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Insights

Unlocking the promise of cost optimization

Death by a thousand cuts? No, thank you. Organizations are moving beyond traditional cost-cutting to embrace growth-oriented cost optimization. We looked at four key strategies.

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Over the last hundred years, many different flavors of cost management frameworks, ideas, and trends have captured the imagination of business leaders. Consider Henry Ford's assembly line in the 1910s, all the way to Japanese management practices like Kaizen, lean, and just-in-time manufacturing in the 1980s. Or the offshoring trend in the late 1990s to early 2000s to save on labor. Several accounting-based tools have also cropped up along the way: "activity-based costing," "zero-based budgeting," and "economic value added" methods, to name a few. The end goal: Maximize productivity and keep costs at a minimum.

As cutting-edge as each of those approaches was, each in their own time, what worked in the past won't necessarily work today. Lean manufacturing, for example, used to be a means to keep costs down, but because that approach relies on precise, just-in-time inventory controls, an increase in supply chain disruptions makes it more difficult to implement without exposing the manufacturer to costly inventory shortages. Meanwhile, consider another common cost-cutting lever: trimming staff. Many organizations have already streamlined operations to a point where further headcount reductions offer diminishing returns or may even backfire, putting the organization at risk of not having the right talent available when investment picks back up again.

With growth at the top of many leaders' strategic agendas—and with growth as an increasingly complex goal to achieve given margin pressures, economic uncertainty, and the increasing competitiveness of innovation—organizations need to avoid "death by a thousand cuts" and adopt a strategic, more holistic approach to cost management instead. This means not only reducing costs to boost short-term profitability but also strategically freeing up capital to invest in long-term growth opportunities such as innovation, enhanced capabilities, and expansion into new markets. Welcome to a new era, one in which cost *optimization*—not cost *reduction*—is taking hold.

We took a closer look at how organizations are fundamentally rethinking their approach to cost management. As a window into the wider universe of companies, we considered examples in two widely different industries: consumer-facing companies like retailers and consumer packaged goods manufacturers, and the energy, resources, and industrials sector, including power and utility companies, energy producers, and industrial manufacturers. Each have distinct challenges and priorities, yet despite their differences, these sectors have shared imperatives to increase operational efficiency in a way that powers their longer-term success. To that end, organizations in both sectors are laser-focused on objectives like working with strategic partners, optimizing physical assets, streamlining supply chains, capitalizing on advanced automation including artificial intelligence, and more effectively managing their people. In both sectors, "It's not so much a question of driving out costs but reinvesting them in the future business," says Tore Christian Jensen, a Deloitte Denmark partner who specializes in operations transformation.

We spoke with strategy, operations, and transformation officers from Fortune 500 companies, as well as professionals from various Deloitte Global member firms around the world, to determine where companies are finding new efficiencies and redeploying savings into areas promising long-term growth. While some approaches take years to implement, others can lead to results in short order. Here are four approaches that appear to be gathering momentum.

Prioritize long-term investments

Under traditional cost management models, organizations often encounter a common pitfall: In striving for short-term profitability, they fail to strategically invest in the company's future. Neglecting strategic investments in favor of short-term cost reductions can backfire by stifling innovation, degrading product or service quality, lowering employee morale, and missing growth opportunities.

Electric utilities offer an interesting example of an industry that's avoiding this pitfall by investing in advanced technology that can open new avenues for cost optimization. Historically, the power sector has been an asset-intensive business, requiring substantial investments in physical infrastructure, including power plants, transmission lines, and distribution networks. Traditionally, utilities had a centralized operating model, generating power and distributing it in one direction to customers. But now, many are moving to a more decentralized approach, in which energy moves in two directions, both *to* and *from* the customer as residential and commercial customers are becoming power producers, not just power consumers. This change is underway due to increased investment in distributed energy resources, namely electric vehicles, rooftop solar, and digital technologies that allow bidirectional flow of power. But the bidirectional flow of data is nearly as important as the flow of electrons, allowing utilities to integrate these distributed energy resources into the distribution system and optimize costs across these assets, says Kate Hardin, executive director of Deloitte's Research Center for Energy and Industrials. "Real-time data on EV charging levels or power generation from rooftop solar panels can help utilities get through peak demand periods without outages, diverting energy to where it's most needed and reducing curtailment." In some cases, the additional storage or generating capacity can offset the need for additional infrastructure spending, she added. The potential cost savings and efficiencies can be significant, but first, utilities should invest capital upfront in upgrading legacy data systems.

Often, that means replacing siloed data architecture with holistic systems that make information instantly available throughout the organization. Utilities aren't alone in this. In Deloitte's 2024 MarginPLUS study of nearly 300 senior business executives, half of the respondents cited legacy technology infrastructure as a barrier to efficiency.[1] Yet the need may be especially acute for utilities: Something as basic as the physical location of an asset may be stored in several different formats (street address, GPS coordinates, or latitude and longitude, for example) across different systems. Emergency crews may lose precious time plowing through multiple applications to be routed to the right location. Instead, data should provide a single source of truth.

> "This isn't about cutting heads. It's about becoming more efficient, spending less on operations and maintenance, and using those resources to invest in the future." – Jian Wei, principal, Deloitte Consulting LLP's power and utilities practice

Utilities are also investing in building out their AI toolkit to make their operations more resilient and mitigate costly risks. Consider climate change and the rising risk of wildfires. A hot day, a strong wind, and a live wire that snaps and tumbles onto dry vegetation. "That's what utilities try to prevent," says Jian Wei, a Deloitte Consulting LLP principal specializing in technology-enabled transformation in the energy industry. Traditional prevention—physically inspecting assets line by line—can amount to shooting in the dark. Plus, every time utilities roll the trucks, they're incurring costs. "Traditional manual inspections become inadequate to mitigate heightened climate risk," Wei says.

Today, drones equipped with high-definition cameras can feed data to AI platforms that can identify problem areas, enabling crews to be far more tactical and precise. "Inspections cost US utilities billions of dollars every year and the budgets keep growing. They could potentially see large efficiency gains by leveraging these technologies," Wei says. "This isn't about cutting heads. It's about becoming more efficient, spending less on operations and maintenance, and using those resources to invest in the future."

Shift from cost management in silos to cost optimization synergies across the organization

Traditionally, many companies have pursued cost reduction in silos, focusing on cutting expenses in specific departments without regard to the broader organizational impact. This method often overlooks the potential for unintended consequences that could stifle the company's long-term growth. In contrast, cost optimization as an organizational strategy offers a more holistic approach. It involves a thorough analysis of spending and processes across the entire organization to identify not just savings, but also opportunities to enhance value. This strategy involves a cultural shift from merely seeking to minimize costs to optimizing them in a way that supports sustainable growth and competitive advantage. By embracing cost optimization, companies can align their financial objectives with their long-term strategic goals, helping ensure that every dollar spent contributes to the overarching mission.

Consider the challenges of a food company, which faced dual pressures of cutting costs and planning for the next decade of growth, but its highly fragmented structure, with work spread across various groups, geographic regions, and business units, compounded the issue. Executives in finance, human resources, marketing, commercial, information technology, legal, and other departments managed their costs in isolation, lacking regular forums for cross-functional collaboration on strategic initiatives and investment opportunities. This siloed approach led to missed opportunities for cost savings through expanded economies of scale.

In a bid to transform its operations, the company embraced a cross-functional operating structure and established regular touchpoints for departmental leaders. This shift revealed that early-stage pain points were causing inefficiencies downstream across multiple departments. Take, for instance, if a supplier added a new food product like dinner rolls or hamburger patties to the company's database but accidentally miscoded the quantity or mislabeled important details like gluten-free or grass-fed product features. What might sound like a minor data-entry error would snowball across teams. With the wrong data in the system, the pricing team couldn't set the correct contracted price, and the sales team might pitch the wrong item to customers, so both teams would have to double back to correct the error. Downstream, multiple resources across the finance and customer service teams would need to get involved to resolve disputes and both the supplier and customer experience would become cumbersome. Under its previous operating model, the executives didn't have visibility into how these inefficiencies compounded across teams, but once they were able to piece together the total costs of these misfires across departments, they were able to build a compelling business case for investing in improvements to their supplier portal. The improvements drove substantial cross-functional savings while also allowing an opportunity to innovate and drive additional revenue-generating opportunities, through better leverage of the data.

Adam Whiting, a principal in Deloitte Consulting LLP's M&A and restructuring practice, specializing in retail and consumer products, emphasizes the significant financial benefits of shifting to a less-fragmented, more holistic approach: "When you look at it by silo, you might be able to assign effective targets to each function, but if you took that same energy and rigor and applied it toward cross-functional process analysis and sizing, you might be able to prioritize that same investment of time and capital to drive 10 times the savings. And that's because you're able to find transformational opportunities that aren't isolated solutions within a function—and drive momentum for larger, more strategic shifts."

Rely on strategic partners, and not just for non-core functions

In the 1990s, some companies embraced a cost-cutting approach advocated by management thinker Peter Drucker in his 1989 *Wall Street Journal* article, "Sell the mailroom."[2] Best captured in the popular motto, "Do what you do best and outsource the rest," it was essentially a cost arbitrage game. Organizations would focus on their core competencies and outsource everything else to third-party contractors, including services like the mailroom, janitors, security, logistics, payroll, and food services.

That classic form of outsourcing initially succeeded in saving organizations money and delivering value to shareholders, but over time, organizations trimmed back-office operations to a point where further cuts could only provide diminishing returns. Now, many companies are looking for partners who can drive transformation and provide continuous innovation. In other words, the focus has shifted from cost-cutting centered on transactional, non-mission-critical functions to driving better, shared outcomes in areas closer to the heart of the business. Think of it as next-generation managed services, or "operations partners."

Brian McCarthy, a principal in Deloitte Consulting LLP's strategy and analytics practice, specializing in retail and consumer products, highlights this shift in the retail sector: "Even things that we might consider as core retail capabilities can now be outsourced." For instance, consider tasks such as space management and the creation of planograms, and schematic plans that retailers develop to display merchandise in a way that maximizes sales. These tasks no longer require a dedicated internal team; they can be managed by external partners, who often have stronger talent and technology to drive innovation and optimization.

In the last few years, many retailers have also been turning to external partners as they invest in curbside pickup, which exploded in popularity following the pandemic. For small stores located inside the sprawling footprint of a mall, running these services is a tricky (and expensive) business.[3] And for a mall with 100-plus stores, offering individual pickup stops for each tenant is simply impractical. Consider the logistical quagmire of managing the limited parking, storage space, and labor involved. To save on these costs, mall operators have been piloting app-based, centralized curbside pickup services for tenants, sometimes in collaboration with supply chain companies. It's a cost-sharing approach that can reduce wait times for customers, increase digital sales, and overall, add value for tenants.[4]

In some cases, external partners can also be trusted with managing core business risks. For example, while artificial intelligence and consumer data present unprecedented opportunities to connect with specific shoppers, consumer companies that appear to mishandle information or compromise privacy face considerable reputational, regulatory, and financial risks. But operating an in-house team to oversee data privacy and cybersecurity requires highly specialized talent and is expensive.

Some consumer companies are turning to external risk management platforms to help identify, flag and mitigate risks before they become crises, says Asish Ramchandran, principal and Deloitte's Global Ecosystems and Alliances Growth leader. "As threats rise, the fixed cost is expected to go up, but you don't have to pay a constantly high price." As such, "The consumer industry is now at the vanguard in making the cybersecurity capability part of its variable cost structure," he adds. This kind of strategic external partnership can help protect against devastating fraud or reputational damage and ensure the organization's future resilience while keeping costs from ballooning.

A key in all of these examples is that the external partners don't just take on the organizations' so-called "mess for less" as in a more traditional outsourcing model. They can drive better strategic outcomes for the business overall. That is not the conversation that was happening 20 years ago. This is a significant shift from more traditional outsourcing models, which focused solely on transactional processing without focusing on business outcomes.

Integrate tech to help with everything from forecasting to talent to risk management

Technology like artificial intelligence tools can be instrumental in transforming traditional cost management approaches.

Take, for example, how organizations across industries are using AI to enhance their decision-making. One Asia-based data and analytics leader with consumer sector experience in both retail and consumer packaged goods manufacturing describes efficiencies to be found through AI-assisted forecasting and analytics tools. Previously, the executive worked for a CPG company where one major challenge involved managing huge volumes of raw materials for manufacturing products like shampoo, laundry detergent, and toothpaste. Here, AI-powered analytics helped challenge conventional wisdom. When one supplier offered a 3% discount for taking bulk delivery upon contract signing, instead of in smaller, incremental allotments, the procurement team initially leapt at the apparent bargain. Yet AI-powered analytics connected the dots across broader company data, unveiling a surprising revelation: Storing unused materials through periods of slower consumer demand was driving up costs by 4%. In other words, the initial 3% *discount* would inadvertently generate a 1% *increase* in overall costs. The team built a new ordering system tied to more precise forecasts of consumer demand. “It was a perfect example of how AI and process optimization can help in terms of improving your overall sales and reducing your cost,” the executive says.

In the energy sector, AI tools are also helping companies mitigate costly disruptions by enabling leaders to make faster decisions in response to changing regulations, geopolitical events, and natural disasters, says Mike Lynn, Deloitte Touche Tohmatsu Limited’s Asia-Pacific oil, gas, and chemicals leader: “Where we’re seeing technology play a part is then the ability to globally source products and then optimize around logistics supply chains in real time.”

For instance, in the event of a geopolitical conflict that disrupts usual shipping routes, AI systems can swiftly analyze data across various systems to recommend the best suppliers for necessary parts. “Let’s say various channels are cut off. Where do I get my parts from now? And before you’d have a whole lot of analysts working, there’s now a whole lot of technology-based solutions that can answer that question in an instant. This is where AI is helping, is that ability to process huge amounts of data from multiple systems to get an optimized answer,” Lynn says. This rapid processing not only accelerates decision-making but also significantly reduces costs by minimizing downtime and optimizing procurement strategies, ensuring that operations can continue smoothly and economically even during disruptions.

“While companies are getting better at setting up technology, there's a graveyard of undeployed functionality that is not in sync with underlying strategy or processes." – Tore Christian Jensen, partner, Deloitte Denmark

A word of caution, though: While technological tools are now a key enabler for cost optimization strategies, tech investments, themselves, can also run the risk of creating unnecessary costs. "While companies are getting better at setting up technology, there's a graveyard of undeployed functionality that is not in sync with underlying strategy or processes," says Deloitte Denmark's Tore Christian Jensen. Technologies implemented too quickly and widely may only magnify failure and increase costs. The challenge is how to scale these technologies in a way that makes a tangible difference across the organization.

The new era of cost management

Cost management has taken many forms over the years, but over time, one principle has remained constant: No company has ever cut its way to prosperity. It is time for organizations to fundamentally reframe their approach. Instead of focusing on traditional cost-cutting or piecemeal improvements, the emphasis is now on creating broader efficiencies across the organization and, in doing so, freeing up resources (whether capital, equipment, or people) that can be redeployed to propel the business toward a more efficient, resilient, and prosperous future.

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Endnotes

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