

booz&co.

**Achieving Cost
Leadership**
*A Sustainable and
Pragmatic Approach*



Booz & Company is a leading global management consulting firm, helping the world's top businesses, governments, and organisations.

Our founder, Edwin Booz, defined the profession when he established the first management consulting firm in 1914.

Today, with more than 3,300 people in 58 offices around the world, we bring foresight and knowledge, deep functional expertise, and a practical approach to building capabilities and delivering real impact. We work closely with our clients to create and deliver essential advantage.

For our management magazine *strategy+business*, visit www.strategy-business.com.

Visit www.booz.com to learn more about Booz & Company.

CONTACT INFORMATION

London

Peter Bertone

Senior Partner

+44-20-7393-3205

peter.bertone@booz.com

Andrew Clark

Principal

+44-20-7393-3418

andrew.clark@booz.com

Daniel West

Principal

+44-20-7393-3440

daniel.west@booz.com

Stuart Groves

Senior Associate

+44-20-7393-3503

stuart.groves@booz.com

Anna Burrage and Miles Puttergill also contributed to this article.

ACHIEVING COST LEADERSHIP

*A Sustainable and
Pragmatic Approach*

As global recession fast approaches, cost containment is returning to the top of the managerial agenda. Many companies are trying but failing to sustainably contain their costs—typically due to an inability to translate ideas into practical interventions applied to the underlying activities behind the cost. We believe, however, that a simple, pragmatic approach can help organizations avoid the many pitfalls of cost containment.

Cost Control: Back at the Top of the Managerial Agenda

The world's developed economies are drifting into recession; confidence is low and credit is nowhere to be seen. Even in the best economic times, no business consciously intends to be inefficient, but with pressure on the top line so intense, costs are again the center of attention. More than short-term performance is at stake. Long-term growth opportunities still exist, and the companies that are healthiest during the downturn will be best positioned to capitalize on the rebound. These companies are focusing on cost control.

The need to manage cost is nothing new, yet a surprising number of organizations struggle to successfully control their operating expenses over time. Some interventions—for example, across-the-board spending cuts or snap reorganizations—can yield short-term results, but those benefits can be difficult to sustain. More systematic approaches, on the other hand, can generate genuine long-term solutions, but often run out of momentum during, or even before, implementation.

Five Common Pitfalls to Cost-Cutting Programs

- 1. Applying blanket cuts across the board**
Blind cuts often do more harm than good, as both core and non-core activities suffer.
- 2. Repeatedly tweaking the operating model**
Organization is one lever for change—but only one of many.
- 3. Looking only at “what I do,” but not “what I spend”**
Total cost of activities is often poorly understood.
- 4. Balking at hard decisions**
Tough calls on cost tend to be avoided because of an inability to prioritize risk.
- 5. Failing to challenge budgeting**
Budget systems should not make it easy for managers to hide their spending or play the system.

All too often, well-conceived cost-containment programs fail due to an inability to translate ideas to practical interventions applied to the source of the cost—that is, the underlying activities behind that cost. At the root of this problem lays a number of common pitfalls. A pragmatic approach can help organizations avoid the many pitfalls of cost containment.

Crash Diet vs. Long-Term Cost Control

Ultimately, actions to manage a company’s cost base will only be successful if the root causes of cost are addressed directly. No doctor would advise a patient seeking to lose weight to simply stop eating for a couple of weeks. It should be no surprise, therefore, that similar crash diets are rarely successful for corporations. Just as a healthy diet is about what you eat (not only about what you don’t), sustainable cost management is about what you do and what you spend doing it (not only about what you don’t spend). If organizations are to achieve successful, sustainable

cost control, it is important to consider their activities and what is spent on them, rather than considering costs per se.

Containing costs need not be complex or slow to pay off. A simple, pragmatic diagnostic is often all that is required to identify potential opportunities. Organizations can then define a structured program of interventions to capture quick wins while longer-term solutions are put into effect elsewhere. To begin, answer these four basic questions.

Question 1: “What Activities Can We Not Live Without?”

Even the leanest organization must perform certain activities if it is to keep the “lights on,” so to speak. Minimum standards are mandated for safety and legal compliance, for example. Much of what organizations do, however, involves an implicit choice about what and how to do things above and beyond such basic activity. To sustainably address the activity base, this distinction must be made explicit.

Question 2: “Which Activities Can We Simplify or Aggregate?”

Just because an activity is necessary doesn’t mean it is always performed efficiently. Processes can become excessively complicated over time as attempts to enhance decision making draw ever more stakeholders into the process. Alternatively, similar activities can become duplicated across functions. Such instances may be well known yet remain unaddressed because changing them would be complicated or time-consuming.

Question 3: “Where Can We Redefine Demand for Activities?”

Even if an activity is delivered efficiently, if it is not managed carefully, costs can spiral. Companies frequently struggle to understand why their overall cost competitiveness is poor while the results of benchmarking individual processes tells them that unit process costs are low. The total demand for an activity, however, has a critical part to play in total cost. If businesses do not have sufficient clarity on the end-to-end impacts of decisions, costs can grow rapidly.

Question 4: “What Activities Could We Stop?”

Although many activities are in some way necessary to the ongoing and successful operations of an organization, many are discretionary. In our experience, history plays an important part in both what and how things are done. Activities that at one time made sense commonly fail to stand up to examination when the organization asks, “Why do we still do that?”

By answering these four basic questions, organizations can take the first step toward achieving sustainable cost containment.

They can begin to understand the underlying activity choices that drive their cost position. Such a diagnostic allows them to truly understand the degrees of freedom that they have in making sustainable changes related to cost (a sample savings breakdown is shown in Exhibit 1). The resulting choices, however, are not always simple or painless. It is at this point that many companies falter.

Tough Choices: Making the Hardest Decisions Easier

Identifying potential opportunities is one thing, but defining the best way forward is quite another. Even where systematic review allows activities to be challenged, there is usually a reasonable argument for doing things the way they are currently done. It is human nature to prefer the devil we know to the devil we don't. Therefore, once opportunities are identified, making cost decisions can still be difficult or even painful.

Implementation depends on strong leadership and a clear method of approaching such decisions.

Just as a pragmatic approach should be used when identifying opportunities for cost containment, a similar approach focused on underlying activity is essential to successfully navigating the decision-making process. Successful prioritization of opportunities can easily be achieved with two simple criteria: (1) the "criticality" of an activity, or its importance to the business; and (2) the ease of implementation or ability to influence in the short term. By categorizing all activities/changes along these two dimensions, decision makers can make an objective assessment of the necessary trade-offs and have a tool to generate buy-in for their planned way forward. We call this assessment the "pain scorecard."

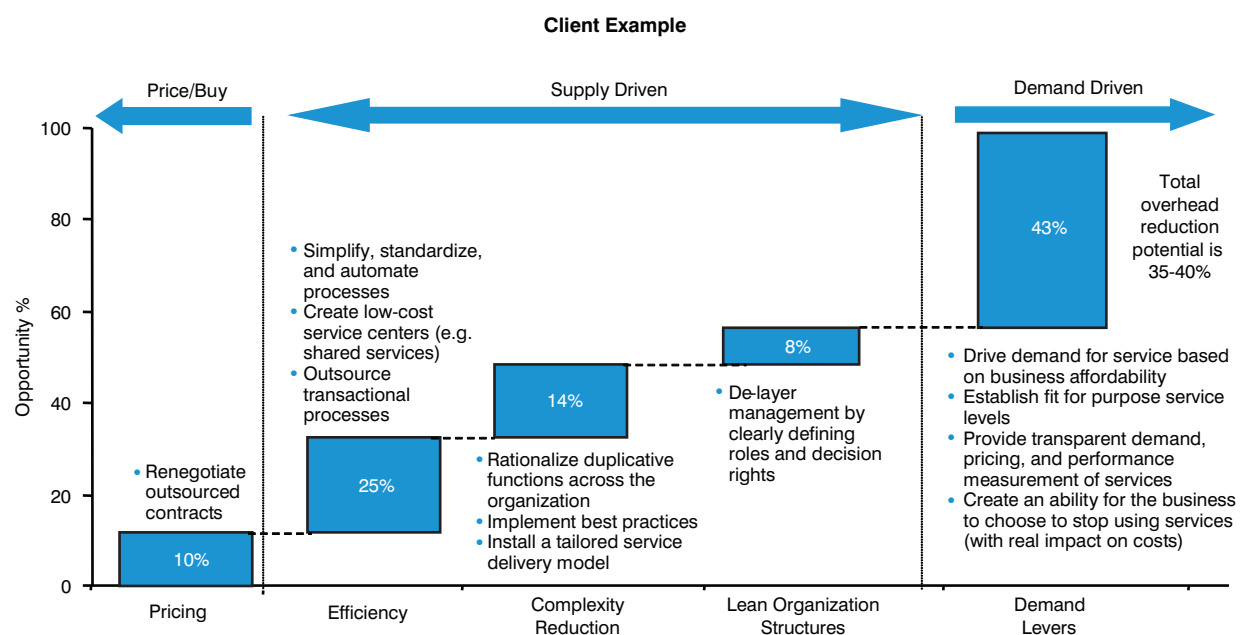
The pain scorecard provides a simple framework to prioritize and to assess how deep to cut (see Exhibit 2). Activities that are less critical and less challenging to stop are obvious places to start. Depending on the extent of the financial challenge faced, one simply works outward from there. As the stakes build up, the line can be drawn wherever decision makers deem appropriate, based on what the organization can realistically afford.

As with opportunity identification, clear, up-front understanding of activities is critical to success at this point. High-pain items tend to contain low-pain sub-items. Without sufficient disaggregation of such groups of activity it is impossible to understand the opportunities to cut costs.

Getting It Done

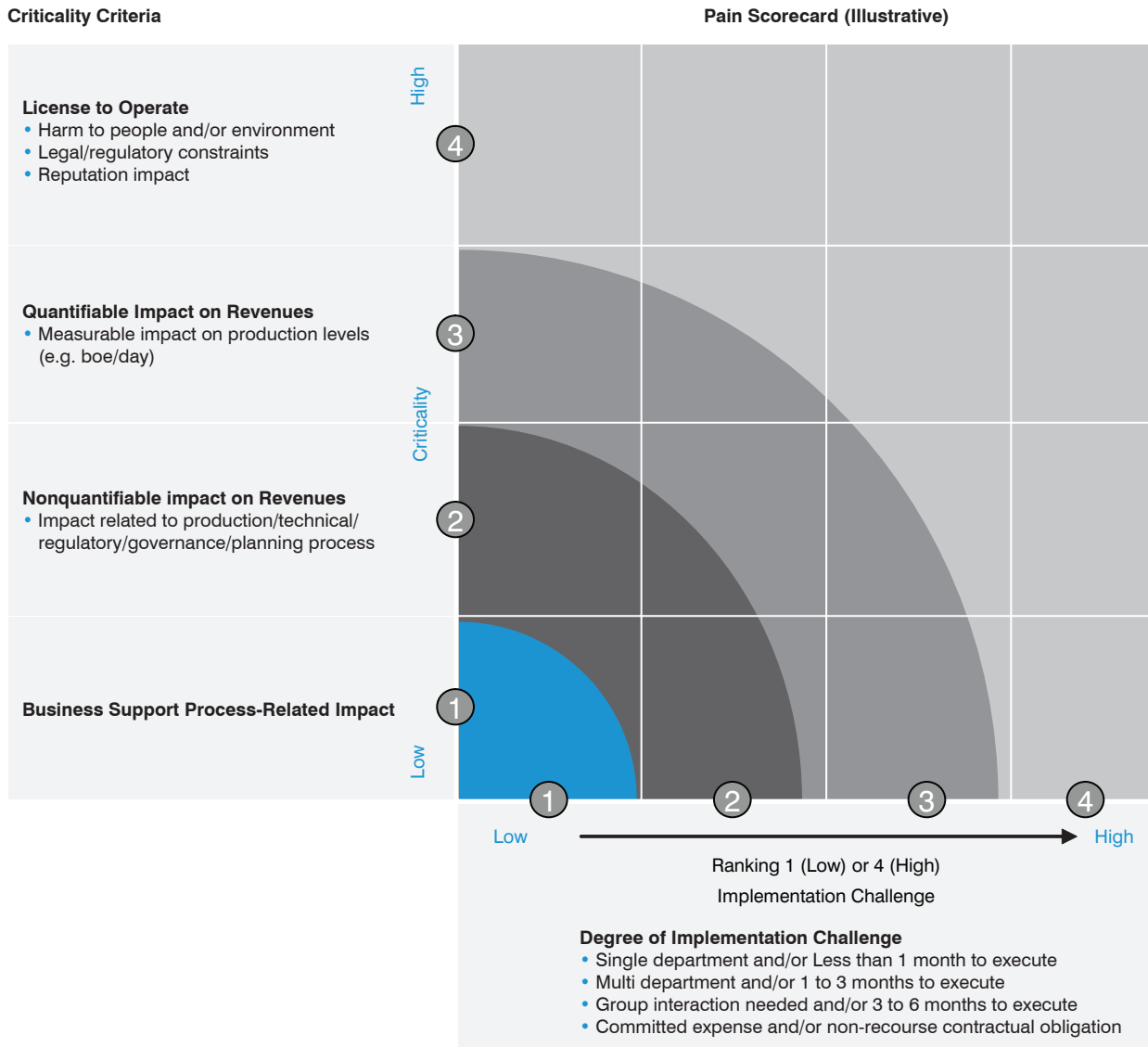
Even with the path forward decided upon and defined, delivery presents

Exhibit 1
Sample Savings Breakdown



Source: Booz & Company analysis

Exhibit 2
The "Pain Scorecard"



Source: Booz & Company analysis

a final challenge. In our experience, the pragmatic approach, again, works best. Few methods have proven more effective in ensuring delivery than the simple expedient of clear accountability and clear auditability.

Opportunities and the responsibility for delivering them should be defined with precision, clearly evaluated, and integrated into budgets to give

lower allowable spends. Ongoing measurement and reporting of progress then becomes critical for ensuring opportunities are realized. Lastly, progress should be discretely measured to ensure clear visibility of each individual intervention. This helps prevent management from substituting ceased activities with other activities, and it results in a clear evaluation of crystallized opportunities and savings.

Conclusion

In an increasingly challenging business environment, cost management has again come to the fore. Many companies fail to deal with this challenge in a sustainable way. At fault is a lack of focus on a practical method to address the underlying activities behind cost. In these times of economic turmoil, such a pragmatic approach is required.

BOOZ & COMPANY WORLDWIDE OFFICES

Asia

Beijing
Hong Kong
Mumbai
Seoul
Shanghai
Taipei
Tokyo

Australia, New Zealand, and Southeast Asia

Adelaide
Auckland
Bangkok
Brisbane
Canberra
Jakarta
Kuala Lumpur
Melbourne
Sydney

Europe

Amsterdam
Berlin
Copenhagen
Dublin
Düsseldorf
Frankfurt
Helsinki
London
Madrid
Milan
Moscow
Munich
Oslo
Paris
Rome
Stockholm
Stuttgart
Vienna
Warsaw
Zurich

Middle East

Abu Dhabi
Beirut
Cairo
Dubai
Riyadh

North America

Atlanta
Chicago
Cleveland
Dallas
Detroit
Florham Park
Houston
Los Angeles
McLean
Mexico City
New York City
Parsippany
San Francisco

South America

Buenos Aires
Rio de Janeiro
Santiago
São Paulo