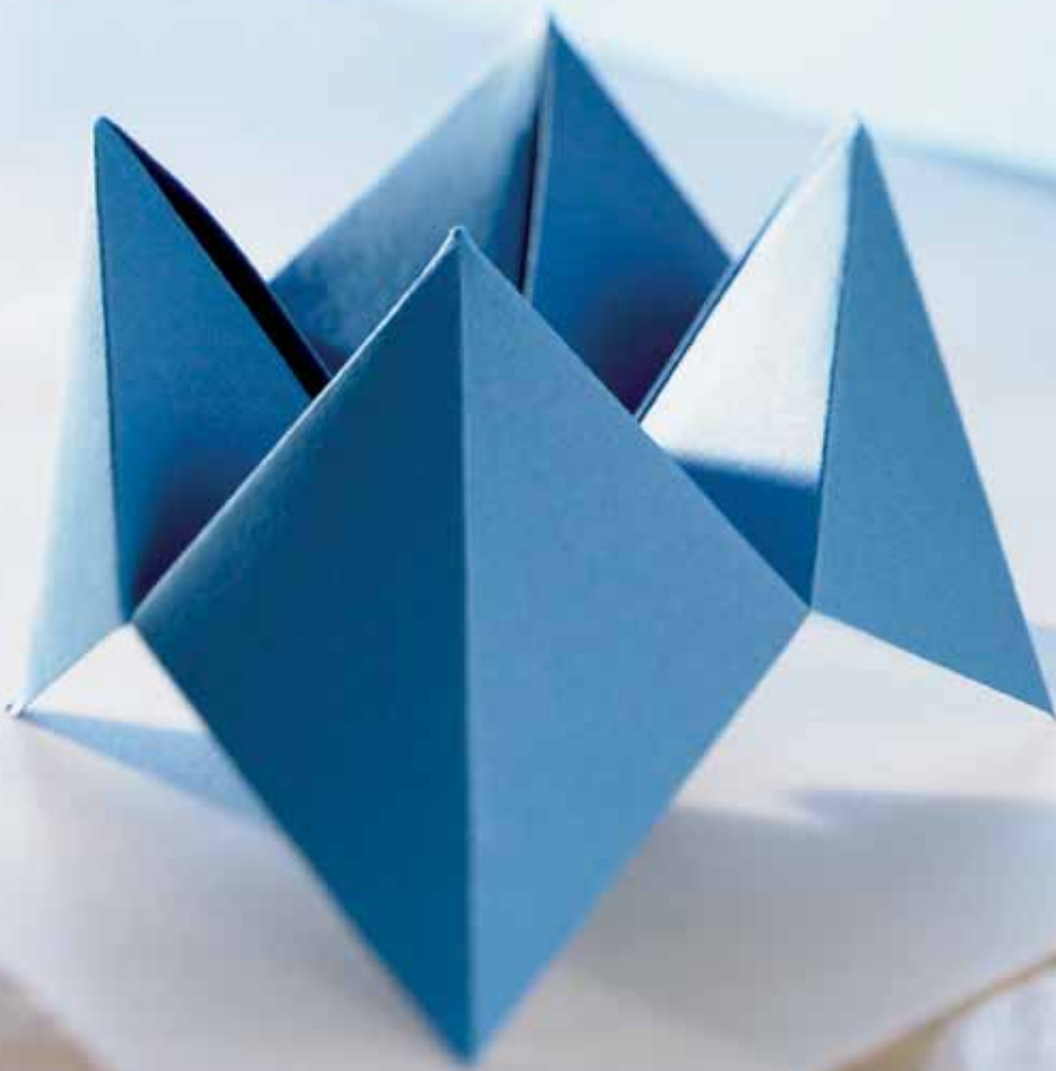


Rethinking Cost Structures

Creating a sustainable cost advantage

ADVISORY



Contents



About the research	p1
Foreword	p2
Executive Summary	p3
Introduction – Thinking about Cost	p5
1. The Cost Environment Case Study: Reynolds American	p7
2. Ownership of Cost Case Study: ABB	p19
3. Cost Strategy and Execution Case Study: Boeing and Wockhardt	p27
4. The Role of Technology Case Study: Bayer MaterialScience	p37
5. Measuring the Impact Case Study: BUPA	p43
6. Changing Behaviors Case Study: BASF Greater China	p51
Conclusion	p57
Appendix	p59

With the exception of the “KPMG perspective” sections, the views and opinions expressed herein are those of the Economist Intelligence Unit and the entities surveyed and do not necessarily represent the views and opinions of KPMG International or KPMG member firms. The information contained is of a general nature and is not intended to address the circumstances of any particular individual or entity.

Due to rounding, graph totals may not equal 100 percent.



About the research



KPMG International commissioned the Economist Intelligence Unit (EIU) to write Rethinking Cost Structures: Creating a sustainable cost advantage. The report is based on the following research activities:

- The Economist Intelligence Unit conducted a global survey of 427 senior executives, half of which were C-level executives. The survey covered a cross-section of industries and large, midsize and smaller organizations.
- To supplement the survey, the Economist Intelligence Unit conducted a program of interviews with 21 experts and practitioners in the field of cost management. We would like to thank those listed below for giving their valuable time and insights.

ABB - Tobias Becker, Head of Corporate Strategy

Alpha Bank - Charalambos Papanayotou, Executive General Manager

BASF Greater China - Helmut Sprengel, Director Finance & Corporate Service Center

Bayer Group/Bayer MaterialScience Greater China - Dr Juergen Dahmer, President

Boeing Corporation - Harry McGee, Controller

BP - Ian Springett, Group Vice President Strategy & Planning

BT - Claire Garrett, VP Procurement Policy

BUPA - Natalie-Jane Macdonald, Director Medical and Healthcare Purchasing

Ciba Specialty Chemicals - Craig Forbes, Global Head, Business Finance

General Electric - Julian Garrido, CFO and Controller of Latin America

Hilton Hotels - Mark Selawry, Senior VP, Productivity and Sourcing

Hydro One - Beth Summers, CFO

Malo - Stefano Ferro, CEO

NGRID - Humza Malik, Group Strategy and Corporate Development Director

RCS MediaGroup - Marco Ottelli, Controller

Reynolds American - Diane Neal, CFO

Sara Lee International - Mariano Domingo, former VP and General Manager of FSSE Center Iberia

Shell International Petroleum Company Limited - Ron Blakely, Executive Vice President Finance Downstream

Tata Chemicals - PK Ghose, CFO

Tellabs - Jean Holley, CIO

Wockhardt - Habil Khorakiwala, Founder and Chairman

Foreword

By Bernd Schmid,
Global Head of Advisory.

Today's businesses are under constant pressure to reduce costs yet many find it hard to do so in a sustainable fashion. 9 out of 10 cost reduction programs fail to achieve their targets, and the gains that are achieved appear to be short lived.

The increasing interdependencies faced by companies - internally between functions and externally with suppliers, customers and other stakeholders - help to make the management of cost a highly complex issue that can only be addressed at a strategic level.

Creating a cost-aware culture is the goal of most if not all of the companies the EIU surveyed, as they strive to respond to downward pressure on prices, intensifying competition, pressure from shareholders and the need to find cash to fund growth.

At the very least this means building cost incentives into employees' rewards and generating reliable cost data against which improvements can be measured. It also means looking at cost not within functions but across whole processes, with managers casting aside their traditional departmental loyalties to take a wider responsibility.

The ultimate manifestation of this approach is to rethink the whole business model around lower costs, possibly taking out whole layers of the organization or supply chain, rethinking customer interfaces and where appropriate embracing outsourcing, shared service centers and offshoring.

This survey, by the Economist Intelligence Unit, of over 400 leading companies from around the world aims to take an in-depth look at how businesses are addressing their cost structures and assesses their successes, the barriers to progress, and their hopes, concerns and expectations for the future.

The results and subsequent analysis are intended to give valuable food for thought for those trying to get to grips with this vital issue.

My special thanks go to the Economist Intelligence Unit for their insightful research and to all those who contributed their time and experience to this report.



Executive Summary



On average companies are achieving only 59 percent of expected savings, and just eight percent of businesses reach or exceed their targets for cost saving initiatives.

Cost structures are not immediately associated with dynamic change, but the reality is that many business innovations of recent times – outsourcing, category management, process standardization, low cost market procurement and some Internet sales models to name a few – arose largely out of cost concerns. In a highly competitive, globalized business environment, the competitive advantage which can arise from reducing expenses, and thereby increasing profits, will continue to fuel innovation throughout the enterprise.

This report investigates the cost challenges of today, how businesses are addressing them and reveals that 9 out of 10 companies surveyed are potentially missing out on major opportunities to boost profits. Some of the key reasons include the following:

Cost strategies are failing

Four out of five survey participants see an efficient cost structure as a source of long-term competitive advantage. But in practice, cost initiatives often disappoint. On average companies are achieving only 59 percent of expected savings, and just eight percent of businesses reach or exceed their targets for cost saving initiatives. One of the single biggest barriers to achieving these targets is the lack of adequate processes to drive cost reduction. Respondents gave their companies roughly a 'C+' rating overall in cost reduction, and until business raises its game, the savings will not flow.

Revenue growth has eroded cost discipline

42 percent of respondents admitted that revenue growth had led their businesses to take the eye off the ball on cost, even though two-thirds of respondents say that cost reduction requires extraordinary focus. One result is that companies are setting themselves low targets: the average business in the survey currently aims to reduce costs by only about two percent per annum. This research helps to show that companies must retain cost discipline during periods of growth or, in the words of one executive interviewed for this report, "it will come back to bite you".

Cost ownership is unclear and too narrow

Responsibility for cost management is unclear in many organizations. CEOs had "significant responsibility" for cost reduction at 60 percent of companies, and CFOs at 57 percent of the companies surveyed. Success in this field at the remaining organizations in the survey is unlikely: several experts interviewed for the report spoke of the importance of having strong backing for cost initiatives from the very top of an organization. Worse still, only 39 percent of respondents say all managers have a significant responsibility for cost management, and only 42 percent of businesses provide incentives for success in cost cutting. Every single person in a business has a role in this area, and each must fulfill it to achieve the culture of cost-consciousness so essential to ultimate success.

Unfortunately, many companies do not have a clear view of what drives costs: indeed, less than half of businesses surveyed make costs and profitability of individual units transparent across their enterprise.

Cost strategies are too cautious

Companies can too often pick the easy option for cost initiatives, rather than the one which will yield most savings. Improving process efficiency, by far the most popular approach to finding savings, can yield significant benefits but only if it is conducted rigorously. Survey respondents indicated that offshoring provided the greatest savings of a range of techniques, but this remains one of the least popular strategies. Of course offshoring can be painful and politically sensitive, but companies must be prepared to adopt major changes to their business model – including offshoring where applicable – in order to remain competitive.

Cost drivers are not clear or transparent

Companies need more insight into what drives cost in their business. This knowledge is vital in helping to ensure that cost cutting is targeted in the right places, and that the success of cost management initiatives is properly measured. Unfortunately, many companies do not have a clear view of what drives costs: indeed, less than half of businesses surveyed make costs and profitability of individual units transparent across their enterprise. In addition to improving efficiencies, IT has a major role to play in providing better quality information to support this goal.

Cost discipline is not embedded in the culture

It is hard to get people excited about cost management initiatives. Nevertheless, companies that achieve a sustainable competitive advantage are often those that embed cost discipline into the culture. A clear strategy and careful communication is vital to the success of any corporate project, but becomes even more so in cost cutting initiatives where employees may (quite understandably) feel threatened by change.

To make deeper savings, companies should seek to understand the link between their cost structure and the wider business. They need to address cost challenges with an extraordinary focus, often demanding cross-organizational thinking outside the 'safer' functional cost boundaries. They need to use IT more effectively to make costs and drivers of cost more transparent and measurable. They must create a cost-aware culture with strong incentives for eliminating waste, and be smart enough to focus on costs in the good times when they have the time and space to create sustainable change. And they must also be prepared to adopt bolder strategies to retain cost-efficiency in an increasingly competitive global economy.

Quick fixes rarely deliver large or lasting savings. A diet helps you lose weight for a while, but it often takes a change in lifestyle to deliver long-term health. It's a lesson that today's managers should take to heart.



Introduction - Thinking about cost

To understand some key elements of cost strategy, it is important to understand companies' underlying thinking about cost.



In other words, the distilled definition from these executives for 'cost structure' is "the costs arising out of a company's business model".

'Cost structure' is a term frequently used, but rarely formally defined. The traditional definition in economic or accounting theory revolves around the spending itself. A typical example is "The relative proportion of fixed, variable, and mixed costs found within an organization."¹

Senior executives, on the other hand, have almost as many definitions as there are companies. Craig Forbes, Global Head, Business Finance at Ciba Specialty Chemicals (a major Swiss-based chemical additives company) thinks in terms of expenses arising from infrastructure, organization, people, and overheads. Jean Holley, CIO of Tellabs (a market leader in the U.S. bandwidth management and fiber access markets, with customers in 100 countries) divides the field into "Run Your Business" costs (where the focus is efficiency) and "Grow Your Business" costs (involving new investment decisions). Understanding the difference is vital to successful spending. PK Ghose, CFO of Tata Chemicals (one of India's leading manufacturers of inorganic chemicals) points more broadly to how costs differ with varying ways of doing business.

What underlies the above answers from corporate leaders, and differentiates them from theory, is a focus not on the nature of the costs but on their root causes. As Beth Summers, CFO at Hydro One (a leading electricity delivery company in Ontario) notes, one needs to "look at the inherent business and what drives the cost. It comes back to your fundamental business model." In other words, the distilled definition from these executives for 'cost structure' is "the costs arising out of a company's business model".

This wording is of more than academic interest: it shows what is at stake when seeking to address costs. Although efficiency gains are always welcome, large improvements can frequently demand adjustments to the business model itself. As with weight control in people, a crash diet yields just temporary improvements: lifestyle change brings real benefits.

This insight points to a more effective approach to cost structures than simply looking where to pare down. Cost sustainability, as it might be called, instead addresses how business is done rather than how money is spent, leading to more lasting improvements and a greater understanding within the organization of why costs need to be controlled.

Summers notes that a focus on the business model helps in prioritizing strategically in cost terms. Holley also prefers not to think about scaling back, but where one is investing. The important part is not "the scissors of cutting costs" but knowing what it takes to run one's business.

¹ (Ray Garrison and Eric Noreen, *Managerial Accounting*, 10th ed., (2002)).

Ian Springett, Group VP Strategy and Planning at BP (the U.K.-based international energy company), insists that “you’ve got to think of costs as an investment... [so the] conversation should be about what can you do to spend the right amount.” Mariano Domingo, until recently a VP of Sara Lee International (a global consumer products company) agrees. The focus should be “making a leaner, more flexible organization”, with cost reduction as the consequence, not necessarily just the target.

Habil Khorakiwala, Founder and Chairman of Wockhardt (an Indian-based global pharmaceutical company) goes further. He insists that his business does not generally take cost cutting measures just because expenses have risen. Instead, it looks at “what constitutes the cost, what has gone wrong” and then redesigns the organization. Ron Blakely, Executive Vice President, Finance Downstream at Shell (the Anglo-Dutch international energy company) describes a similar approach there. Rather than setting arbitrary targets, the company looks for places to say “here is an opportunity to get cost out by changing the way we do it”. He likens simply imposing percentage reductions on people to attacking a complex problem with a blunt object, the result of which “typically is not sustainable”. Individuals may simply cut corners for a year or two.

This approach changes cost management from a reactive, managerial discipline to an innovative one – a key advantage in a competitive world where simplification and efficiency alone are not enough.

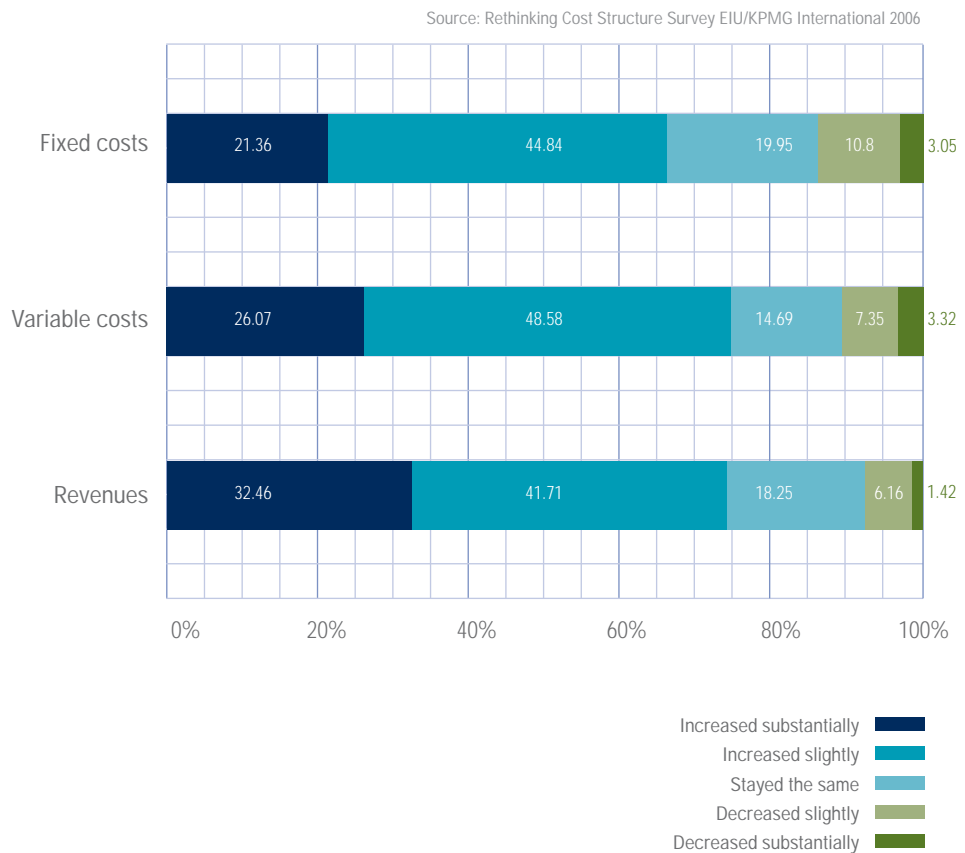
The focus should be “making a leaner, more flexible organization”, with cost reduction as the consequence, not necessarily just the target.



1. The Cost Environment

However they approach it, companies regard today's cost environment overall as, if not benign, at least not hostile. Over the past three years, businesses worldwide have seen fixed and variable costs increase slightly, but revenues growing faster, according to the survey.

Q1: How have fixed costs, variable costs and revenues changed in your company over the past three years?





A closer look, however, reveals different perceptions depending on the location and size of the business in question. For example, North American enterprises surveyed report a harsher climate, with expenses surpassing revenues, while those in Asia have experienced notably faster rises in income; smaller companies have had a harder time than larger ones over the past three years, with costs and revenue increasing at roughly the same rate.

Individual costs centers display similar degrees of variation across businesses grouped by size or geography. At an individual company level cost concerns are even more diverse. None of the senior executives interviewed for this study named the same set of leading worries. Blakely describes the situation concisely: "The world should not be deluded by the standard CPI publication around inflation" with its broad averaging. "Understanding the inflation in your business is more important than it has been in a long time," he adds. No single cost issue completely dominates concerns: instead each business's cost environment is a complicated function of geography, size, sector, and business model.

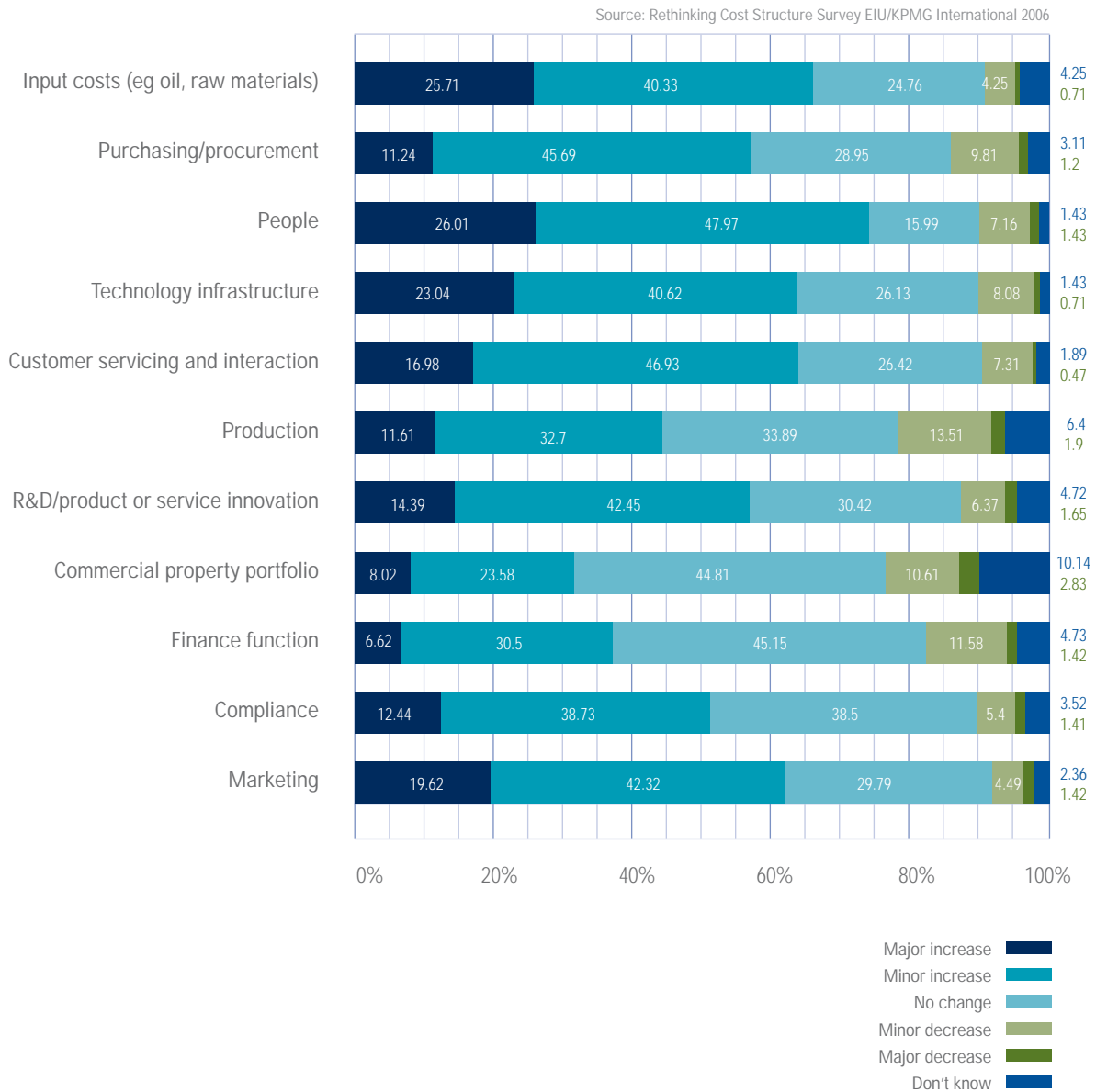
Acknowledging the diversity of the cost environment, a few broad generalizations are nonetheless useful. For one, there is strong agreement among executives in the survey over the importance of cost control. Some 83 percent agreed that changing costs structures could provide long-term competitive advantage.

There is also widespread agreement on key cost pressures. In particular, companies think that the biggest challenge in the next three years will be people-related costs: 74 percent of companies expect this to be an area where costs increase. This is perhaps to be expected at a time when many companies are having to increase employee remuneration and benefits in a bid to attract and retain scarce talent.

Close behind are input costs (66 percent) and technology (64 percent), followed by marketing (62 percent). Although individual items rise and fall in importance based on corporate size and geography, these are very important to most enterprises, and people costs are a universal concern. Moreover there is a consensus that costs will rise most slowly in production, financing and commercial property spending.

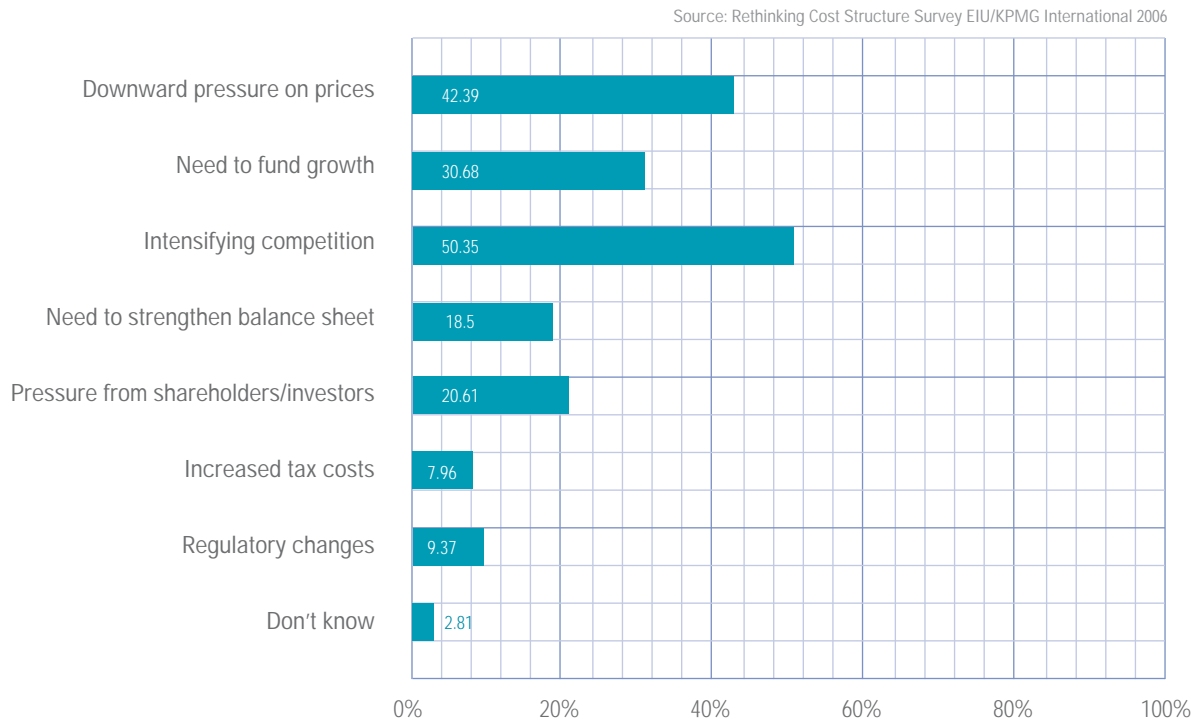


Q5: How will costs change in the following areas of your business over the next three years?



Another important universal is the need to address cost structures continuously at a time where, in the words of Harry McGee, Controller of Boeing Corporation (one of the world's leading aircraft manufacturers), "profitability is constantly challenged by a competitive environment". Intensifying competition (50 percent of companies) and downward price pressure (42 percent) were the most frequently cited reasons for rethinking costs, followed by a need to fund growth (31 percent). Such marketplace exigencies exceeded those from the stock market – pressure from shareholders was cited by 21 percent – even in large businesses where increased investor demands were accompanied by even higher concerns about competition. Moreover, businesses interviewed for this study where investors exercised little direct influence – such as the mutual society BUPA or government-owned Hydro One – felt just as much pressure over spending as the others did.

Q4: Which of the following trends are most likely to increase pressure to rethink cost structures in your organization?



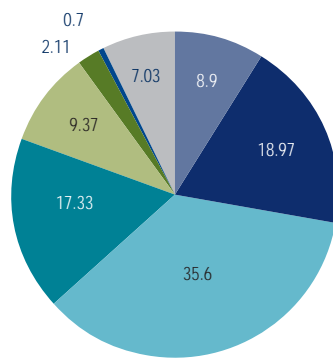
...companies think that the biggest challenge in the next three years will be people-related costs: 74 percent of companies expect this to be an area where costs increase.



Missing an easy target

Two-thirds of executives in the survey said that changing cost structures requires extraordinary focus rather than a 'business as usual' approach. But the survey also suggests that many companies do not bring this degree of focus to cost initiatives in practice. According to the survey, the mean target for cost savings over the next three years is 8.6 percent, or just over two percent per year taking account of compounding.

Q2: What level of cost savings does your company aim to make across the business over the next three years?



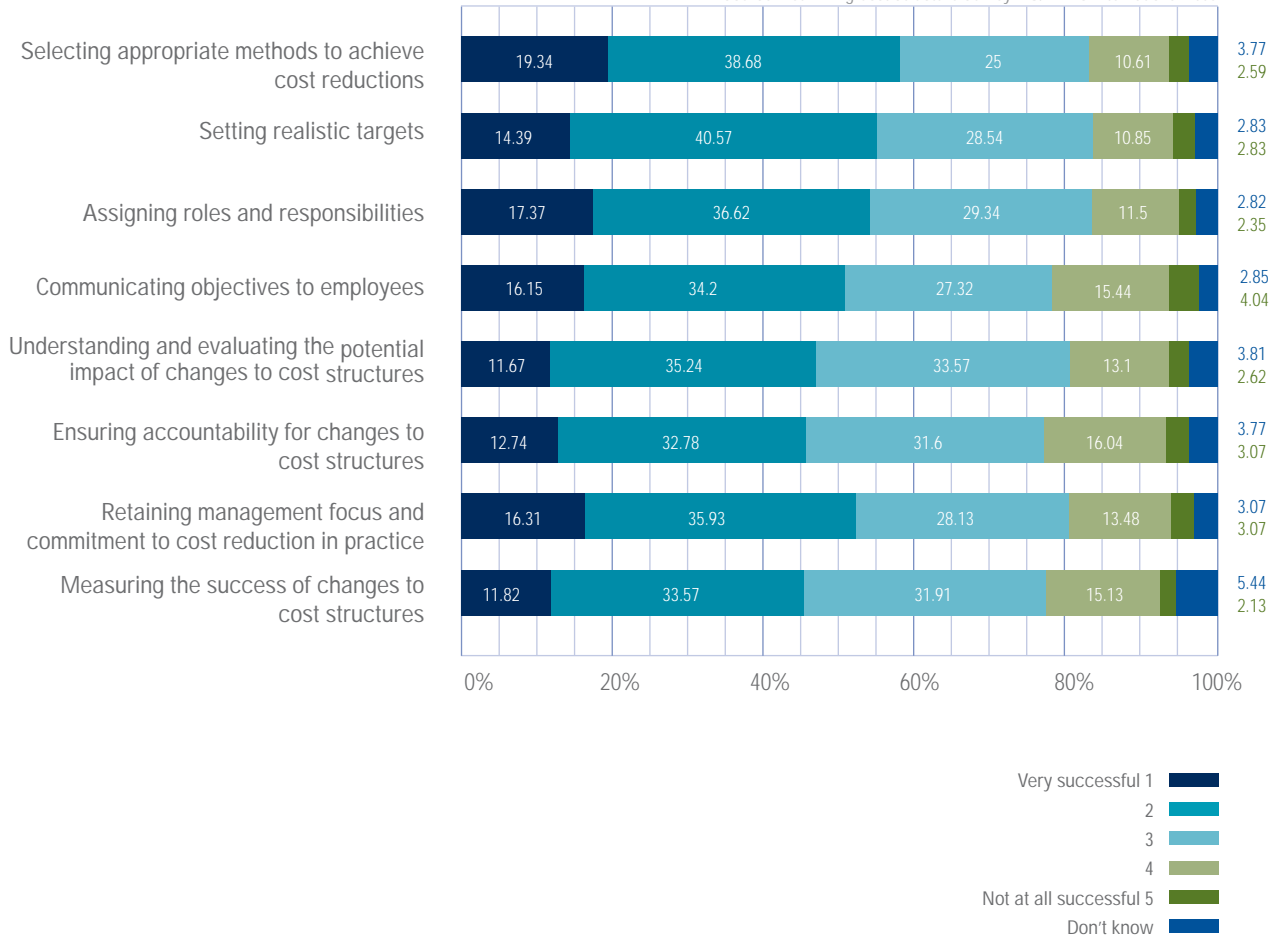
Source: Rethinking Cost Structure Survey EIU/KPMG International 2006

- No planned savings
- 1-5%
- 6-10%
- 11-15%
- 16-20%
- 21-25%
- 26% or higher
- Don't know



Q15: How successfully do you think your organization performs the following aspects of cost reduction programs?

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006



Setting a realistic goal is, of course, crucial in any business initiative. Charalambos Papanayotou, Executive General Manager of Alpha Bank (Greece's second largest commercial bank), says that "the key word is planning"; and that this applies as much to goals as to tactics. Forbes agrees "the more you plan, the more you get out of it".

Interviews for this study showed no single preferred way to set goals. Senior management at Tata Chemicals, for example, sets a “visionary” figure, which initiates a dialogue with other staff about the realities of how it might be achieved, resulting in a broadly agreed final goal. Claire Garrett, VP Procurement Policy at BT (a U.K. telecommunications company) spoke instead of a detailed look at areas of spend and growth going forward leading to “appropriate but stretching targets in each sector.” Whatever the methodology, however, those interviewed repeatedly stressed that the targets need to be achievable, but also challenging. Over-emphasis on cost should not harm operations, but this was no excuse to avoid the difficulties of building a leaner business.

More worrying than low targets among surveyed businesses is the apparent lack of focus on cost issues that this seems to suggest. A period of growth has had an analgesic effect. Of respondents, 42 percent agreed that a focus on revenue had eroded their company's cost discipline, against 27 percent who disagreed, even though revenue growth has only slightly outpaced increases in spending for most companies in the survey.

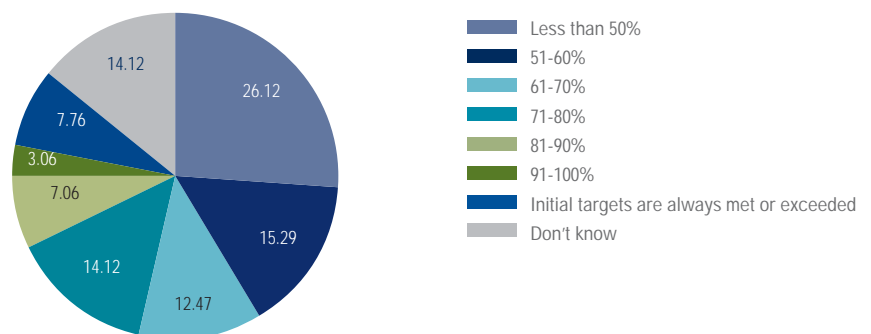
Such a development could be dangerous. Mark Selawry, Senior VP for Productivity and Sourcing at Hilton Hotels, was one of several executives interviewed to point out that, despite the natural tendency in good times for people to focus less on costs, attention to income and expenses have to “go hand in hand.” Helmut Sprengel, Director, Finance & Corporate Service Center, BASF Greater China, an arm of the chemical company which is seeing double-digit growth, adds that, “it's easier to be cost conscious in a growing area than when you have to look at cutting costs.”

Tight cost discipline on base operations in such an environment is “really tricky”; but its absence “will come back to bite you.”

At the same time, all concur that it is crucial not to leave this to chance. Papanayotou, whose bank has fast growing revenues, stressed that cost control in such an environment, is "the most important element". Reducing this focus in periods of growth is "the biggest mistake" one can make: it can leave you ill prepared for the next downturn. Blakely from Shell agrees. Tight cost discipline on base operations in such an environment is "really tricky", but its absence "will come back to bite you." Ghose cites his own company as an example. Despite Tata Chemicals's current solid revenue growth, he feels the company would have become uncompetitive had it not aggressively targeted spending a few years ago. Every company needs to be concerned about costs: good fortune cannot replace best practice forever.

Q16: When your organization decides to implement cost saving ideas, on average, what proportion of planned savings does your company typically achieve in practice?

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006

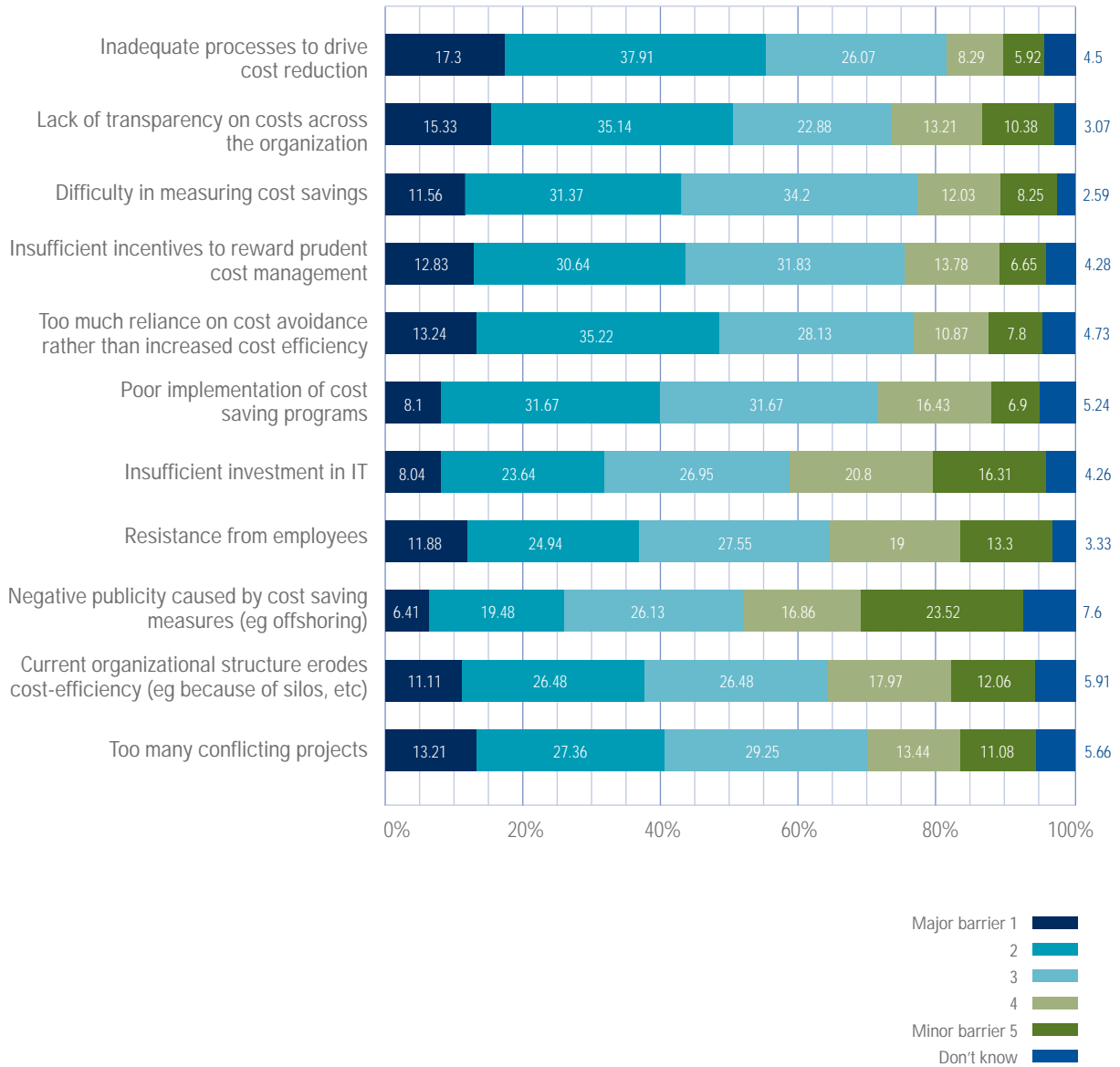


The survey results suggest, however, that things are not as they should be. On average companies surveyed typically achieve only a sobering 59 percent of planned savings from cost reduction programs and just eight percent of businesses reach or exceed their targets. This is consistent with respondents' own assessment of their firms' success in carrying out such initiatives, where they give themselves a 'C+' ranking. Moreover, one of the biggest barriers to optimizing cost structures was inadequate processes to drive cost reduction.



Q18: What are the biggest barriers to optimizing cost structures in your organization?

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006



An in-depth look at what businesses are and should be doing – particularly as regards to ownership of initiatives, strategy, execution, and the use of IT – helps explain this unsettling performance.

The Cost Environment

KPMG's perspective

Case Study - Reynolds American

The Cost Environment: not business as usual

Organizations can achieve cost leadership by being bold and thinking holistically.

A short sighted but common approach to cost reduction is to attack in isolation a single part of the business such as procurement, people and systems through a single, finite project. Unfortunately such efforts rarely achieve their desired goals; either they run out of steam or else the costs simply pop up in another part of the organization. Even for those that do succeed, the benefits tend to be short lived, with the same problem cropping up again in the near future.

Those companies setting the pace in cost leadership have gained an understanding of how their overall business model impacts their expenditure and by making changes at a strategic level, have managed to build in a permanent, sustainable lower-cost base. Over the past few years, U.S. electronics manufacturers have successfully removed intermediaries from the supply chain. This has not only helped to cut out a massive layer of cost but has proved to be a smart strategic maneuver that has brought them far closer to the customer.

Management should however be aware that building a cost-aware environment is certainly not 'business as usual' and requires an extraordinary level of focus across the organization to avoid failure at the implementation stage. For example, achieving cost leadership through process optimization requires the organization to think and behave along 'process lines', in addition to traditional functions.

Rallying the 'call to arms'

Once a company has declared its intention to become a lower cost business, those charged with making it happen need the data and reports to track progress and make individuals more directly accountable. Of course, money talks and linking incentive programs and ideas schemes to savings is vital to maintain momentum.

A novel but increasingly popular way of encouraging people to meet their targets is to visibly use cost savings to fund actual business initiatives. One media organization (that had previously not been at all cost-conscious) chose to direct savings straight into new, cutting edge digital technology, a move that generated a lot of excitement among staff and achieved outstanding results. In another example a large consumer products company made it very clear that any new advertising campaigns could only be funded through taking costs out of other parts of the business, which concentrated the minds of those striving to take products forward.

Ultimately management must realize that its vision of a lower cost business model can take time and constant attention to produce a new way of looking at the business. The alternative is yet another short-lived project that fails to deliver the goods, which may also damage revenues and reputations.

Case Study – Reynolds American: From Merger Synergies to a Lean Culture

Two years ago, RJ Reynolds Tobacco Holdings, the parent company of RJ Reynolds Tobacco, completed its acquisition of the US operations of Brown & Williamson Tobacco Corporation, a U.S. subsidiary of British American Tobacco. A key driver behind the merger was the ability of the newly formed US\$10 billion company, Reynolds American, to achieve large synergies. Operating in an industry with significant litigation costs and unit volume declines of the order of two percent a year for the past 24 years, Reynolds American must be prepared to survive difficult times.

“With duplication across the two companies, there is significant opportunity to achieve cost synergies,” says CFO Diane Neal. The integration plan called for the company to combine its two sales forces and litigation groups within 90 days of the merger; marketing efforts within five months; and to shut down the former Brown Williamson manufacturing facility in Macon, Georgia within 18 months. By the end of 2006, Neal expected the company to have achieved its goal of reducing annual operating expenses by \$600 million.

But for Neal, this is just the beginning. “With our industry in decline, there is an inherent pressure against our cost structure,” she says. The only way for the company to sustain earnings growth and maximize shareholder value is to continue to squeeze out costs. Management therefore makes cost containment part of the new company’s culture. Early in 2006 it introduced a program, known as “Continuous Productivity Improvement”, to reduce costs by at least \$325 million over the next five years. The bulk of the savings is expected to come from productivity enhancements achieved through new information technology systems, a greater use of shared service centers, and a significant reduction in the number of its brands.

Written by the Economist Intelligence Unit

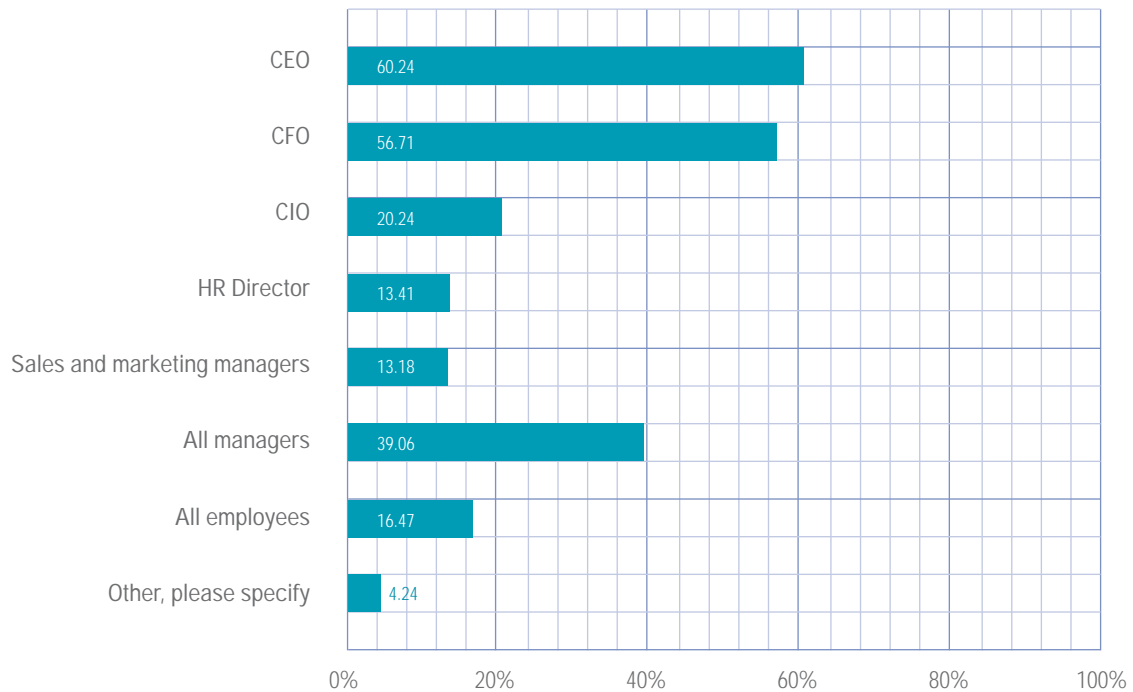
2. Ownership of Cost: The Buck Stops Where?

If cost control requires focus and determination, then the survey's findings on ownership of cost issues bode ill. Of various key aspects of cost reduction programs, businesses had the least success in ensuring accountability for changes.

Respondents quite rightly put CEOs and CFOs at the head of those with "significant responsibility for cost management initiatives." However, only 60 percent selected the former and 57 percent the latter – the disconcerting implication of which is that at nearly 40 percent of companies the CEO and at 43 percent the CFO do not hold significant responsibility in this area.

Q7: Who in your organization holds significant responsibility for cost management initiatives?

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006



Cost initiatives at such businesses will almost certainly fail. While CEOs and CFOs shouldn't be micro-managing cost initiatives, their leadership is vital in a number of areas:

- Before even looking to reduce costs, as Khorakiwala points out, senior executives must pay attention to the business model itself " If you take care of design, you create a competitive cost structure at all levels".
- C-level executives, especially the CEO and CFO, are the key players in setting the broad strategy, where everything starts.

Written by the Economist Intelligence Unit



- Also essential during these efforts is that these same corporate officials articulate a clear vision and then drive the message down. Humza Malik, Group Strategy and Corporate Development Director at NGRID (a large international network utility company) calls "clarity in terms of what one is actually trying to do" a critical success factor in the company's recent 45 percent reduction in U.K. IS operational costs. "It might seem an obvious statement, but you'd be surprised. You need to build a broad understanding and alignment across the business if large scale change is to be successful." According to BT's Garrett, the CEO has to "translate the big words into something meaningful for people." Tobias Becker, Head of Corporate Strategy at ABB (a leading worldwide engineering business) credits his company's recent highly successful cost cutting efforts in part to the CEO's regular communications and ability to get across the "sense of urgency" appropriate to the situation.
- During cost cutting exercises, they must provide unambiguous commitment. Marco Ottelli, Controller of RCS MediaGroup (a media and publishing business with leading journals in Italy, Spain and France) which recently completed a very successful reduction program, called "the key" to that achievement "a strong mandate from the CEO."
- Related to the above, and perhaps more important, is that the CEO needs to lead by example.

If accountability for cost management is sometimes lacking at board level, it is even less entrenched elsewhere. Only 39 percent of respondents say that all managers are responsible for cost management initiatives, and only 16 percent believe all employees hold responsibility in this area. Lack of accountability at these lower rungs jeopardizes a business' ability to remain competitive. Malik insists that to be successful cost initiatives "must be owned within line management... with them driving it". Forbes argues that local involvement is critical: "It is dead easy at the top corporate level to see the slide and say that's what we need" but this is vastly different from getting people with the "right mentality who fight for the savings" in the trenches. Ghose adds that at his company getting input from the bottom up is an integral part of cost control. Only the people on the ground can say how specifically to make centrally dictated goals happen so as to help rather than hurt operations. An American executive in the online survey summed up the necessary attitude: responsibility for costs goes from the board "right down to janitorial services".

Lack of broad commitment across the organization to good cost management manifests itself in the patchy application of industry best practice in this area. Only half of all companies in the survey set clear targets and margins for every business unit, and that proportion declines in smaller companies in the research. Less than half (47 percent) of companies have transparency of costs and profitability across individual business units throughout the enterprise. Only 38 percent have cost reduction targets integrated into annual budgets. North American companies – despite expecting the most difficult cost environment – score slightly worse on almost all of these, but Western European and Asian responses showed that at best about half of companies still did not pursue these sensible strategies.

The survey reveals also that 58 percent of companies do not provide managers or teams with incentives to reduce costs. This is surprising, given that respondents cite insufficient incentives as one of the leading barriers to cost optimization in their organizations. Seventy-eight percent also agree that success in rethinking cost structures required adjustment to performance incentives. If nothing else, such inducements are the flip side of effective cost ownership, without which, as Blakely at Shell warns, companies can end up with a muddle where everyone “points fingers at everybody else.”

Of course, getting incentives for cost discipline right is not always straightforward. Short term incentives, just like ill-considered targets, produce at best temporary and at worst very damaging results. Even in the longer term, Becker notes, one thing which hindered cost cutting at ABB for many years was that misalignment between bonuses and strategy, processes and incentives led to what he describes as “sub-optimal behavior”. Quite simply, companies get what they reward.

Only the people on the ground can say how specifically to make centrally dictated goals happen so as to help rather than hurt operations. An American executive in the online survey summed up the necessary attitude: responsibility for costs goes from the board “right down to janitorial services”.

Targets, transparency and incentives, though, are more than just good ideas or carrots and sticks. In companies which are managing costs well, they are part of an attempt to achieve the Holy Grail in this field – in the words of Domingo, a “non-stop culture” of continuous cost improvement. Ottelli insists on the need for this “real cultural change” his ideal would be employees who ask “if the money I’m spending now were my money, would I spend it or not?” Julian Garrido, CFO and Controller of General Electric Latin America sees incentives, transparency and regular measurement as ways to make sure people feel responsible for their part of the company. Becker of ABB also credits such measures for the “quite substantial” cultural change which was central to that company’s dramatic turnaround (see case study on page 26).

It is hard to over-emphasize the importance and difficulty of such a cultural shift. Boeing’s McGee points out that many people in organizations are not used to focusing hard on fundamental change. It is tempting to resist change but people need to get moving. “Change is probably the hardest thing we do,” McGee says, but you need “to look at what could be.” At its very best, this change helps the shift in a company’s approach toward one of cost sustainability described in the previous section – from seeing painful reductions to searching out ways to improve the business model. “Philosophically it’s a different way of looking at things,” according to Holley at Tellabs.



Ownership of Cost

KPMG's perspective
Case Study - ABB



Ownership of Cost: venturing across functional boundaries

Cost reduction programs should look beyond individual departments to take a broader view of the company's value chain, to help ensure continued success.

Cost cutting is not the most glamorous of tasks and it's no surprise that many initiatives fizzle out and fail to deliver. KPMG firms often see senior management announcing a new program with a triumphant fanfare, only to lose interest soon afterwards, thinking that those at the coal face can provide the necessary momentum. A frequently overlooked missing link is middle management; they are often the people who can really carry a program through by providing direction and motivation.

The interconnected structures of today's organizations can render functional borders obsolete. Subsequently those sweating to take costs out of their own area often don't see the fruits of their labors, with the benefits actually enjoyed by a different division altogether. Failure to look beyond these dividing lines can lead to a series of uncoordinated cost cutting efforts, with in some cases more than one group attacking the same area separately and both claiming success.

Interestingly, the respondents in this survey have declared that process optimization will be a catalyst to achieving future sustainable cost savings. Therefore, a more enlightened approach is to consider the cost of a whole end to end process such as purchase to pay, order to cash, or supply chain and then select a number of managers to take ownership of these processes, with no allegiance to a single function. In this way, organizations can create the right transparency, so departments can identify the drivers of cost and spot the usual inefficiencies created at the functional boundaries and hand off points.

Every Friday morning the CEO would phone up one (usually very nervous!) project manager at random somewhere in the world and ask for an update of progress. Word of this ritual spread quickly around the company, keeping everyone on their toes.

Measurement and incentives

Naturally process managers must be measured and rewarded for hitting very specific cost targets, and as a first point of contact for more junior staff they can deal with any concerns about where the project is heading, and handle thorny issues such as redundancy. Businesses must put in place systems for generating the appropriate data and make sure that any successes are broadcast loudly.

The CEO's role cannot be underestimated and he/she must be visibly committed throughout the program. One global engineering conglomerate had several thousand projects running concurrently as part of a cost-reduction push. Every Friday morning the CEO would phone up one (usually very nervous!) project manager at random somewhere in the world and ask for an update of progress. Word of this ritual spread quickly around the company, keeping everyone on their toes. 'Walking the walk' in such a direct fashion will help convince everyone that the company is serious and committed about reducing costs.

Case Study – ABB: Lessons from Success

In mid-2002, ABB needed to do something. In spring, a long-term share price decline of nearly one-third led the company to announce that it would renew its focus on core business areas and streamline from eleven business divisions down to two – Power Technologies and Automation Technologies. A surprise second quarter loss of US\$13 million then prompted a further 23 percent drop in share prices. In October, the company, as part of the measures to turn things around, announced its “step change” program – an attempt to identify opportunities across the enterprise to increase productivity – with the goal of achieving annual savings of \$800 million.

Observers might have been forgiven for skepticism. ABB’s previous cost cutting programs had, according to current Head of Corporate Strategy, Tobias Becker, achieved only 40-50 percent of their desired savings which was “quickly eaten up” by other spending. Moreover, the company had become known for its repeated failures to meet over-optimistic targets.

Instead, “step change” quickly became such an overwhelming success that its target was moved to \$1billion. Actual annual savings on its more than 1,300 projects exceeded the revised goal by a further \$100million when the project wound down in 2004. Becker credits several factors which created the “quite substantial” cultural change needed to bring this about:

- *Clear leadership and communication:* The CEO Juergen Dormann issued an all-hands communication every Friday which maintained a strong sense of urgency and demonstrated commitment to renewal at the highest level. It also helped set out the issues and get everyone, including unions and work councils, involved in the process.
- *Realistic targets:* ABB had learned that unattainably ambitious goals mean that employees do not bother trying to improve at all. Becker insists that the cliché remains very true: targets must be stretching but realizable.
- *Proper incentives structures:* Previously the alignment of strategy, process and incentives at ABB “was not really hanging together”. In particular incentives had focused employees “on the things in front of them.” Now higher level aggregates play a much bigger role, causing greater attention to success of the whole enterprise.
- *Focus on what you do best:* In divesting itself of various divisions, ABB kept an eye on cost issues. In particular, it sold off those businesses where it was certain other owners, “more savvy” in certain niche markets, could reduce expenses better. Becker gives the power line business as an example.

Written by the Economist Intelligence Unit

3. Cost Strategy and Execution

Amid complications and uncertainty, dealing with costs is as much art as science. Even at the conceptual level, well performing companies can differ on how to approach cost.

Some think it makes perfect sense to begin by thinking of costs as a whole before dividing them into constituent parts. Selawry explains that this allows businesses to see common drivers affecting a range of areas, and devise appropriate mitigation strategies. Forbes adds that with this approach “you drive bottom line thinking.” Ghose, on the other hand, feels it is generally more important to focus on specific areas. Papanayotou goes further because of the need to understand “the dynamics of each line”; the only way conceptually to address costs is “line by line.”



Instead of uniform solutions, there is an arsenal of useful tools and techniques to draw on as appropriate. As markets globalize, these tools become available to enterprising businesses of whatever size and nationality. For example, Stefano Ferro, CEO of the small Italian fashion house Malo, notes that it gets its cashmere – 80 percent of its raw material – straight from Mongolia. “We practically buy it from the goat.” The problem, as the survey indicates, is that many companies are using these tools very timidly, or sometimes not at all.

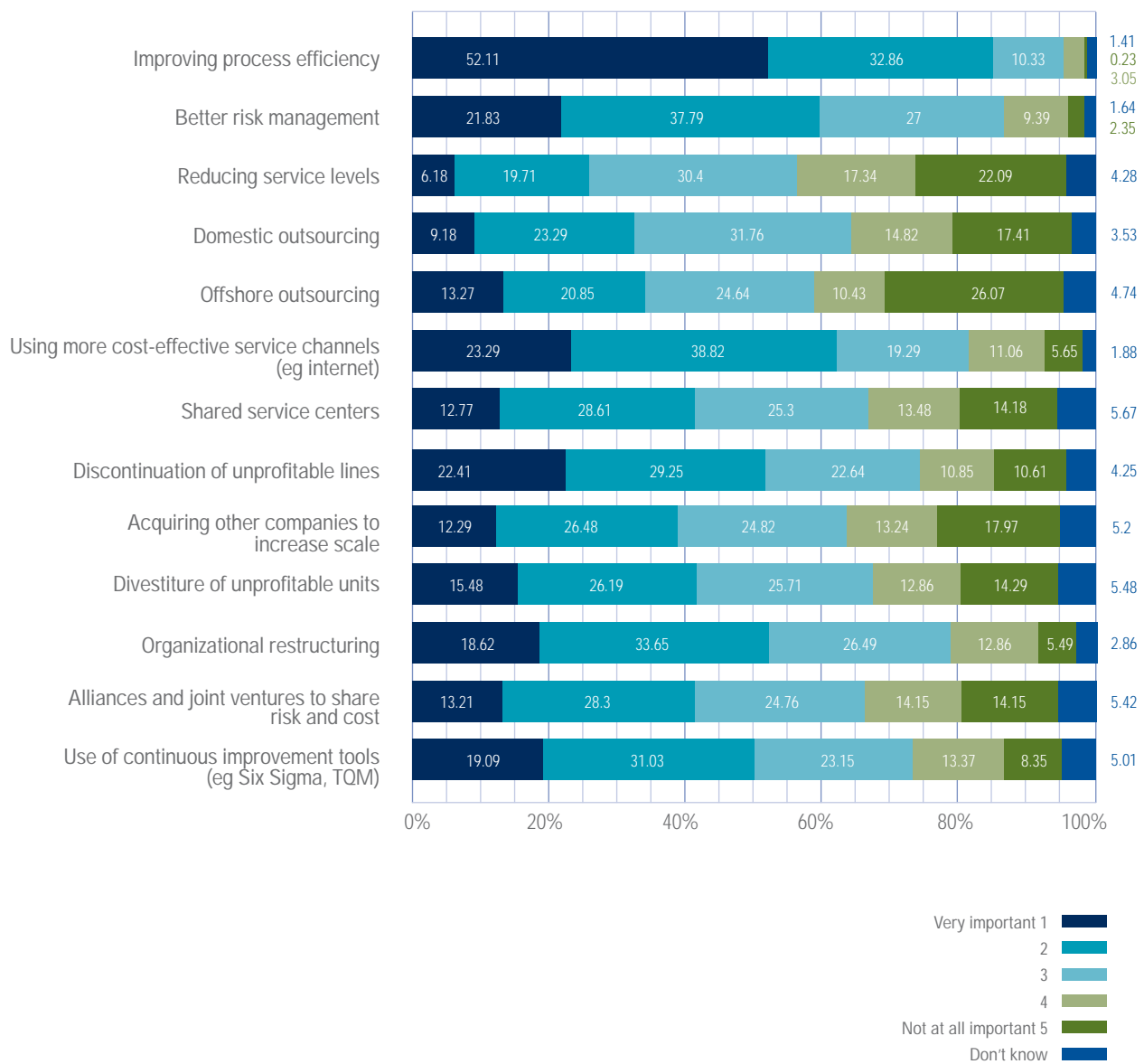
The caution starts with the general approach. When asked which strategies would be the most important to cost management over the next three years, respondents placed the greatest emphasis on those which potentially require the least disruption. Improving process efficiency was more than twice as popular as any other option, with over half of businesses ranking it as “very important” to their strategy. The next most popular items – better risk management and finding more cost-effective service channels – though very valuable also emphasized improvement over change, coming comfortably ahead of more painful choices like organizational restructuring or even discontinuation of unprofitable lines. Far behind were even more disruptive choices such as divestiture of unprofitable units, or adoption of shared service centers, outsourcing or offshoring.



Written by the Economist Intelligence Unit

Q6: How important will the following strategies be as part of your cost management over the next three years?

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006



Forbes points out, that businesses can “start off and grab the low hanging fruit, or the things that create a little ripple” without significant effect, precisely because going further is so much more difficult. With less than half of companies having financial data transparent across the entire company, it raises questions about how challenging the process efficiencies being sought are.

Process efficiency of course is both essential and capable of engendering substantial organizational innovation. At Shell, for example, Blakely notes that to introduce common processes in a structure formerly encompassing dozens of national operating units, with “many, many different ways to achieve the same end”, requires a huge effort with a significant amount of change over a broad geography. The challenge is that “to do it globally you have to do it concurrently in a number of areas.” Springett describes BP’s standardization of processes as having been “a long journey” especially given the series of mergers and acquisitions in the last decade for his company.

Process efficiency, however, can be attractive in some cases because it is easy. Summers notes that Hydro One began cost cutting efforts several years ago with a focus on promoting such efficiencies within individual business lines – relatively simple pickings which led to great success. Although her company moved forward, there is the danger, as Forbes points out, that businesses can “start off and grab the low hanging fruit, or the things that create a little ripple” without significant effect, precisely because going further is so much more difficult. With less than half of companies having financial data transparent across the entire company, it raises questions about how challenging the process efficiencies being sought are.

As noted, outsourcing and offshoring are still only being used by a minority of firms. Business, especially in Europe, continues to show a higher comfort level with keeping operations close to home. This is surprising given the cost advantages which respondents acknowledge outsourcing and offshoring offer. For those companies that had used the technique and where the respondent knew the results, offshoring has provided the highest cost savings of a number of strategies, including increased process efficiency or more cost effective service channels. Moreover, although pursuit of efficiency gains within business operations yielded the next highest degree of savings, outsourcing and shared service centers were not far behind.

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006

Weighted average of annual savings achieved from:	
Offshore outsourcing	6.10%
Business process optimization initiatives	5.48%
Domestic outsourcing	5.32%
Cost-effective service channels	5.19%
Shared service centers	5.14%

Source: Question 14

There are also knock-on advantages to some of these more disruptive approaches. Sprengel, for example, notes that in addition to expected cost savings of around 10 percent, BASF Greater China's new Asia-Pacific back office shared services center will make integration of acquired companies easier. In other post-merger situations, with their initially complex corporate structures, these have proved an overwhelming success (see Boeing case study on page 35).

The disconnect between potential savings and adoption of these strategies suggests that innate caution, as much as sound business strategy, is at work. Domingo, who also served as General Manager of Sara Lee's Financial Shared Services Europe Center, notes that a "narrow mindset" among managers, especially if they fear a loss of power, can inhibit a company from embracing initiatives like shared service centers. Instead, Malik contends, decision makers need to ask themselves in each area of their business, "Who out there can do things better than you can? Can you do it better than them, in a meaningful timescale? Do you want to tie up your talent getting there or should you be focused on more value creating activities?"

Going forward, consideration of more thorough modifications to business models might prove crucial. Several of the areas most frequently kept in-house, notably customer service (71 percent of those surveyed handle this function via an internal business unit) and marketing (70 percent) are also those areas expected to see the biggest cost increases.



Cost Strategy and Execution

KPMG's perspective

Case Studies - Boeing and Wockhardt



Cost Strategy and Execution

Sourcing: looking at the bigger picture

Rather than seeking quick ways to save money, organizations should view their sourcing strategy as a means of building lasting competitive advantage.

So far there has been a mixed response to the incessant pressure to take costs out of the business. Manufacturers have been quick to exploit cheaper labor costs by offshoring operations to developing markets like China, but have not fully confronted the thorny issue of expensive internal services such as HR, Finance and IT, all of which can eat into profit margins. The financial services sector on the other hand has embraced regional and global shared service centers and outsourced many back office functions, although in some cases this has been to the detriment of service quality to both internal and external customers.

Not all sourcing initiatives deliver their promised benefits, often because managers may be looking for quick fixes by simply opting for the cheapest outsourcing provider. One large multinational spent so much management time and money flying people out to India to resolve relationship difficulties that all its planned savings were wiped out. And there can also be other unexpected costs; another large company discovered that pension liabilities for staff at its service center in India were so high as to render the unit uncompetitive.

To be able to make meaningful decisions about sourcing, a business needs to look at costs from a company-wide perspective and get on top of all the expenses in the business. Amazingly, it's not uncommon for organizations to struggle to even agree how many people are working in a particular function worldwide, with large numbers of staff carrying out 'shadow' roles in HR and Finance.

One large multinational spent so much management time and money flying people out to India to resolve relationship difficulties that all its planned savings were wiped out.

Making it happen

Embarking upon an outsourcing or shared service center arrangement is a huge step and the organization must brace itself for a major change program. A business needs a firm direction and guidance from the very top and a fully committed team of senior managers; many such ventures fail because those responsible are either on secondment or external contractors, and subsequently don't have to live with the results. By marrying incentives to broader strategic goals, an organization can hopefully prevent managers from pursuing short-term decisions that may enhance their immediate goals but do little for the business longer term.

Outsourcing also introduces a high level of complexity and risk into a business. A number of food retailers have entered into the financial services market and outsourced most of the service and delivery, leaving their brand reputation exposed, with the company dependent on a third party to manage a business that they know little about. And more than one airline has suffered from contracting out catering services that fail to meet customer expectations. These examples highlight the need not only to carefully think through the choice of outsourcing partner but also the subsequent working contract.

Ultimately the competitive pressures on management may mean that no business can afford to ignore alternative sourcing options. Those that can do this as part of a broader cost management strategy can be expected to reap the greatest rewards.

Supply chain: taking a holistic view

To cut costs, organizations should think less about one-off projects and more about strengthening relationships across the supply chain to create a sustainable competitive advantage.

Many companies have successfully brought down costs by locating purchasing, manufacturing and other operations in low-tax countries.

In the drive for lower costs, companies have attempted numerous new initiatives including reducing inventory levels, introducing purchasing catalogues, outsourcing business processes and finding lower cost providers in developing markets. At best these have tended to only produce short-term gains and at worst have led to the projects simply being repeated at regular intervals in a corporate version of 'Groundhog Day'.

Inventory management is a perfect example of this where a company can make relatively easy 'quick wins' by cutting stocks to the bare minimum. However, by taking a longer-term and more radical approach, management could choose to invest in Radio Frequency Identification (RFID - or 'electronic tagging'), allowing monitoring of stock movements and automatic re-ordering. By boldly going one step further and sharing these systems with suppliers, businesses can create a permanent, finely tuned process that responds swiftly and efficiently to changing customer demands and gives cost savings year after year.

Such a spirit of collaboration, both with suppliers and across internal functions, can also help to improve product life cycle management. A more inclusive approach to new product development would bring purchasing professionals, manufacturing, sales and suppliers together at the design stage, to come up with new products that are intrinsically low-cost throughout their lifetime through to them being discontinued.

Another important consideration that can often be overlooked is Tax Efficient Supply Chain Management. Many companies have successfully brought down costs by locating purchasing, manufacturing and other operations in low-tax countries.

Managing complexity – bucking the trend

Bringing together a range of internal and external parties introduces a much higher level of complexity into the business model and runs contrary to the mantra of simplicity that is behind many cost cutting initiatives. Subsequently, organizations are now discovering that there is a real competitive advantage to be gained by going against this trend and actually mastering complexity. With customers demanding a wider range of increasingly bespoke products and services, delivered faster than ever before, businesses need to be supremely flexible to meet this challenge.

This can only be achieved through a sophisticated supply chain that opens up business processes to suppliers and may also include outsourced manufacturing and design facilities. This approach can enable a business to be more nimble than the competition and those that can rise to the challenge of such complexity can open up a real competitive gap.

Case Study – Boeing: Shared Services Group Brings Huge Savings

In the 1990s Boeing Corporation expanded greatly through acquisitions and mergers with several very large aerospace companies, notably Rockwell International's aerospace and defense units (1996), McDonnell Douglas (1997), and Hughes Space and Communications (2000). The resultant complexity cost money.

One highly successful way that the company has addressed the problem has been its internal Shared Services Group (SSG). Established in 1997, SSG's aim was to take a lean methodology and apply it to support activities previously handled by units in different locations. These include a vast array of services: site services, information management, facilities maintenance, purchase of non-production goods, human resource services, and even fire protection.

The results have been impressive:

- Since 1998 infrastructure costs have gone down by nearly US\$1.4 billion.
- In that time, the department has been able to get \$1 billion out of a \$4 billion operating budget.
- Because of its efforts, Boeing was able to vacate 106 buildings and reduce floor space by 7.25 million square feet by 2003.
- Since 2001, SSG has reduced computing applications across Boeing by over 23 percent.
- In 2005, its in-house email filtering technology led to the launch of MessageGate, Boeing's first private-equity-financed spinoff.

Boeing Controller Harry McGee had nothing but praise for "the great job" Shared Services had done "of coordinating administrative activities across the company." Part of its strength had been its ability to leverage the whole of Boeing's purchasing power – rather than that of smaller units – and thereby build up long-term supplier relationships or identify areas where outsourcing might be appropriate. Even more important has been attitude and culture: "They've been doing this for eight years, and are still finding good ideas. They're one of the most creative groups in the company." As McGee acknowledges, initiating change in a large organization is difficult, but in this case it was clearly worth the effort.

Written by the Economist Intelligence Unit

Case Study – Wockhardt: Leveraging Successful Cost Structures in Takeovers

Wockhardt is an Indian pharmaceutical company with extensive operations in Europe and growing sales in the United States. Chairman Habil Khorakiwala has taken the company over several decades from its foundation to a market capitalization of some US\$1.3billion.

Usually, Indian pharmaceuticals are deemed to derive their competitive advantage from low labor costs, especially for research scientists. Khorakiwala would certainly not disagree. Wockhardt spends seven-eight percent of revenues on R&D of various sorts – from seeking improved generics to its own IP generating biotech programs – in India, where it is “cost effective.”

Wockhardt, however, is built on far more. Khorakiwala sees his role as the overall designer of the business, and the structures it has in place have allowed it to extract extra value from a series of takeovers in Europe.

The company first put its toe into the generics market there with the purchase of Wallis Laboratories in the United Kingdom in 1998, followed by CP Pharmaceuticals in the same country in 2003. The next year it bought out the German company esparma, with a series of patented products, making Europe a bigger market for Wockhardt than India for the first time. Finally, in October 2006, it purchased Pinewood Laboratories Ltd., Ireland’s biggest generic pharmaceutical company.

Khorakiwala explains that one reason for these purchases was market access, but that the other important reason was careful consideration of possible synergies with Wockhardt. “It is possible to remove a lot of overheads,” sometimes in very traditional ways such as combining production facilities of all the U.K. purchases at a large Welsh plant and adding R&D inputs from India.

In specific areas, Wockhardt has been able to extract particular value. Khorakiwala has “observed uniformly that there are a lot of cost savings in procurement.” In fact, “every time we acquire a company, we get savings within months” from the supply chain.

He adds, when looking at “a new company, you can look at what is essential and not essential.” Comparing management practices with those of acquired businesses inevitably has brought savings. In most cases, Wockhardt has been able to improve costs by between 10 - 20 percent, and it has never done less well than it estimated it would. Khorakiwala considers this record one of the company’s most successful achievements in the field of costs and credits the fact that “as an organization we have a very strong team and good processes in place.”

Written by the Economist Intelligence Unit

4. The Role of Technology

Information technology has a very particular role in the current cost universe.

Garrido notes that the CIO needs to be a "strategy player" in this area, and GE Latin America hired a CIO specifically because of technology's importance for cost strategy.

On the one hand, it is expensive. After people and inputs, IT is expected to be the area with the highest increases over the next three years, according to the survey. Part of this arises from the continuing rapid pace of innovation in the area, but Ottelli at RCS also finds this a particularly hard area to convince people that they do not always need the most expensive equipment available. An over-spending IT department can have knock on effects beyond the technology.

Malik strongly believes "that if the function can't keep its own house in order, its ability to be an important engine of value for other parts of the business is hugely diminished."

Such growing expense, and the ability of IT to be delivered over a distance, has led to this function being one of the most frequently handled within a shared service center or outsourced. It also comes a close second to the production of goods as the function most often offshored. The smaller the company, the greater the likelihood that it keeps IT in-house, but even in companies with revenues of less than USD500m per year, only 53 percent handled this area via an internal business unit.

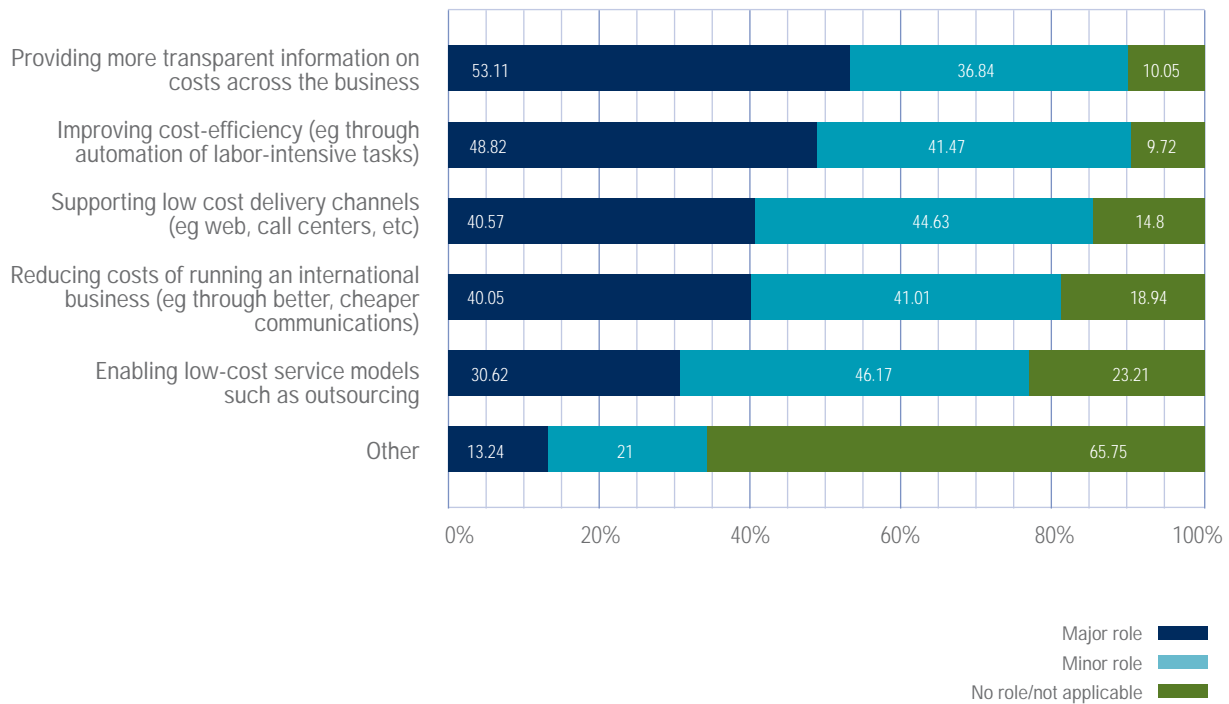
IT is costly, but it can also be a major weapon in the fight against costs at both large and small businesses. Garrido notes that technology is an important part of cost strategy and he sees the CIO as a "key player." For Ferro, IT plays "a key strategic part" of cost control for Malo as well. IT plays a major role at roughly half of surveyed businesses in the crucial cost-containment areas of providing more transparent information (53 percent) and improving cost efficiency (49 percent). Companies in Asia are making particular use of the technology, with 52 percent also giving it a major role in reducing the day-to-day expenses of running an international business.



Written by the Economist Intelligence Unit

Q9: Where does IT have a significant role to play in helping your company to reduce costs?

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006



The competing images of IT as cost-center and as cost cutter arise from the challenges involved in applying technology to cost issues.

As Ghose notes, given problems of measurement, it is “extremely hard to justify return on IT investments”. Jean Holley, Tellabs’ CIO, puts the dilemma simply “If I automate another’s procedures, my costs go up, but somebody else’s go down. IT is a bit unique in that way.”

It is also important to recognize that IT is not a ‘silver bullet’ – it requires correct use to get desired savings. Though essential for efficiency in numerous areas, if implemented incorrectly, notes Forbes from Ciba Specialty Chemicals, it can simply “build in inefficiencies”. Domingo stresses the importance of using IT to facilitate processes, rather than turning over ownership to them.

At the same time, IT’s potential as a catalyst of more far reaching improvement should not be underestimated. Blakely often finds “that the change process is underpinned by a technology application” because it allows companies to extract efficiencies.



Tellabs provides voice, data and video transport and network access systems to telecom customers. In 2005, after several lean years, the company returned to profitability through increased revenues and cost control. CIO, Jean Holley commented on some requirements for using technology effectively to reduce spending, basics which can all too often be neglected:

- IT is not magic. It does not change underlying best practice. Every project still needs a business owner or sponsor, good project methodology, and tight controls. Decisions on technology use need to be cross-functional. On Tellabs’ IT Governance Council, for example, IT people are in the minority.
- IT should never be a substitute for clear thinking. Without understanding what you wish to achieve, the only result of introducing technology is that “you’ll have an automated mess, rather than a manual mess”. In particular, IT is not a sort of tool to reach for indiscriminately because “when you use tools to solve process problems, it won’t work.”
- IT’s strength is rather that, with the right people and processes, it can lead to reduced complexity and simpler solutions, especially to larger problems which technology allows businesses to break down.
- Finally, IT as a function needs to be as cost conscious as the rest of the business. Holley says this focus is “not something you turn on and off”.

The Role of IT

KPMG's perspective

Case Study - Bayer MaterialScience



The Role of IT: proving its worth

By taking a more independent role, the Chief Information Officer (CIO) can direct internal and external IT resources to where they're most needed and show that they're delivering real value for money.

Organizations are often uncertain as to what they're getting in return for their investment in IT, viewing it primarily as an expense, when in fact many projects are designed to either cut costs or help the business to grow. It would help if IT leaders could drive home the message that the entire portfolio of IT programs has a business case with firm financial benefits. Even for something as apparently unexciting as a systems upgrade, the value of the project could be highlighted by showing that an alternative 'do nothing' scenario would give a higher medium to long-term cost to the business.

By aligning IT more closely with the business - as is the case with sectors such as technology, automotive, banking and retail - you can build better risk assessment into the initial planning and exercise tighter control over projects. Organizations also need to become less emotionally attached to existing systems; in many cases it's cheaper to replace these altogether than to attempt the complex task of integrating old with new.

Given that many businesses outsource a high proportion of their IT, it's ironic that many internal IT functions may often be the most resistant to this approach, and where possible prefer to retain an in-house pool of well-paid IT development staff, usually at more expensive locations. This can breed inefficiency and high cost during low usage periods, unless structured as a purely 'demand' rather than 'supply' side function.

A changing role for the CIO?

IT as a function needs to become smarter at planning ahead to meet the longer-term demands of the business. One potentially radical solution is for the CIO to become a 'broker', charged with pulling together resources - internal and external - but without direct line responsibility for full-time delivery staff. This could help prevent the creation of expensive IT empires and allow a more balanced, objective view of the sourcing needs of competing programs from a 'supply side' perspective. The CIO would retain control of the 'demand side' organization, responsible for working directly with the business to align IT strategy, create the IT program portfolio and manage standards, capabilities and service while leveraging an external, flexible 'supply side' delivery capability.

This approach has been popular in Asia, particularly in Japan, where IT development is not perceived as a core part of the business. Companies in this region have looked initially to Korea and more recently to China to source 'supply side' IT resources to build and maintain IT systems. This can also be seen in the US and Europe with increased offshoring to India.

IT managers are faced with the tricky question of: how much to outsource? Companies with a highly complex set of older systems may find it cheaper to outsource the entire job of rebuilding or replacing them. However, when it comes to services such as helpdesks, on which the business is very dependant, it's wise to keep the highest levels of support close to home, either in-house or as a shared service center at a nearby location. The more technical or basic support can be passed onto external providers.

In managing the quality of both in-house and outsourced services, an independent CIO would be at the core of the business while being organizationally divorced from the ownership and management of IT delivery resources. He/she would then be in a position to apply rigorous controls to help to ensure that the business receives the best, most flexible, value for money service internally and externally.

Case Study – Bayer MaterialScience: Differentiating between cost and investment

Bayer MaterialScience has spent US\$1.8 billion to set up a state-of-the-art facility that brings leading manufacturing technologies to China.

The Bayer Integrated Site is a 1.5km² facility based in Shanghai that manufactures raw materials for plastic grades used in products ranging from CDs to automotive parts. The decision to bring this technology to China marks a departure from five to ten years ago when companies employed older equipment in the country in order to protect intellectual property. Bayer has assembled this technology in an effort to capture a market growing at above 10 percent per year, and believes that the site will be the role model for future investments further afield.

“We at Bayer MaterialScience made the decision to bring the newest technologies to China because we want to be competitive in the long-term. The most modern technologies are the technologies that are competitive from the cost perspective,” says Dr Juergen Dahmer, President of the China, Hong Kong and Taiwan operations of both the Bayer Group and Bayer MaterialScience.

Dahmer cites the first line opened at the Bayer Integrated Site – producing polycarbonate for DVDs and other electronic applications – as an example of how the new facility provides a major cost advantage. With an annual production of 100,000 metric tons, it creates economies of scale to take advantage of the low cost structure. “Only if you use the most modern technologies can you really provide lower specific manufacturing and investment costs,” Dahmer insists.

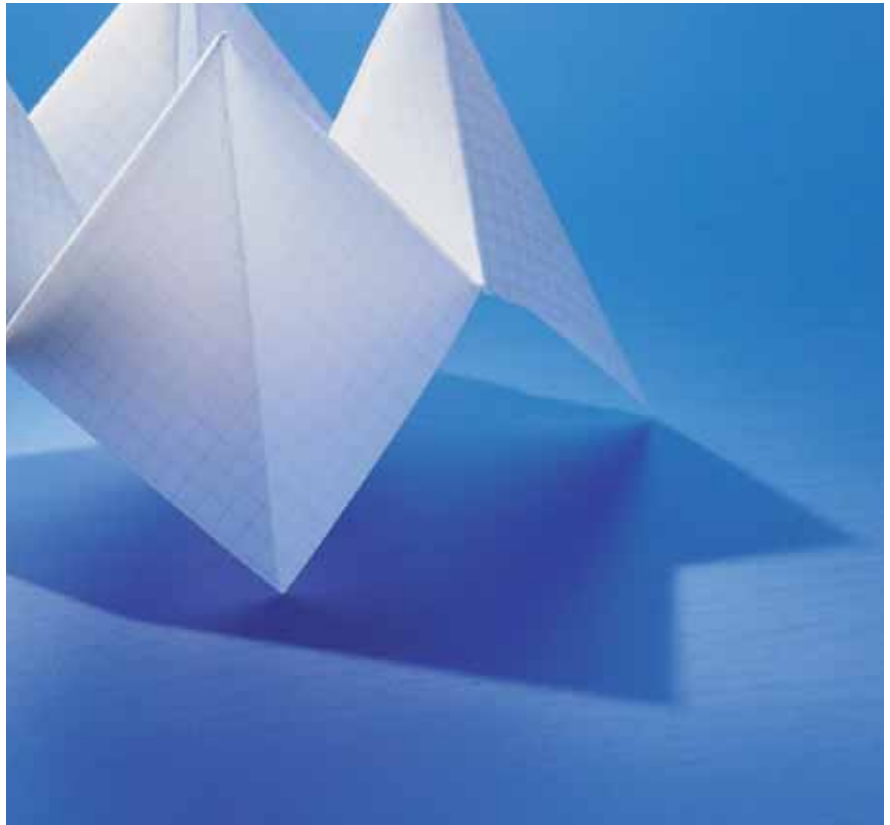
In a field with intense competition, addressing such cost issues is crucial, but the company does not take a slash and burn approach to keeping down expenditure. Bayer MaterialScience “is driven from a total cost perspective” rather than one focused on individual line items, Dahmer points out. Its “cost philosophy is to aim for the right equilibrium between the lowest possible total cost and the need for the market. The need for the market is the highest priority. This is the prerequisite for everything now.”

Written by the Economist Intelligence Unit

5. Measuring the Impact

It is possible to get all the mechanics of cost containment right, and still fail through a lack of understanding of what is being attempted and its effects on the wider enterprise.

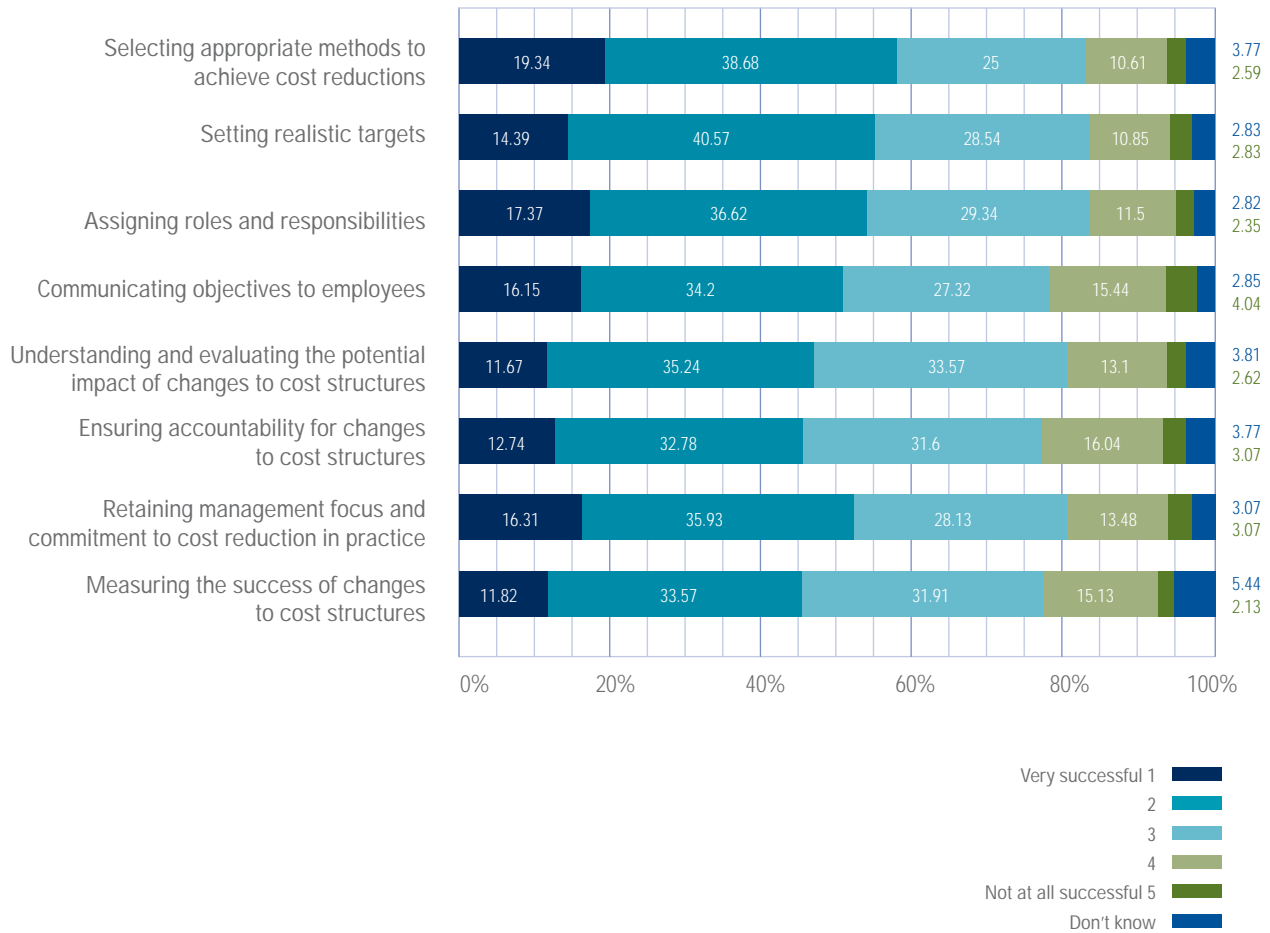
This survey reveals how widespread this difficulty is. Respondents indicated that two of the three elements of cost containment where their companies performed worst were understanding potential impacts of cost structure changes and measuring the success of cost initiatives. On the latter point, 51 percent agreed that their companies found this very difficult. Moreover, the second biggest barrier to optimizing cost structures in surveyed companies was lack of transparency on costs across the organization. All of these relate to the need for better information.



Written by the Economist Intelligence Unit

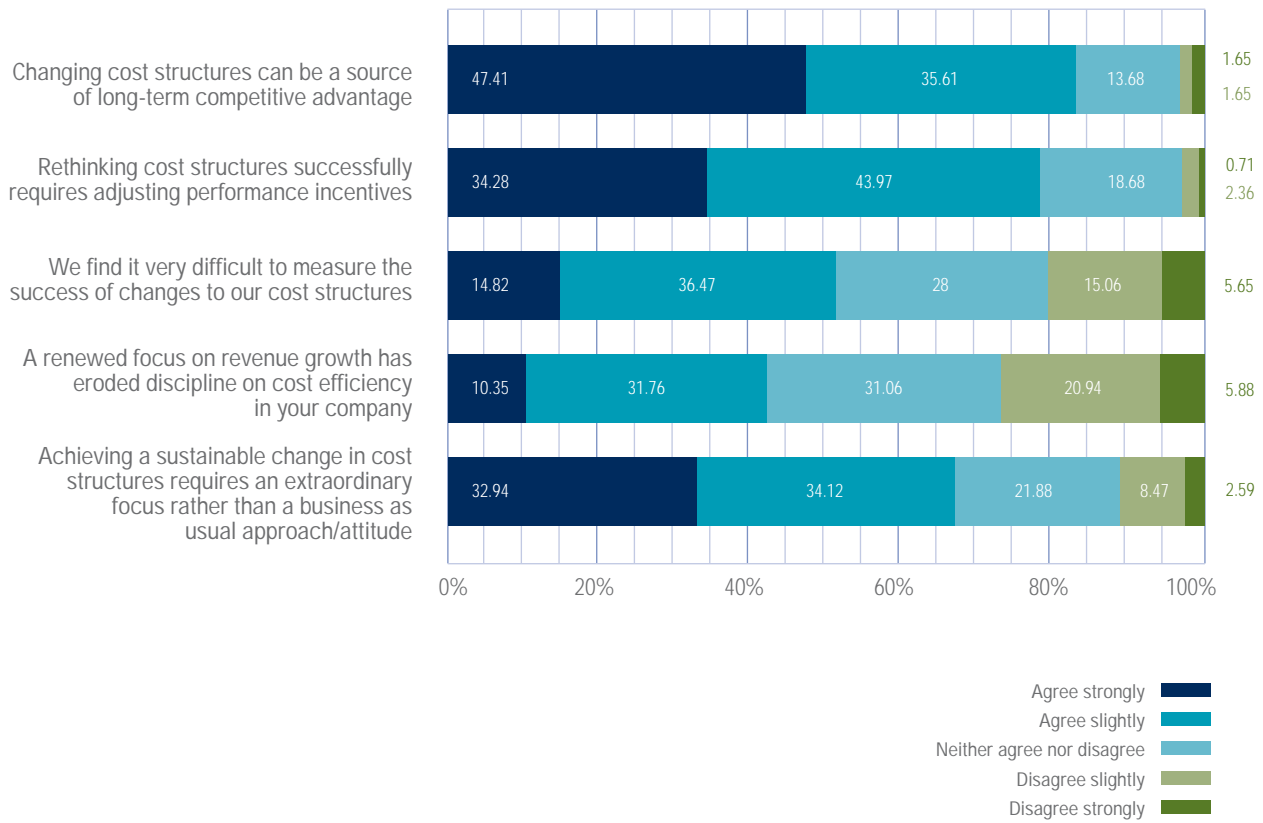
Q15: How successfully do you think your organization performs the following aspects of cost reduction programs?

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006



Q19: Please indicate whether you agree or disagree with the following statements

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006



Ottelli finds the annual audit an extremely good preparation for addressing cost issues, with the auditors acting almost like cost advisors.

Senior executives agree on just how important it is to get this right. GE's Garrido, among others, considers knowledge the absolute key to success in cost cutting: "You can't attack costs without in-depth knowledge. You have got to know the root costs." Otherwise you will target the wrong thing. "If you just stick in one metric, you're not going to get it" because people address the metrics they are given, not necessarily the real costs. McGee adds, "good, clear visibility is really key" for cost reduction.

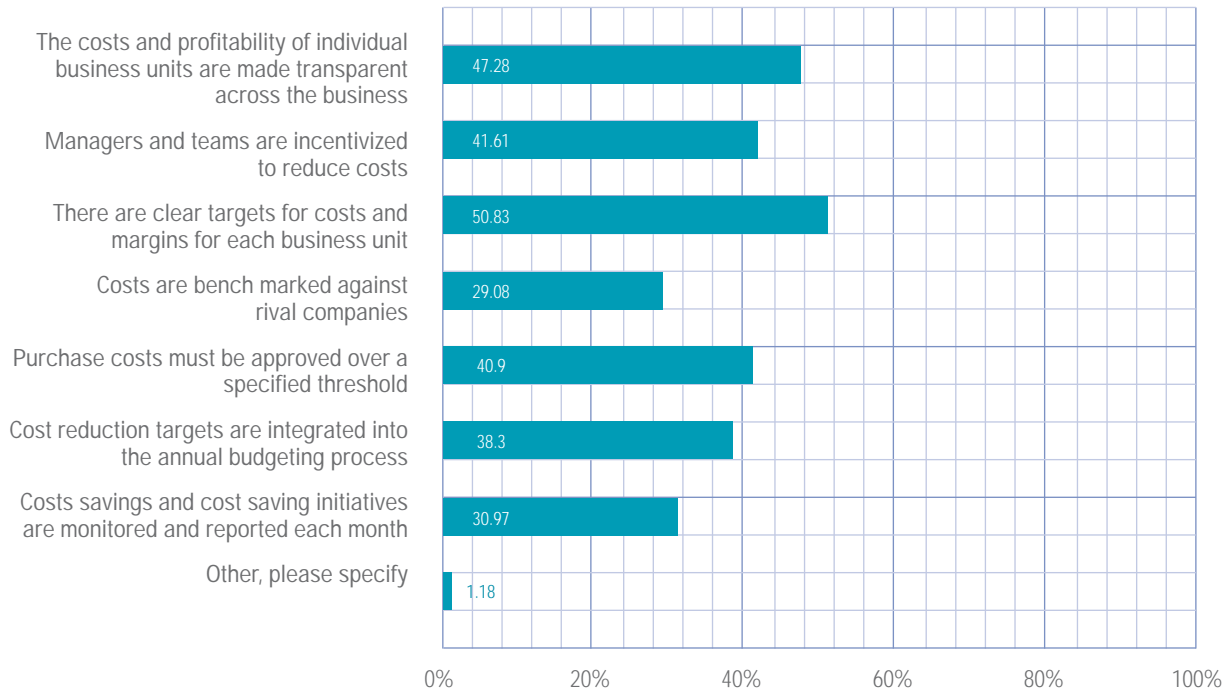
Different types of knowledge need to feed into this thorough understanding, each of which has a role to play in cost control. Some of the major ones include:

- *Knowledge of the cost itself* – Selawry at Hilton notes, for example, that many see low cost country sourcing as a "panacea, but there are hidden costs".
- *Knowledge of the degree of success of changes* – Without strong follow up it is impossible to tell not only the result, but even if people are doing what they are supposed to.
- *Knowledge of the deeper impact of changes* – Ciba's Forbes warns that one problem with finding true savings is that actions taken to reduce costs can change the business itself, having knock on effects.
- *Knowledge of what is driving costs in other parts of the company* – Ottelli and Ferro both have seen significant savings merely by bringing together people from different parts of their businesses or users of supplies and suppliers who might not normally discuss each other's activities and needs.

Once acquired, it is then essential to communicate information about what is really going on across the organization. Less than half of businesses surveyed make costs and profitability of individual units transparent across the enterprise. Khorakiwala, however, notes that information is a "very major tool to sensitize people": If people know the real situation, "most managers will automatically adjust". Diane Neal, CFO of Reynolds American (the second largest US tobacco company) also views this sort of communication as key in efforts to create a corporate culture of cost-reduction.

Q8: How is cost efficiency encouraged among managers and employees in your business?

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006



Knowledge of a company's cost structures comes from gaining a full insight into the implications of one's own business model. Ottelli finds the annual audit an extremely good preparation for addressing cost issues, with the auditors acting almost like cost advisors.

Measuring the Impact

KPMG's perspective
Case Study - BUPA



Measuring the Impact: don't celebrate too soon

To realize lasting benefits from a cost reduction program, a business must build the improvements permanently into their future business practices.

Many cost cutting programs are doomed to failure from the start, simply because there are no clear measurements in place. Without baseline costs at the beginning, and with no ongoing tracking, it's impossible to assess how much progress - if any - has been made. The real danger is that organizations start reinvesting savings before they have 'cashed the cheque'.

Much of the confusion stems from a lack of clear direction and leadership; coordinating multiple initiatives requires strong central control and a clear set of objectives. For example, is a business aiming for pure cost reduction - such as losing people? Or perhaps it is looking for cost avoidance - doing something now to avoid spending money in the future. And as mentioned previously, a project in one part of the business may actually produce cost savings in another area completely, so this must be acknowledged between the respective departmental heads.

The end of any program is really only the beginning of a longer-term process of embedding these hard won benefits into a business. Future funding, budgets and performance targets must be adjusted accordingly to avoid people slipping back into bad habits. For instance, if procurement has managed to negotiate a lower price from a supplier, then it must follow through to ensure that this saving is correctly applied in subsequent budgets, planning, tenders and transactions.

An art not a science

Cost reduction is often not an exact science, and trying to analyze savings at too low a level of detail can lead to frustration. It's far more important to make people accountable through business as usual mechanisms, for example enlisting Finance Directors to test and validate savings locally and then following through by ensuring lower-cost targets are baked into objectives that are linked to incentives.

With so many complex cause and effect links between cost cutting activities and the accrued benefits, organizations should try to focus on clear, tangible results that everyone can relate to. Try to make the reporting process as formal as possible and stick to simple metrics such as headcount reduction, lower budgets or increased funding for specific areas as a result of savings made elsewhere. Above all, broadcast successes loudly and frequently to keep the momentum going. Keep a spotlight of accountability on leadership, but don't create a 'measurement industry'.

Case Study – BUPA: Finding the Right Medicine for Health Costs

Properly addressing costs requires a thorough knowledge of business operations which allows interventions at the correct point. This is nowhere more important than when facing rapidly escalating costs in health care.

Natalie-Jane Macdonald, Director Medical and Healthcare Purchasing for BUPA explained that it is “exceedingly difficult” to address health care costs because of how spending decisions are made. The actual consumer of services has a limited ability to judge the value or necessity of interventions. Meanwhile the medical caregiver represents only 30-40 percent of the care a patient receives but makes decisions which account for 90 percent of the cost, all without any fiduciary responsibility. Nevertheless, with a 54 percent increase in healthcare costs, from 2000 to 2005, and annual inflation for drugs for certain complicated diseases topping 30 percent, it would mean financial disaster to do nothing.

The solution BUPA prescribes is not to set arbitrary spending limits or discourage members from seeking medical care, and thereby potentially increasing long-term risks. Instead, says Macdonald “we can do individual things that have a bearing on individual clinical services.” This involves learning – sometimes through sponsoring medical research – how to reduce costs while improving health outcomes. Macdonald contrasts the company’s successful efforts on back pain and MRI scans.

Back pain has multiple causes and had traditionally received a variety of types of care. It is also expensive, costing business annually in the U.K. an estimated £50 billion – an issue of importance to BUPA, two-thirds of whose British members are insured through their employers. The company decided to address this issue at the individual treatment level. It conducted a two phase exercise, first identifying those non-surgical interventions which really work and adjusting what it pays for accordingly. For example, it now avoids “endless physiotherapy”. In the second phase, the company looked at the evidence and funding for surgical interventions and set up an accreditation process for Functional Restoration Programs – multidisciplinary approaches to chronic and complex back pain patients. Efforts also included using this information to spread best practice across the medical system, and give members information on how best to take care of their own backs. The program led to a striking long-term reduction in the growth of spending per member on back pain.

MRIs required another tack. In April 2006 BUPA announced the establishment of a network of MRI facilities around the U.K. which had met its standards. About two-thirds of the metrics used were based on quality, but the other third were based on value for money, allowing BUPA both to ensure a high standard of care while inculcating practices which dropped the average payment per scan by over 18 percent in this fast escalating area.

Although there is no simple solution for health care’s intense cost pressures, by obtaining and using an enhanced understanding of their services and customer needs, BUPA could realize savings in order to offset rises elsewhere, allowing it to, in Macdonald’s words “provide the broadest and deepest health care cover that we can”.

Written by the Economist Intelligence Unit

Source: All figures from BUPA 2006

6. Changing Behaviors

There is a human as well as commercial dimension to any kind of change management program, but this is particularly so for cost initiatives.

Forbes notes that cost debates that try to go beyond the easy targets frequently take time and “become emotional”. Sometimes “you get people arguing that the business will be destroyed. It’s real human stuff.” The problem is not merely attachment to old methods, but a not unreasonable conviction based on experience and anecdote that the existing strategy, which has served well, is the right one. Business models in successful companies, after all, have evolved under market conditions – changing them involves risks. The survey respondents sympathized with this. They identified the biggest danger arising in their companies from cost optimization projects as attendant threats to product/service quality.

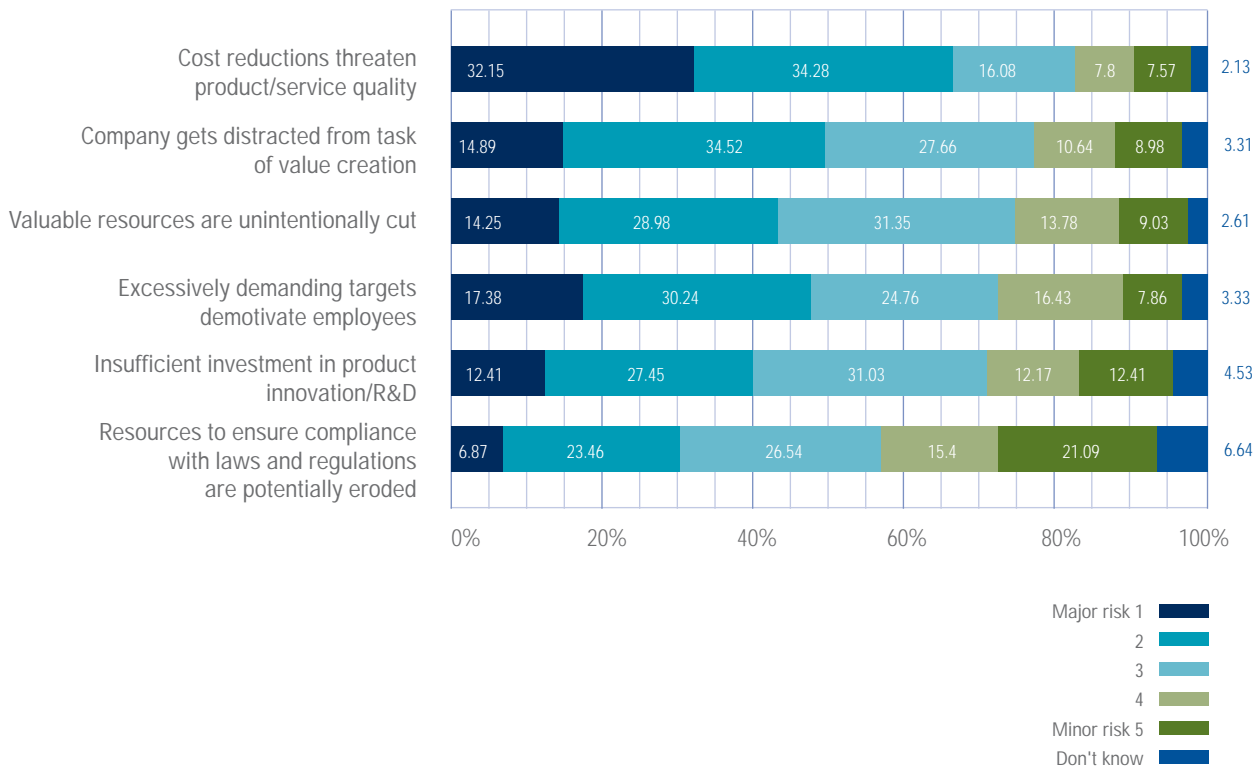
Cost containment is therefore not just about hard numbers but about winning over people within the organization. Otherwise companies risk running up against what McGee likens to an “immune system”.



Written by the Economist Intelligence Unit

Q17: What are the biggest risks associated with cost optimization projects in your organization?

Source: Rethinking Cost Structure Survey EIU/KPMG International 2006



McGee has faced such arguments, and notes they tend to be the initial instinctive reaction to fundamental change and not based on data: "Change is never really a popular process." There is "a lot of inertia to remain the same" at all big companies, and people "need a compelling reason to change" behavior which has previously brought success. Driving an organization toward true competitive advantage is therefore not just about hard numbers but about winning over people within the organization. Otherwise companies risk running up against what McGee likens to an "immune system."

Hydro One's Summers notes in this context the importance of using resultant gains wisely. For example, applying freed up resources more efficiently in another area can represent just as big a gain as downsizing, with the added benefit that "people aren't scared of identifying huge cost savings". Malik also stresses the importance of getting the balance right. At some companies the culture can be overly obsessed with costs. Inept efforts to instill a cost culture, by trying to "track pencils and shove people into grotty working environments" will be counter-productive because the only employees left will be "those who can't go somewhere else". "Instead organizations should spend their time identifying the best way of doing things, putting in place effective change programs, and creating a culture and environment where people are sufficiently motivated and excited not only to out-perform the competition, but also to have a good working environment."

Even with everything else right, failure to, in Garrido's words, "work the human side" will scupper any initiative.

Changing Behaviors

KPMG's perspective

Case Study - BASF Greater China



Changing Behaviors:

bringing people on board

Cost reduction programs don't reduce costs . . . people do.

Outsourcing, tax efficient supply chain, shared services, cross-functional collaboration. All of these approaches to reducing costs have one thing in common. They rely on people working together in a different way. Anyone who has ever tried to effect serious, long-lasting change in people's behavior will know how difficult this can be.

Getting people to assume personal responsibility for cost management is always difficult – it's easy to assume it's someone else's job. On the flip side, cost reduction programs are often associated with job losses and if this is indeed the case, strong emotions will be surfaced as staff worry about their future – and that of their friends and colleagues.

It has become popular to assume that employees stubbornly resist change 'just to be difficult', when in fact it is entirely natural. Learning new ways to work can be painful and unsettling; the benefits seemingly stacked in favor of the business not the individual. There is often a dip in performance as people reluctantly learn to master new skills.

To effectively manage change, there is no 'silver bullet'. You need to tackle it on a number of fronts, namely with:

- Strong leadership
- Effective communication
- Alignment of people processes
- A dignified transition plan
- Looking after the survivors

We often liken the role of the senior sponsor in such a program to that of an election candidate. If you're not delivering your stump speech at least three times a day, you're not trying hard enough.

It comes back to Leadership

As with any change program, it needs to start at the very top. This is no time for senior management to retreat to their Ivory Tower. Executives need to be out canvassing support, explaining the reasons why this is important, answering the difficult questions and selling the benefits. We often liken the role of the senior sponsor in such a program to that of an election candidate. If they are not delivering their stump speech at least three times a day, they are not trying hard enough.

To create lasting change, words of encouragement are necessary, but not sufficient. Alignment of performance management, reward, learning and development, promotion and even recruitment processes are critical to 'lock-in' the new behaviors. The private equity sector's track record of balancing cost cutting with performance and growth has been achieved by focusing management's minds firmly on the specific objectives. They set clear cost-reduction targets that are linked to generous incentives, put in place accurate measurement processes and broadcast the results around the organization to show the progress being made. If progress is not being made, they act.

Being well prepared to manage any resulting redundancy or other work place change is absolutely critical, as well as morally correct. Treating people affected with dignity, fairness and honesty is the only way for sponsors of cost reduction programs to retain credibility and respect. A 'slash and burn' approach may work once, but second time round employees will be less forthcoming.

The HR function has a critical role to play here, and also in looking after those that remain. Re-defining clear job roles, supporting individuals through learning and development, and yet more communication is an essential last step in the change process.

Case Study – BASF Greater China: Labor Costs Pose Challenges Everywhere

BASF, along with many other multinationals in China, has found rising personnel costs difficult to control. The main issues revolve around motivation and retention. For technical employees salaries can double with a job change, while finding and training new staff is creating significant wage inflation for employers.

Helmut Sprengel, Director, Finance & Corporate Service Center, BASF Greater China, reports that his company's strategy for retaining and motivating employees pays particular attention to what he calls "the soft factors", some of which cost relatively little. In BASF's experience, issues such as the work environment, fair treatment and recognition are decisive in retaining employees.

The company of course does not ignore financial issues. As another part of its retention strategy for China, BASF inaugurated a savings scheme – similar to a pension plan in other countries – to which both employee and company contribute. The arrangement exceeds Chinese labor law requirements and is integrated into BASF's performance management program.

Although ostensibly an increase in labor costs, Sprengel says BASF considers the savings scheme a part of cost efficiency. Cost reduction is not an absolute. Instead, in Sprengel's view, "cost efficiency is to have the most efficient processes," a philosophy which guides the company's ongoing heavy investment in China.

Written by the Economist Intelligence Unit

Conclusion

A diet helps you lose weight for a while: a lifestyle change makes you healthy.

Cost issues and structures are too important to ignore. Costs can slowly and almost imperceptibly build in companies until the situation is at the very least unhealthy or, if the environment changes rapidly, dangerous. Hostile takeovers of cost-bloated companies are not an unusual end.

Many businesses seem to be aware of this, but too few are acting on this knowledge. Overly-timid goals of two percent per year are reached barely 60 percent of the time. Ownership of cost is insufficiently widespread, and is unlikely to be so when leanness garners few incentives. It is sometimes unclear whether IT is a problem or a solution. Rising revenues have lulled too many businesses into a false sense of security.

The nub of the difficulty seems to be how a business thinks about keeping down expenses. Too many treat it as an unpleasant exercise in abstinence, a need to keep doing the same things only a little bit more efficiently.

A better approach is to see cost as a symptom, not a disease. Costs are not simply the price a company pays in the course of doing business – they are a function of the business model itself. Efficiency is laudable, and necessary, but the deeper cost savings come from making sometimes extremely difficult strategic choices about the model itself. Companies that realize that costs are at the core of business can create a culture where everyone owns them, everyone wants to reduce them, and everyone seeks new ways to do so because they are the very stuff of business competition. One of the overarching lessons from this study is not the possible benefits arising from a series of techniques, but the importance of unified thinking about business models and cost. A diet helps you lose weight for a while: a lifestyle change makes you healthy.



Appendix

1: How have fixed costs, variable costs and revenues changed in your company over the past three years?

	Increased substantially		Increased slightly		Stayed the same		Decreased slightly		Decreased substantially	
Fixed costs	91	21.36%	191	44.84%	85	19.95%	46	10.80%	13	3.05%
Variable costs	110	26.07%	205	48.58%	62	14.69%	31	7.35%	14	3.32%
Revenues	137	32.46%	176	41.71%	77	18.25%	26	6.16%	6	1.42%

(Response: 427)

2: What level of cost savings does your company aim to make across the business over the next three years?

No planned savings	38	8.90%
1-5%	81	18.97%
6-10%	152	35.60%
11-15%	74	17.33%
16-20%	40	9.37%
21-25%	9	2.11%
26% or higher	3	0.70%
Don't know	30	7.03%

(Response: 427)

3: How important do you expect the following aspects of cost management to be in your organization?

	Very important				Not at all important					Don't know		
	1	2	3	4	5							
Cost reduction	181	42.49%	134	31.46%	83	19.48%	14	3.29%	12	2.82%	2	0.47%
Cost avoidance (ie refraining from investment)	54	12.83%	120	28.50%	129	30.64%	71	16.86%	40	9.50%	7	1.66%
Increased cost-efficiency	193	45.63%	142	33.57%	63	14.89%	19	4.49%	3	0.71%	3	0.71%
More flexible cost structure	102	24.00%	157	36.94%	116	27.29%	31	7.29%	9	2.12%	10	2.35%
Greater process efficiency	180	42.45%	140	33.02%	68	16.04%	24	5.66%	6	1.42%	6	1.42%
Greater operational efficiency	187	44.31%	140	33.18%	64	15.17%	22	5.21%	6	1.42%	3	0.71%
More rigorous cost-benefit analysis	111	26.24%	151	35.70%	96	22.70%	45	10.64%	10	2.36%	10	2.36%

(Response: 427)

4: Which of the following trends are most likely to increase pressure to rethink cost structures in your organization?

Downward pressure on prices	181	42.39%
Need to fund growth	131	30.68%
Intensifying competition	215	50.35%
Need to strengthen balance sheet	79	18.50%
Pressure from shareholders/investors	88	20.61%
Increased tax costs	34	7.96%
Regulatory changes	40	9.37%
Don't know	12	2.81%

(Response: 427)

5: How will costs change in the following areas of your business over the next three years?

	Major increase		Minor increase		No change		Minor decrease		Major decrease		Don't know	
Input costs (eg oil, raw materials)	109	25.71%	171	40.33%	105	24.76%	18	4.25%	3	0.71%	18	4.25%
Purchasing/procurement	47	11.24%	191	45.69%	121	28.95%	41	9.81%	5	1.20%	13	3.11%
People	109	26.01%	201	47.97%	67	15.99%	30	7.16%	6	1.43%	6	1.43%
Technology infrastructure	97	23.04%	171	40.62%	110	26.13%	34	8.08%	3	0.71%	6	1.43%
Customer servicing & interaction	72	16.98%	199	46.93%	112	26.42%	31	7.31%	2	0.47%	8	1.89%
Production	49	11.61%	138	32.70%	143	33.89%	57	13.51%	8	1.90%	27	6.40%
R&D/product or service innovation	61	14.39%	180	42.45%	129	30.42%	27	6.37%	7	1.65%	20	4.72%
Commercial property portfolio	34	8.02%	100	23.58%	190	44.81%	45	10.61%	12	2.83%	43	10.14%
Finance function	28	6.62%	129	30.50%	191	45.15%	49	11.58%	6	1.42%	20	4.73%
Compliance	53	12.44%	165	38.73%	164	38.50%	23	5.40%	6	1.41%	15	3.52%
Marketing	83	19.62%	179	42.32%	126	29.79%	19	4.49%	6	1.42%	10	2.36%

(Response: 427)

6: How important will the following strategies be as part of your cost management over the next three years?

	Very important								Not at all important		Don't know	
	1		2		3		4		5			
Improving process efficiency	222	52.11%	140	32.86%	44	10.33%	13	3.05%	1	0.23%	6	1.41%
Better risk management	93	21.83%	161	37.79%	115	27.00%	40	9.39%	10	2.35%	7	1.64%
Reducing service levels	26	6.18%	83	19.71%	128	30.40%	73	17.34%	93	22.09%	18	4.28%
Domestic outsourcing	39	9.18%	99	23.29%	135	31.76%	63	14.82%	74	17.41%	15	3.53%
Offshore outsourcing	56	13.27%	88	20.85%	104	24.64%	44	10.43%	110	26.07%	20	4.74%
Using more cost-effective service channels (eg internet)	99	23.29%	165	38.82%	82	19.29%	47	11.06%	24	5.65%	8	1.88%
Shared service centers	54	12.77%	121	28.61%	107	25.30%	57	13.48%	60	14.18%	24	5.67%
Discontinuation of unprofitable lines	95	22.41%	124	29.25%	96	22.64%	46	10.85%	45	10.61%	18	4.25%
Acquiring other companies to increase scale	52	12.29%	112	26.48%	105	24.82%	56	13.24%	76	17.97%	22	5.20%
Divestiture of unprofitable units	65	15.48%	110	26.19%	108	25.71%	54	12.86%	60	14.29%	23	5.48%
Organizational restructuring	78	18.62%	141	33.65%	111	26.49%	54	12.89%	23	5.49%	12	2.86%
Alliances and joint ventures to share risk and cost	56	13.21%	120	28.30%	105	24.76%	60	14.15%	60	14.15%	23	5.42%
Use of continuous improvement tools (eg Six Sigma, TQM)	80	19.09%	130	31.03%	97	23.15%	56	13.37%	35	8.35%	21	5.01%

(Response: 427)

7: Who in your organization holds significant responsibility for cost management initiatives?

CEO	256	60.24%
CFO	241	56.71%
CIO	86	20.24%
HR Director	57	13.41%
Sales and marketing managers	56	13.18%
All managers	166	39.06%
All employees	70	16.47%
Other, please specify	18	4.24%

(Response: 425)

8: How is cost efficiency encouraged among managers and employees in your business?

The costs and profitability of individual business units are made transparent across the business	200	47.28%
Managers and teams are incentivized to reduce costs	176	41.61%
There are clear targets for costs and margins for each business unit	215	50.83%
Costs are benchmarked against rival companies	123	29.08%
Purchase costs must be approved over a specified threshold	173	40.90%
Cost reduction targets are integrated into the annual budgeting process	162	38.30%
Costs savings and cost saving initiatives are monitored and reported each month	131	30.97%
Other, please specify	5	1.18%

(Response: 423)

9: Where does IT have a significant role to play in helping your company to reduce costs?

	Major role		Minor role		No role/ not applicable	
Providing more transparent information on costs across the business	222	53.11%	154	36.84%	42	10.05%
Improving cost-efficiency (eg through automation of labor-intensive tasks)	206	48.82%	175	41.47%	41	9.72%
Supporting low cost delivery channels (eg web, call centers, etc)	170	40.57%	187	44.63%	62	14.80%
Reducing costs of running an international business (eg through better, cheaper communications)	167	40.05%	171	41.01%	79	18.94%
Enabling low-cost service models such as outsourcing	128	30.62%	193	46.17%	97	23.21%
Other	29	13.24%	46	21.00%	144	65.75%

(Response: 426)

10: In the next three years, which of the following strategies will be most critical to reducing people-related costs?

Reducing headcount	135	31.91%
Recruitment freeze	93	21.99%
Restructuring of benefit offerings (eg pensions)	96	22.70%
Better use of performance management	230	54.37%
Training in cost reduction/cost efficiency	141	33.33%
Greater use of outsourcing	134	31.68%
Greater use of contract/temporary workers	105	24.82%
Cutting of expense accounts	77	18.20%
Other, please specify	10	2.36%

(Response: 423)

11: In the next three years, which of the following strategies will be most critical to reducing supply chain costs?

Better sharing of information with suppliers	152	36.10%
Strategies to reduce inventory	161	38.24%
Shared service centers	102	24.23%
Outsourcing of business processes	138	32.78%
Centralization of procurement to increase company buying power	121	28.74%
Smart sourcing of materials and components from lower cost markets	137	32.54%
Use of e-marketplaces	108	25.65%
Use of third-party logistics	62	14.73%
Other, please specify	6	1.43%

(Response: 421)

12: In the next three years, which of the following strategies will be most critical to reducing finance costs?

Use of benchmarking	106	24.94%
Improving tax position	132	31.06%
Renegotiation of financing terms	131	30.82%
Improving credit control	165	38.82%
Restructuring of asset portfolio	107	25.18%
Use of technology eg automated invoicing	160	37.65%
Use of activity-based costing	113	26.59%
Use of more cost-effective finance models eg leasing	86	20.24%
Other, please specify	3	0.71%

(Response: 425)

13: What is the primary way your company handles the following activities?

	Internal business unit		Shared service center		Domestic outsource provider		Offshore provider		Don't know	
Customer service	301	70.82%	75	17.65%	23	5.41%	11	2.59%	15	3.53%
HR & payroll management	224	52.96%	103	24.35%	84	19.86%	1	0.24%	11	2.60%
R&D/product development	255	60.00%	84	19.76%	48	11.29%	9	2.12%	29	6.82%
Production	232	54.85%	77	18.20%	65	15.37%	17	4.02%	32	7.57%
Procurement	253	59.67%	97	22.88%	48	11.32%	8	1.89%	18	4.25%
Finance and accounting	263	62.17%	93	21.99%	44	10.40%	11	2.60%	12	2.84%
Logistics	183	43.26%	110	26.00%	96	22.70%	13	3.07%	21	4.96%
Property management	175	41.57%	101	23.99%	91	21.62%	7	1.66%	47	11.16%
Sales	297	70.55%	58	13.78%	34	8.08%	9	2.14%	23	5.46%
IT	197	46.57%	107	25.30%	90	21.28%	16	3.78%	13	3.07%
Marketing	296	69.65%	61	14.35%	42	9.88%	8	1.88%	18	4.24%
Tax and treasury management	205	49.28%	103	24.76%	79	18.99%	8	1.92%	21	5.05%

(Response: 427)

14: What annual savings have you achieved from the following?

	Strategy not used		Strategy not used yet		1-5%		6-10%		11-15%		16%+		Don't know
Domestic outsourcing	103	24.35%	77	18.20%	72	17.02%	66	15.60%	29	6.86%	12	2.84%	64
Offshore outsourcing	186	44.50%	64	15.31%	32	7.66%	31	7.42%	16	3.83%	23	5.50%	66
Shared service centers	125	29.69%	73	17.34%	68	16.15%	46	10.93%	25	5.94%	13	3.09%	71
Business process optimization initiatives	82	19.34%	73	17.22%	87	20.52%	74	17.45%	28	6.60%	15	3.54%	65
Use of more cost-effective service channels	86	20.33%	73	17.26%	84	19.86%	62	14.66%	27	6.38%	12	2.84%	79

(Response: 427)

15: How successfully do you think your organization performs the following aspects of cost reduction programs?

	Very successful								Not successful at all		Don't know	
	1	2	3	4	5	6	7	8	9	10	11	12
Selecting appropriate methods to achieve cost reductions	82	19.34%	164	38.68%	106	25.00%	45	10.61%	11	2.59%	16	3.77%
Setting realistic targets	61	14.39%	172	40.57%	121	28.54%	46	10.85%	12	2.83%	12	2.83%
Assigning roles and responsibilities	74	17.37%	156	36.62%	125	29.34%	49	11.50%	10	2.35%	12	2.82%
Communicating objectives to employees	68	16.15%	144	34.20%	115	27.32%	65	15.44%	17	4.04%	12	2.85%
Understanding and evaluating the potential impact of changes to cost structures	49	11.67%	148	35.24%	141	33.57%	55	13.10%	11	2.62%	16	3.81%
Ensuring accountability for changes to cost structures	54	12.74%	139	32.78%	134	31.60%	68	16.04%	13	3.07%	16	3.77%
Retaining management focus and commitment to cost reduction in practice	69	16.31%	152	35.93%	119	28.13%	57	13.48%	13	3.07%	13	3.07%
Measuring the success of changes to cost structures	50	11.82%	142	33.57%	135	31.91%	64	15.13%	9	2.13%	23	5.44%

(Response: 426)

16: When your organization decides to implement cost saving ideas, on average, what proportion of planned savings does your company typically achieve in practice?

Less than 50%	111	26.12%
51-60%	65	15.29%
61-70%	53	12.47%
71-80%	60	14.12%
81-90%	30	7.06%
91-100%	13	3.06%
Initial targets are always met or exceeded	33	7.76%
Don't know	60	14.12%

(Response: 425)

17: What are the biggest risks associated with cost optimization projects in your organization?

	Major risk				Minor risk				Don't know			
	1	2	3	4	5							
Cost reductions threaten product/service quality	136	32.15%	145	34.28%	68	16.08%	33	7.80%	32	7.57%	9	2.13%
Company gets distracted from task of value creation	63	14.89%	146	34.52%	117	27.66%	45	10.64%	38	8.98%	14	3.31%
Valuable resources are unintentionally cut	60	14.25%	122	28.98%	132	31.35%	58	13.78%	38	9.03%	11	2.61%
Excessively demanding targets demotivate employees	73	17.38%	127	30.24%	104	24.76%	69	16.43%	33	7.86%	14	3.33%
Insufficient investment in product innovation/R&D	52	12.41%	115	27.45%	130	31.03%	51	12.17%	52	12.41%	19	4.53%
Resources to ensure compliance with laws and regulations are potentially eroded	29	6.87%	99	23.46%	112	26.54%	65	15.40%	89	21.09%	28	6.64%

(Response: 425)

18: What are the biggest barriers to optimizing cost structures in your organization?

	Major barrier				Minor Barrier				Don't know			
	1	2	3	4	5							
Inadequate processes to drive cost reduction	73	17.30%	160	37.91%	110	26.07%	35	8.29%	25	5.92%	19	4.50%
Lack of transparency on costs across the organization	65	15.33%	149	35.14%	97	22.88%	56	13.21%	44	10.38%	13	3.07%
Difficulty in measuring cost savings	49	11.56%	133	31.37%	145	34.20%	51	12.03%	35	8.25%	11	2.59%
Insufficient incentives to reward prudent cost management	54	12.83%	129	30.64%	134	31.83%	58	13.78%	28	6.65%	18	4.28%
Too much reliance on cost avoidance rather than increased cost-efficiency	56	13.24%	149	35.22%	119	28.13%	46	10.87%	33	7.80%	20	4.73%
Poor implementation of cost saving programs	34	8.10%	133	31.67%	133	31.67%	69	16.43%	29	6.90%	22	5.24%
Insufficient investment in IT	34	8.04%	100	23.64%	114	26.95%	88	20.80%	69	16.31%	18	4.26%
Resistance from employees	50	11.88%	105	24.94%	116	27.55%	80	19.00%	56	13.30%	14	3.33%
Negative publicity caused by cost-saving measures (eg offshoring)	27	6.41%	82	19.48%	110	26.13%	71	16.86%	99	23.52%	32	7.60%
Current organizational structure erodes cost-efficiency (eg because of silos, etc)	47	11.11%	112	26.48%	112	26.48%	76	17.97%	51	12.06%	25	5.91%
Too many conflicting projects	56	13.21%	116	27.36%	124	29.25%	57	13.44%	47	11.08%	24	5.66%

(Response: 426)

19: Please indicate whether you agree or disagree with the following statements

	Agree strongly		Agree slightly		Neither agree nor disagree		Disagree slightly		Disagree strongly	
Changing cost structures can be a source of long-term competitive advantage	201	47.41%	151	35.61%	58	13.68%	7	1.65%	7	1.65%
Rethinking cost structures successfully requires adjusting performance incentives	145	34.28%	186	43.97%	79	18.68%	10	2.36%	3	0.71%
We find it very difficult to measure the success of changes to our cost structures	63	14.82%	155	36.47%	119	28.00%	64	15.06%	24	5.65%
A renewed focus on revenue growth has eroded discipline on cost efficiency in your company	44	10.35%	135	31.76%	132	31.06%	89	20.94%	25	5.88%
Achieving a sustainable change in cost structures requires an extraordinary focus rather than a business as usual approach/attitude	140	32.94%	145	34.12%	93	21.88%	36	8.47%	11	2.59%

(Response: 427)

20: In which region are you personally located?

Asia-Pacific	105	24.59%
Latin America	16	3.75%
North America	149	34.89%
Eastern Europe	21	4.92%
Western Europe	121	28.34%
Middle East & Africa	17	3.98%

(Response: 427)

21: What is your primary industry?

Agriculture and agribusiness	6	1.41%
Automotive	18	4.22%
Chemicals	15	3.51%
Construction and real estate	11	2.58%
Consumer goods	39	9.13%
Defence and aerospace	2	0.47%
Education	25	5.85%
Energy and natural resources	15	3.51%
Entertainment, media and publishing	16	3.75%
Financial services	72	16.86%
Government/Public sector	18	4.22%
Healthcare, pharmaceuticals and biotechnology	24	5.62%
IT and technology	47	11.01%
Logistics and distribution	11	2.58%
Manufacturing	33	7.73%
Professional services	44	10.30%
Retailing	12	2.81%
Telecoms	16	3.75%
Transportation, travel and tourism	5	1.17%

(Response: 427)

22: What are your company's global annual revenues in US dollars?

\$500m or less	210	49.18%
\$500m to \$1bn	61	14.29%
\$1bn to \$5bn	62	14.52%
\$5bn to \$10bn	34	7.96%
\$10bn or more	61	14.29%

(Response: 427)

23: How has your company's EBITDA changed over the past 12 months?

Decreased	36	8.49%
No change	76	17.92%
<5% increase	76	17.92%
6-10% increase	85	20.05%
11-20% increase	39	9.20%
Over 20% increase	64	15.09%
Don't know	48	11.32%

(Response: 424)

24: Which of the following best describes your title?

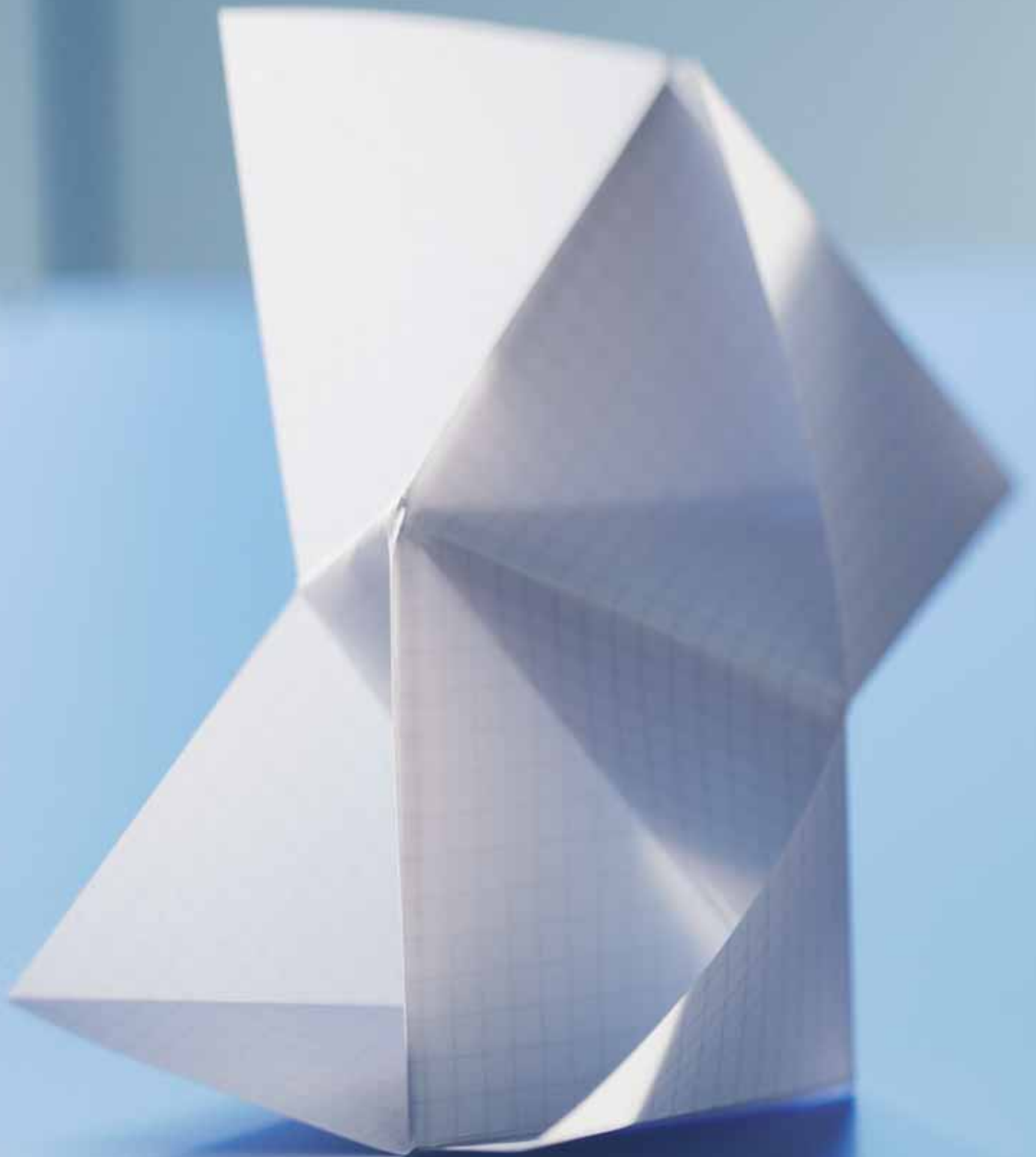
Board member	29	6.79%
CEO/President/Managing director	74	17.33%
CFO/Treasurer/Controller	42	9.84%
CIO/Technology director	32	7.49%
Other C-level executive	36	8.43%
SVP/VP/Director	43	10.07%
Head of Business Unit	22	5.15%
Head of Department	35	8.20%
Manager	78	18.27%
Other	38	8.90%

(Response: 427))

25: What are your main functional roles? Please choose no more than three functions?

Customer service	74	17.33%
Finance	102	23.89%
General management	162	37.94%
Human resources	19	4.45%
Information and research	54	12.65%
IT	65	15.22%
Legal	21	4.92%
Marketing and sales	85	19.91%
Operations and production	62	14.52%
Procurement	18	4.22%
Risk	38	8.90%
R&D	28	6.56%
Supply-chain management	27	6.32%
Strategy and business development	110	25.76%
Other	15	3.51%

(Response: 427))



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