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In fighting shape?

2008 survey of cost-improvement
trends in the Fortune 500



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Executive Summary

Cost improvement has become a standard operating practice for many companies. According to our study of 70 Fortune 500 companies, more than two-thirds have maintained an ongoing focus on cost improvement—even during the recent economic boom. This is good news, particularly because conventional wisdom we've heard suggests that businesses only pay attention to cost reduction when times are tough. The bad news is the approach these large companies are taking to cost improvement may not be sufficient to see them through the uncertain times ahead.

The survey results show that 64% of the companies are primarily reducing costs through incremental strategies such as improving processes, cutting travel and training budgets, deferring expenses, negotiating lower prices with vendors, and reducing headcount. Such efforts are expected to deliver only marginal cost savings. Although this level of improvement might have been adequate when times were good, it may not be sufficient to carry companies through a prolonged economic slump.

In a downturn, we believe that many companies will need to take advantage of all the cost levers at their disposal. That means adopting a transformational approach to cost reduction that focuses greater attention on strategic, structural improvements such as streamlining the company's infrastructure, creating a scalable cost structure, and redesigning the business model. These types of improvements can position a company to achieve double-digit cost savings that are both larger and more sustainable than incremental reductions.

This report examines the latest trends in cost improvement, and offers practical and time-tested insights to help companies as they choose an approach for the future.



About the Study

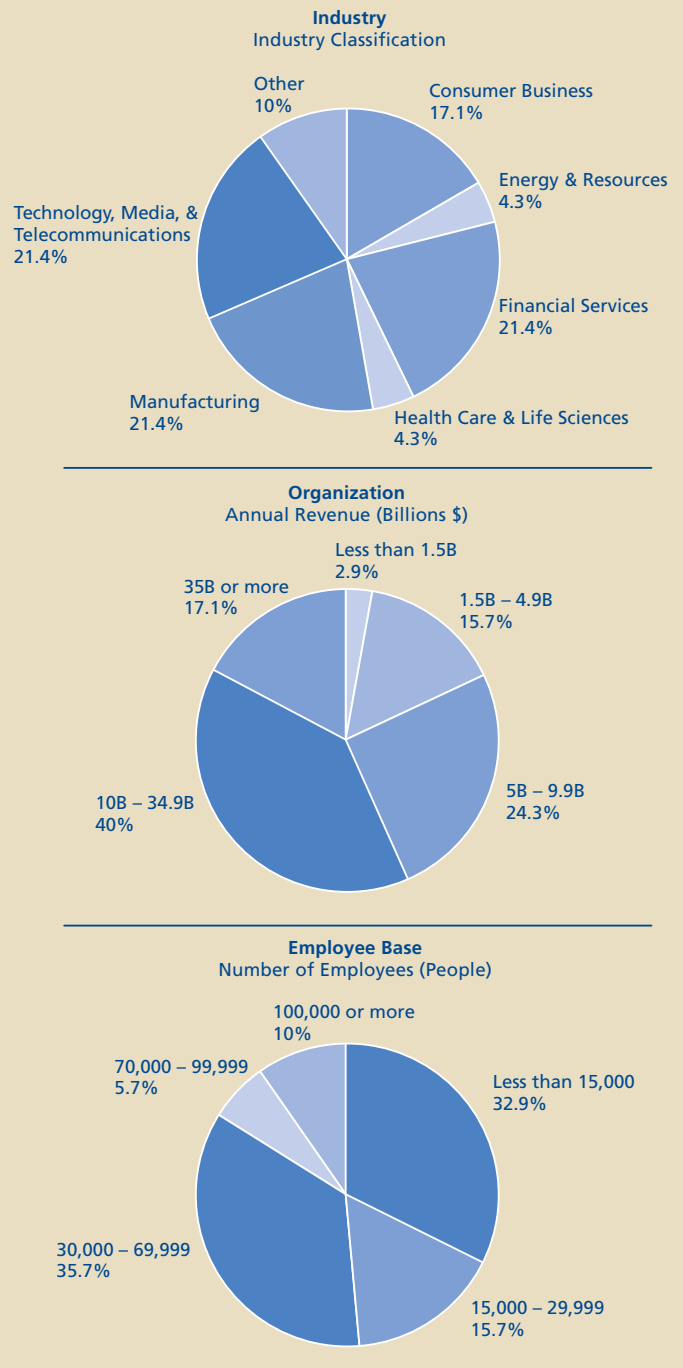
In conjunction with The Marketing Audit, Deloitte Consulting LLP (Deloitte Consulting) conducted in-depth interviews with executives from 70 Fortune 500 companies from October through December 2007. The goal was to understand cost-improvement approaches, effective practices, pitfalls, and lessons learned that companies of every shape and size could apply to their own unique situation. Participants were asked about their most recent cost-improvement effort, as well their past initiatives and future plans. The interviews were supplemented with Deloitte Consulting's analysis and experience helping clients in their efforts to design and execute sustainable cost-improvement programs.

Participating companies varied significantly in terms of industry, revenue, and number of employees.

Fast Facts

- The C-Suite is actively championing cost improvement but typically delegates the task of implementation to lower levels in the organization. More than 70% of companies report that a C-level officer sponsored their most recent cost-improvement initiative; however, only 25% report that a C-level officer was responsible for implementing the initiative.
- Transformational cost improvement is more likely to exceed expectations, even though expectations are higher. Thirty-six percent of transformational initiatives surpassed their targets; only 20% of incremental initiatives surpassed their targets.
- Companies are pursuing cost improvement primarily as a response to external competitive pressure—an unfavorable cost position compared to peers, or a desire to reinvest. These external pressures rank higher than internal pressures, which include “decline in profitability” and “mergers and acquisitions.”
- Services companies have more cost-improvement initiatives currently underway than other industries (87% for services companies vs. 62% for all others). They also have more aggressive goals—more than one in four expects to achieve 15 to 20% savings.
- Nearly three in five respondents indicate that lack of stakeholder alignment was a barrier to achieving desired results.
- Many companies say they severely underestimated the effort needed to communicate and manage cultural issues.

Figure 1. Sample selection



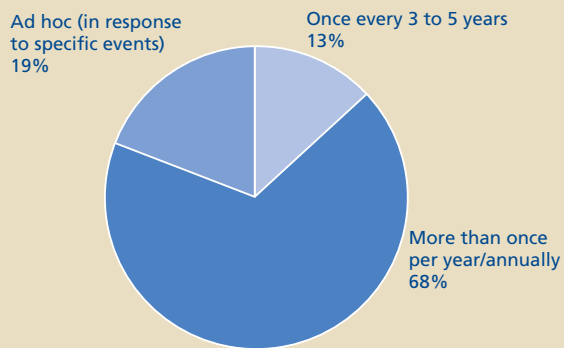
Current Trends

The survey data provides an indication of how today's companies are approaching cost improvement. In general, companies are highly focused on cost improvement initiatives—not as a fad, but as a discipline. Yet most are looking for immediate savings to keep pace with their competitors and satisfy rising shareholder expectations.

Frequent and Ongoing

The majority of respondents are pursuing cost improvement on a frequent and ongoing basis. Two out of three companies are attempting to take cost out of the business at least once a year.

Figure 2. Frequency of undertaking cost-improvement initiatives

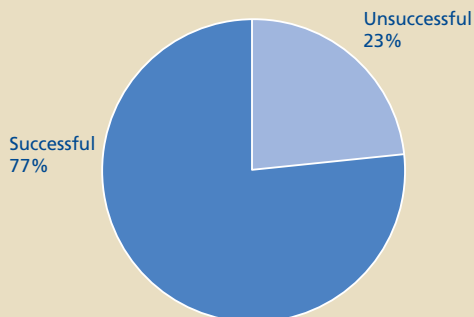


Cost improvement is most prevalent in financial services. Nearly 90% of respondents in the financial services industry currently have ongoing cost-reduction initiatives, compared to 60% in other industries.

Respondents Report Positive Results

Companies are paying a lot of attention to cost improvement—and most consider their initiatives effective.

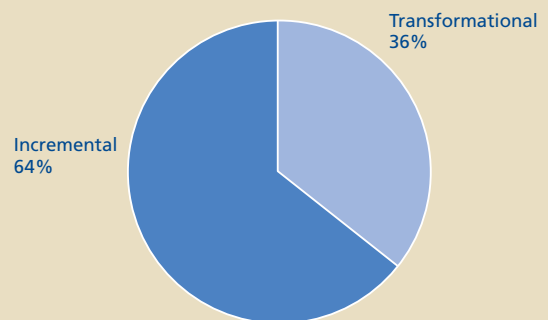
Figure 3. Success rate of cost-improvement initiatives



Approaches Vary

Different companies are approaching cost improvement in fundamentally different ways. The majority are looking to reduce costs by less than 10% through small, “incremental” improvement to individual processes or other areas of focus. In contrast, roughly a third of the surveyed companies hope to achieve double-digit cost reductions through strategic, “transformational” improvements to their cost structure.

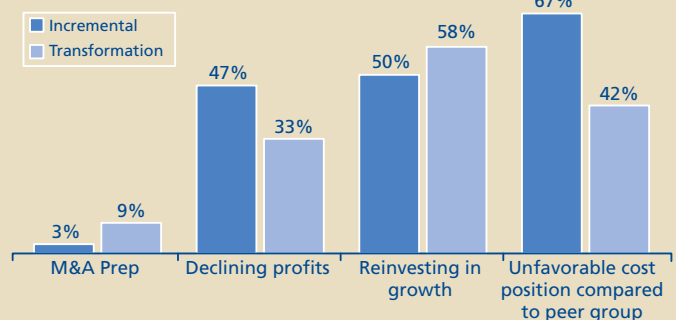
Figure 4. Currently ongoing cost-improvement initiatives



Drivers Vary

Incremental initiatives are typically a reaction to problems such as an unfavorable cost position (67%). Transformational initiatives tend to be more proactive and strategic, with 58% primarily driven by a desire to reinvest in growth.

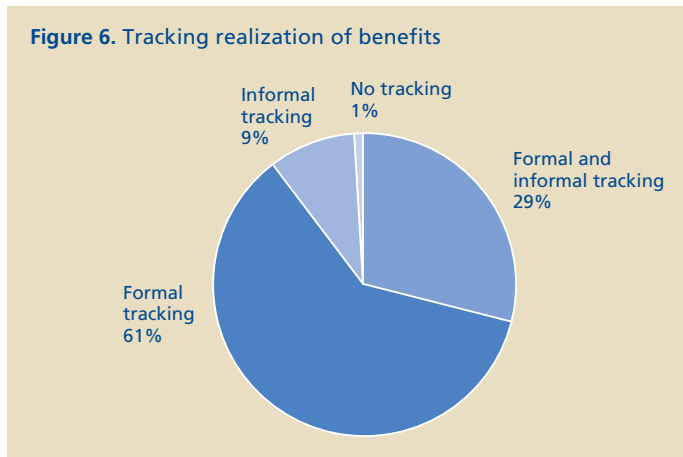
Figure 5. Why did your company undertake a cost-improvement initiative? (%)



Primary drivers also vary by company size and industry. According to the survey, the majority of small companies (revenue less than \$1.5 Billion) are reducing costs in order to close the competitive gap. On the other hand, three-fourths of large companies (revenue greater than \$35 Billion) are launching cost-reduction programs so they increase their investments in growth. Eighty percent of manufacturing companies are undertaking a cost-improvement initiative because of an unfavorable cost position—a much higher percentage than in other industries.

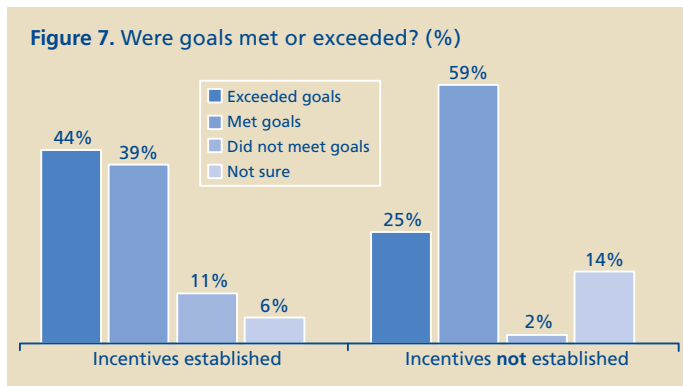
Tracking the Benefits

Companies are serious about tracking their cost savings. More than 98% track realization of benefits, with 90% establishing formal tracking mechanisms. This is good news. Cost-improvement initiatives without formal tracking are more likely to veer off course.



Providing Incentives

Companies with formal incentives for achieving cost improvement are more likely to exceed their savings targets. According to the survey, only 26% of companies established formal incentive structures for their cost-reduction initiatives. Yet among those companies, 44% exceeded their reduction goals, compared to only 25% for companies without formal incentives.

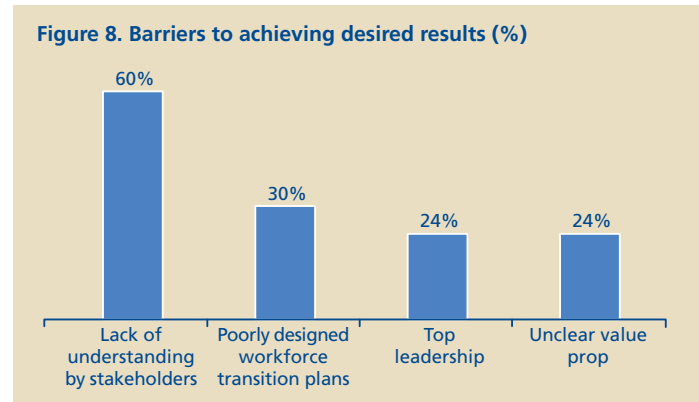


Learning From the Past

Cost reduction is simple in concept, but making it happen is not easy. The survey results provided a number of practical insights to help companies improve their chances for achieving financial goals.

Align Stakeholders from the Top Down

In the survey, 60% of respondents cited lack of stakeholder understanding as a barrier to achieving the desired cost savings. Lack of alignment and support from top leadership was also a significant barrier. As one respondent commented, “Our business is so competitive—everything has to be done yesterday. Yet we probably should have taken more time to explain the rationale to our stakeholders so we could have them on board with the initiative.”



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Communicate and Manage the Culture

Effective cost reduction requires a change in corporate culture and employee behavior. Unfortunately, the survey shows that many companies overlook this requirement. Half of the survey respondents reported that they underestimated the effort needed to address cultural issues. In addition, 29% underestimated the effort to communicate—an activity that is critical to winning stakeholder support and changing employee behavior.



Looking to the Future

In the face of a downturn, companies should revisit their approach to cost improvement. Will incremental savings be sufficient, or will fundamental transformation of the cost structure be required?

Although 78% of the companies in the survey regard cost improvement as a high priority, most continue to emphasize an incremental approach. In fact, 86 percent said the cost lever they will focus on going forward is “process excellence.” But will this be enough?

If structural improvements have already been implemented, incremental changes may be the right choice. But in situations where higher-order cost management capabilities are needed, a company might have to adopt a more fundamental and comprehensive approach—one that involves making structural changes to the company's foundation in terms of liquidity, working capital, income statement, and balance sheet.

Figure 9. Areas where effort was underestimated (%)

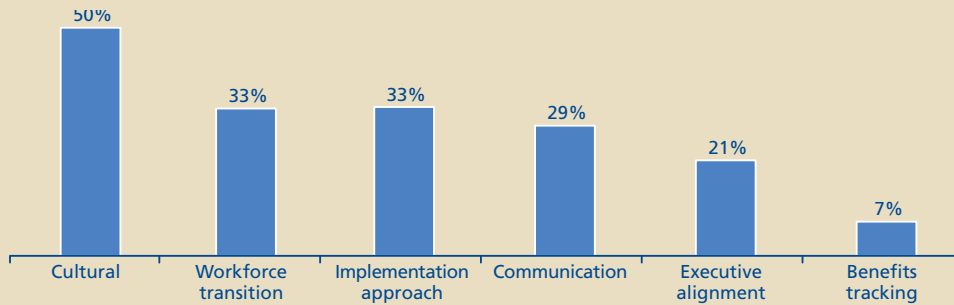
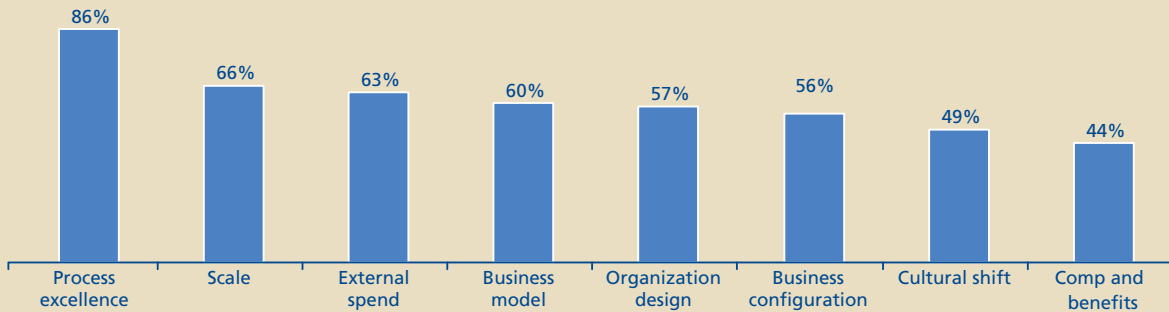


Figure 10. Cost levers for initiatives (%)



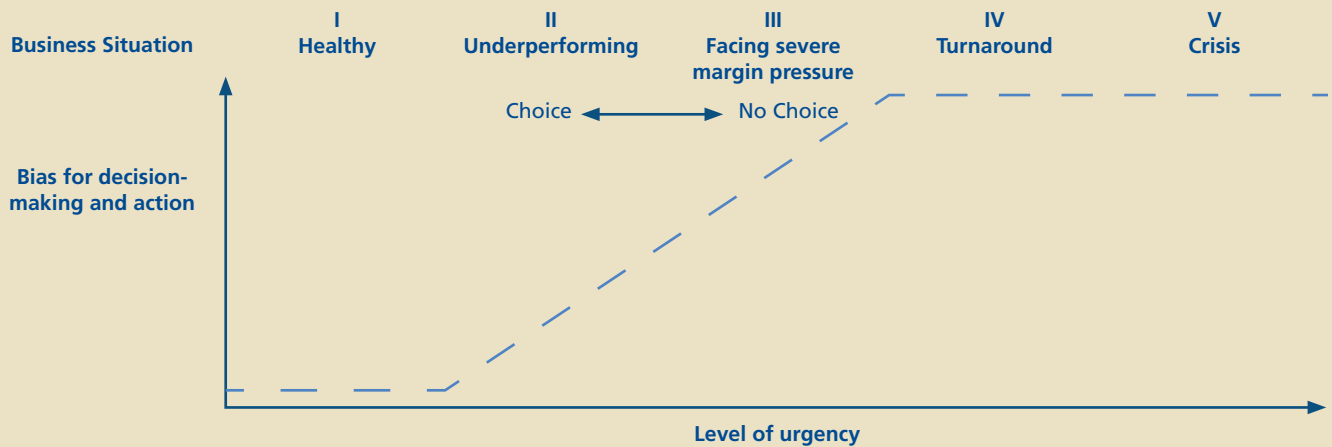
A Comprehensive Approach to Cost Reduction

A comprehensive approach to cost management is valuable no matter what the overall economy is doing; however, it is particularly important when times are tough. In a downturn, companies generally need cost savings that are both larger and more sustainable than those which typically result from an incremental approach to cost-cutting. That said, the right strategy varies from company to company. Businesses in a turnaround or crisis situation often have no choice but to immediately reduce their costs using every available cost lever. On the other hand, healthy companies may have the luxury to pick and choose their opportunities, using the downturn to gain a long-term strategic advantage over the competition (Figure 11).

Although every company has different cost reduction needs, here are five practical, time-tested, and cost-cutting tips that likely apply to most companies during a downturn.

- 1. Start with the obvious.** For many companies, the most immediate cost savings will come from streamlining the General and Administrative (G&A) functions and aggressively tackling external spend (the materials and services a company buys). Improvements in these areas can deliver substantial savings with little or no downside. Also, since these functions don't have a direct impact on customers or day-to-day operations, it is easier to make changes without disrupting the business or putting customer relationships at risk.

Figure 11. A full range of cost reduction scenarios



Bias for Decision-making/Action	Low "Too risky"	Some "We must be bold"	High	Very High "Act now"	Infinite "Just do it"
Primary Cost Levers	<ul style="list-style-type: none"> Revenue enhancement Process-focused continuous improvement 	<ul style="list-style-type: none"> SG&A Indirect spend 	<ul style="list-style-type: none"> SG&A functions Indirect spend Direct spend COGS functions 	<ul style="list-style-type: none"> SG&A functions Indirect spend Direct spend COGS functions Infrastructure Balance sheet 	<ul style="list-style-type: none"> SG&A functions Indirect spend Direct spend COGS functions Infrastructure Balance sheet Cash flow Financial restructuring
Time to Value	<ul style="list-style-type: none"> Long-term 	<ul style="list-style-type: none"> Medium- to long-term 	<ul style="list-style-type: none"> Short- to medium-term 	<ul style="list-style-type: none"> Short- to medium-term 	<ul style="list-style-type: none"> Short-term

2. Take an enterprise view. During a downturn, companies must find cost reduction opportunities that cut across organizational silos. An enterprise-wide analysis of actionable spend (i.e., costs that are within the company's control over the next 12 months) can help uncover new opportunities. This enterprise view can be quite an eye-opener, since most managers and executives only have visibility to a narrow set of costs related to their day-to-day responsibilities. Seeing everything rolled up together can help a company put its existing cost-reduction initiatives into perspective, and help decision-makers understand the broader opportunity. It can also provide guidance and input on where the company should focus its efforts (Figure 12).

3. Protect strategic investments. An "enterprise view" should not be confused with across-the-board cost-cutting. In their zeal to reduce costs, many companies make the mistake of slashing investment in areas that are critical to the long-term strategy of the business—such as R&D, marketing, and advertising. Deep cuts in these types of areas can hinder a company's ability to capitalize on the recovery and should be avoided if possible. Instead, companies should strive to make thoughtful spend decisions in these areas while seeking higher returns on these critical investments.

4. Balance short- and long-term improvements. In a downturn, companies are often in such a hurry to cut costs that they end up overlooking some of their biggest improvement opportunities. A tiered approach provides a better mix of short-term savings and long-term structural improvement. Tier 1 typically includes incremental, short-term opportunities such as decreasing discretionary spending, and improving span of control. Tier 2 consists of medium-term opportunities such as process improvement, shared services, outsourcing of ancillary processes, and strategic sourcing. Tier 3 generally comprises long-term

opportunities such as reengineering or outsourcing of core business processes, changing the company's business model, restructuring the global supply chain, and large scale technology investments. With proper planning, Tier 1 savings can provide some or all of the funding for the more significant structural improvements in Tier 2 and Tier 3. Also, in a turnaround or crisis situation it is often possible to accelerate Tier 2 and Tier 3 activities because people feel a greater sense of urgency and understand the need for rapid change (Figure 13).

Figure 13. A tiered approach to cost reduction

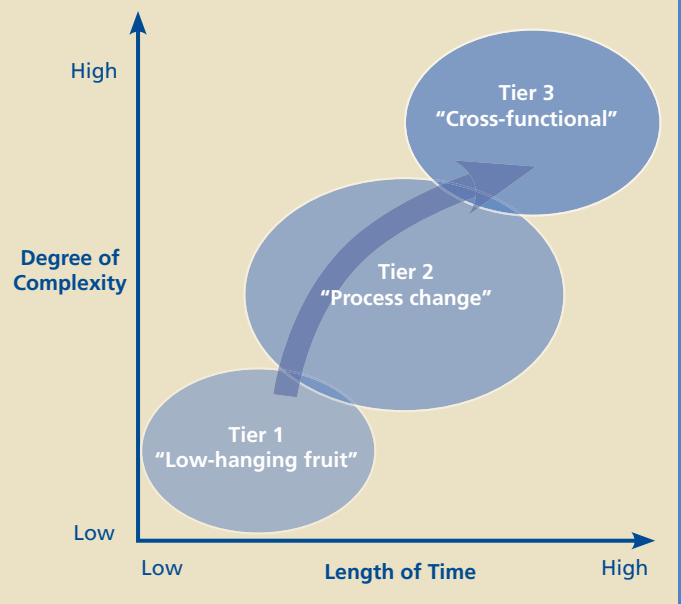
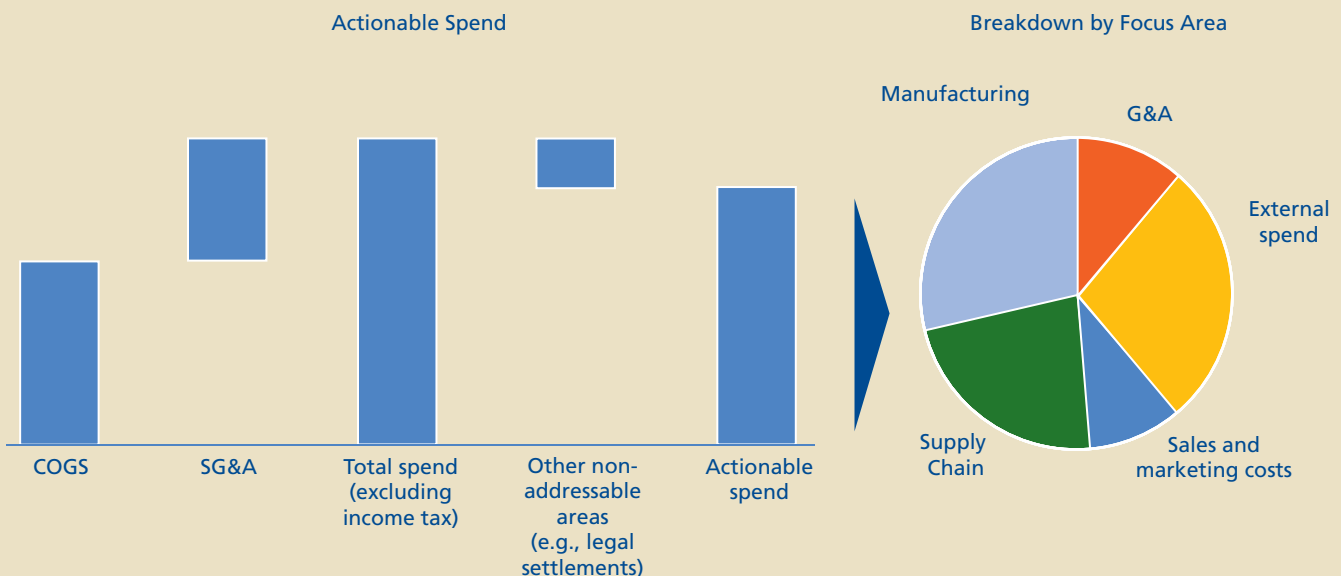


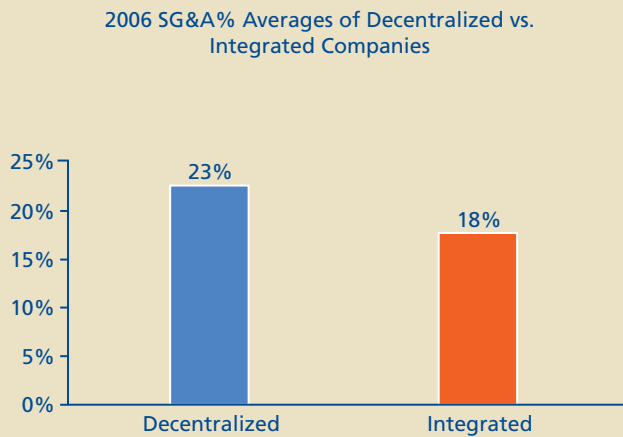
Figure 12. Enterprise cost analysis (sample)



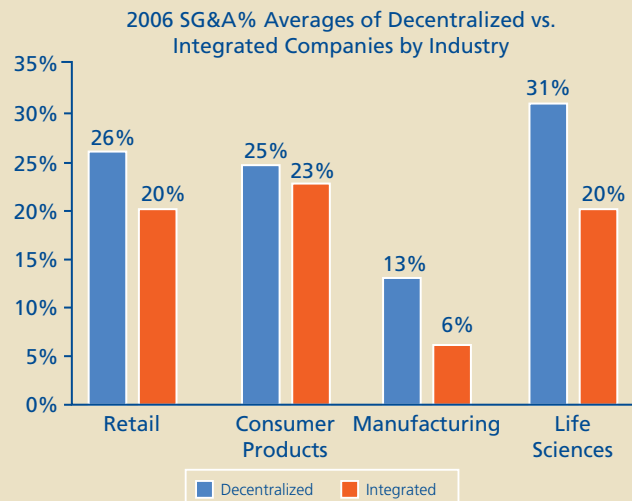
5. Choose the right business model. In some cases, the only way for a company to achieve the necessary costs savings is to move toward a more centralized, integrated business model, rather than allowing individual businesses to operate independently. According to our research, companies with integrated business models have significantly lower SG&A costs due to increased

standardization and economies of scale. Of course, an integrated business model is not right for every company. Increased integration often makes sense for mature and low-growth companies; however, fast-growth companies may feel it is more important to give their business units autonomy in order to promote innovation and market responsiveness (Figure 14).

Figure 14. SG&A costs for integrated and decentralized companies



Source: Deloitte. Data for 75 Fortune 500 Retail, Consumer Packaged Goods, Manufacturing, and Life Sciences companies



Source: Deloitte. Data for Fortune 500 comprised of 19 Retail, 20 Consumer Packaged Goods, 21 Manufacturing, and 15 Life Sciences companies.

Moving Ahead

Cost improvement is both a science and an art. On the one hand, it is critical to identify and pursue tangible cost savings. On the other hand, less tangible factors such as stakeholder buy-in, culture management, and timely communication are often just as important to achieving the desired outcome.

The good news is that, according to the survey results, most companies have adopted cost management as an ongoing discipline. The bad news is that their current approach to cost improvement may not be sufficient to address the challenges ahead. Over the past decade, studies have shown that shortsighted remedies such as major layoffs and across-the-board cost reductions do not produce sustainable results. To prosper in a downturn, companies need an efficient and flexible cost structure. Now is the time for companies to rethink their approach to cost improvement.



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