Gillum Strategy Partners

V I E W P O I N T

Cost Reduction

Putting a Stake in the Ground

Always a Good Time to Look at Cost Structure

Must Be Treated as a Major Corporate Effort:

Placing the stake in the ground is critical to successful implementation.

Whether preparing for an economic downturn, seeking to increase profitability or improve efficiency across the board, organizations can create long-term value by developing and implementing a cost reduction strategy. Cost reduction is not reserved just for companies seeking to gain an edge on incumbent leaders – best-in-class organizations constantly seek ways to simplify to keep their own edge in the competitive landscape (no matter how good a company is at cost management, it can probably do better). Companies that exhibit a culture of on-going efficiency and simplification are best equipped to withstand challenging economic environments and achieve a superior competitive position.

Developing and executing an effective approach and process towards cost reduction is not a simple task – especially when faced with a tightening economy, soft markets or increased competitive threats. However, the payoff to effectively focusing your company on cost reduction can have a tremendous impact on overall performance for both the short and long term.

"Stake-in-the-Ground" Approach

Management must approach cost reduction in a strategic and focused manner that puts a stake in the ground for company leaders, business managers and employees who are accountable for driving the savings. Gillum Strategy Partners ("GSP") recommends a 9-Step Approach for creating and implementing a cost reduction strategy:

1. Identify Key Contributors and Assign a Senior Leader as Project Champion

Form a steering committee comprised of senior leaders within the business units as well as from the major functional areas (e.g., IT, legal, HR). The Committee should include an appropriate mix of executive sponsors (to help evangelize the effort) and high-potential mid-level managers (to ensure successful execution). Without ownership from the key organizational leaders, the effectiveness of any plan will be severely constrained. The company CEO should serve as executive sponsor of the Committee.

Management should also designate one project champion (Committee Chairman) to lead the initiative, reporting to the CEO. Frequently this individual is someone who reports directly to the CEO, such as Chief Financial Officer, Chief Operating Officer, or President of a major division. Assigning the role to a senior-level leader underscores the importance of the initiative.

2. Understand and Benchmark Cost Base

Understanding the company's foundation is a prerequisite first-step to any strategic planning effort. Hence, before the Committee can identify specific opportunities

Goals Must Be Clear and Well-Communicated:

Management needs to ensure that the organization understands the objectives and value they bring.

Starting Point:

Managers should first look at discretionary and non-essential spending, followed by areas of the business that are highly complex and have potential for redundancy

for cost reduction, it must understand the current state of the company's cost base and structure. Detailed data on current costs must be collected and evaluated, which will also help to understand previous decisions that led to the current cost structure. The team should then benchmark the company's cost structure against internal measures (e.g., compare spend percentages among all the divisions, track spend for each division over an elapsed time period) as well as against major competitors or industry averages. The key is to understand cost trends and whether the company spends more (as a percentage) than the industry and competitors. This analysis will help in setting appropriate and realistic targets for savings.

3. Determine High Level Goals

Once management has a sense for the existing cost base, goals and objectives can start to be formed. There should be a clear, measurable and realistic goal accompanying any cost reduction endeavor. GSP recommends setting an aggregate, aggressive stretch goal for cost reduction that can be easily communicated to company leadership so that the organization understands the goal and the attention the effort will require. Whether this goal is reflected in dollar savings, additional percentage points of profitability or other measurements of efficiency, the value should allow the company to achieve a best-in-class cost position several years out.

4. Convene a Cost Strategy Meeting - Put a "Stake in the Ground" with the Leadership Team

At this session – led by the Committee Chairman and attended by the CEO – the Steering Committee must assign high-level cost reduction targets for the divisions and business functions, based on analysis completed in the benchmarking phase. In essence, the goal of this meeting is to agree on where in the P&L and in which functional areas the savings will come from. There may be discomfort in this meeting, as executives and business leaders will be expected to take responsibility for reductions without knowing yet how these targets can be achieved. Through benchmarking and an understanding of the compressibility and different elements of cost structure, the team needs to arrive at allocations and assignments at the agreed upon time horizon.

5. Identifying Cost Reduction Opportunities

After the "Stake in the Ground" meeting, division and functional heads must convene with their respective teams to plan how they will achieve their cost reduction assignments. Trimming non-essential and discretionary spending and focusing on reducing complexity and redundancy throughout the organization will generate a strong list of potential initiatives. The following functional areas at the corporate and divisional levels should be analyzed for savings opportunities:

- **Discretionary spending.** This is the most appropriate area to begin identifying cost savings opportunities,

including Travel & Entertainment and applicable SG&A Expenses. Many companies implement a freeze on travel or entertainment, or a policy that requires manager approval. Of course, the business must be careful not to debilitate its ability to generate revenue. Activities focusing on highest potential clients as well as the most profitable current clients should be maintained or strengthened while similar expenses for smaller and less profitable ones should be reduced.

- **Human Resources.** Areas to review include compensation structure, benefits and administrative support. Non-essential training and continuing education should also be considered as these activities represent discretionary spending.
- **Marketing.** Though this function is important to growing the top-line, there are certainly opportunities to reduce costs. Tactics such as consolidating vendors (e.g., web-design or PR firm), reducing direct mail to only include top prospects (not the entire universe) and reducing expenses on promotional events are potential areas for cost reduction. To ensure that marketing dollars are being spent wisely, the marketing department should also implement a process for measuring and tracking return on marketing investment (ROMI) if not already doing so.
- **Real Estate.** Occupancy costs are significant for any manufacturing company and should be reviewed accordingly. Relocating (to a lower rent location) and renegotiating leases are two specific tactics to consider. Companies should also explore opportunities to secure business incentives from local government, such as tax incentives or deferrals.
- **Information Technology.** Businesses should identify redundant systems and opportunities to outsource IT support as well as to centralize systems (particularly if the company has made any acquisitions that retained legacy systems). However, management must be careful when considering savings in the IT category – sometimes new system implementations meant to save money end up costing more than expected.
- **Procurement:** Particularly important for manufacturing businesses, management should look for places to improve the supply chain efficiency, including simplifying the ordering process, negotiating more favorable prices and reducing complexity within the organization. Maintaining a lean inventory can also help drive down costs.
- **Other Back-Office.** Functions such as legal, finance/accounting, customer order processing, and customer service should be reviewed for redundancies, areas to consolidate vendors and opportunities to centralize activities. Also, how can the processes around these functions be improved?
- **Other Corporate.** Executive expenditures should be evaluated to measure cost savings against ability for

Simplification Approach Should Consider the Long-Haul:

Sometimes investments to reduce cost can ballon and cost more than expected, particularly in areas such as IT the executive to execute the company's strategy. The objective is to identify non-essential expenses that can be reduced or eliminated. Examples would include, but are not limited to: corporate airplanes, corporate apartments, club memberships and car services.

Outsourcing should also be considered for many of the functional areas listed above, but must be employed as part of a specific strategy and not relied upon as "the answer" to all cost issues. Therefore, once a business function or division has identified the most efficient process for operating, it should then consider how specific workflows (supported by internal resources) can be swapped out for cheaper, outsourced alternatives.

Manufacturing companies should take cost into account during the design phase. Standardized parts, which are cheaper and easier to obtain, should be used whenever possible. However, doing so during the design phase is essential, as failing to use them can cause complexity and further costs to implementation down the road. By focusing on the production process, a company can reduce costly errors, increase the productivity of workers, and further reduce inventory. Simplifying product lines by discontinuing less profitable lines can also lead to significant savings.

6. Separate Quick Hits from Long-term Initiatives

After developing a comprehensive list of potential cost cutting moves, the next step is to divide the list into two categories: quick hits and long-term initiatives. "Quick hits," the low-hanging fruit which can be easily, cheaply, and rapidly implemented, tend to be more short-term focused in nature. Long-term initiatives generally require an investment (in dollars and/or staff hours) and will take time until sustained benefits are realized. Any sound strategic plan aimed at cost cutting should include a mix of both.

7. Prioritize Initiatives

Prioritizing initiatives will enable a company to fully develop the best strategic course of action. Keeping in mind that there should be a balance of quick hits vs. long-term initiatives, each opportunity must be carefully analyzed to determine the overall expected impact. All risks must be considered while weighing any potential adverse effects from phasing out, cutting, or reducing specific expenditures. Management must ensure that the company will not reduce its ability to remain competitive. The key objective throughout this process is to not compromise areas of expense which are critical to executing the company's overall strategy.

8. Develop and Launch Implementation Plan

Once the cost cutting opportunities have been identified and prioritized, an effective implementation plan must be created. This action plan should contain a clear timeline, milestones to be achieved and task ownership. The plan will consist of goals

broken out by major milestones that will be achieved on a challenging yet achievable timeline.

9. Tracking Progress

As the implementation plan is being executed, there should be regular meetings to monitor progress. Developing a scorecard approach across functions and divisions enables the CEO, the project champion, and the executive steering committee to actively supervise and track the development of the overall plan. This visibility into execution of the plan helps to prevent major road blocks. In addition, the regularly scheduled meetings and scorecard approach ensure accountability and ownership of tasks. Throughout the process, the company should celebrate successes while learning from failures.

Management Must Consider Impact on Growth Potential:

Cost trimming should not inhibit the company's ability to grow and fulfill its core strategy

Key Success Factors

Similar to any corporate initiative, a successful cost-reduction program relies on important assumptions that are critical to implementation and achieving management's objectives, including the following:

- Alignment with corporate strategy. The initiative must not inhibit the organization's core growth strategy. It should, however, support a more efficient implementation of that strategy and contribute to greater efficiency and simplification from the sales office to production to customer service.
- Leadership "buy in." The program gains legitimacy and sends the appropriate signals to employees responsible for implementing the plan when leadership "buy in" is present.
- Accountability and commitment. The only way to ensure that team members' interests are aligned with those of management is to hold players accountable while maintaining their and management's commitment to the initiative.
- Strong communication plan. Keeping the organization informed is the best method for avoiding adverse reactions among the employee base. Employees will be more effective if they feel that the changes are part of a long-term strategic initiative to increase overall competitiveness in the marketplace, and not part of a desperate effort to keep the company afloat.
- Keep your eye on the goal. Remember to manage overall costs, not just specific targets.

By having strong leadership, a strategic plan with clear goals, and an executable implementation and tracking plan, a company can keep itself well insulated from downturns and cyclicality in its business. Finding a good target mix of cost reductions can create a superior cost structure that will provide competitive advantages in any economic environment, allowing it to serve its clients most effectively.

Gillum Strategy Partners (GSP) is a boutique strategic consulting firm based in Chicago, providing services to top tier clients in a broad base of industries, including technology, manufacturing and services. GSP's areas of expertise include go-to-market strategies, marketing effectiveness, channel and alliance management, growth strategies, sales productivity and operational improvement. We emphasize pragmatic solutions with measurable results and often work with our clients through implementation.

Address:

455 North Cityfront Plaza Drive
Suite 3100
Chicago, Illinois 60611

Contact:

Brad Gillum
Managing Partner
312.961.1441
brad.gillum@gillumstrategy.com