

Unlocking hidden efficiency reserves – boosting performance through focused programs instead of imprudent cross-the-board cost cutting

by Stefan Heppelmann, Konstantin Wrona and Dimitri Belobokov

Management Summary

The agenda for senior executives has changed drastically within the last year. Realizing growth just by adding more business to the investment portfolio is not the only driver for value creation any more. More and more companies are planning or have already started comprehensive cost savings programs – a true venture for most enterprises. The sheer enormity of the current crisis offers the chance to an active management team to unlock enormous efficiency reserves slumbering in the organization. In reality, however, most programs look like defensive acts of desperation rather than targeted efficiency improvements. Applying the undifferentiated motto “10% improvements are always possible” leads to undifferentiated cross-the-board cost cutting. Even worse, it endangers the company’s substance.

So far reality and bad news – good news are that these programs are nothing to be frightened about if some principles are followed. Sustainable results and long-term success is based on three principles:

1. Start from processes instead of cost centers and headcounts
2. Attack structural causes of inefficiencies
3. Control effects of single measures intensively and keep up pressure until effects have materialized in the P&L statement

Introduction

The economic barometer is showing downwards – cost reductions and earnings improvement are necessary measures to survive the current crisis. These kinds of measures are not new for international senior executives. CORE, STAR, ForMotion ... – almost every key executive has been in touch with one of these big programs in previous years somewhere in the world. They all follow a very simple idea: reduce costs and improve cash flow as well as earnings.

How effective are such initiatives? On the one hand, they have undoubtedly contributed to the good results of the past few years in Europe and partially in the US. On the other hand, a deeper analysis shows that most of these programs did not realize everything that was possible. Many efficiency potentials were either not touched upon or only touched upon half-heartedly. Only a part of the claimed savings in the project reporting also actually ended up improving earnings. In other cases, the measures were only of short duration – a year later the inefficiencies appeared again – only hidden somewhere else.

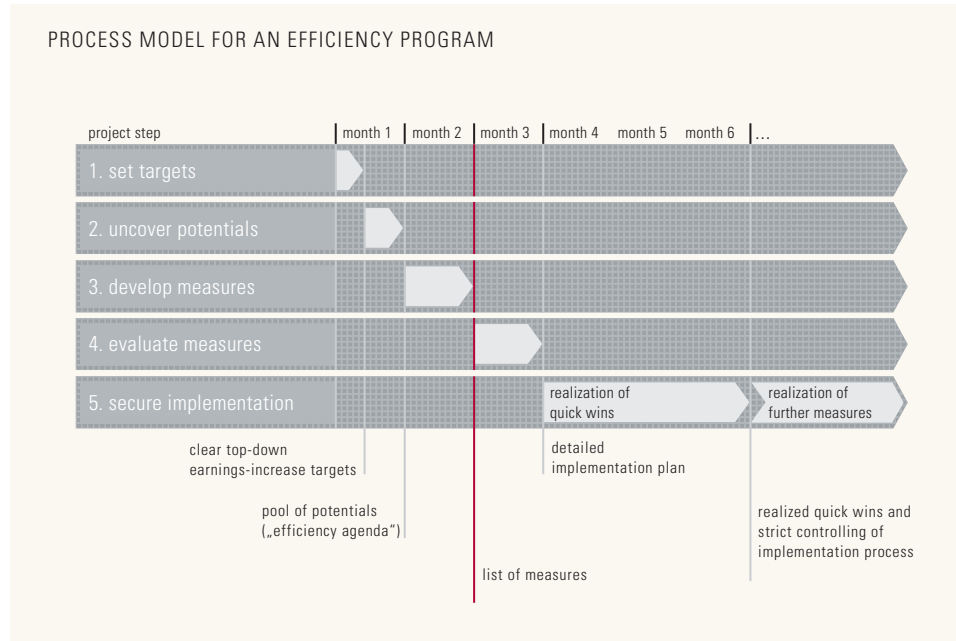
A reason for that is that savings targets are quite often being distributed along the functional organization following the lawn mower principle. Thus, every division tries to realize efficiency reserves out of its own processes. Unfortunately, strong inefficiencies are often located at the interfaces of processes. These are not eliminated but only moved further on along the value chain.

Another reason for untapped potentials is short-term focus. Earnings increase programs need to work quickly by nature. That is the reason for starting many small measures in order to treat the symptoms and produce immediate results. But often, no one dares to touch upon the real potentials and their causes – the necessary changes loom too threatening. Moreover, many measures fail in implementation. When the first hurdles appear, implementation drags itself out too long or comes to a halt.

In the following we will present a process model of how to create more efficient and effective efficiency programs.

Effectively implement efficiency programs

An efficiency program typically follows a 5-phase approach. The duration of each step can vary according to company size; the process model though tends to be very similar:



Get up to speed quickly at the beginning:

Status quo analysis, allocation of costs and capacities as well as negotiations about target distribution within the company should be done quickly. On average after two months, measures have been attached to the targets; after six months there are clear results.

Act more consequentially at the end:

Controlling of measure implementation is being pursued until the monetary result is visible in the P&L and sustainability is secured.

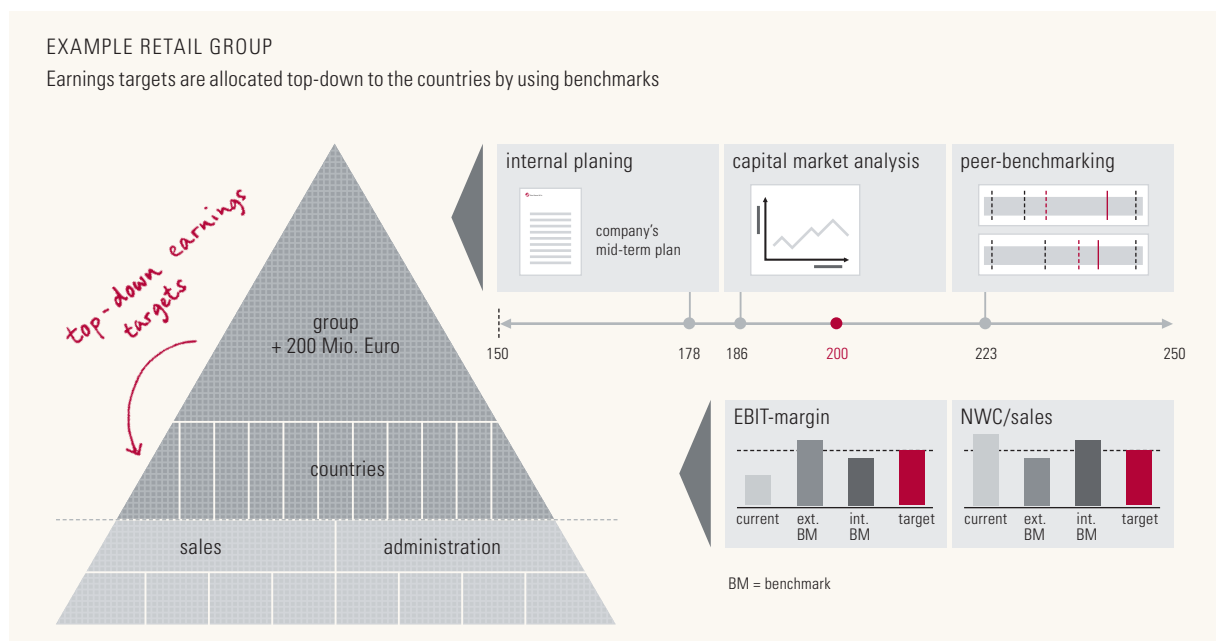
In the following the 5 steps will be described in detail.

Set targets

The first step serves to establish and/or to increase pressure for realizing efficiency gains in the operating units. For the definition of targets a „starting level“ is needed – this is defined on the basis of existing data. The allocation of actual costs and current personnel capacities to the processes is only pursued at the top process level, in special cases possibly one level below. The documentation of activities at level 5 to 6 with an exactness of less than one full-time-equivalent is never a precondition for the identification of potentials. If that is necessary for the evaluation and implementation of measures it is better applied on a case-by-case basis in later project phases.

It is the responsibility of the company's management to provide a quantified earnings or cash flow increase target for every operating unit. While doing this, it is very important to avoid (a) time consuming discussions about target distribution and (b) losing oneself in details. Two recommendations help to achieve this:

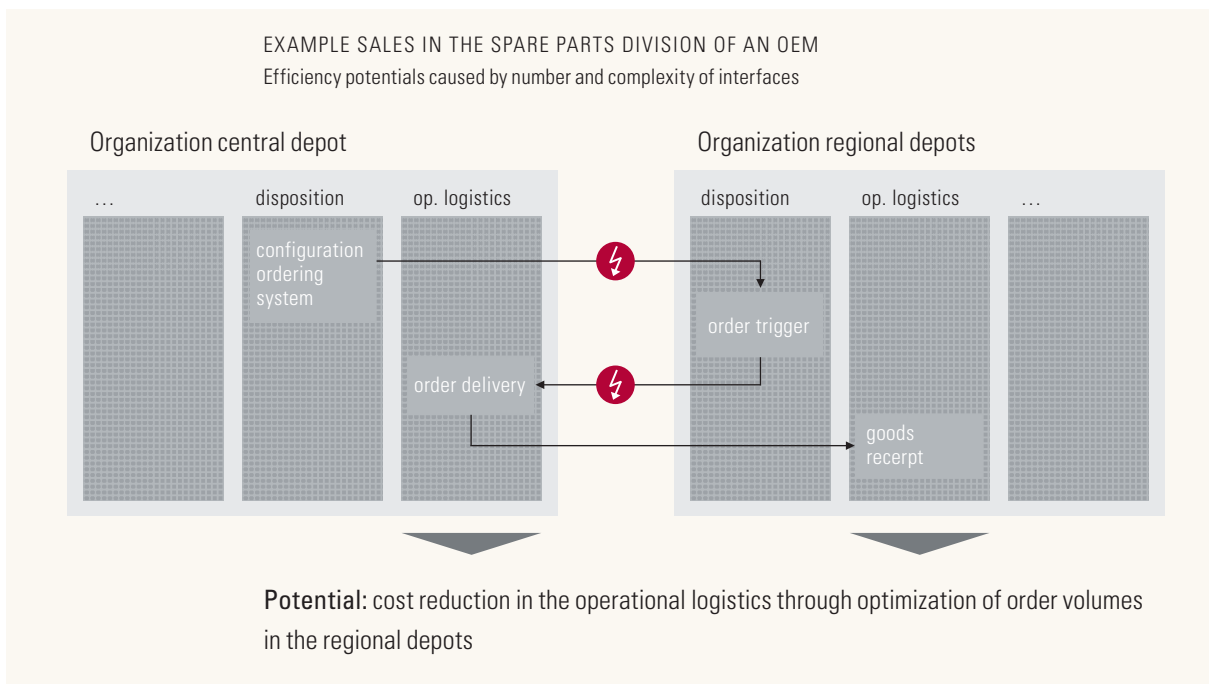
1. Limit specifications of targets for earnings and cash flow increase to levels within the organization where an integrated optimization of the process value chain is possible
2. Set targets top-down, but use internal and external benchmarks to validate them



At the end of this step, every operating management team knows the target of its earnings or cash flow improvement.

Uncover potentials

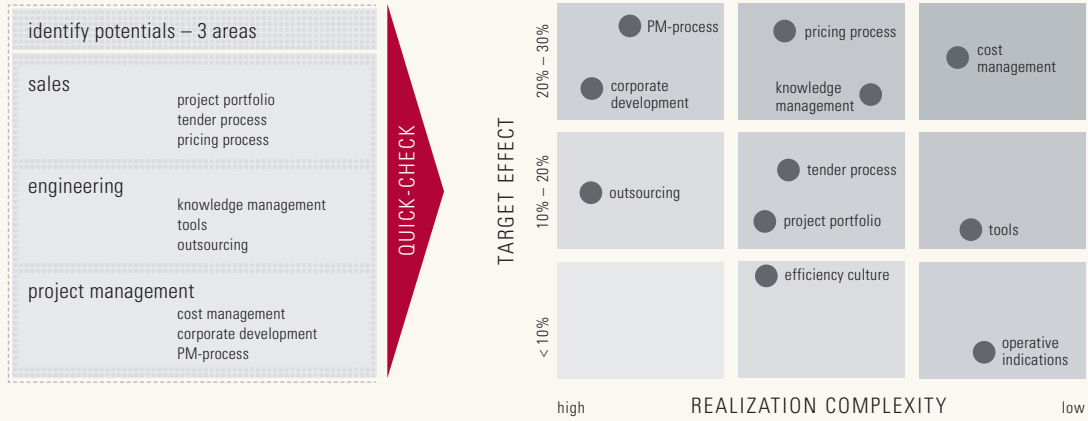
The goal of this step is the quick determination of substantial potentials on the basis of an efficient status quo analysis. Again, it is not about detailed modelling of current processes but about understanding the logical coherency in the company's value chain. The goal is to lay bare the interfaces and therefore to map the known business model process structures into the organizational structure. From this result, hypotheses regarding efficiency potentials can be directly derived. As we have seen for example in the spare parts business of an OEM, the strongest cost driver in the centralized logistic center was the ordering process of decentrally located internal customers. Because of the way the system operates, the ordering process was also strongly influenced by the materials planning department – and that's precisely also where the biggest cost reduction lever has been identified.



Identified potentials are then submitted to a "quick check". Based on a qualitative criteria catalogue potentials are classified with regard to estimated target contribution and to realization complexity. On the one hand, this results in a clear prioritization of potentials. On the other hand, it is already the first test whether target realization can be secured: In this phase, the potentials to be followed upon should add up to a cumulated target contribution level of at least 150%.

EXAMPLE INDUSTRIAL SERVICE COMPANY

potentials prioritized according to realization complexity and target effect



For the identification and prioritization of potentials, only a few weeks of analytical work in the project team are needed in addition to 2–3 workshops with the operational management. This project step results in the creation of an efficiency agenda. It also includes a realistic number of top-potentials which clear measures are attached to within the next step.

EXAMPLE WASTE MANAGEMENT COMPANY

An efficiency agenda lists the starting points for measure definitions

core process	potential	priority	responsibility
sales/ sales management	<ul style="list-style-type: none"> simplification of supplementary contracts standardization of test process increase attestation limit 	<ul style="list-style-type: none"> A B C 	<ul style="list-style-type: none">
finance	<ul style="list-style-type: none"> automation accounts clearing optical archival storage invoicing / dunning 	<ul style="list-style-type: none"> A C B 	<ul style="list-style-type: none">
IT	<ul style="list-style-type: none"> introduction of clearance system inclusion of data and system history 	<ul style="list-style-type: none"> B C 	<ul style="list-style-type: none">
...	<ul style="list-style-type: none"> 	<ul style="list-style-type: none"> 	<ul style="list-style-type: none">

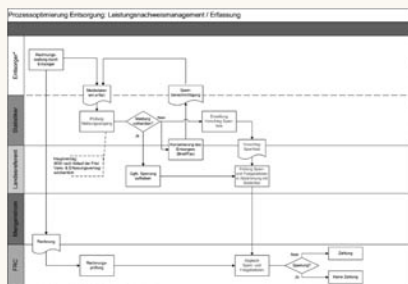
Develop measures – attack the root-causes

This step it is about identifying the causes for inefficiencies and defining clear measures to eliminate them. Firstly, every potential is analyzed through roll back analysis in order to determine the link between the cause and the symptoms. On demand, focused process and system analysis as well as the interpretation of the operational data are applied. Following this approach inefficiencies are exactly localized and their monetary effect can be approximated.

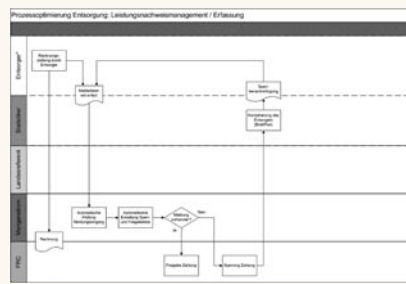
EXAMPLE INSURANCE COMPANY

Process optimization in the damage department:
standardization of identical processes, process variety is reduced

Before optimization



After optimization



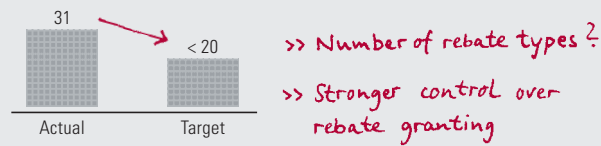
Depending on the causes of inefficiencies, improvement measures are defined for every potential along the following dimensions: processes, systems, operating resources, organizational structure and knowledge as well as target- and incentive system. First, the short-term measures with immediate monetary results („quick wins“) are elaborated followed by measures dealing with the rudimentary causes of inefficiencies.

EXAMPLE CONSUMER GOODS COMPANY

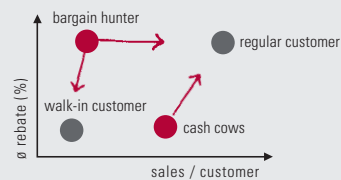
Short-term improvement of margins and sustainable optimization of the pricing process

Quick wins

1. Simplification of rebate system



2. Adjustment of customer contracts



Measures for sustainability

3. Creation of transparency regarding margins

Introduction of margin controlling

4. Extension of target system for sales

Profit margin instead of sales focus

5. Optimization of pricing process

Clear process oriented organization between pricing department, product management and sales regions

The result of all this is a comprehensive list of measures which shows how potentials can be achieved on a sustainable basis.

Evaluate measures

The exact localization and evaluation of the resulting earnings effects is the goal of this step.

Firstly, measures are timed according to the expected cost savings or earnings improvements. Then, expected cost savings or earnings improvements as well as implementation costs and needed investments are evaluated. In order to build a successful implementation controlling, all monetary effects are categorized according to type (sales, personnel and material costs, net working capital, etc.), location (profit center, cost position) as well as time of realization (year, quarter).

In addition to this, measures are also being examined regarding non-monetary aspects. This includes their qualitative benefits (e.g. when they are necessary for ensuring the sustainability of other measures) as well as their potential implementation risks.

It has proven to be a key success factor to include everything in one measure card. From this point in time onwards the measure owner is also included. He is responsible for implementing each measure. These measure cards are also a very valuable controlling instrument in the subsequent implementation phase.

EXAMPLE TELECOMMUNICATIONS COMPANY

Measure cards summarize all effects and ensure implementation controlling

<table border="1"> <tr> <td>Titel der Maßnahme:</td> <td>Stichwort der Maßnahme:</td> <td>System:</td> </tr> <tr> <td>Vorbereitung (M&P):</td> <td>Verbreitung (M&P):</td> <td></td> </tr> <tr> <td>Personaleffekte:</td> <td>Materielle Effekte:</td> <td>Wirtschaftliche Auswirkungen:</td> </tr> <tr> <td>Personaleffekte:</td> <td>Personaleffekte:</td> <td>Personaleffekte:</td> </tr> </table>	Titel der Maßnahme:	Stichwort der Maßnahme:	System:	Vorbereitung (M&P):	Verbreitung (M&P):		Personaleffekte:	Materielle Effekte:	Wirtschaftliche Auswirkungen:	Personaleffekte:	Personaleffekte:	Personaleffekte:	identification of measure										
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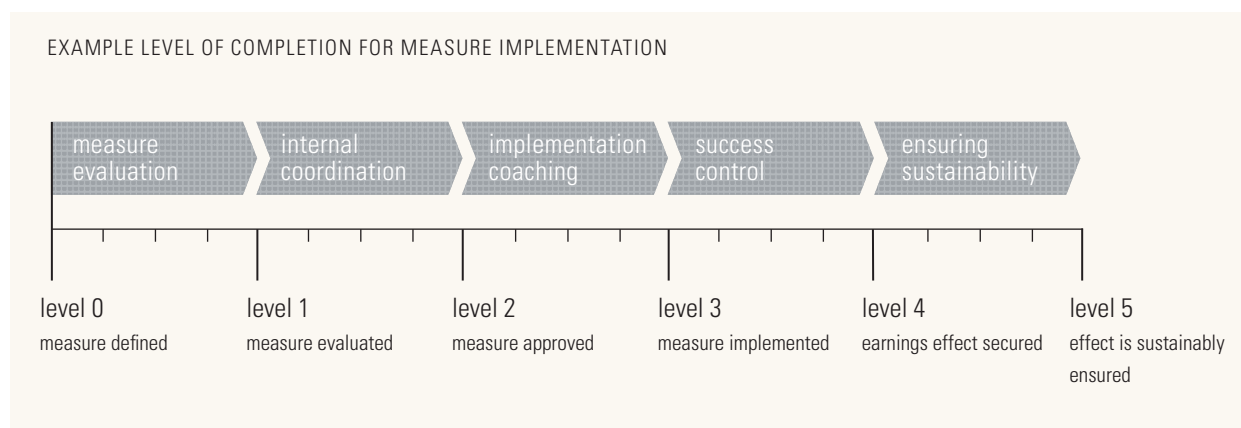
At the end of this project step, all potentials are fully attached to measures and the project can only be deemed to be “on track” if the cumulated financial effect of all the measure cards – reduced by the implementation costs – results in a target achievement of at least 120%.

Financial effects of all measures are being aggregated per responsibility area (e.g. divisions, groups). Thus, not only measure owners but also the heads of respective divisions are responsible for realizing the effects of the measures. Moreover, this secures the inclusion of all effects in budgets and forecasts.

Secure implementation

In a last step, measures have to be implemented and the realization of potentials has to be secured. In this phase it makes sense to structure the program into many sub-projects usually according to the size of potentials. Responsibility for implementation lies typically decentrally with the respective operational management. It has proven itself over and over again that the amount of realized potentials that finds its way into the P&L-statement is also depending on using a strong centralized project office.

Central program steering is necessary until the effects of measures are visible in the P&L. Even after that, this tool is still beneficial – until all other measures have also been implemented, upon which the sustainability of the effects is depending on. In order to keep the pressure up until the end, completion needs to be controlled and measured with the specific metric of “realization levels” – no measure should be described as completed until its potential is actually realized.



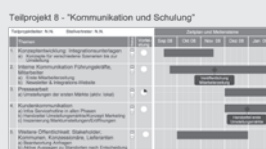
In the implementation phase though, some simple factors determine the success of the whole program. Following these principles requires a lot of strictness in project management:

- Combine responsibility for measures and for planned results with individual targets of management
- Demonstrate continuously and clearly that the program is still on top of the management agenda
- Control realization of potentials very strictly – if necessary even at the level of single cost categories or cost positions. This is especially true for savings measures in the overhead area – personnel costs there tend to show a very strong inertia despite process optimization
- Ensure coordination between sub-projects, their information and communication flows through a highly powered program office
- Communicate intensively the progress of the program internally
- Support program management with simple and understandable rather than technically complicated tools

EXAMPLE RETAIL GROUP

Simple and effective program management tool

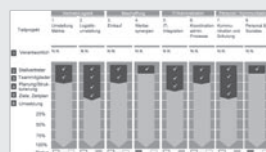
controlling of milestones



measure list

Maßnahme	Maßnahmenbeschreibung	Start	Ende	Status
1	Maßnahme 1	01.01.2010	31.12.2010	100%
2	Maßnahme 2	01.01.2010	31.12.2010	100%
3	Maßnahme 3	01.01.2010	31.12.2010	100%
4	Maßnahme 4	01.01.2010	31.12.2010	100%
5	Maßnahme 5	01.01.2010	31.12.2010	100%

early warning indicator



overview over potentials

Maßnahme	Maßnahmenbeschreibung	Start	Ende	Status
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3	Maßnahme 3	01.01.2010	31.12.2010	100%
4	Maßnahme 4	01.01.2010	31.12.2010	100%
5	Maßnahme 5	01.01.2010	31.12.2010	100%

Summary

In closing, we list the central key success factors of earnings increase programs summarily:

- Perform as little data and process analysis at the beginning as possible
- Attack inefficiencies at the process interfaces
- Focus on top potentials instead of many little measures
- Realize quick wins and eliminate important causes for inefficiencies
- Assign personal responsibility for each measure and the subsequent results
- Localize and control measure effects exactly
- Apply pressure until all P&L-effects are achieved sustainably

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