Deloitte.

Thriving in Uncertainty

Deloitte's first biennial cost survey: Cost improvement practices and trends in Europe

UK version

Contents

Executive summary

Macroeconomic factors may be having a major impact on cost improvement priorities and actions throughout Europe. To learn what European companies are doing to manage costs, Deloitte recently surveyed 349 CXOs, executives, and senior management from large and mid-size companies in nine European markets – the UK, France, Germany, Spain, Italy, Belgium, the Netherlands, Poland, and the Nordics – which together comprise 88% of the European Union (EU) economy based on gross domestic product (GDP).[1] We also analysed key macroeconomic factors in order to establish a broader context for the survey results.

This study is part of a global survey effort that includes Deloitte's fourth biennial cost survey in the United States (published in April 2016),[2] as well as our first biennial cost survey in Latin America (published in June 2016).[3]

1. *EIU data*
2. *"Cost management and improvement trends in the Fortune 1000, Thriving in uncertainty: Deloitte's fourth biennial cost survey," Deloitte, April 2016*
3. *"Thriving in Uncertainty, Deloitte's first biennial cost survey: cost improvement practices and trends in Latin America," Deloitte, June 2016*
4. *EIU data*
5. *exchangerates.org.uk*

Macroeconomic trends

- Over the two-year period ending March 2016, overall growth across the region has been low (average of 1.6% annual growth for major markets), with the lowest growth rates in France (1.0%) and Italy (0.3%). Unemployment rates are high, particularly in Spain (21%), Italy (12%), and France (10%).[4]
- During that same two-year period, the pound and euro have weakened substantially against the dollar, with the pound declining 15% and the euro declining 20%. Immediately following the Brexit vote, the euro remained stable but the pound fell an additional 10%.[5]

Key findings from the study

- Despite challenging economic conditions, most respondents (67%) reported positive revenue growth over the past 24 months, and even more (76%) expect growth to continue over the next 24 months.
- The top three strategic priorities are sales growth (30%), product profitability (28%), and cost reduction (28%), which add up to a cost management strategy that we call "save to grow": using cost savings to fund growth activities.
- Balance sheet management – which is typically associated with times of distress – emerged as a top strategic priority this year. This defensive posture – combined with concerns about macroeconomics, exchange rate volatility, and political factors such as Brexit – suggests an environment of caution and uncertainty not seen since the financial crisis.
- Brexit is a major concern for UK companies, with 36% of UK respondents citing it as a top external risk versus 0% – 10% for respondents from other European markets.
- Despite Europe's relatively low cost targets (52% of respondents cite targets of less than 10%), cost programme failure rates are high, with 57% of respondents indicating their cost programmes failed to meet targets. Implementation challenges are viewed as the main barriers to effective cost management, with four of the top five barriers directly related to implementation. These include not only the general issue of "challenges in implementing initiatives" (48%), but also more specific implementation-related

issues: erosion of savings (20%), weak business case (23%), and poor design and tracking (17%).

- European companies tend to rely more on tactical approaches to cost reduction, rather than strategic ones. The most frequently cited cost management approach is "streamlining business processes" (38%), which is a tactical approach. The least frequently cited approach is outsourcing/off-shoring (26%), which is a more strategic approach. Greater reliance on tactical cost actions, rather than strategic ones, could be a key factor contributing to Europe's low cost targets and high cost programme failure rates.
- Only 7% of respondents currently use zero-based budgeting (ZBB), and only 8% plan to do so in the future, suggesting that ZBB is not a mainstream cost reduction approach and adoption might be topping out.

Regional comparison highlights

- Respondents from all three regions – US, Latin America, and Europe – view "macroeconomic concerns/recession" as the top external risk.
- In the EU, government regulation and taxes are a much greater concern (16%) than in Latin America (9%) and the US (12%). This is especially true for UK respondents, which makes the Brexit decision less surprising.
- In Latin America, respondents are much more concerned than companies in other regions about global exchange rate fluctuations (38% versus overall EU average of 11%) and commodity price fluctuations (31% versus overall EU average of 18%).
- In the US, concern about digital disruption is far higher (19%) than in the EU (6%) and Latin America (1%) – and the issue is quickly rising to the top of the strategic agenda. Other regions may soon face a similar impact from digital disruption.
- Although growth expectations remain positive globally, European companies – especially those from the UK – are the least optimistic. According to our survey, 76% of European respondents expect positive revenue growth over the next 24 months, versus 85% in the US and 87% in Latin America.
- Whilst the vast majority of companies in all three regions expect to pursue cost reduction over the next 24 months (92%), European companies are somewhat less likely to do so (83%).
- Although European respondents cite less aggressive cost targets, failure rates are high across all three regions: Latin America (67%), US (58%), and Europe (57%).
- European companies cite lower utilisation rates for all five typical cost management approaches in the survey, which implies they are less likely to use structured cost programmes. This is consistent with the fact that their cost targets are less aggressive.

Choosing the right cost management approach

- To improve their cost management performance and achieve more aggressive targets, many companies may need to adopt a more strategic and transformational approach to cost reduction. Companies that stick to tactical cost actions and the status quo will likely continue to face implementation problems and high cost programme failure rates.
- Businesses in pursuit of strategic cost improvements have traditionally fallen into one of three categories: (1) distressed, (2) positioned for growth, or (3) growing steadily. However, today's volatile and complex global business environment seems to be giving rise to a fourth category that we call "thriving in uncertainty" – a scenario that straddles the line between "distressed" and "positioned for growth" and involves organisations simultaneously pursuing the seemingly conflicting goals of growth, cost improvement, and balance sheet management.
- It remains to be seen whether this fourth category is a new and permanent feature of the business landscape, or simply a stepping-stone to one of the traditional categories.
- For the UK, France and Italy, macroeconomic factors seem to be pushing them towards greater uncertainty, requiring a playbook with value creation levers that may need to be more defensive in nature. The other European markets surveyed seem to be moving towards a more positive outlook, possibly requiring a different playbook with value creation levers that may need to be more focused on growth.

About the survey

Figure 1. Firmographics summary for all European respondents (349)

Notes:

Due to small sample sizes collected in the Netherlands (15), Belgium (15), the Nordics (Norway (7), Denmark (5), and Poland (7), non-statistically significant results have been flagged (◇) in charts when appropriate – this symbol indicates that data may represent outliers or simply non-statistically significant results due to small sample sizes.

The red bar in the bar charts represents the weighted average response rate from all survey participants in all markets (349 total respondents).

Polish data is not presented as a unique data series in charts due to small sample size (7); however, this data sub-set is part of the "weighted average" series.

In May and July of 2016, Deloitte Consulting LLP conducted its first biennial survey of current and future cost reduction initiatives at large and mid-size companies in the UK, France, Germany, Spain, Italy, Belgium, the Netherlands, Poland, Norway, and Denmark – Ten markets that comprise 88% of the European economy based on gross domestic product (GDP). We have been conducting similar studies of large companies in the US since 2007, and this year decided to expand the studies to include both Europe and Latin America in order to gain a more global perspective supported by detailed regional insights.

The survey included 349 responses, 90 of which were gathered after the UK voted to leave the European Union (EU). This enabled us to test the initial data set and ensure the outlooks and behaviours amongst cost management executives were consistent before and after the Brexit decision. The data collected post-Brexit proved to be consistent with the data collected pre-Brexit, which is what we expected given that questions about the future focused on a 24-month time horizon that included the possibility UK voters would elect to leave the EU.

Key objectives

- Understand factors, approaches, actions, and targets related to cost initiatives
- Assess the effectiveness of cost initiatives, including lessons learned from previous efforts
- Understand the drivers and scope of future cost initiatives

Qualification criteria

- C-suite level executive (CEO, CFO, COO, CIO, Board of Directors, etc.), executive management level (Division/Business Unit/Regional President, Controller, Treasurer, or other company officers), or senior management level (SVP/VP of a Business Group, or SVP/VP of an enabling function such as Finance, HR, or IT)
- Annual company revenue of at least €150 million (€100 million for companies based in Belgium and the Netherlands)
- Personal involvement in manageing cost reduction initiatives within the company

Eighty-six percent of respondents are from the five largest economies in Europe (Germany, the UK, France, Italy, and Spain), which comprise 72% of the European Union by GDP. The nine markets included in the survey comprise 88% of the European Union by GDP. (Figure 1A)

Most respondents are from the consumer & industrial products industry (32%) or financial services (21%); 13% are from technology, media, and telecommunications; 13% are from energy and resources; 7% are from the public sector, and 4% are from life sciences & health care. (Figure 1B)

Fifty-eight percent of respondents' revenues are generated within the EU, indicating that the surveyed organisations are heavily dependent on trading within the EU. Fifty-one percent of the UK's revenue comes from the EU, making Brexit highly relevant to our survey and findings. Also, the UK is the top European trading partner for the US and North America. Spain derives much more revenue from Latin America (17%) than do other European countries. (Figure 1C)

Forty percent of respondents are from companies earning €1 billion in annual revenue or more; 60% of respondents are from companies earning €500 million in annual revenue or more; only 40% of respondents are from companies earning less than €500 million in annual revenue. (Figure 1D)

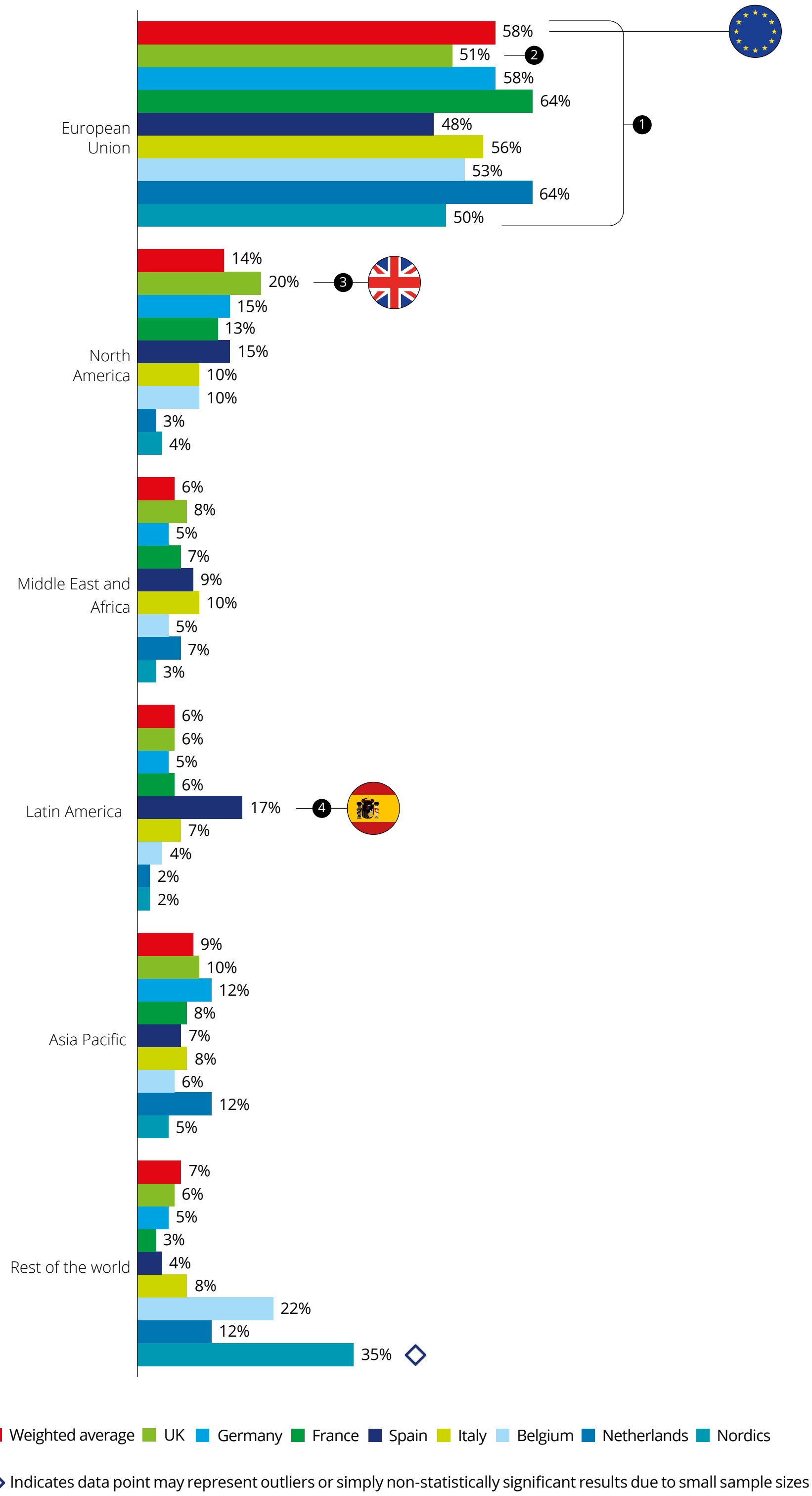
The distribution of responses across management levels is relatively even, with 61% of respondents at the CXO or executive management levels. (Figure 1E)

Sixty-four percent of respondents are from organisations with less than 15,000 employees; 36% of respondents are from organisations with 15,000 employees or more. (Figure 1F)

Demographic comparisons

1. 58% of respondents' revenues are generated within the EU, inferring respondents' organisations are heavily dependent on trading within the EU
2. The UK trades heavily with the EU (51% of revenues), making Brexit particularly relevant to our survey respondents across continental Europe
3. The UK trades more frequently with the USA / North America (20%) relative to other European economies (14%)
4. Spain trades much more frequently with Latin America (17%) relative to other European economies (6%)

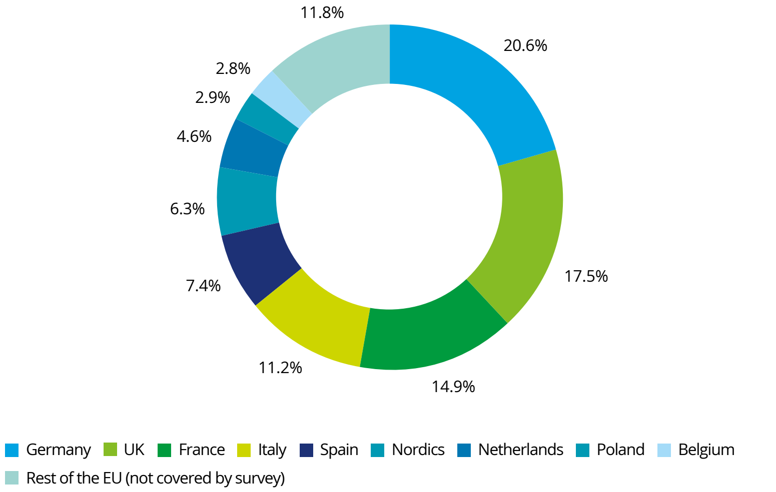
Figure 2. Respondents' revenue footprint



Macroeconomic trends

The nine markets covered in our survey comprise 88% of the EU economy as measured by GDP. (Figure 3)

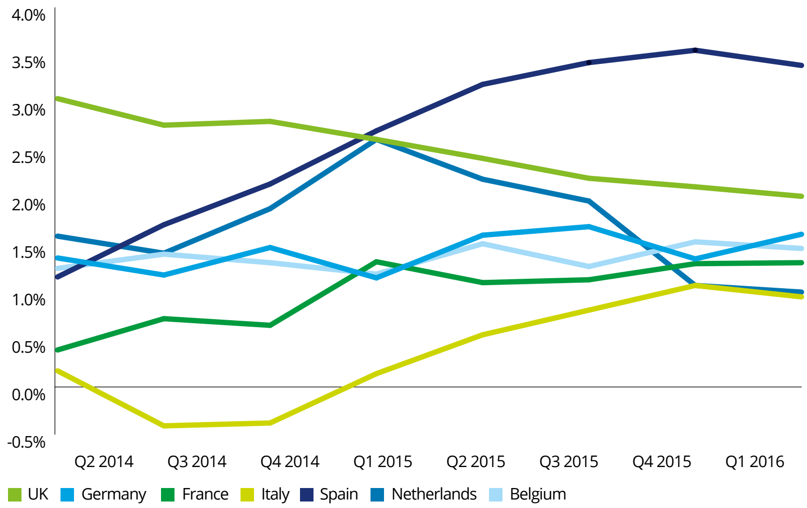
Figure 3. Survey sample coverage (% of EU economy by GDP)



Source: EIU

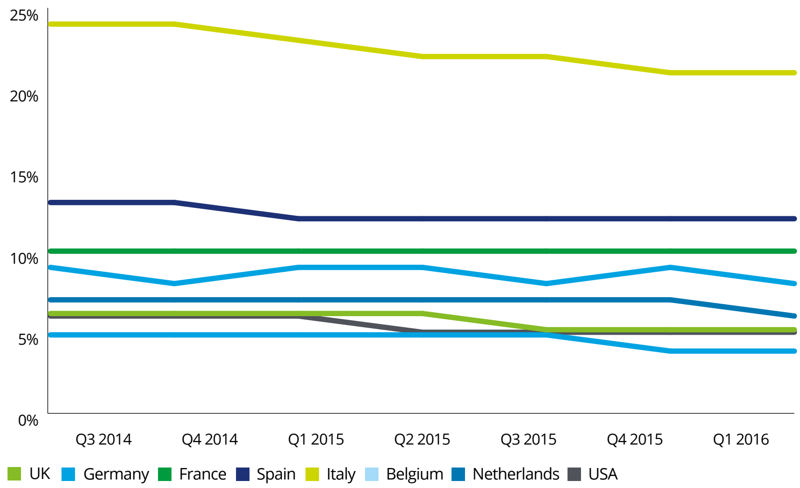
Looking at the major European markets, we find that overall growth across the region has been low (average annual growth of 1.6% over the past two years). Annual growth has been particularly low in France (1.0%) and Italy (0.3%). (Figure 4)

Figure 4. Real GDP in past 24 months



Source: EIU

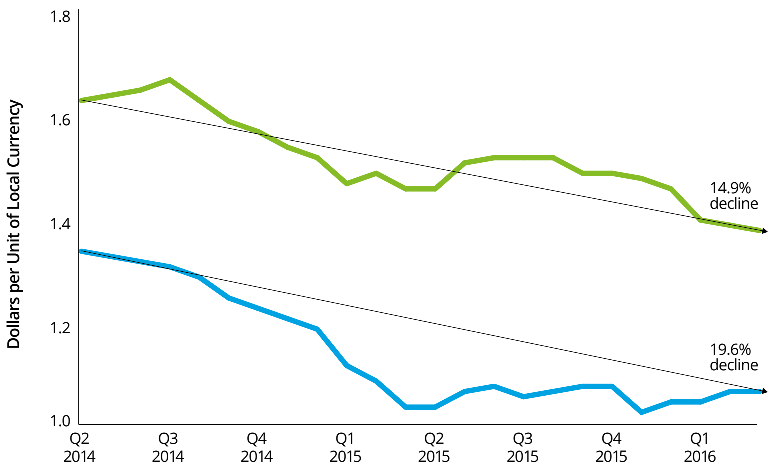
Figure 5. Unemployment in past 24 months



Source: EIU

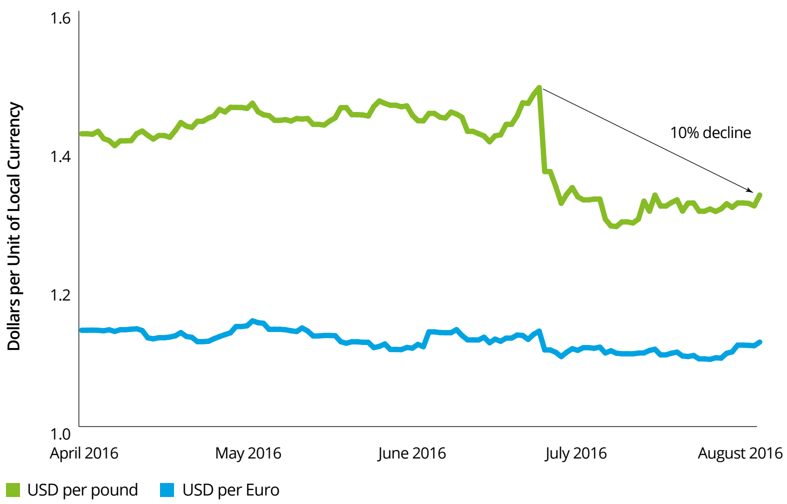
Unemployment is generally high, especially in Spain, Italy, and France, which all have unemployment rates consistently at or above 10%. (Figure 5)

Figure 6A. Exchange rates in past 24 months ($ USD: Local Currency)



Like other major global currencies, the pound and euro weakened relative to the dollar over the two year period ending March 2016 (Figure 6A). Immediately following the Brexit vote, the euro remained stable but the pound fell an additional 10%, and global equity prices have been volatile since that time. (Figure 6B)

Figure 6B. Recent currency movements ($ USD: local currency)



Source: EIU

Survey findings

Our survey of 349 CXOs, executives, and senior management from across Europe provided deep insights into what large and mid-size companies throughout the region are doing to manage costs.

Macroeconomic factors are the top external risks

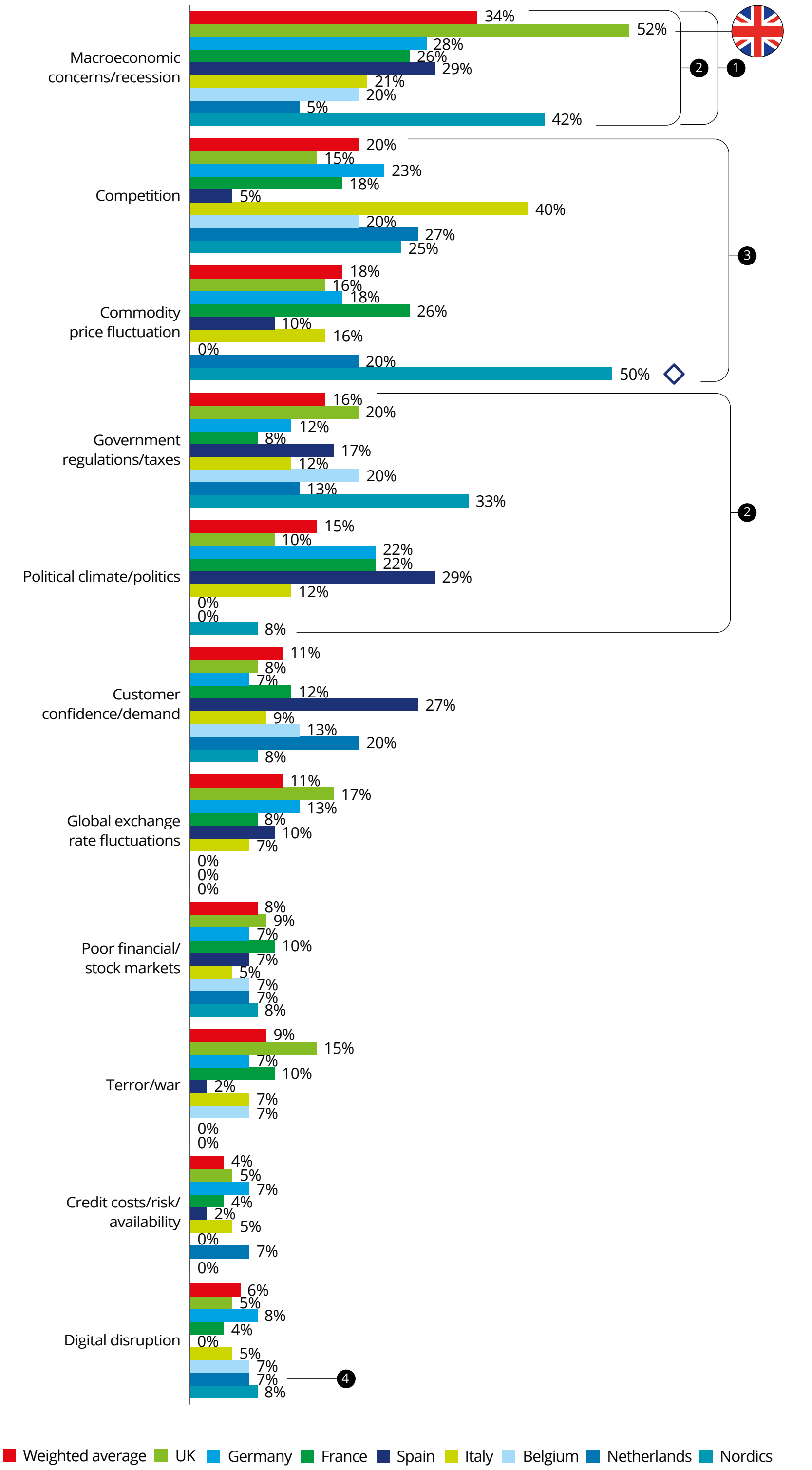
Much of Europe continues to face lackluster economic growth, weakening currencies, and continued high unemployment. Thus, it is not surprising that "macroeconomic concerns/recession" is the most frequently cited external risk (Figure 7). In the UK, the economy's performance has been relatively strong, so much of the concern expressed by UK respondents is more likely related to uncertainty about the future, especially Brexit.

In this survey of European companies, digital disruption is at the bottom of the list of external risks. This is in sharp contrast to the US where digital disruption is rapidly being recognised as one of the most powerful forces shaping the business landscape – a trend that seems likely to reach Europe in the very near future. (See the "Regional Comparisons" section to learn more about the similarities and differences between the survey results for Europe, the US, and Latin America).

Survey findings

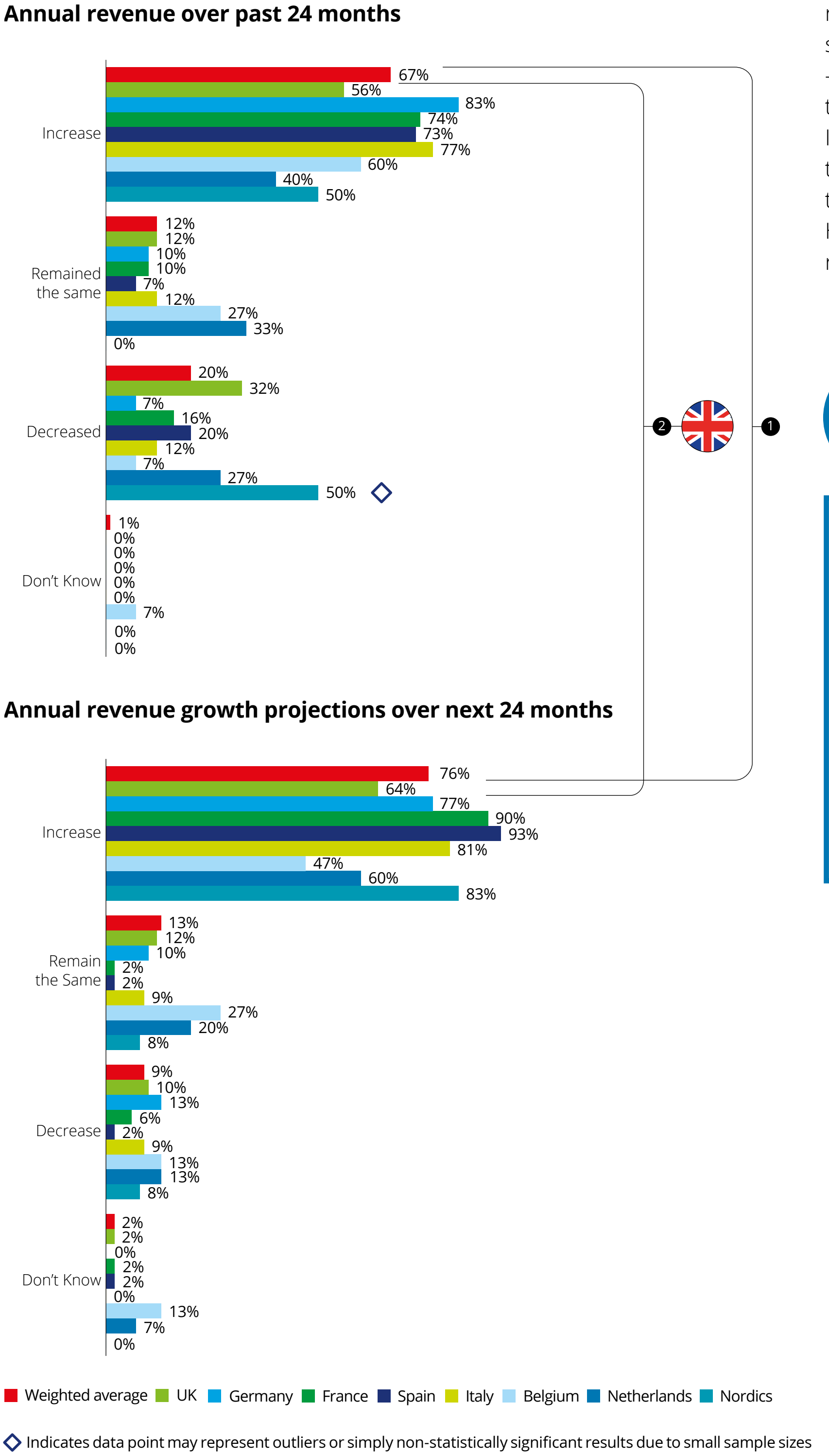
1. Macroeconomic concerns/recession (including uncertainty created by Brexit) represented the most frequently cited external risk (34%), particularly amongst respondents from the UK (52%)
2. Three of the top five most frequently cited external risks are related to government/politics (macroeconomic concerns/recession, government regulations/taxes and political climate/politics)
3. Two of the top five most frequently cited external risks are market related (competition and commodity price fluctuation)
4. Digital disruption represented the least frequently cited external risk at 6%

Figure 7. Top external risks



◇ Indicates data point may represent outliers or simply non-statistically significant results due to small sample sizes

Figure 8. Annual revenue trends



The cost/growth paradox

Despite a challenging economic environment, respondents in most of the surveyed countries have seen their revenues grow over the past 24 months – and an even larger number of respondents expect their revenues to grow over the next 24 months. In the UK, past growth performance was lower than the overall survey average (56% versus 67%), as was the expectation for future growth (64% versus 76%). However, even those lower-than-average numbers still reflect an optimistic outlook about growth. (Figure 8)

Demographic comparisons

1. 67% of the respondents reported revenue growth over the past 24 months, whilst 76% of respondents believe that revenues will continue growing for the next 24 months
2. In the UK, respondents cited lower revenue growth expectations with only 56% of UK respondents citing revenue growth over the past 24 months, and only 64% of UK respondents citing continued revenue growth for the next 24 months

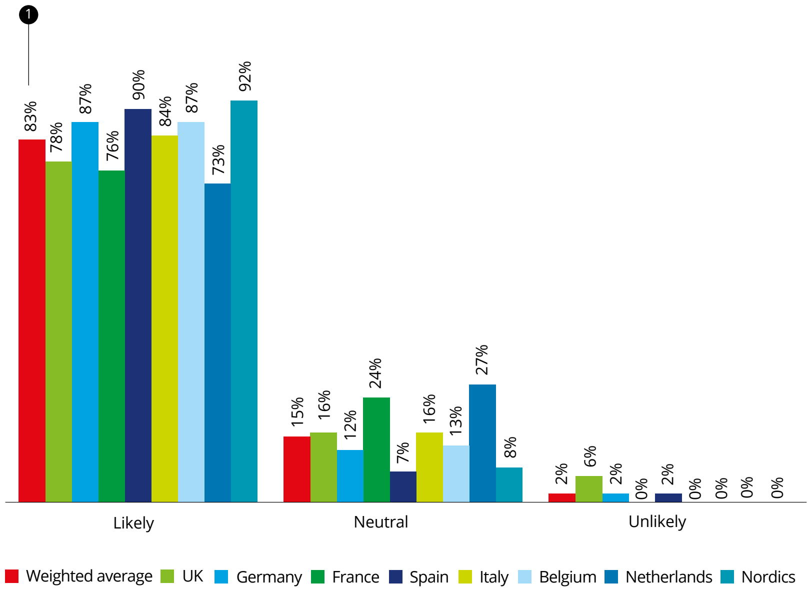
At the same time, the vast majority of responding companies in all surveyed countries (83%) say it is "likely" they will pursue cost reduction over the next 24 months. (Figure 9)

The simultaneous pursuit of these two seemingly conflicting priorities – growth and cost reduction – is a cost management strategy we call "save to grow," in which companies use cost savings offensively to help fund their growth initiatives.

Survey findings

❶ 83% of the respondents indicated their organisations are likely to undertake cost reduction activities over the next 24 months

Figure 9. Likelihood of cost reduction in next 24 months



Cost reduction is nearly universal

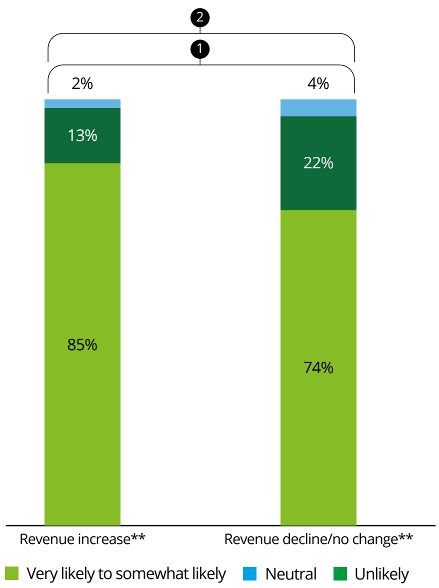
Of course, it is not just growing companies that expect to reduce costs; the vast majority of all survey respondents say they are likely to reduce costs over the next 24 months. This is true both for companies that expect their revenues to rise (85%), and for those that expect their revenues to remain flat or decline (74%). (Figure 10)

Survey findings

❶ Respondents are highly likely to undertake cost reduction initiatives, regardless of whether or not revenues are increasing (85%) or decreasing (74%)

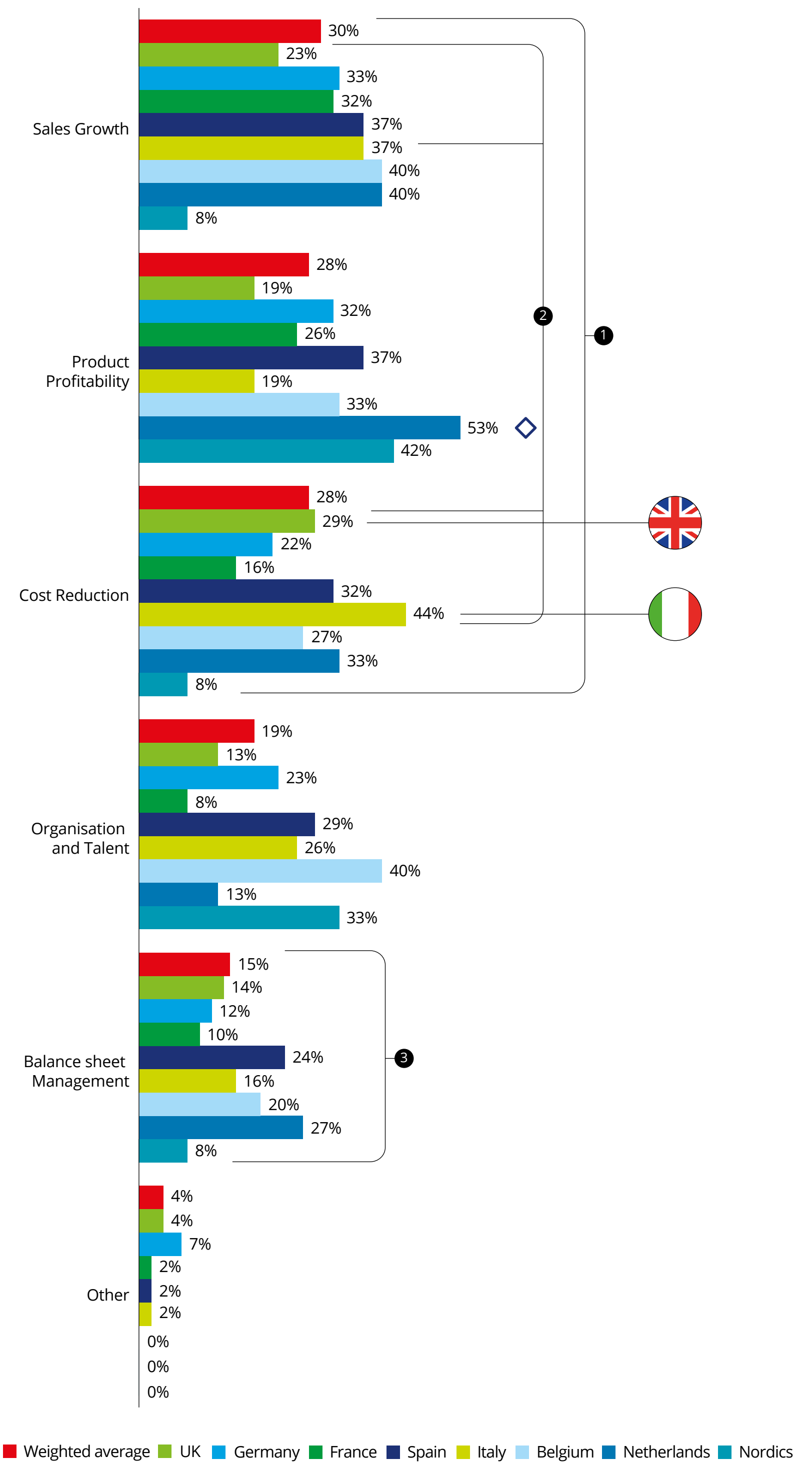
❷ Respondents expecting future revenue increases are even more likely to undertake cost reduction initiatives, potentially indicating a more growth-oriented posture

Figure 10. Likelihood of cost reduction next 24 months*



* Includes responses from UK, Germany, France, Spain, Italy, Belgium, Netherlands, Nordics and Poland
**Revenue changes refer to change in revenue over the next 24 months

Figure 11. Strategic priority in next 24 months



◇ Indicates data point may represent outliers or simply non-statistically significant results due to small sample sizes

Thriving in uncertainty

The top three strategic priorities – "sales growth" (30%), "product profitability" (28%), and "cost reduction" (28%) – are all very consistent with a "save to grow" strategy. So is "organisation and talent" (19%), which helps a company grow. And for most of the surveyed countries, growth appears to be a higher priority than cost reduction. In fact, Italy and the UK are the only countries where cost reduction scored higher than sales growth as a strategic priority. (Figure 11)

That being said, the "save to grow" approach that was prevalent in recent years now seems to be tempered by a renewed focus on balance sheet management, which has traditionally been associated with companies in distress and was a top priority during the financial crisis. We call this newly evolved approach "thriving in uncertainty" because it implies that whilst companies continue to focus on growth and cost savings, they are also playing defence in the face of an uncertain future by cautiously manageing their balance sheets – including a focus on working capital, credit, treasury-related items, and in some cases perhaps even liquidity.

Survey findings

1. Sales growth, product profitability and cost reduction represent the top strategic priorities for respondents, underscoring the "save to grow" theme
2. Italy and the UK are the only two markets reporting a higher focus on cost reduction than on sales growth, potentially indicating the need for a different cost management approach
3. Despite strong growth priorities, the focus on balance sheet management underscores a theme of "uncertainty" and a defensive posture not seen since 2008

Cost reduction drivers underscore the theme of "thriving in uncertainty"

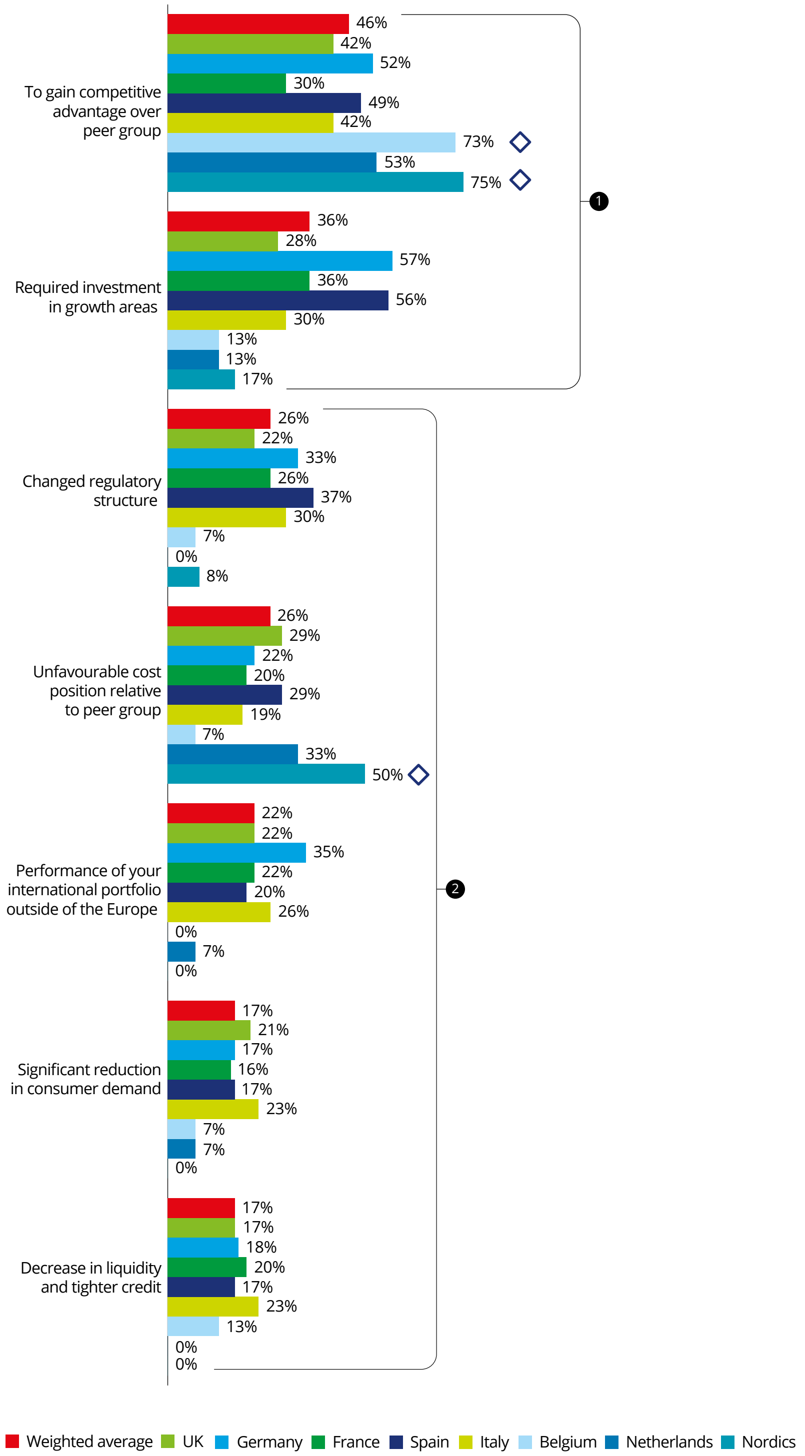
Although the top two drivers of cost reduction are growth-orientated, five of the top seven drivers are defensive in nature and underscore the increasingly important secondary theme of uncertainty and caution. These defence-orientated cost reduction drivers include everything from decreased liquidity and tighter credit to reduced consumer demand, unfavourable cost positions, changing regulatory structures, and poor international portfolio performance. (Figure 12)

Survey findings

❶ The top two drivers of cost reduction are offensive in nature, focusing on cost reduction as a mechanism to fuel growth – 46% of respondents cited gaining a competitive advantage as a key driver, and 36% of respondents cited required investment in growth areas as a key driver

❷ Five of the top seven drivers of cost reduction are defensive in nature and suggest uncertainty about near-term business performance

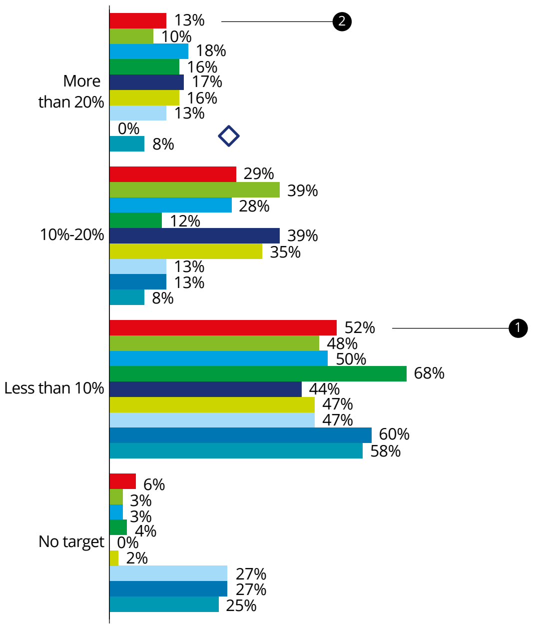
Figure 12. Drivers of cost reduction



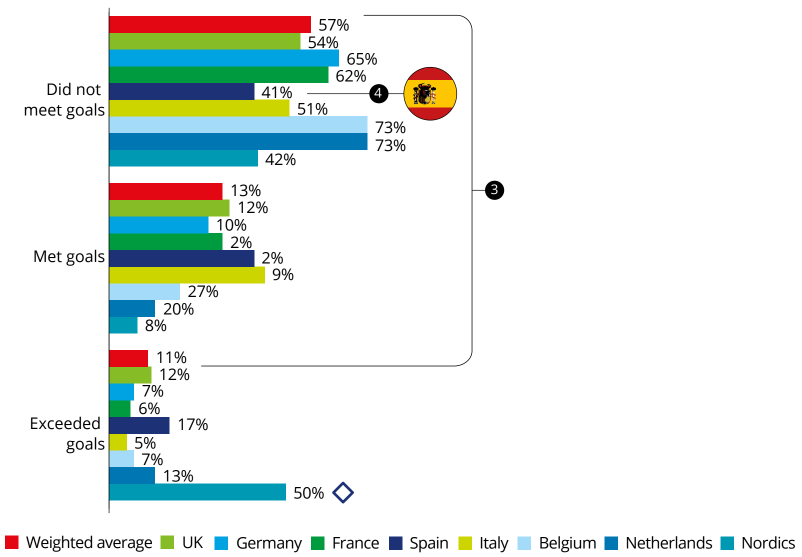
◇ Indicates data point may represent outliers or simply non-statistically significant results due to small sample sizes

Figure 13. Cost reduction targets and success of cost programs

Annual cost reduction targets



Success in meeting cost targets



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Low cost targets and high failure rates

The majority of respondents (52%) are pursuing cost reduction targets of less than 10%, whilst only a small minority (13%) are pursuing targets of more than 20%. And whilst it might seem as if these low targets would be easy to achieve, the survey results show that most companies (57%) are failing to meet their targets, whilst only 11% are exceeding their targets. (Figure 13) This combination of low targets and high failure rates suggests that European cost programmes may have significant room for improvement.

Survey findings

1. 52% of the respondents cite cost targets less than 10%
2. Only 13% of respondents cite cost targets greater than 20%, and the UK reports the lowest response rate (10%)
3. 57% of respondents did not meet their cost reduction targets with only 11% exceeding goals
4. Respondents from Spain indicated the lowest failure rates (41%)

What factors are behind this disappointing cost management performance?

Implementation is the biggest challenge

Implementation challenges are viewed by respondents as the main barriers to effective cost management, with four of the top five barriers directly related to implementation. These include not only the general issue of "challenges in implementing initiatives" (48%), but also more specific implementation-related issues: erosion of savings (20%), weak business case (23%), and poor design and tracking (17%). The only barrier in the top five not directly tied to implementation is "lack of understanding" (32%), which is primarily a change management issue. (Figure 14)

Survey findings

1. 48% of the respondents cite implementation challenges as the key barrier to effective cost management
2. Only "lack of understanding" is related to change management and represents the second most frequently cited barrier to effective cost management
3. Four of the top five barriers to effective cost management are related to implementation challenges

Figure 14. Barriers to effective cost management

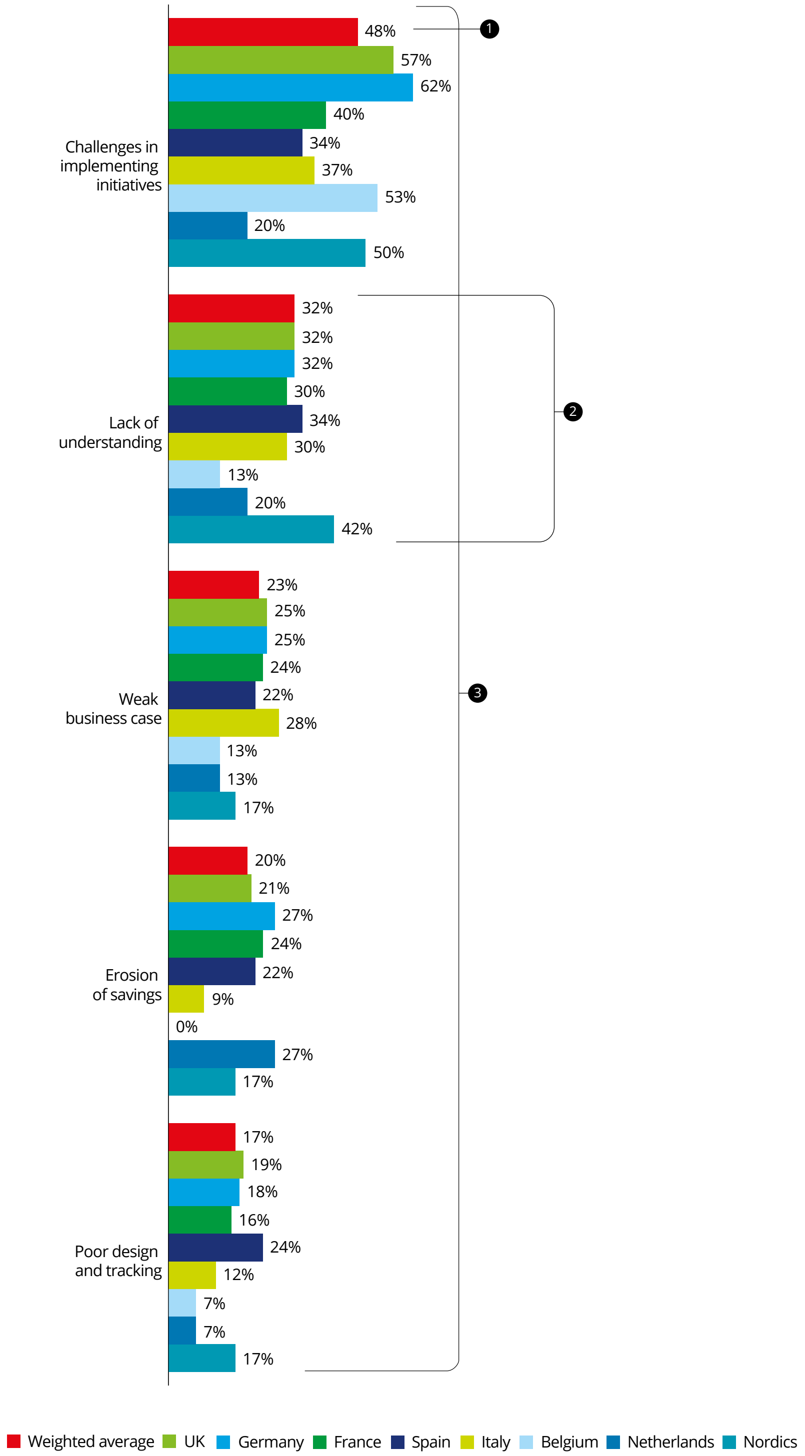
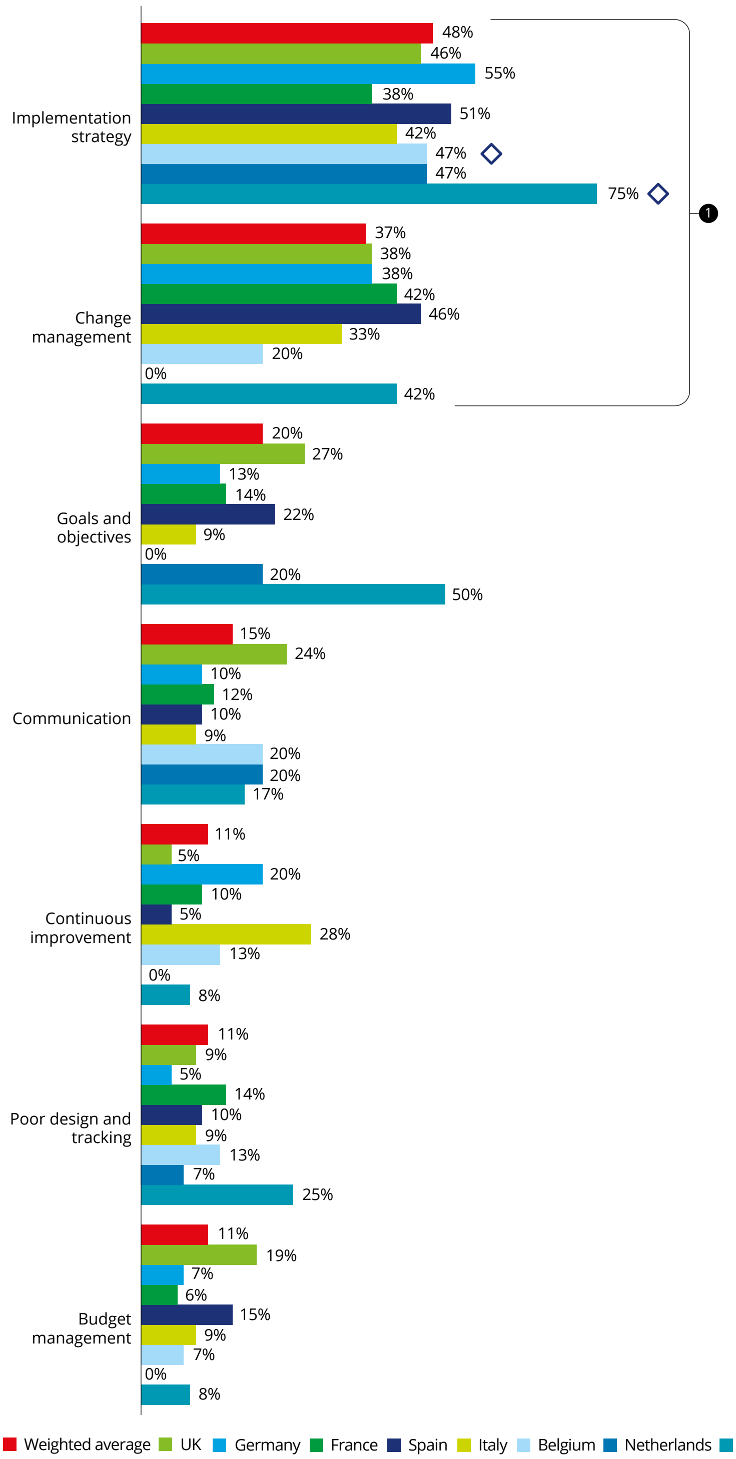


Figure 15. Lessons learned – past 24 months



◇ Indicates data point may represent outliers or simply non-statistically significant results due to small sample sizes

Lessons learned

Since issues related to implementation and change management are seen as the biggest barriers to effective cost management, it makes sense that those same two areas are where respondents feel their companies have learned the most over the past 24 months. (Figure 15)

Survey findings

❶ Implementation strategy and change management are the most commonly cited categories of lessons learned

Companies are actively developing their cost management capabilities

Over the past 24 months, surveyed companies have developed a variety of capabilities to support more effective cost management. The top three capability areas cited by respondents are: processes for forecasting, budgeting, and planning (47% of respondents); cost management policies and procedures (44%); and IT capabilities, including infrastructure, systems, and business intelligence platforms (42%). German companies led the way in developing IT capabilities. Spanish companies led the way in developing new policies and procedures (Figure 16). It should be noted that zero-based budgeting (ZBB) ranked very low, with only 3% of respondents having developed ZBB capabilities over the past 24 months. (See sidebar for a detailed discussion of ZBB).

Survey findings

❶ The most frequently cited capabilities developed over the past 24 months were: Improved processes for forecasting, budgeting and reporting, set-up IT infrastructure, IT systems and business intelligence platform and implement new policies and procedures

❷ Respondents from Germany cited a higher response rate (58%) for setting up IT infrastructure, IT systems and business intelligence platforms

❸ Respondents from Spain cited a higher response rate (63%) for implementing new policies and procedures

❹ ZBB represents the least likely capability to have been developed within the past 24 months with only 3% of respondents citing ZBB capability development

Figure 16. Capabilities developed over past 24 months

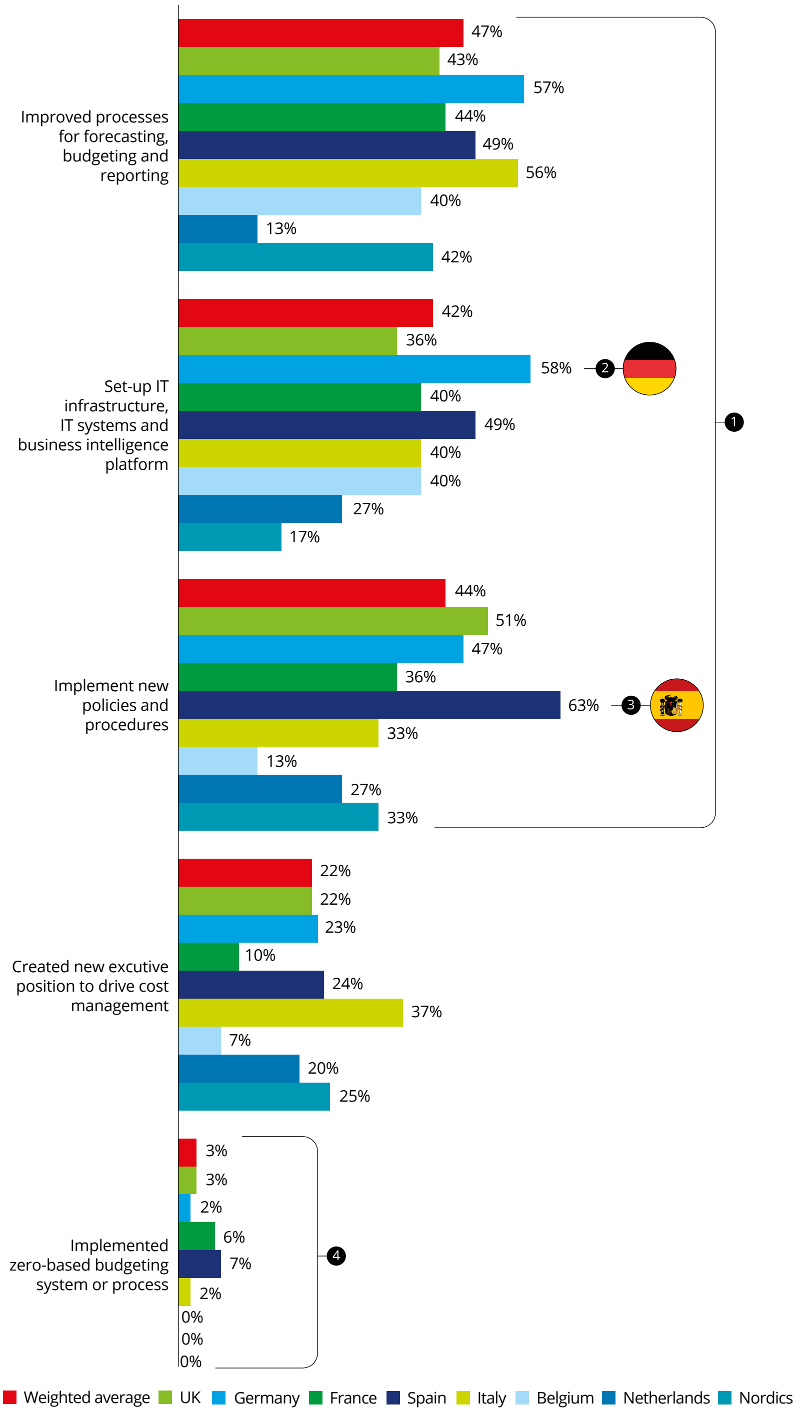
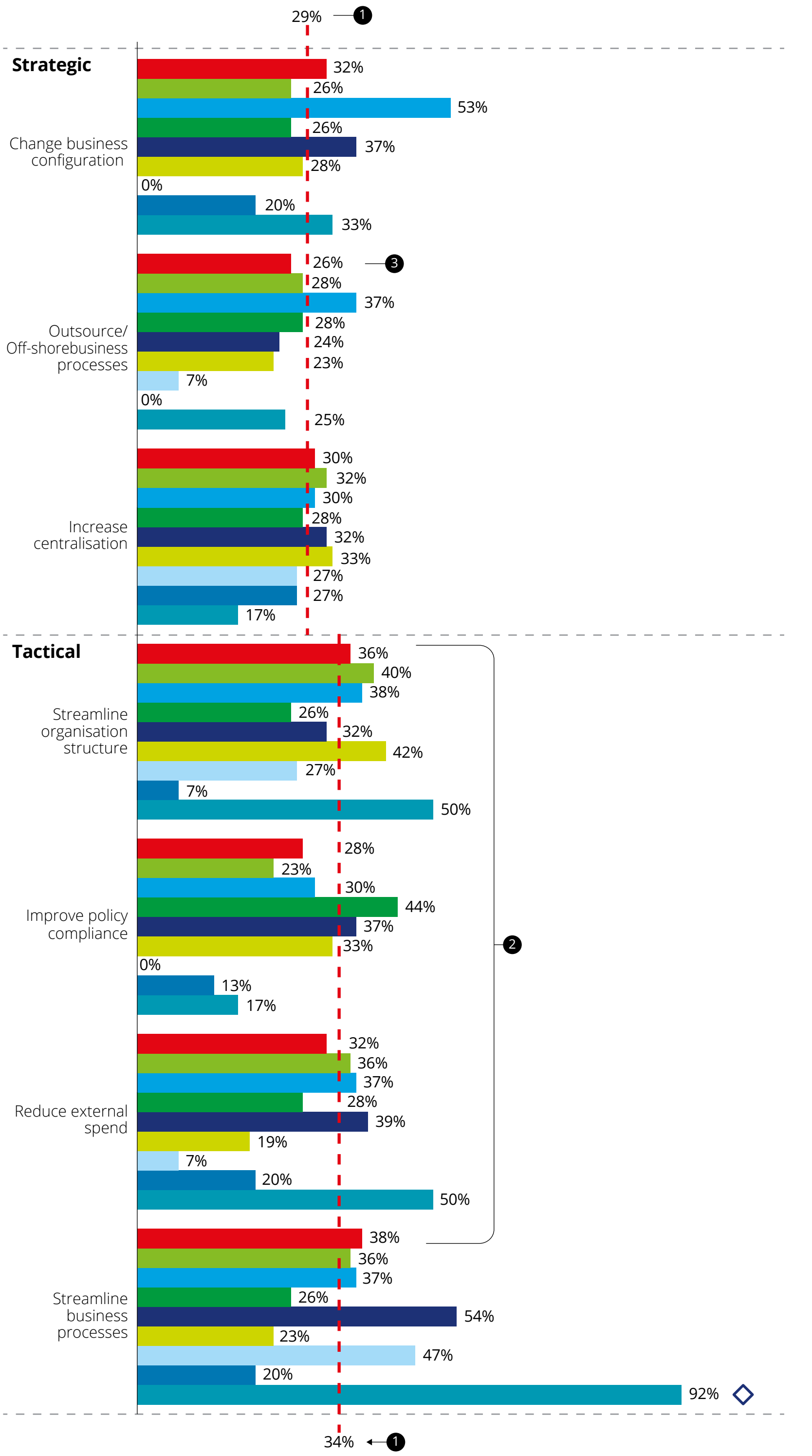


Figure 17. Cost actions viewed as most likely in next 24 months



Weighted average, UK, Germany, France, Spain, Italy, Belgium, Netherlands, Nordics

-- Indicates average response rates within either the "strategic" or "tactical" categories

◇ Indicates data point may represent outliers or simply non-statistically significant results due to small sample sizes

Tactical versus strategic cost reduction

Many of the surveyed companies plan to rely primarily on tactical cost actions such as reducing external spend (32%), streamlining organisation structures (36%), and streamlining business processes (38%). Overall, respondents ranked those tactical actions higher than strategic cost actions such as outsourcing/ offshoring (26%), centralisation (30%), and changing the business configuration (32%). Collectively, the various tactical actions on average were cited by 34% of respondents, compared to an average of only 29% for the various strategic actions (Figure 17). This emphasis on tactical actions may be due to the fact that cost reduction targets in Europe are relatively low, limiting the need for approaches that are more strategic.

However, if competitive pressure and other market forces – particularly digital disruption – create an imperative to reduce costs more aggressively, European companies will likely need to shift their focus to strategic cost reduction approaches, since tactical actions cannot be relied upon to deliver cost savings greater than 10%.

Survey findings

❶ On average, only 29% of respondents plan to undertake a strategic cost action vs. 34% that plan to undertake a tactical cost action

❷ The most frequently cited cost actions likely over the next 24 months were streamlining business processes (38%) and streamlining organisation structure (36%) – both of these actions are tactical in nature

❸ The least frequently cited cost action likely over the next 24 months was outsourcing / off-shoring business processes (26%) – this action is strategic in nature

Zero-based budgeting: breakthrough or passing fad?

The traditional approach for developing a budget is to start with the previous period's budget and make adjustments as needed. Zero-based budgeting (ZBB) is a fundamentally different approach that involves developing a new budget from scratch every time (i.e., starting from zero). The theory is that ZBB prompts decision-makers to constantly look at the business with fresh eyes, free from the limitations of past assumptions and targets. But how well does the theory translate into practice?

In our survey of European companies, ZBB was the lowest ranked approach to managing costs over the past 24 months (Figure 18).

Survey findings

1. Utilisation of ZBB over the past 24 months is the lowest amongst typical approaches to cost management (response rates range from 0% - 15% with a weighted average of 7%)

Figure 18. Approaches to manage costs over the past 24 months

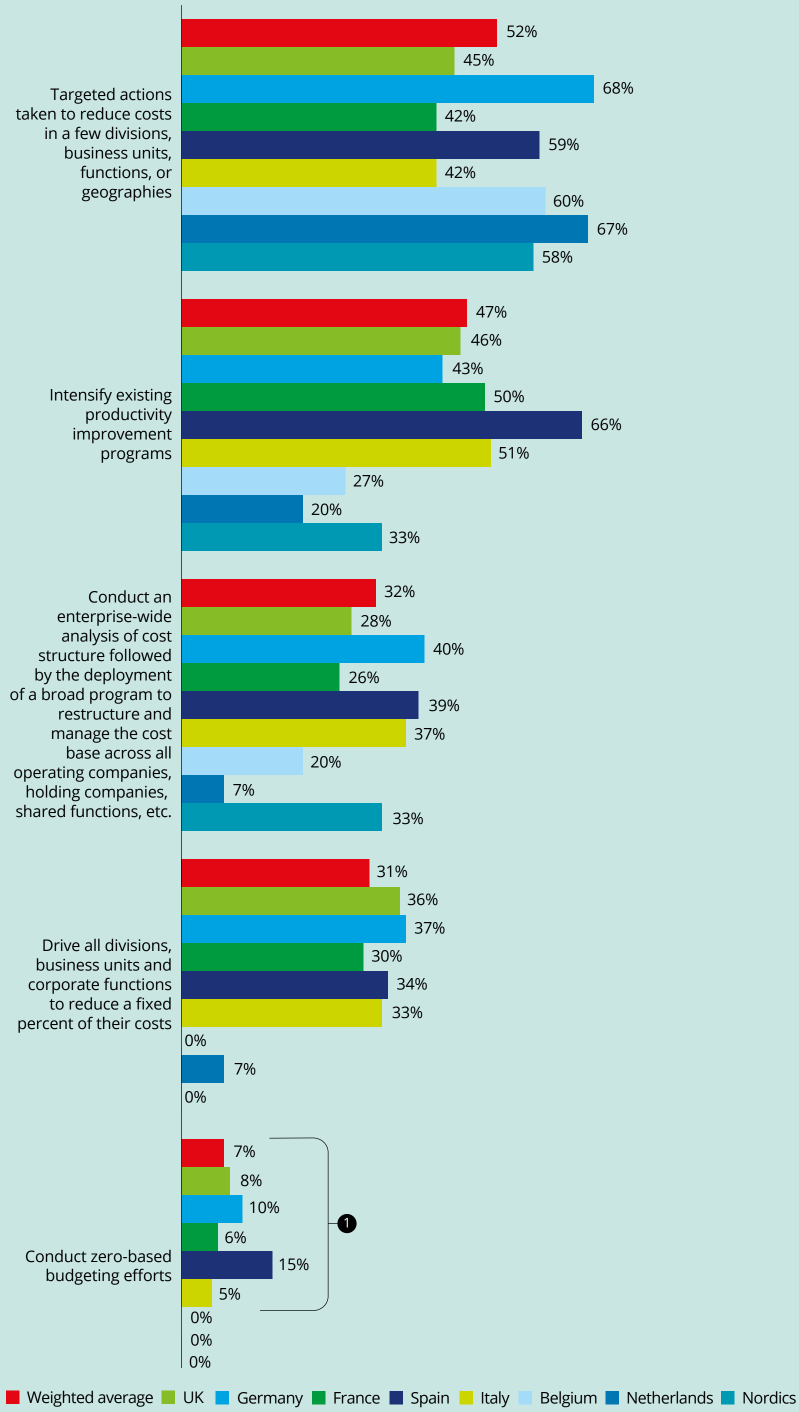
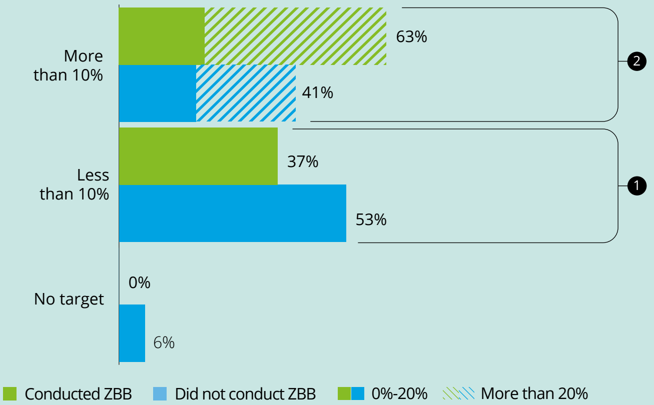
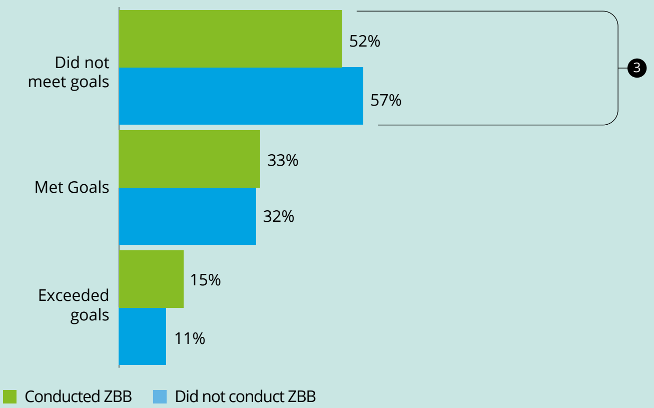


Figure 19. Cost Reduction Targets and Success

Annual cost reduction targets*

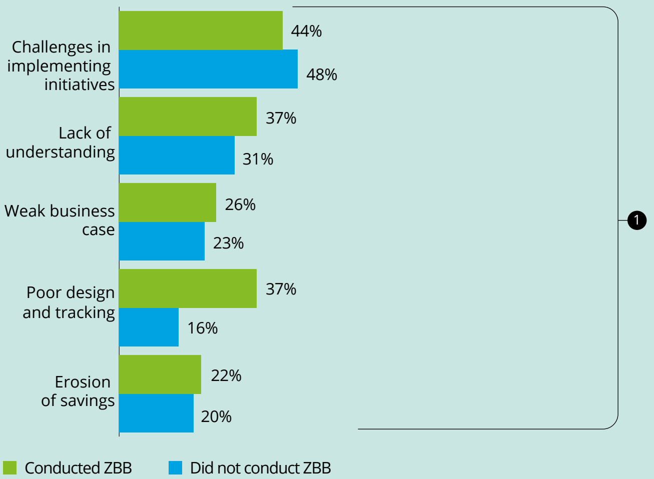


Success in meeting cost targets*



* Includes responses from UK, Germany, France, Spain, Italy, Belgium, Netherlands, Nordics and Poland

Figure 20. Barriers to effective cost management*



* Includes responses from UK, Germany, France, Spain, Italy, Belgium, Netherlands, Nordics and Poland

Although adoption of zero-based budgeting remains very low, companies in our survey that use ZBB report marginally higher success in meeting or exceeding their cost targets (48%) versus those that do not use it (43%). However, this small difference may have more to do with the fact that most companies in Europe – especially those with cost targets of less than 10% – do not follow a structured approach to cost management, which can limit their success. Amongst companies with cost targets of 10% or higher, 63% use ZBB compared to only 37% of companies with cost targets of less than 10% (Figure 19). As a structured approach to cost reduction, ZBB is better than nothing. However, our experience suggests that other structured approaches may be even more effective when properly applied.

Survey findings

1. A high percentage of respondents cited cost targets of less than 10%, likely indicating a less structured approach to cost management
2. The proportion of respondents citing cost targets of 10% or greater is higher for those conducting ZBB (63%) vs. those not conducting ZBB (41%)
3. Respondents conducting ZBB cited lower failure rates, but the difference was small (5%); the higher success rates reported by ZBB users may result from those respondents taking a more structured approach to cost management as the majority of European companies do not utilise structured programmes, which can be more effective at achieving results

Companies that have used ZBB over the past 24 months are likely to report more barriers to effective cost management – perhaps because they are pursuing higher cost targets (Figure 20).

Survey findings

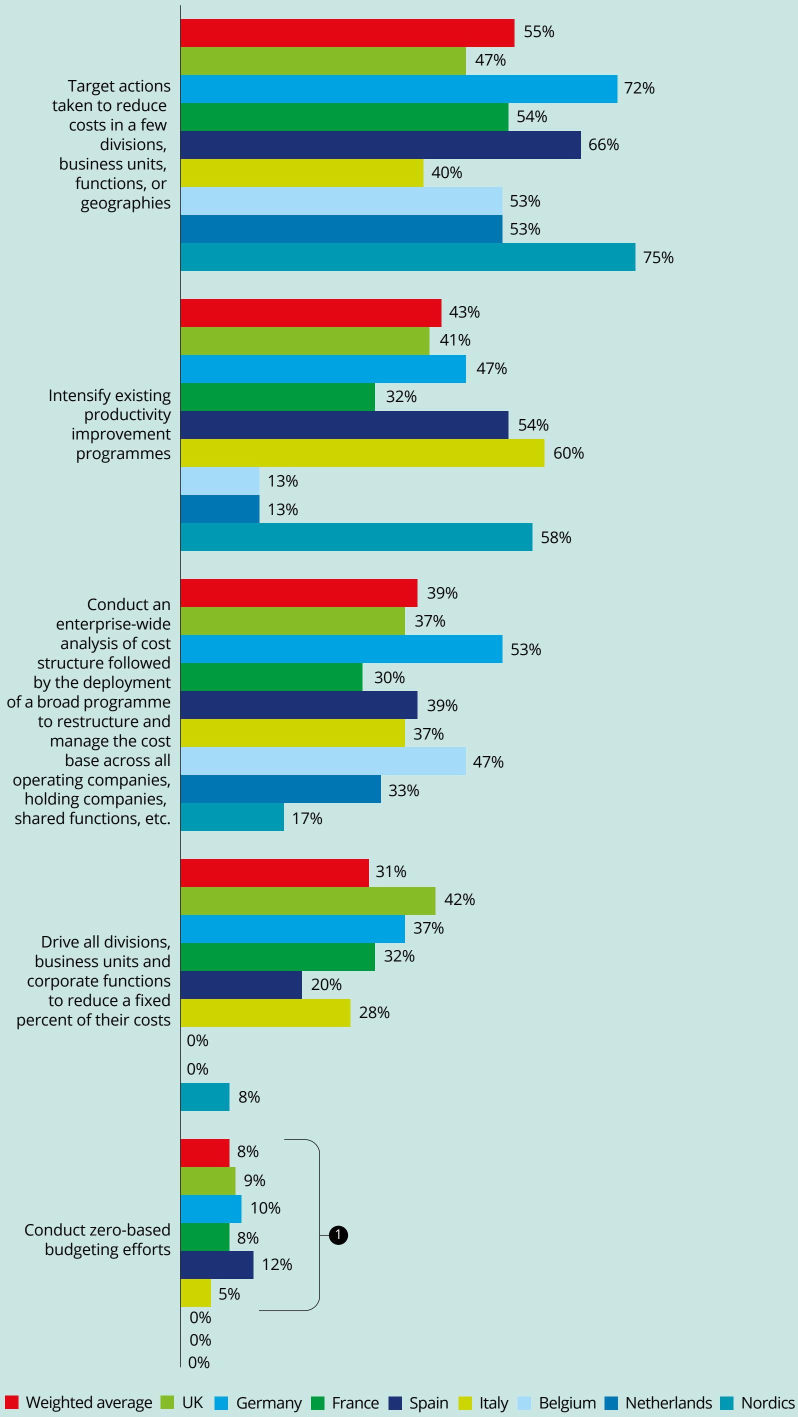
1. Respondents from organisations conducting ZBB over the past 24 months reported a higher frequency of barriers to effective cost management in four out of five categories

Looking ahead, the survey data shows that adoption of ZBB over the next 24 months is expected to remain low at 8%, up only slightly from 7% over the past 24 months (Figure 21). This relatively flat adoption rate suggests the ZBB trend might already be topping out.

Survey findings

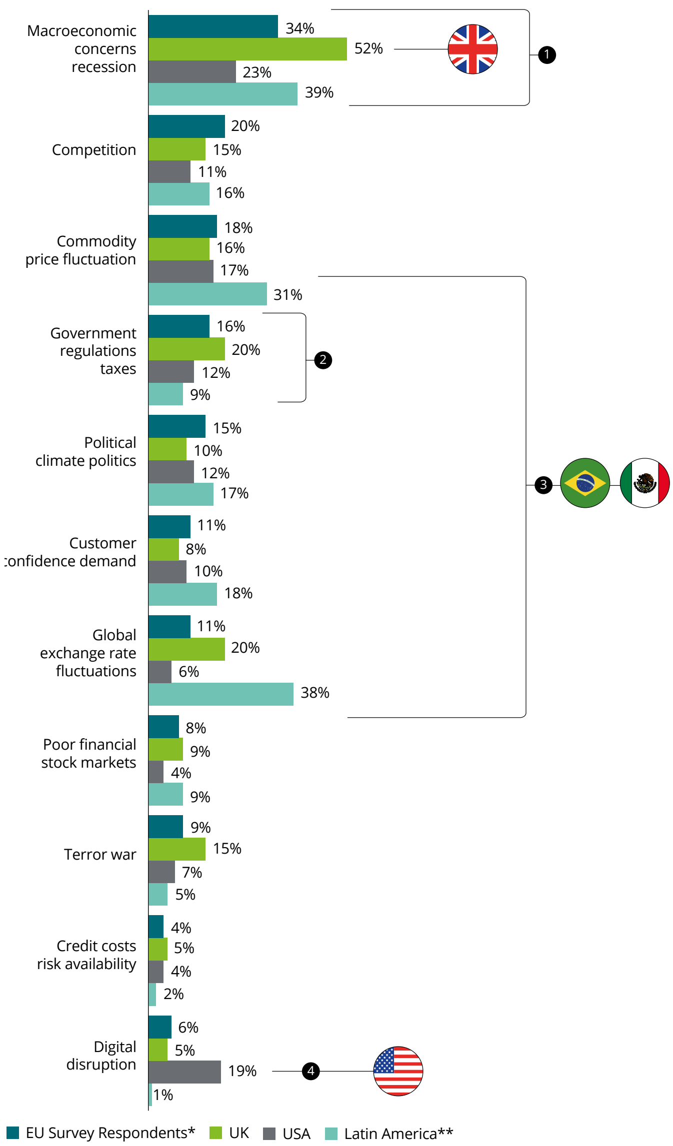
1. Overall planned utilisation of ZBB over the next 24 months is low (8%) compared to other typical cost management approaches; the same number of respondents that have been conducting ZBB in the past expect to do so in the future with no meaningful change in expected ZBB Utilisation rates

Figure 21. Planned cost improvement initiatives in next 24 months



Regional comparisons

Figure 22. Top external risks in next 24 months (Regional)



*Includes responses from UK, Germany, France, Spain, Italy, Belgium, Netherlands, Poland and the Nordics

**Includes responses from Brazil and Mexico

Comparing and contrasting the results from the three regional cost studies Deloitte conducted this year offers some revealing insights into how companies around the globe are managing costs. Looking across regions reveals a number of common themes, as well as some surprising and enlightening differences.

The economy tops the list of external risks in all regions

Macroeconomic concerns – and the prospect of recession – tops the list of external risks for all three regions: Latin America (39%), EU (34%), and US (23%). Companies in the UK are particularly concerned about macroeconomic risk and recession, especially Brexit.

In the EU, government regulation and taxes are a much greater concern (16%) than in Latin America (9%) and the US (12%). This is especially true for UK respondents, which makes the UK's decision to leave the EU less surprising.

Latin America is more concerned about commodities and exchange rates

In Latin America, respondents are much more concerned than companies in other regions about global exchange rate fluctuations (38% versus overall EU average of 11%) and commodity price fluctuations (31% versus overall EU average of 18%).

Digital disruption is only prevalent in the US

In the US, concern about digital disruption is far higher (19%) than in the EU (6%) and Latin America (1%) (Figure 22). In fact, amongst many of the leading companies we work with, digital disruption is quickly rising to the top of the strategic agenda. Companies in other regions may soon face a similar impact from digital disruption, and should consider getting themselves into fighting shape.

Survey findings

1. Consistent with respondents from the USA and Latin America, respondents from the EU (and from the UK in particular) cite macroeconomic concerns / recession as the top external risk
2. Respondents from the EU (and from the UK in particular) cite government regulations / taxes as a top external risk more frequently relative to other regions
3. Respondents from Latin America cite commodity price / global exchange rate fluctuations as top external risks more frequently relative to other regions
4. Respondents from the USA cite digital disruption as a top external risk nearly four times more frequently relative to other regions

Growth is the norm in all regions

Growth remains the dominant trend in all surveyed regions. However, companies in the EU are the least likely to have grown over the past 24 months (67%, versus 81% in the US and 73% in Latin America). Also, they have the least optimistic growth expectations over the next 24 months. This is especially true in the UK, where the numbers for past growth performance (56%) and future growth expectations (64%) are significantly lower than the averages for each of the three regions surveyed (Figure 23).

Survey findings

❶ Respondents from Europe (in particular the UK) cited lower revenue growth over the past 24 months

Cost reduction is a strong global trend

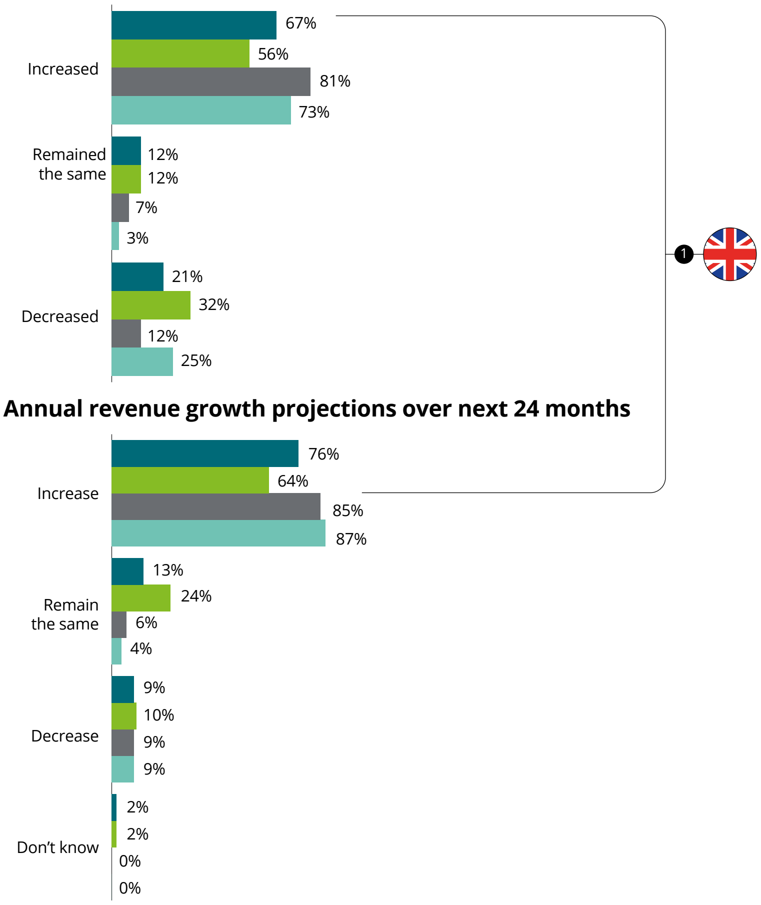
Cost reduction is more likely to take place in Latin America (96%) and the US (88%) than in the EU (83%) – especially the UK (78%). However, in all surveyed regions the vast majority of companies expect to pursue cost reduction over the next 24 months (Figure 24). The lower likelihood of cost reduction activity in the EU may be related to the fact that cost reduction targets tend to be lower there, giving companies less incentive to take action.

Survey findings

❶ Whilst all respondents in all regions surveyed are highly likely to undertake cost reduction over the next 24 months, European respondents (respondents from the UK in particular) are somewhat less likely to do so (83% in Europe vs. an average of 92% in other regions) – this effect may translate into the lower cost targets cited by European respondents

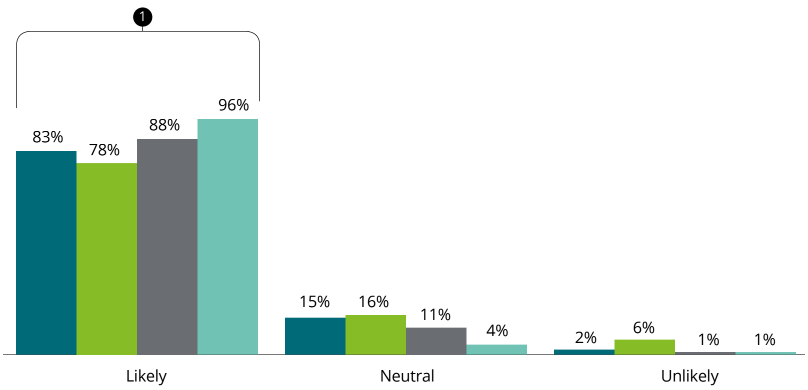
Figure 23. Revenue trends (Regional)

Annual revenue over past 25 months



EU Survey Respondents* UK USA Latin America**
*Includes responses from UK, Germany, France, Spain, Italy, Belgium, Netherlands, Poland and the Nordics
**Includes responses from Brazil and Mexico

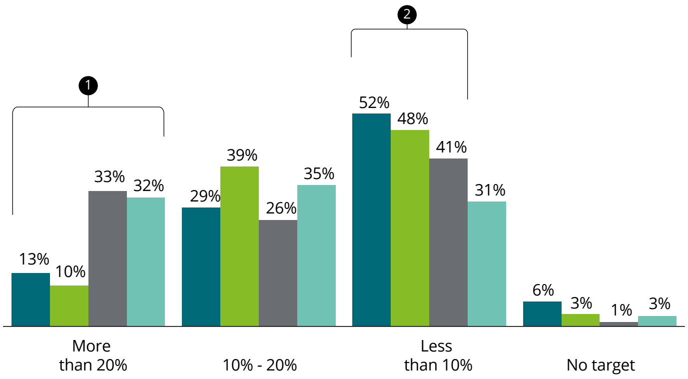
Figure 24. Likelihood of cost reduction in next 24 months (Regional)



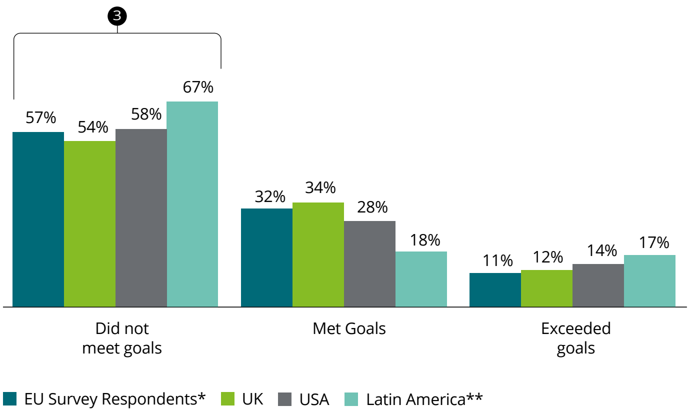
EU Survey Respondents* UK USA Latin America**
*Includes responses from UK, Germany, France, Spain, Italy, Belgium, Netherlands, Poland and the Nordics
**Includes responses from Brazil and Mexico

Figure 25. Cost Reduction Targets and Success (Regional)

Annual cost reduction targets



Success in meeting cost targets



*Includes responses from UK, Germany, France, Spain, Italy, Belgium, Netherlands, Poland and the Nordics
**Includes responses from Brazil and Mexico

Europe seems to be less aggressive about reducing costs

As noted above, European companies generally have lower cost reduction targets than do companies in other regions. Specifically, only 13% of EU respondents cited annual cost targets of greater than 20%, compared to 33% of respondents in the US and 32% in Latin America. Similarly, 52% of EU respondents cited cost targets of less than 10%, compared to 41% of respondents in the US and 31% in Latin America (Figure 25). Europe's relatively low cost reduction targets may reflect a wide range of factors, from social values and government policies to the prevalence of labour unions. It may also reflect the fact that structured approaches to cost reduction are less common in Europe, thus limiting the cost savings that companies can expect to achieve.

Despite lower cost reduction targets in the EU, cost programmes there had a similar failure rate (57%) to those in the US (58%). The rate of failure was highest in Latin America, where 67% of surveyed companies did not meet their cost goals.

Survey findings

1. An average of 32% of respondents from regions outside Europe cited annual cost reduction targets of 20% or more, but only 13% of European respondents cited the same
2. 52% of respondents from Europe (and 48% of respondents from the UK) cited cost reduction targets of less than 10%, suggesting European respondents may execute cost reduction via less structured approaches relative to other regions
3. Although targets cited by respondents in the UK and Europe are lower, programme failure rates are generally the same as in the USA

Implementation is the biggest barrier for all regions

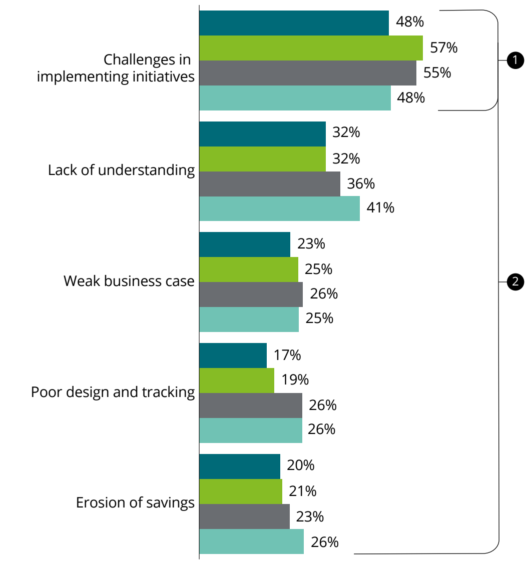
Respondents in all regions rate "challenges in implementing initiatives" as the top barrier to effective cost management, followed by "lack of understanding" (Figure 26). It is interesting that these two barriers are consistently at the top of the list in all regions, despite significant regional variations in cost reduction approaches and targets. Clearly these are important challenges that need to be addressed head-on.

Survey findings

❶ Implementation challenges rank highest amongst barriers to effective cost management

❷ European respondents generally cite lower rates of barriers to effective cost management relative to other regions, although this might be expected given the prevalence of less structured cost programmes in Europe

Figure 26. Barriers to effective cost management



■ EU Survey Respondents* ■ UK ■ USA ■ Latin America**

*Includes responses from UK, Germany, France, Spain, Italy, Belgium, Netherlands, Poland and the Nordics
**Includes responses from Brazil and Mexico

Cost management programmes are less common in Europe

According to the survey results, cost reduction in Europe is more likely to be pursued ad hoc, rather than through standard cost management approaches that are more common in other regions. Enterprise-wide cost analysis and broad restructuring was much less common over the past 24 months in the EU (32%) than in the US (62%) and Latin America (50%). But that is just the most dramatic example. EU respondents cited lower utilisation rates than other regions for nearly all cost management approaches, except for the one category of highly focused "targeted actions" where the EU was behind the US (52% versus 62%) but slightly ahead of Latin America (50%) (Figure 27).

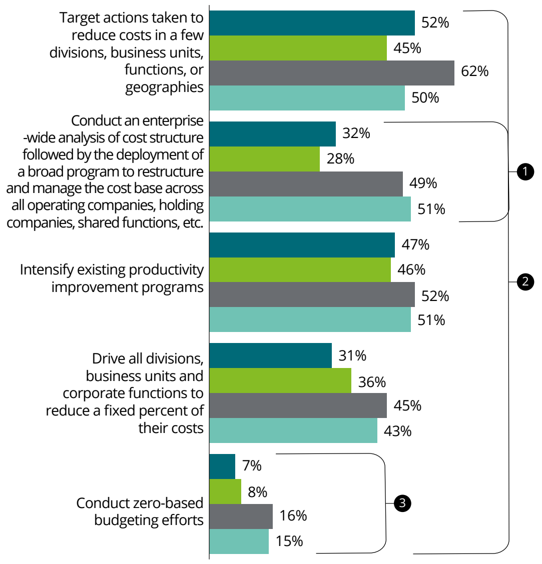
Survey findings

❶ Respondents from Europe cited lower utilisation rates for conducting an enterprise-wide analysis of cost structure over the past 24 months

❷ In general, European respondents cite low utilisation rates for all approaches to cost management, perhaps indicating that European respondents are less likely to pursue structured cost programmes

❸ Respondents from Europe are least likely to have conducted ZBB over the past 24 months

Figure 27. Approaches to manage costs over the past 24 months



■ EU Survey Respondents* ■ UK ■ USA ■ Latin America**

*Includes responses from UK, Germany, France, Spain, Italy, Belgium, Netherlands,Poland and the Nordics
**Includes responses from Brazil and Mexico

Choosing the right cost management approach

In Europe, the "save to grow" mentality that emerged as the global economy was bouncing back from the financial crisis is now being tempered by a renewed focus on balance sheet management. Although companies throughout the region continue to place a strong emphasis on growth and cost reduction – using cost savings to fund growth activities – many are also adopting a more defensive posture by tightening up their balance sheets. This mix of strategic priorities – what we call "thriving in uncertainty" – seems to reflect an environment of cautious optimism combined with uncertainty about the future.

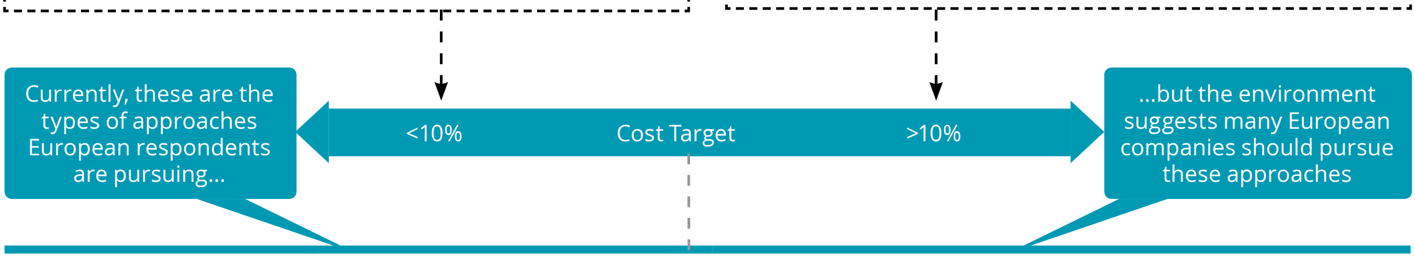
Low targets and high failure rates imply that European cost programmes are not as effective as they could be, creating an opportunity for companies to significantly improve how they manage costs. Some improvements might be tactical in nature, such as focusing on new cost areas and simultaneously pursuing multiple cost levers. But even with such improvements, a tactical approach to cost reduction is unlikely to deliver cost targets beyond the single digits.

Achieving cost targets greater than 10% generally requires a cost management approach that is more strategic and transformational in nature (Figure 28). However, the right strategic approach varies from one company to the next, depending on its unique situation and challenges. Companies pursuing strategic-level cost reductions may soon reach a fork in the road where they must choose between a more offense-oriented cost strategy (typically associated with businesses that are growing rapidly), or a more defence-oriented cost strategy (typically associated with businesses in distress).

Figure 28. The cost management continuum

- 52% of European respondents cited cost targets of less than 10%
- 57% of European respondents did not meet cost reduction goals
- 34% of European respondents plan to undertake tactical cost actions with the most frequently cited action being to streamline business processes (38%)

- 29% of European respondents cited cost targets between 10% and 20%
- 13% of European respondents cited cost targets greater than 20%
- Only 29% of European respondents plan to undertake strategic cost actions



	Tactical/Continuous Improvement Approach	Strategic/Transformational Approach
Scope/Cost Areas	Narrow/selective e.g., streamline organisation structure, improve policy compliance, reduce external spend, streamline business processes	Broad e.g., change business configuration, outsource/offshore, increase centralisation
Cost Target Range	<6% (Continuous Improvement)/ 6%–10% (Tactical)	>10%
Sustainability/Scalability	Lower	Higher
Change Management Needs	Lower	Higher

Source: Deloitte

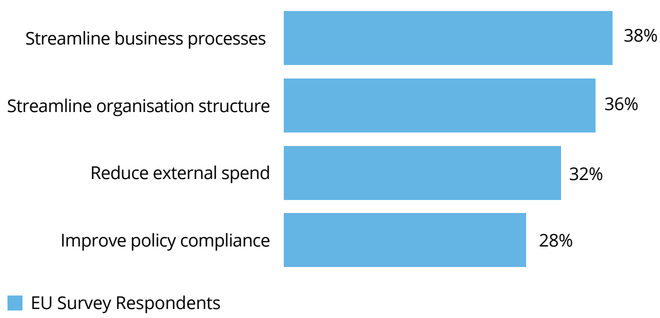
As noted earlier, European companies tend to use tactical cost actions more than strategic cost actions. Looking at the entire pool of EU respondents, the most common tactical cost actions are to: streamline business processes (38%), streamline organisation structure (36%), reduce external spend (32%), and improve policy compliance (28%) (Figure 29).

Our experience working with companies around the world suggests the last two may have a greater cost impact than the first two, even though the survey results show they are less utilised. Also, companies often can improve their results and achieve higher cost reduction targets by focusing on a broader number of tactical cost reduction levers.

That being said, many companies will not be able to achieve their required cost improvements through tactical actions alone. Instead, they will need to adopt a cost management approach that is more strategic and transformational.

Traditionally, companies in pursuit of strategic cost improvements could be categorised as: (1) distressed, (2) positioned for growth, or (3) growing steadily (Figure 30).

Figure 29. Most common tactical cost actions

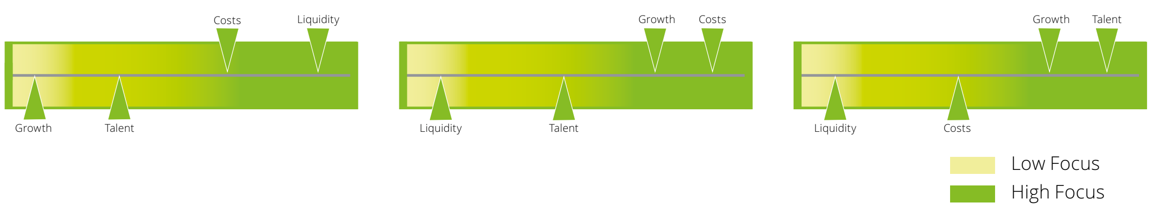


Survey insights

- Higher targets and better results can be obtained by focusing on multiple tactical levers
- The tactical levers with the most cost impact may be reducing external spend and improving policy compliance, but they are the least likely to be utilised

Figure 30. Traditional cost management scenarios

	1. Distressed	2. Positioned for Growth	3. Growing Steadily
Competitive situation	• Losing market share • Structural operating flaws • Liquidity concerns • No clear growth options	• Recovering from recession • Adjusting to demand levels • Growth concerns • Conditional options for growth	• Healthy balance sheet • Excess cash flow/reserves • High growth potential • Unconstrained options
Priority balance			
Primary objectives	• Conserve cash • Renegotiate costs • Restructure debt • Downscale business model	• Transform operating model • Optimise business processes • Right-size FTE structure • Fuel growth through savings (capital efficiency)	• Focus on investment and M&A • Optimise and align customer and product portfolios • Focus on efficient execution and delivery

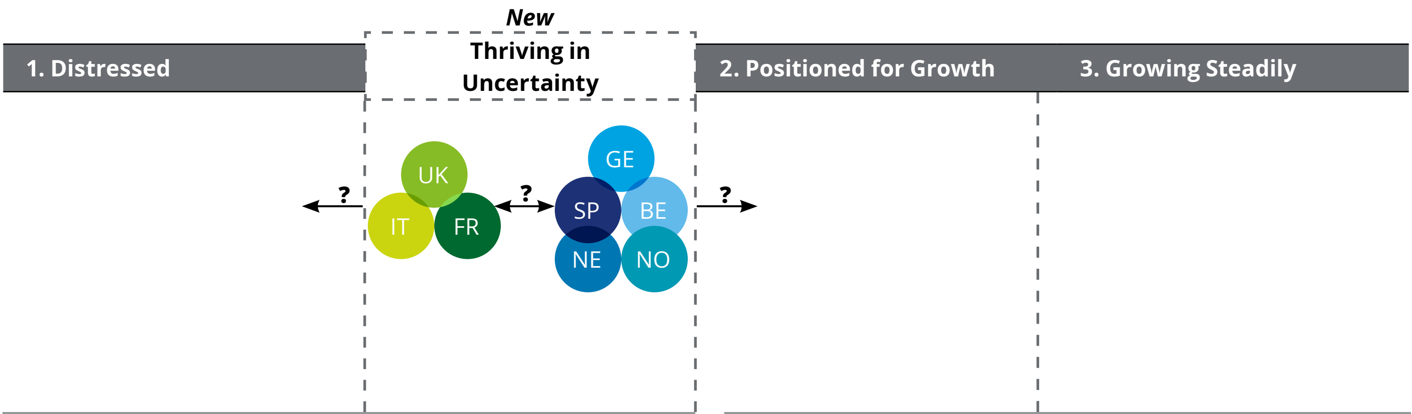


Source: Deloitte

A "distressed" business typically focuses on short-term survival and balance sheet improvement – looking for any cost and liquidity improvements that can help stabilise the business. A business that is "positioned for growth" typically starts by focusing on structural improvements, such as choosing the right operating model; it can then look for additional cost reduction opportunities to help fund its growth initiatives. A company that is "growing steadily" typically focuses on achieving profitable and sustainable growth through structural cost efficiencies and improvements – such as smart investments, M&A, and management of customer and product portfolios – actions that can strengthen its performance and competitive position.

Until recently, most companies fell into one of these three traditional categories; however, today's volatile and complex global business environment seems to be giving rise to a fourth category that we call "thriving in uncertainty" – a scenario that straddles the line between "distressed" and "positioned for growth" and involves organisations simultaneously pursuing the seemingly conflicting goals of growth, cost improvement, and balance sheet management. It remains to be seen whether this fourth category is a new and permanent feature of the business landscape, or simply a stepping-stone to one of the traditional categories (Figure 31).

Figure 31. A new cost management scenario has emerged



UK/France/Italy Competitive Situation

IT UK FR

- The UK faces a more uncertain business environment as a result of Brexit – 36% of UK respondents cite Brexit as a top external risk
- UK survey respondents cite both past (56%) and future (64%) revenue growth less frequently than other European respondents
- Cost reduction is the most frequently cited strategic priority in the UK (29%) and Italy (44%), indicating a more defensive posture
- GDP growth is low in France (1.3%) and Italy (1.0%)

Other European Economies' Competitive Situation

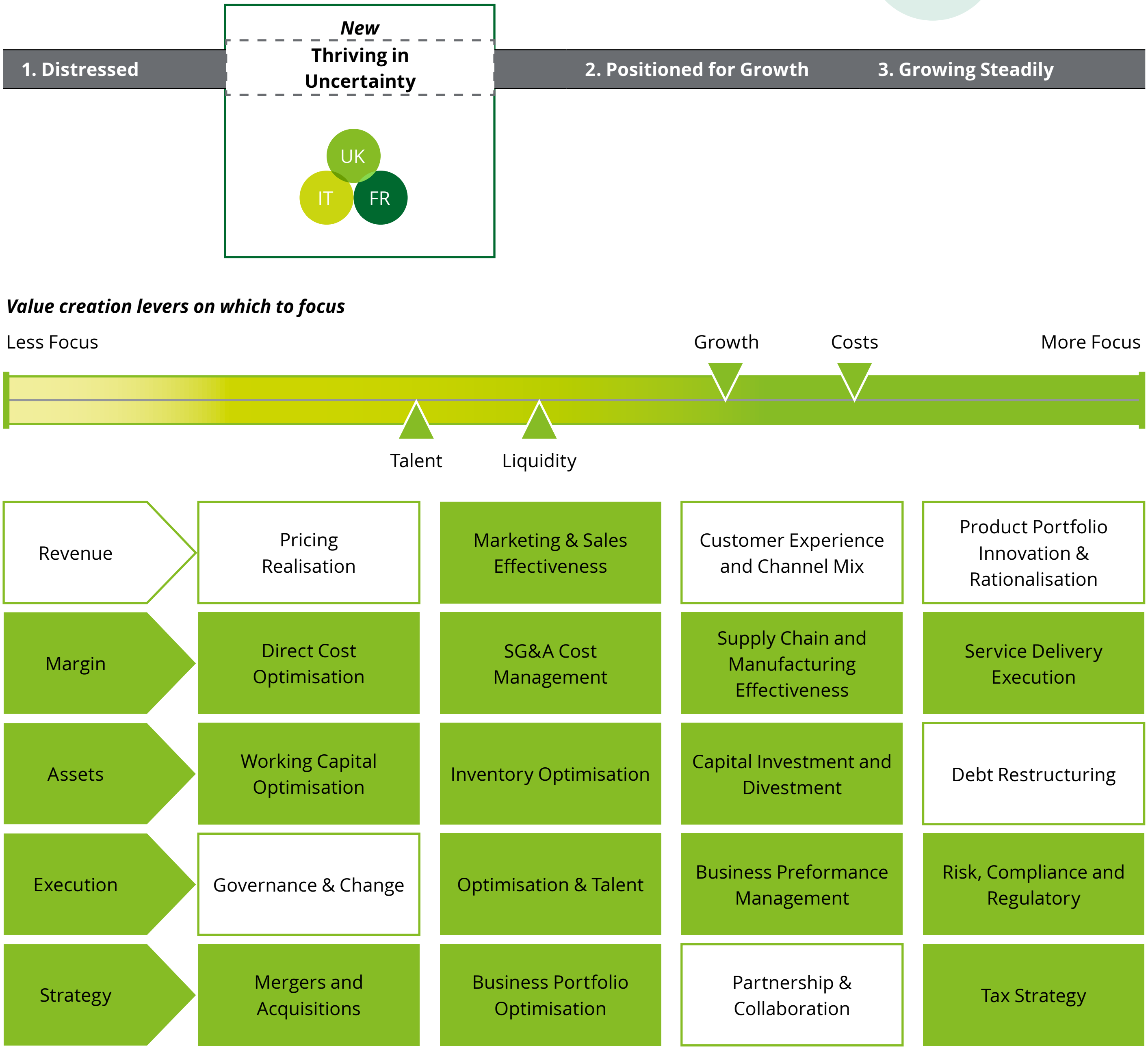
SP NE NO GE BE

- Germany, Spain, Belgium, Netherlands and the Nordics all cite sales growth as a higher priority than cost reduction, indicating a more offensive posture
- High unemployment rates in Spain (20.5%) have dropped significantly over the past two years, and GDP growth is picking up (3.4%)
- Macroeconomic factors like GDP growth and unemployment in Germany, Netherlands, Belgium and the Nordics are stable and improving

Source: Deloitte

For the UK, France, and Italy, macroeconomic factors seem to be pushing companies towards greater uncertainty, requiring a playbook with value creation levers that may be more defensive in nature (Figure 32).

Figure 32. Defence-oriented Playbook

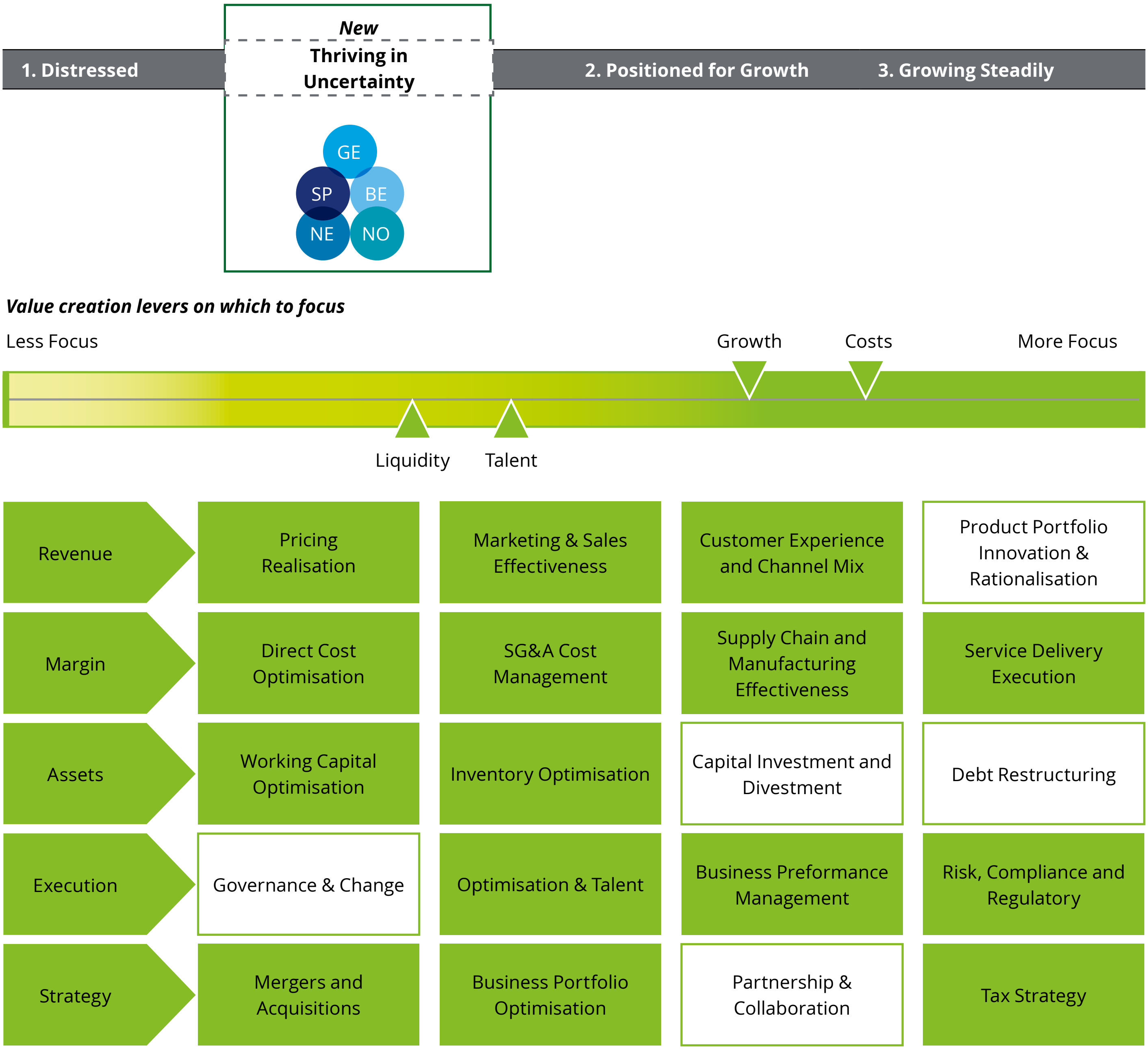


Indicates levers that Deloitte identified as potential focus areas

Source: Deloitte

In contrast, the other European markets surveyed seem to be moving towards a more positive outlook, requiring a different playbook with value creation levers that tend to emphasise growth (Figure 33).

Figure 33. Growth-oriented Playbook



Indicates levers that Deloitte identified as potential focus areas

Source: Deloitte

Looking ahead

Companies across Europe face a number of challenges, including slow GDP growth, high unemployment, and uncertainty associated with Brexit. Also, the tidal wave of change driven by digital disruption will likely spread quickly beyond the US, potentially reshaping the competitive landscape in all regions.

To tackle these complex and varied challenges, many European companies may need to pursue cost reduction more aggressively. Tactical cost actions alone will likely not be able to deliver the required level of cost savings. Instead, companies in the EU may need to adopt new approaches to cost management, shifting to actions that are more strategic and structural, such as increasing centralisation, reconfiguring the business, and outsourcing/offshoring business processes.

One question to ponder is whether there are hidden social, political, and economic barriers in Europe that make it difficult for companies to pursue and achieve aggressive cost reduction. And if so, have executives in the EU subconsciously accepted the barriers and scaled back their cost reduction targets accordingly – even if a more aggressive approach to cost management could help their businesses thrive?

During periods of uncertainty, companies that take bold action can recover more quickly and gain sustainable competitive advantages that boost performance both in good times and bad. Companies that are able and willing to make bold cost moves could find the current economic environment is a prime opportunity to position themselves for long-term success.

UK Appendix
Playing defence in the face of uncertainty

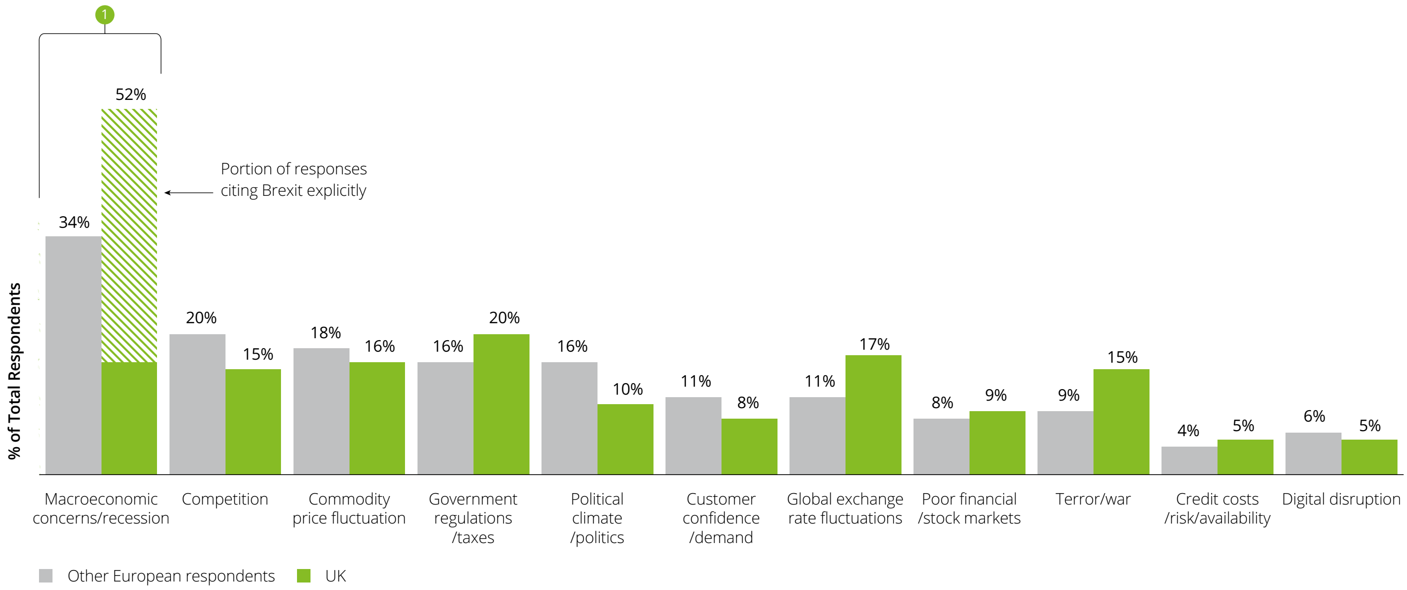
Cost reduction is the top strategic priority for UK companies, and past growth performance and future expectations are both lower than the EU average. This defensive posture is likely tied to significant uncertainty about the impact of Brexit.

Key survey findings for the UK

Concern about the economy and uncertainty created by Brexit. UK companies cite "macroeconomic concerns/recession" as a top external risk much more frequently than the EU average (52% versus 34%), primarily due to uncertainty created by Brexit (Figure B1).

Figure B1. UK respondents cite macroeconomic concerns / recession as the top external risk, primarily due to uncertainty created by Brexit

Top external risks

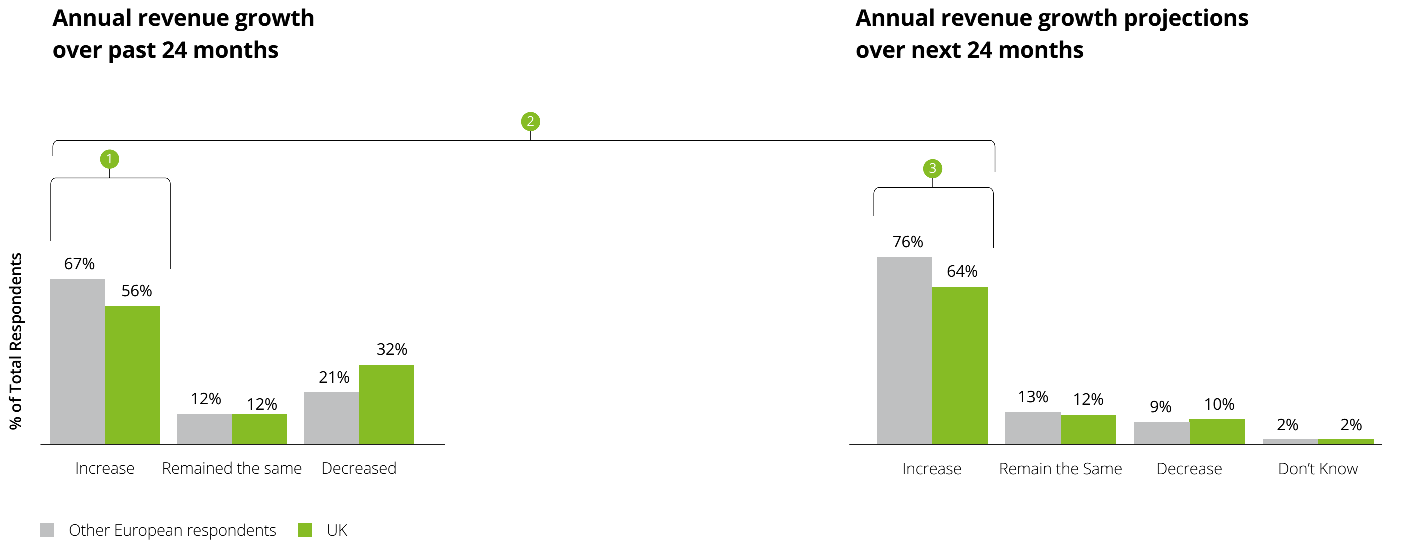


Survey findings

1. UK respondents cite macroeconomic concerns / recession as a top external risk more frequently (52%) relative to other European respondents (34%), primarily due to uncertainty created by Brexit

Lower than average growth. Compared to other EU countries, fewer companies from the UK reported revenue growth over the past 24 months (56% versus the EU average of 67%) or expect revenue growth over the next 24 months (64% versus the EU average of 76%) (Figure B2).

Figure B2. UK respondents cite past and future revenue growth at lower rates compared to other European respondents



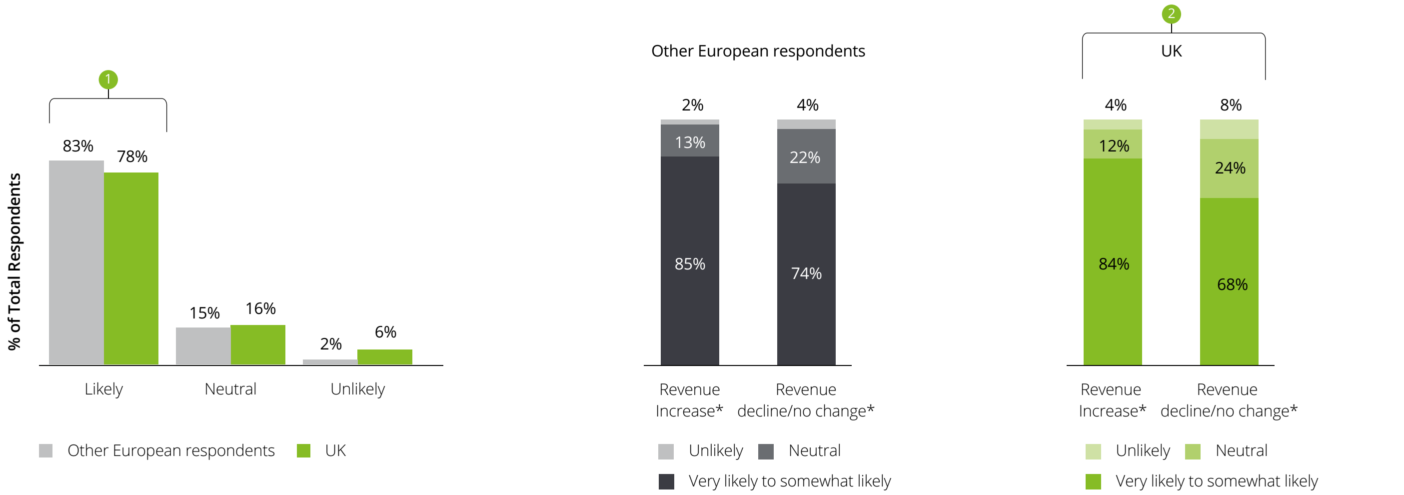
Survey findings

1. 56% of UK respondents reported revenue growth over the past 24 months, but 67% of other European respondents cited the same
2. While only 56% of UK respondents reported revenue growth over the past 24 months, 64% cited projected revenue growth over the next 24 months
3. 64% of UK respondents reported revenue growth over the next 24 months, but 76% of other European respondents cited the same

Saving to grow. UK companies are more likely to undertake cost reduction initiatives if they expect revenue to increase over the next 24 months (84%) than if they expect revenue to decrease (68%) (Figure B3).

Figure B3. UK respondents are more likely to undertake cost reduction initiatives if revenue is projected to increase over the next 24 months

Likelihood of cost reduction next 24 months



Survey findings

1. 78% of UK respondents indicated their organisations are likely to undertake cost reduction activities over the next 24 months – slightly lower than the rate for the rest of Europe (83%)
2. UK respondents are more likely to undertake cost reduction initiatives if revenue is projected to increase over the next 24 months (84% vs. 68%)

*Revenue changes refer to projected change in revenue over the next 24 months

Cost reduction is the top priority. UK companies are more focused on cost reduction than on any other strategic priority, reflecting a defensive posture (Figure B4).

Figure B4. UK respondents are more focused on cost reduction than on any other strategic priority

Strategic priority in next 24 months

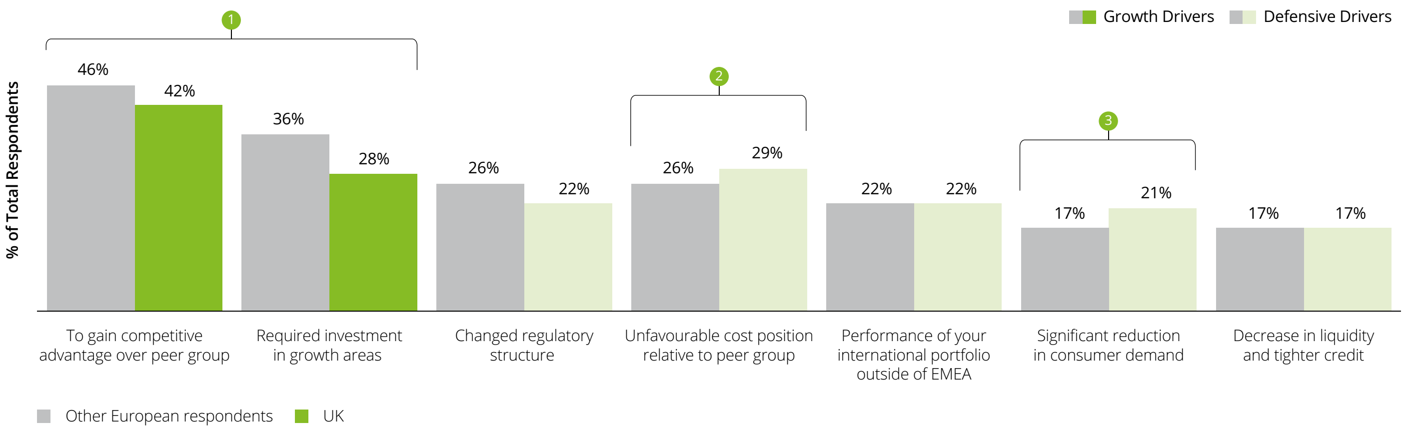
Survey findings

1. Unlike the growth-oriented priorities of other European respondents, cost reduction represents the most frequently cited strategic priority among UK respondents (29%)
2. UK respondents cite organization and talent as a strategic priority less frequently (13%) relative to other European respondents (19%)

Cost efforts less driven by growth. Overall, UK companies cite growth-oriented drivers of cost reduction less frequently than other EU companies, possibly indicating a more defensive posture (Figure B5).

Figure B5. UK respondents cite growth-oriented drivers of cost reduction less frequently relative to other European respondents

Drivers of Cost Reduction



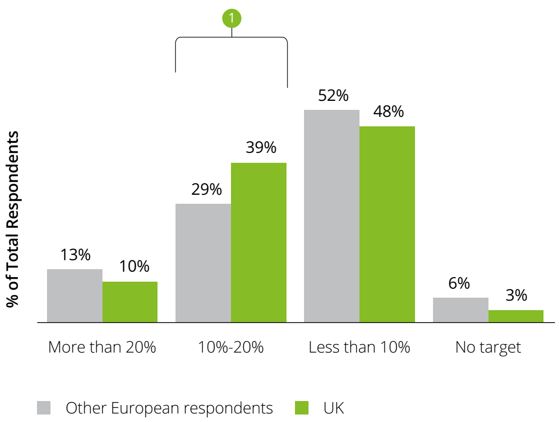
Survey findings

1. UK respondents cite growth-orientated drivers of cost reduction less frequently relative to other European respondents, possibly indicating a more defensive posture
2. UK respondents cite unfavourable cost position relative to peer group as a driver of cost reduction more frequently (29%) relative to other European respondents (26%)
3. UK respondents cite significant reduction in consumer demand as a driver of cost reduction more frequently (21%) relative to other European respondents (17%)

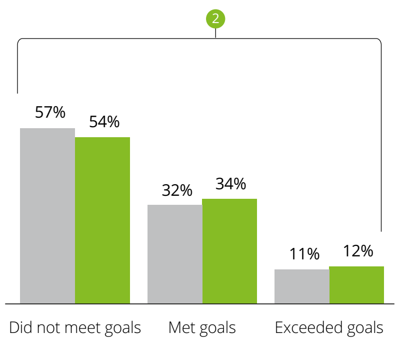
Higher targets. Similar failure rates. Although UK companies cite more aggressive cost reduction targets, reported failure rates (54%) are similar to those cited by all European respondents (57%) (Figure B6).

Figure B6. Although UK respondents cite more aggressive targets, failure rates are consistent with those cited by other European respondents

Annual Cost Reduction Targets



Success in Meeting Cost Target



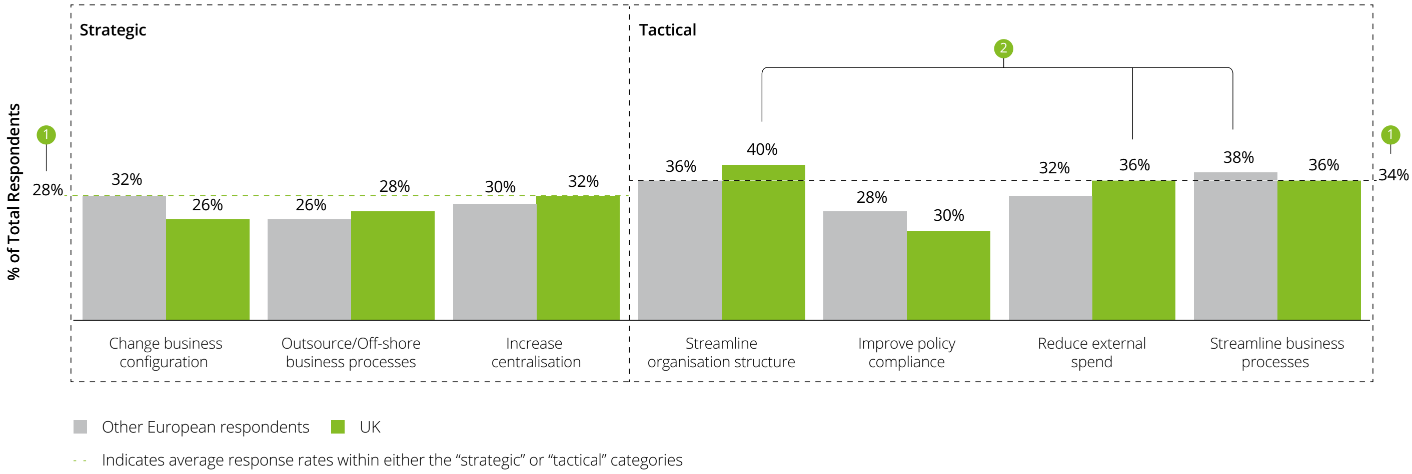
Survey findings

1. UK respondents cite cost targets of 10% – 20% more frequently relative to other European respondents, indicating their targets are slightly more aggressive
2. Although UK respondents cite slightly more aggressive targets, failure rates (54%) are consistent with those cited by other European respondents (57%)

Tactical actions favoured over strategic. Over the next 24 months, UK companies are more likely to use tactical cost actions (34%) than strategic cost actions (28%). The top-ranked tactical actions are: streamlining organisation structure (40%), reducing external spend (36%) and streamlining business processes (36%) (Figure B7).

Figure B7. UK respondents cite tactical cost actions as more likely to be utilised in the next 24 months

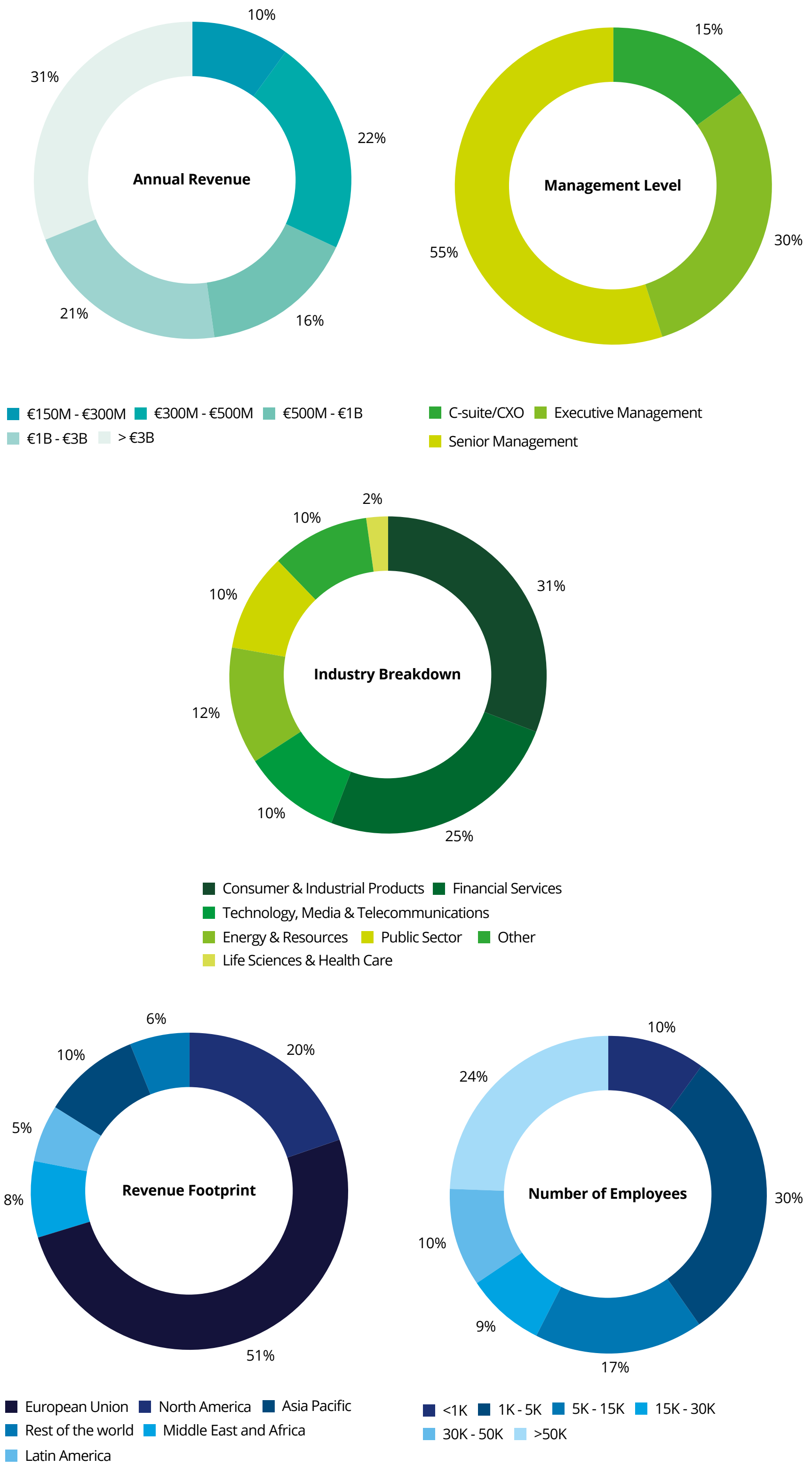
Cost Actions Viewed as Most Likely in Next 24 Months



Survey findings

1. UK respondents cite tactical cost actions (34%) as more likely to be utilized in the next 24 months relative to strategic cost actions (28%)
2. The top three most frequently cited cost actions are tactical in nature: Streamline organisation structure (40%), reduce external spend (36%) and streamline business processes (36%)

Figure B8. Firmographics Summary for UK (106 Responses)



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