onsite</li> <li>Service desk</li> </ul>	<ul style="list-style-type: none"> <li>Dispatch (business critical) key office</li> <li>Drop-ship, depot (non-business critical)</li> </ul>

Client Example

**Performance Impact**  
Annual Cost to Serve (By Customer Segment)



Note: Cost to serve based on a 750-person office size and depot for Remote Business Critical

Source: Booz Allen Client Experience

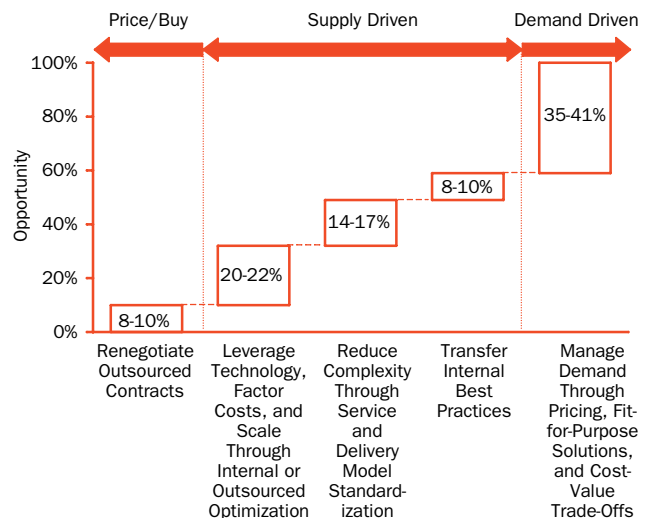
As Exhibit 5 illustrates, fit-for-purpose solutions result in an overhead architecture in IT desktop services that varies widely from segment to segment in its economics and flexibility. For instance, in some locations (e.g., a small remote facility), it doesn't make sense to maintain dedicated IT staff and equipment. Employees there are best served by the local Best Buy or CompUSA, letting the store perform warranty work. In other areas, however, where decisions made on desktops are business critical, companies should provide far more responsive on-site support.

**It's About Time**

Those cost-cutting initiatives that require nominal investment and carry low execution risk have long since been tapped. The next wave of fundamental overhead cost reduction will come as companies make difficult, critical and clear supply-demand affordability trade-offs. By applying the framework and levers outlined here, companies can "variabilize" fixed overhead costs, while lowering total overhead substantially. Companies, in our experience, can achieve structural cost reductions of up to 40 percent (see Exhibit 6), but the time to act is now.

**Exhibit 6**

Impact of Supply-Demand Optimization on Overhead Costs



Source: Booz Allen Client Experiences

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