

Cost Resilience amid and after COVID-19

Thriving in uncertain times

These are unprecedented times; confronting many leaders with challenges and questions they never faced before. How can strategic cost management play a crucial role in defining the right actions to thrive and win in these uncertain times?

Only a few would have predicted that the cause of the next economic downturn would be a virus. Setting aside the human toll it is taking globally, the Covid-19 pandemic has caused significant disruptions to the way businesses operate. The many unknowns surrounding the virus – such as the duration of its spread, the possibility of additional waves and the extreme volatility of demand and supply – make it very difficult for firms to adjust and plan for the future. Rapid response to the new conditions is required.

For many companies, cost management has been a strong, annually recurring imperative. However, as companies continued to have positive expectations for revenue growth, many didn't focus on cost performance structurally. Consequently, cost, operating and business models have drifted away from each other. During such crises, the unprepared are quickly confronted with a plummeting top-line and are struggling to adjust their cost model. Immediate action is often tactical: cash flows and working

capital are being optimized, whilst more radical cost measures start to be considered. Within Deloitte, we strongly believe a more structured approach, going beyond cost-cutting, is required to safe-guard your competitive position and future growth potential. To help you navigate through these times, we gathered our experience into this point of view, including the key elements to consider when strategically reflecting on the cost measures to take during and after the COVID-19 crisis.



Mind the gap ! History has favoured the prepared

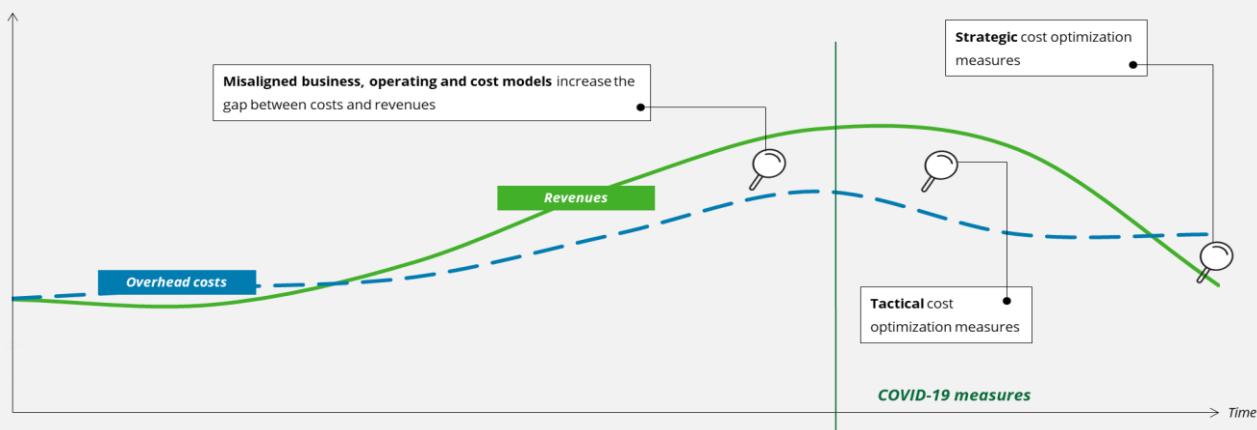
There is no question that the COVID-19 situation has or will result into a cost optimization exercise for many companies. Temporary freezes on new hires, renegotiation of key contracts, review or delay of CAPEX investments, optimisation of inventory levels or cut of performance rewards: here is a snapshot of some measures that organizations have already taken to *respond* to the situation.

These are examples of typical tactical short-term oriented cost-savings actions. Nevertheless, there is more to tell about the cost story: whilst short-term initiatives are necessary to cope with the current situation, a more structured and strategic reflection on cost models is required to boost *recovery* and prepare your business to *thrive* during these uncertain times.

Mind the gap

Let's start by taking a step back to better understand where we come from. The situation many organisations are confronted with today is the consequence of a limited, structural focus on costs prior the virus outbreak. With no real burning platform such as COVID-19, costs have been approached in a very opportunistic way. Whilst time and effort were mainly spent modelling future revenues, little attention was given to the supporting cost model.

Illustration 1: costs and revenues management over time



The current COVID-19 outbreak, highlights two major flaws when paying little attention to your cost model:



A lack of cost transparency preventing a central steering, a structural control and a strategic reorientation of the bottom line



Business and finance working as stand-alone departments resulting in a lack of mutual understanding

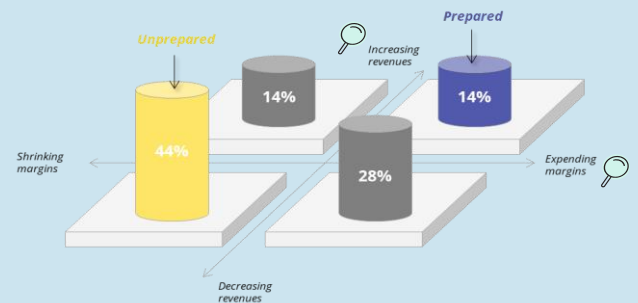
As a consequence, organizations' cost, operating and business models have drifted away from each other, with cost models no longer funded by business and many losing track of where costs reside, their origin, their nature. (see illustration 1)

History has favoured the prepared

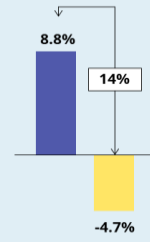
There can be never-ending debates about when the world goes back to normal and even what new normal will be. It is also difficult to assess today the long term impact that this virus outbreak will have on the economy. However, what is clear is that being prepared for new lockdowns or outbreaks will be a pre-requisite to thrive.

Moreover, history shows that those organisation that prepare themselves, are better equipped to outperform the unprepared during those turbulent time. As visualized in illustration 2, prepared companies are able to grow both revenues and margins (costs). But what does "being prepared" exactly means from a cost point of view? What are the checks you should have in place to be responsive and thrive in these uncertain COVID-19 times?

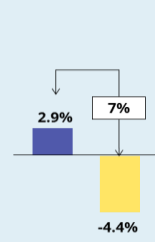
Illustration 2: history favours the prepared*



Revenue growth (CAGR)



Change in EBIT Margin



Only 14% of organisations manage to increase their revenues and expand their margin but they significantly outperform competition having, on average revenues and margins respectively higher by 14% and 7%.

Source: BHI, based on S&P Compustat and Capital IQ data

Setting-up for a cost reboot

To be prepared facing a new crisis such as the COVID-19 pandemic, companies have to swiftly adjust their cost models relying upon a truly agile and scalable business, including:



Improved flow of resources to areas of strategic importance



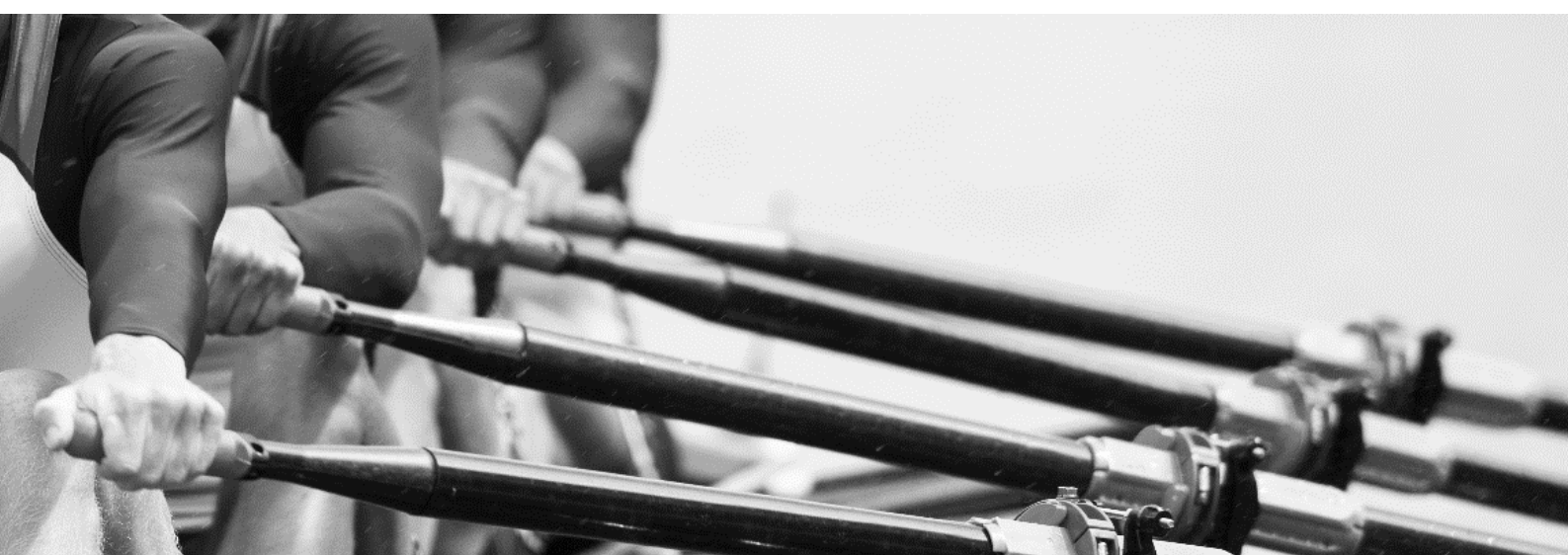
Minimized effects of organizational weakness



Reduced level of inefficiencies



Decreased amount of effort and costs dedicated to non-strategic activities



Following a pragmatic and efficient approach, this view point will walk you through three steps we advise you to follow to reboot your costs:

- 1 Determine your total – addressable – baseline
- 2 Explore the different cost levers
- 3 Don't over-promise but ensure successful delivery

1. Determine your total baseline

The first step of our recommended approach is to determine your baseline. This baseline will be the starting point to identify your cost improvement and saving initiatives. It is made of:



Indirect spend

Costs related to the purchase of goods and services allowing the organisation to operate but not directly linked to the manufacturing of its goods or delivery of its services (typical examples are travels and expenses, office supply, trainings, hiring fees, ...)



Extended workforce

Costs related to off-balance sheet workforce including contingent workers (individuals working for the organisation with clear job descriptions and reporting lines but their salary is not processed through the company's payroll) and external providers (third-party organisation hired for a specific mission/activity)



Labour

Costs directly linked to the compensation of on-balance sheet employees (permanent and fixed-term); including salary, performance rewards and other on-cost (taxes, welfare plans, pension accounts, ...)

Important element to note: you can only manage those costs that you can control directly. Therefore, focus on addressable costs when determining your baseline, leaving behind for now non-addressable costs such as taxes or depreciations.

2. Explore the different cost levers

The second step of our approach aims to assess the cost baseline by exploring different cost levers to identify cost improvement initiatives. Six cost levers can be considered, resulting in both tactical and strategic transformative improvement initiatives resulting in long-term benefits:



Demand management: Reducing level of effort through elimination of work (i.e., rationalizing management reports, standardizing master data, harmonizing policies)

Typical initiatives: re-evaluate (internal) service levels according to demand, rationalise reporting needs and standards



External spend management: Aggressively sourcing and managing indirect external spend; applying deep category-specific insights to develop the right program to manage each major spend category

Typical initiatives: review (travel) and expense policy, consolidate sourcing (office supply, health insurance, ...), renegotiate/reduce contingent workforce



Business process optimisation: Simplifying, standardizing, re-engineering and automating end-to-end processes (e.g., order-to-cash, procure-to-pay) across business units and geographies (including enabling technologies)

Typical initiatives: eliminate process duplication (data quality check, ...), automate processes, maximize value of ERP enabled processes

Scanning through your functional cost baselines applying those different lenses will allow to identify cost-saving opportunity



Business and operating model: The Operating Model determines how a company will be structured and governed to achieve its strategic intent
Typical initiatives: review return on investment of key programs, real estate rationalization, manufacturing footprint & supply chain network



Service delivery model: Clearly defining and optimizing what work is performed, where, with how many resources and at what cost, resulting in optimal realignment of functional staff
Typical initiatives: re-balance delivery models (offshoring, near shoring, ...)



Organisation design: Aligning the organisational structure with overall business and operating models; defining required functional capabilities and roles / responsibilities and reducing layers and broadening spans of control
Typical initiatives: review performance management and incentive structure, review spans & layers, eliminate/relocate low-added value activities

3. Make your cost saving program a success

Success of a cost transformation program, however, goes beyond a structured approach and methodology. It is easy to set targets, but the implementation of your initiatives will ultimately define your success.

Based on our long-standing experience of strategic cost transformation programs, we strongly recommend you to consider four key success factors that will help you implement your cost savings initiatives successfully:



Stakeholder ownership

Designated stakeholder need to become owner of cost saving initiatives

Emphasis on the benefits to the business from day 1 to the broader audience



Actionable initiatives

Identify actionable initiatives; no "theory talks"

Take into account the "agility" of your organisation, focus on bite-sized initiatives

On the longer term, consider cross-functional initiatives



Fact base, data-drive approach

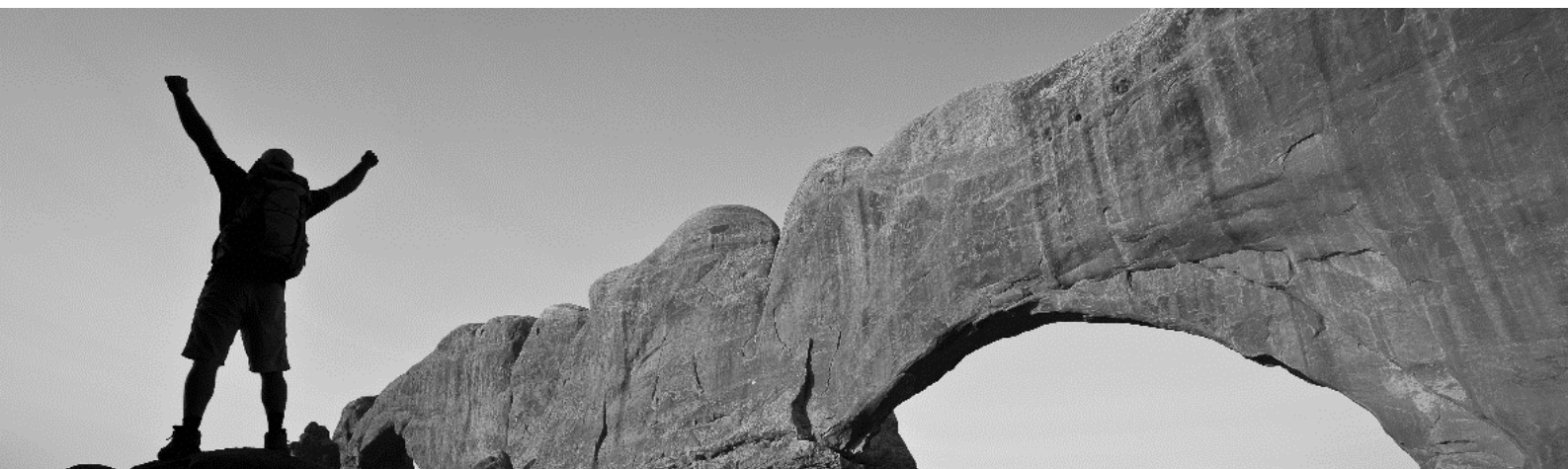
Define a clear current state cost base that is detailed enough to withstand challenges

Set clear targets and timelines – what outcomes need to be delivered and who is accountable



Cost Program Command Centre

Establish a dedicated cost reduction team to monitor costs, benefit realization and initiate corrective measures



Are you prepared for the next crisis?

With our recommended three step approach, we are confident that you have the right toolkit to look at rebooting your cost structure and are prepared to thrive in these uncertain times.

Following this approach, your cost model will be: transparent, scalable and flexible:

Moreover, your organization will have: cost-savings initiatives, the ability to monitor cost performance and a cost governance structure:

✓ Your cost baseline is transparent

- You have consistent and aligned data on your addressable cost categories
- You have a clear view on cost kinds (e.g. personnel, supplier spend, etc.), cost nature (fixed, variable, etc.), cost drivers (e.g. activity volume asset size, #FTE), and cost origin (e.g. transfer pricing, cost re-charges)



✓ You have identified pro-active and realizable cost-savings initiatives

- You know what to do to optimise your cost on the short-term, mid-term and long-term
- You have an execution plan for each initiative: business case, owners and KPI



✓ Your cost baseline is scalable

- The impact of an increase/decrease in sales is proportionally that the impact on your cost
- You can predict profit margin throughout business cycles and seasonality



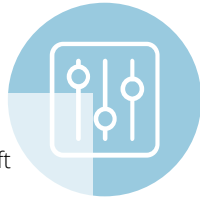
✓ You monitor your cost performance

- You benchmark your cost against your peers and track evolution
- You track the cost and profitability for each of your business activities



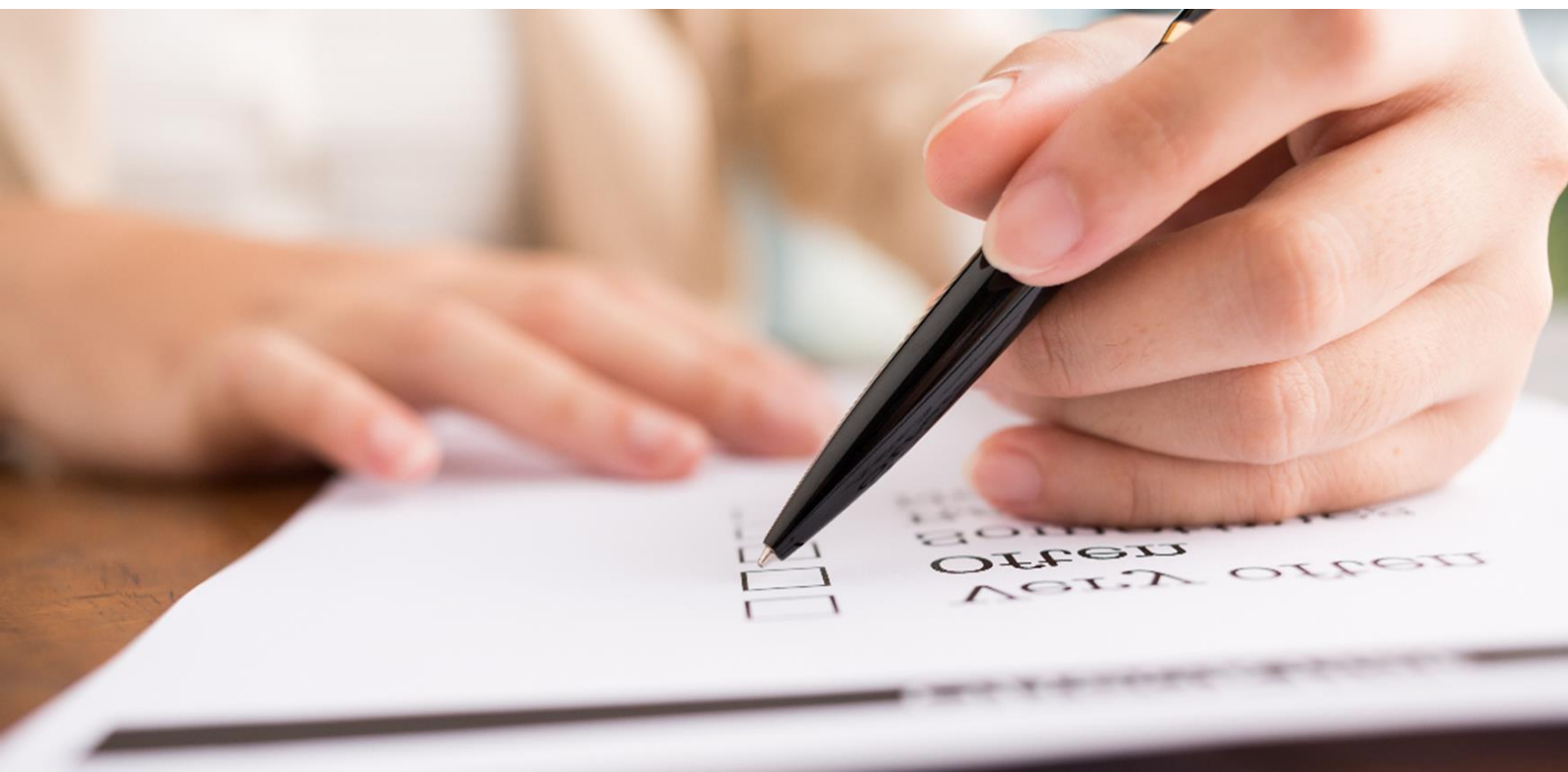
✓ Your cost baseline is flexible

- You can reallocate resources and shift priorities across your business
- You have an adaptable cost baseline through outsourcing and contingent labour



✓ You have a cost governance structure in place

- Your cost savings initiatives are endorsed by your leadership team
- There are processes, skills and tools available to deliver and monitor these initiatives



Summary

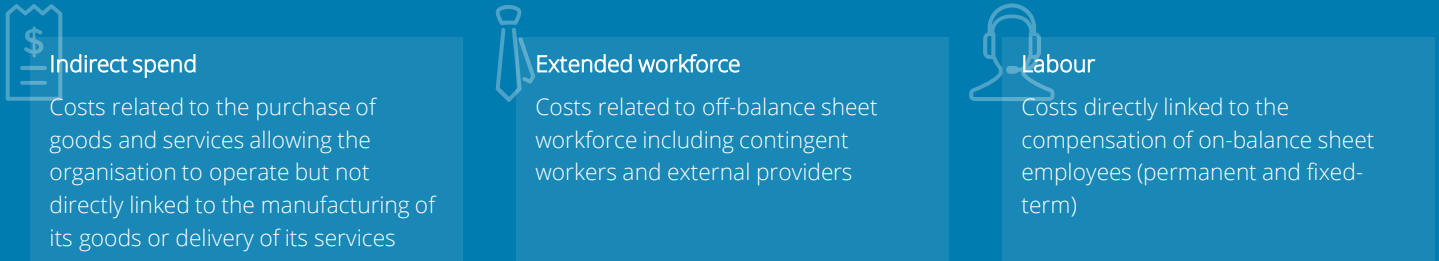
There is no question that the COVID-19 outbreak has substantially impacted business performance, requiring the swift implementation of measures to *respond* to the crisis. It is our recommendation to leverage strategic cost transformation as a key lever not only to mitigate the impact of the pandemic on the short term but also, and more importantly, to *recover* and *thrive* in the longer term.

As the economic environment has been favorable over the past years, time and effort was mainly spent modelling future revenues, whilst little attention was given to the supporting cost model. As a consequence, the cost management and governance of many businesses lack transparency, central steering and structural control.

This burden of the past has caught up with us today, slowing companies down in their cost decision making process. As history proves that prepared companies are thriving in uncertain times, we suggest you to follow a three step approach to reboot your costs and get prepared to thrive these uncertain times.

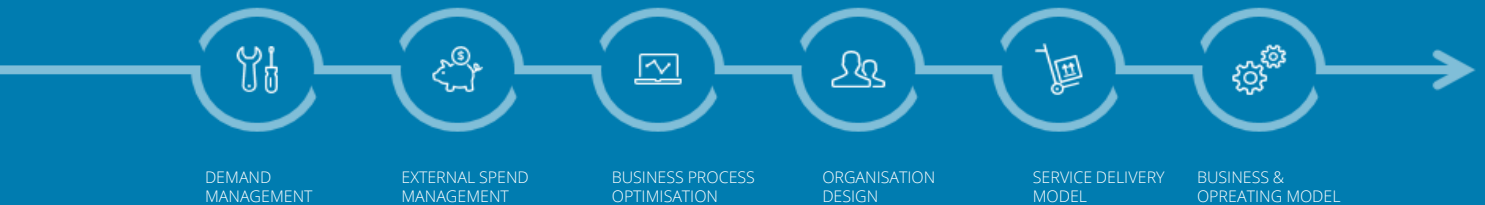
1. Determine your addressable baseline

The first step is to consolidate a baseline, starting point of your cost reboot exercise. This baseline is made of three cost categories:



2. Explore the different cost levers

The second step aims at identifying cost improvement initiatives scanning the baseline through six different cost levers. This will result in in both tactical and strategic transformative improvement initiatives bringing long-term benefits:



3. Make your cost saving program a success

Based on our long-standing experience of strategic cost transformation programs, we strongly recommend you to consider four key success factors that will help you implement your cost savings initiatives successfully:

-  Stakeholder ownership
-  Actionable initiatives
-  Fact base, data-drive approach
-  Cost Program Command Centre

Following this three step approach, we are confident that you have the right toolkit to reboot your cost management and thrive these uncertain times

- ✓ Your cost baseline is transparent
- ✓ You have identified pro-active and realizable cost-savings initiatives
- ✓ Your cost baseline is scalable
- ✓ You monitor your cost performance
- ✓ Your cost baseline is flexible
- ✓ You have a cost governance structure in place

Contact

If you want to learn more about the Strategic Cost Transformation practice within Monitor Deloitte and how our reboot program can help you, please contact the authors.



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