Rethinking **Cost Management** in the **Digital Age**

CATALANT

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01 A New Era in Cost Management

Not long ago, cost management was a tactic reserved for struggling companies: When cost threatened profitability, something was done about cost. At that time, successful organizations focused on growth, leaving cost management for leaner times.

The digital age, with its massive potential for reinvention and disruption, changed everything. Now, smart organizations are focused on cost and growth, looking to fund innovation with the savings from improved efficiency.

But they are struggling — mightily. Most organizations are failing to meet their cost management goals, even when those goals are modest. The reason is that most traditional cost management tactics are no longer suited for today's operational and market conditions. Short-sighted strategies, silos of information and decision-making, and incremental approaches are unlikely to produce results.

Fortunately, there is hope. Smart organizations are rethinking cost management by reframing costs as capabilities. This simple but powerful shift is the key to unlocking a long-term cost management strategy that drives growth.

02 Cost Management Drivers and Obstacles

Today's business landscape is defined by technological disruption, leading organizations to prioritize efficiency and growth at the same time. This has changed the nature of cost management initiatives from primarily cost-savings measures to something more complex. Recent research from Deloitte found that "Gaining a competitive advantage" and "Required investment in growth areas" are the top two drivers of cost management initiatives (Figure 1). Efficiency is now a strategic imperative.

At the same time, it's easier than ever to spend money. According to Gartner, costs have risen faster than revenues since 2013, creating a squeeze on profitability that leaves finance leaders in a difficult position. The CFO cannot credibly demand reduced spending across the board without inadvertently derailing potential growth opportunities, and without visibility into cost (Gartner says 87% of companies struggle with poor cost visibility) a CFO won't know where to place the right bets.

If the CFO is flying blind, he or she has no chance of connecting cost management to strategy. And if that link is not clear and actionable, finance leaders have little hope of successfully implementing a cost management initiative.

In fact, 63% of companies studied by Deloitte failed to meet their cost management goals — even when those goals are to reduce costs by 10% or less. Most companies have little

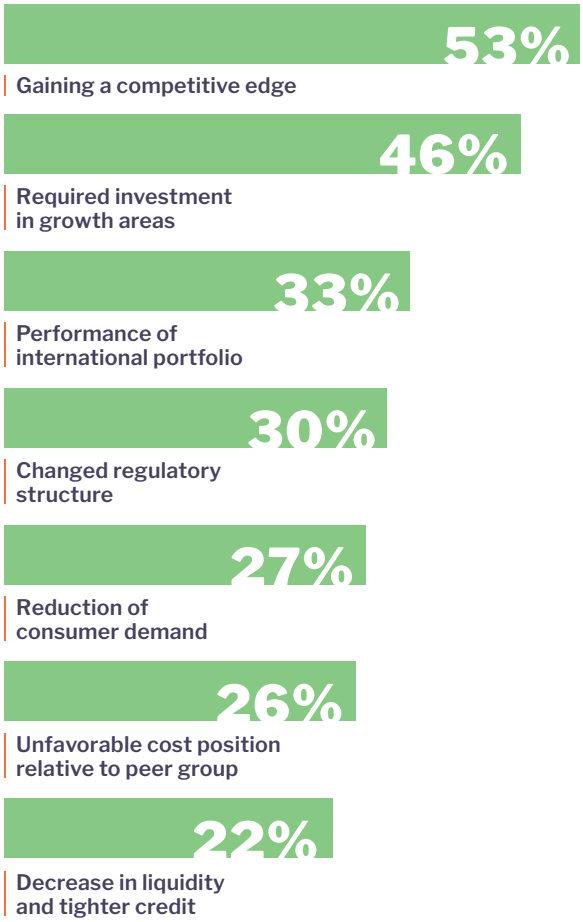
confidence in their ability to translate strategy into action (70%), citing lack of resource allocation (92%) and the complexity of change initiatives (82%) as key drivers.

In short, companies are trying and failing to manage costs — and not because they're setting their targets too high.

According to Deloitte research, the key drivers for cost management include beating the competition and investing in growth areas.

FIGURE 1

Cost management drivers



Deloitte, 'Thriving in uncertainty in the age of digital disruption", 2018

FIGURE 2

The failure of cost activities and strategy go hand-in-hand

63% **fail to meet their cost reduction targets of less than 10 percent**

Deloitte, 'Thriving in uncertainty in the age of digital disruption", 2018

Gartner, 'Strategy Agenda Poll", 2019

So what's the issue? Company leaders seem to know what they want to accomplish and why. But they fail, because they don't understand how to fix it.

Most CFOs and their counterparts struggle to make cost management strategic for three reasons:

- They're balancing short-term pressures with long-term strategies
- They're building static budgets that are outdated the day they're created
- They lack visibility and alignment to see and anticipate problems

EXPERT VIEW

The Big Why

We've all heard of cost management going wrong in a very particular way. It typically starts with the CEO or CFO dictating a percentage cut in spending across the board. Business unit or division leaders must then huddle with their senior managers and decide how to deliver those cuts.

Inevitably, those cuts are made to minimize short- term pain. Maybe they push back vendor agreements, reduce consulting spend, implement a hiring freeze, or restructure to reduce FTSs (typically toward the bottom of the org chart). And just as inevitably, those costs return once the scrutiny of budget season recedes. And the cycle continues.

For Tony Swanson, Managing Partner at AMS Endeavors, the solution to avoiding the cost management hamster wheel is to start by asking a radically honest question: **Why?**

"The most important thing is to be as honest as you can about why you're doing this," Swanson says. "Is it because some analyst complained about earnings or your CEO is looking to reach a short-term incentive? Or is it because you've found a more fundamental dynamic that needs to be addressed — perhaps a new opportunity to grow or a new competitive threat?"

Swanson, who works primarily with industrial companies but has consulted in pharma, biotech, automotive and other industries, says he's seen several examples of organizations driving cost management initiatives based on long-term sustainability. When the focus is on sustainable profits, the focus frequently changes from "cost-cutting" to "growth" or out-maneuvering the competition. For example, a company in a regulated industry might at first seek to reduce costs by trimming the global sales force, but opt instead to repurpose the vast stores of compliance-mandated data it has collected as a new product line or value-added service, increasing win rates and profitability per sales rep.

The execution of your cost management strategy is arguably more important than the strategy itself, says Swanson. Lack of preparation and communication can lead to disaster if the rest of the organization is unclear on the "why."

"The culture part is the hardest part," says Swanson. "The executives leading change are almost always smart and capable; it just takes considerable time and energy to hitch your wagons to new horses, and consistent focus to keep it on track. Make sure your rationale is clear and compelling enough to keep the team motivated to head in the right direction."

03 Reframing Costs as Capabilities

So how do smart organizations succeed in tying cost management to strategy — and in executing on those initiatives despite the obstacles?

They reframe costs as capabilities.

Cost is just money out the door. It's the ballooning obstacle to profitability and the villain of the balance sheet. Capabilities, on the other hand, are opportunity. They are the pistons of your organization's growth engine — the discussion should be about how many pistons you need and which direction the engine should face.

CFOs and business leaders already recognize that costs and people are closely linked. That's why so many of the most common cost management tactics are focused on reducing people-related costs (Figure 3).

FIGURE 3

Most common tactics in cost management. How many are directly related to people?

- Headcount reductions
- Spending Freezes
- Budget Freezes or Reduction Zero Based Budgeting
- Automation
- New Technologies
- Process Optimization
- Shared Services
- Continuous Improvement
- Internal Transformation
- Consulting Firms
- ERP
- Procurement
- Supply Chain Management
- Offshoring

Thinking about costs as capabilities (the collective skills, abilities, and expertise of the organization) will help shift the cost conversation from “how do we spend less money?” to “what is the most valuable work we should be funding?” Business and finance leaders should be prepared to answer these questions:

- Which capabilities are required for us to execute on our strategy?
- How will we assess the impact of the work done toward our strategic goals?
- How will we choose which capabilities to invest in, and which to cut?

Not only does reframing costs as capabilities help clarify the connection between cost and strategy, but it also provides a better unifying principle for the entire leadership team. Gone are the days of annual mandates to slash ten percent of spending, replaced with an ongoing discussion of capabilities and their impact on strategic initiatives.

EXPERT VIEW

The Surprising Economic Impact of Employee Engagement

Cost management and productivity are two sides of the same coin. Too many cost management initiatives are focused on spending less, even while there's a larger opportunity to scale productivity by boosting employee engagement.

In fact, says Allan Steinmetz, founder of Inward Strategic Consulting, employee engagement is one of the best-kept secrets in business. Engaged employees — those who are enthusiastic about their jobs and feel strong ownership over their work — drive results. Disengaged employees, who put time but not energy into their work, hold their peers back.

"It's pretty simple: When there is alignment between employees and the customer, productivity increases," says Steinmetz.

Steinmetz's conclusion is backed by science. A recent Gallup study of over 100,000 people in 150+ countries found that companies in the top quarter of employee engagement saw a 17% lift in productivity over those in the bottom quarter. Top-performing companies outperform their peers in almost every category, from workplace safety to employee turnover (Figure 4).

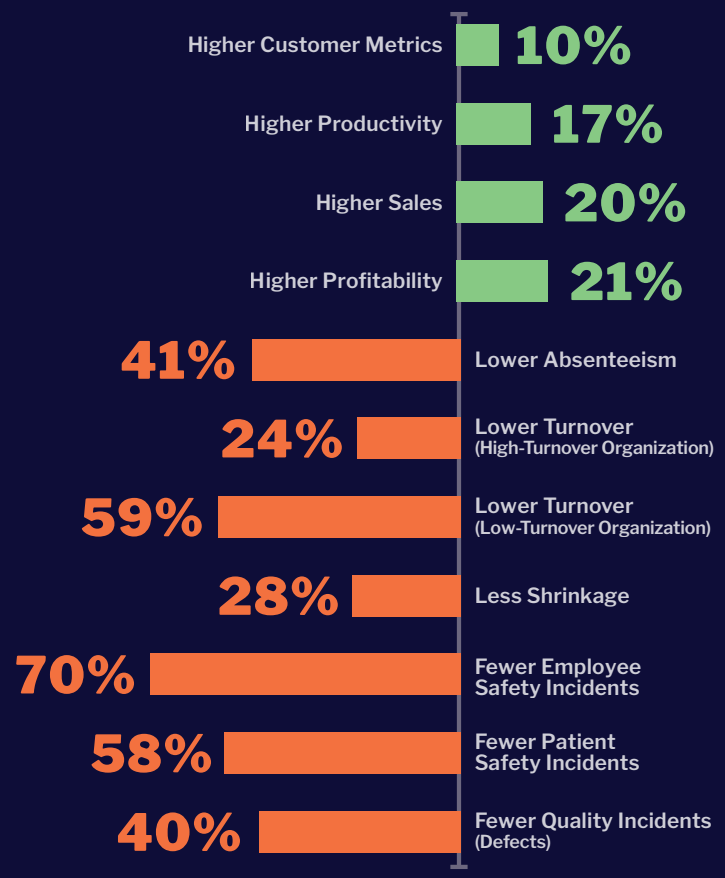
The same survey found that 85% of workers globally were either "disengaged" or "actively disengaged," meaning they actively work against their employers' interests.

This crisis of engagement, says Steinmetz, requires action at the highest levels of every organization. Over nearly 30 years, he's worked with high-level leaders at some of the world's most successful organizations to improve engagement through leadership training, internal communications, health and wellness, personal and professional development, and other programs. The results, when done right, can have a remarkable impact on the bottom line.

"This needs to be in every CEO's playbook," says Steinmetz. "Engaged employees are happier, stay at work longer, and less likely to leave for other opportunities. They tend to be solution-focused rather than job-focused. All of these intangible things are worth money."

FIGURE 4

Companies in the top quarter of engaged employees outperform those in the bottom quarter in almost every way



Gallup, 'State of the Global Workplace", 2017

04 Four Pillars of Strategic Cost Management

Reframing costs as capabilities is a great start, but it also introduces a lot of complexity. Part of the allure of cost management tactics like simple percentage-based spending cuts or zero-based budgeting is the simplicity. There's a number to hit, and as long as that number shows up on the spreadsheet, the job is done.

Unfortunately, this simplistic focus on a single number or process bears the blame for much of the failure we've seen in cost management initiatives. Short-sighted horizons, silos of bureaucracy and information, and incrementalist approaches lead to fragmented half-measures that fail to drive results.

When you start to think of costs as capabilities and focus on lasting value rather than hitting a number, things get a lot more complicated — decisions must be made in a three-dimensional space that accounts for strategy, people, and work.

Fortunately, there are four clearly-defined pillars of strategic cost management to help guide implementation.

- Visibility Into Work
- Empowered Centralized Teams
- Smart Resource Allocation
- Control Over External Spending

Visibility Into Work

Understanding where the money goes is less important than understanding how the work funded by the money impacts the business. Unfortunately most finance leaders — and even business leaders — still see cost as a dollar amount in a spreadsheet cell. Connecting spend to business outcomes typically requires an exhausting track meet of data aggregation, spreadsheet amalgamation, and graphics manipulation.

Providing leaders with greater visibility into work happening across their organization not only helps them to ensure alignment with their short and long-term strategy, but also gleans valuable and actionable insights.

Empowered Centralized Teams

Fiefdoms and silos do more than hamper visibility into costs and results, they also bog down necessary cross-functional transformation efforts. Centralized teams — empowered with people, process, technology, and a mandate from senior leadership — are the agents of change organizations need to create holistic models for strategic cost management.

Theses specialized teams should be empowered to cut across business lines, functions, and geographies, ensuring greater cohesion, sharing of best practices, and efficient deployment of subject matter expertise where and when it's needed most.

Smart Resource Allocation

If costs are capabilities, then managing the efficient deployment of those capabilities is cost management. Strategic cost management requires finance and business leaders to know what critical projects their employees and contractors are working on, and to have the ability to redeploy those resources as results come in or priorities change.

This level of visibility and actionability ensures that discretionary spending is aligned with strategy, and that the results of that spending is clear to leadership.

Control Over External Spending

One of the benefits of thinking of costs as capabilities is that it reframes external spending (on contractors, consultants, technology vendors) as part of the broader effort to drive efficiency and growth. At most organizations, external spend is simply a line item on a balance sheet — disconnected from business outcomes.

As the future of work changes, so do the ways finance and business leaders need to manage external spending. Centralizing all vendors — including the firms that you're already engaged with or have done business with previously — into a single portal boosts the efficiency of procurement and deployment of these resources.

EXPERT VIEW

Inside Highmark Health's Transformation Initiative

Great strategic cost management practices aren't solely the domain of finance. In this Q&A, we asked Highmark Health Chief Human Resources Officer (CHRO) Larry Kleinman about a long-term transformation effort his office is driving to reduce spend while spurring growth.

How long have you worked at Highmark Health?
I joined Highmark Health in 2015 after several HR leadership roles at other healthcare organizations. I've also held leadership roles at Campbell Soup Company, Nabisco, and SAP.

You have a reputation as a "business-first" HR leader. Is that uncommon?
I think it's fair to say that most CHROs were at one time very focused on their own functions, but I do believe the CHRO of the future is more likely to be more focused on driving business outcomes. My point of view on HR is pretty simple: As long as I understand the competitive landscape and our company strategy, I can look inward and find the right talent and how to design the organization to win in the marketplace.

Tell us about the thinkUP initiative at Highmark.
In 2015, it was clear that we needed to change the way our organization worked. We were very dependent on outside consultants at that time. That cost a lot of money, but it also wasn't clear to us how much value we were getting from those projects. About a year and a half ago we launched thinkUP, an initiative to centralize and standardize how Highmark Health engages across its business units and with many outside consulting firms on important work within the organization.

What kinds of projects does thinkUP tackle?
We started small, with just four or five people, but we had a few key principles we followed. First, we wouldn't accept any projects that would last more than 15 or 16 weeks. Secondly, we would only accept projects in which we could measure the outcome. We treat our project portfolio like an investment portfolio, committing 60-70% of our time to projects that will drive value beyond just cost savings. As we've grown, our team has started tackling more enterprise-wide initiatives to drive as much value as possible.

What results are you seeing?
In our first year, we completed 15 projects and delivered almost $60 million in value to the company. From there we've ramped up our delivery capability significantly, to the point we believe we can consistently drive value back to the business. This year we've completed over 60 projects and are ahead of our financial projections.

Any advice for others driving big transformation initiatives?
We started with a grand plan that has morphed a lot along the way. We have strong support from our CEO and an amazing team that is really capable of navigating a large, matrixed organization. We've learned a lot about how to work with the rest of the business, how to drive adoption, and surface insights.

EXPERT VIEW

Avoiding the Cost Management Hamster Wheel

Peter Fisher, the founder of Cortus Advisors, has helped organizations in several industries support growth and transformation initiatives. He's seen several organizations fall victim to the "hamster wheel" of cost management — in which organizations backslide on cost management or focus on short term gains at the expense of market direction.

To avoid the hamster wheel, Fisher suggests several tactics to be used during key moments in the strategic cost management planning stage.

1. **Understanding the true motivation for this initiative**
   It is vital for business and finance leaders to understand whether their cost management initiatives are driven by current market conditions or future market conditions, and whether they are narrowly focused on immediate product competitors or are considering the broader scope of consumer substitutes. For example, an automotive company slashing funding for innovation in order to maintain profitability parity with traditional competitors is ignoring that the competitive landscape now includes ride-sharing business, autonomous cars, and other innovations. Deeply considering these questions in the right context can help companies avoid early missteps.

2. **Documenting the current state**
   A thorough accounting of the current state of the organization, including a deep understanding of how the people, processes, and technologies within the organization benefit the customer.

3. **Optimizing before automating**
   Automation is a siren song for cost-conscious leaders, but Fisher warns against automating indiscriminately. Many processes should be optimized before they are automated, which adds time to the initiative but may prevent disaster down the line. "A prime example of this is robotic process automation," says Fisher. "If you automate an inefficient process, your competitors will leapfrog you."

4. **Planning for the Future**
   Successful cost management is not a one-time tactic, says Fisher. Instead, leaders need to plan for perpetual cost optimization that reacts to changing conditions and understand the new market structure that will exist when they and competitors improve cost structures. "Organizations need to understand how cost structure changes will influence price competition, economies of scale, and competition with product substitutes. The last step is the actual management of the cost optimization program. You have to have goals and accountability, and it needs to be evergreen."

05 Enabling Strategic Cost Management with Technology

As cost management strategies evolve from one-dimensional (focused on spending) to two-dimensional (focused on spending and growth) to three-dimensional (focused on strategy, capabilities, and work), business leaders are going to find that yesterday's tools are no longer adequate for today's operational conditions.

Today's CFOs and business leaders need technology that goes beyond numeric cells and simple dashboards. In order to connect cost management to strategy, they need software that brings together the organization's strategic objectives, capabilities, resources, projects, outcomes, and insights (Figure 5).

In a traditional organization, the software tools for managing each of these critical pieces are managed by a variety of owners from different functional domains, geographies, divisions, and more. This makes the task of consolidating information a political one, delaying the flow of information.

Leaders looking to overcome these obstacles have a few options. They can:

- Work with a vendor or internal technical resources to create a system that combines the aggregation power of a business intelligence tool with the project tracking and resource allocation capabilities of a leading project management system
  Pros: Highly customized environment
  Cons: Expense and delays from custom programming and integration

- Rely on manual reporting across the entire spectrum of tools, requiring siloed resources to consolidate and report on data at regular intervals
  Pros: Fewer political hassles
  Cons: Time wasted with manual efforts, potential for disagreements on data quality

- Work with a software vendor to implement a platform for capturing the highest-level information and providing real-time views into business outcomes
  Pros: Purpose-built software faster to value
  Cons: Additional spend for software

Ultimately, reframing costs as capabilities requires leaders at the highest levels of the organization to rethink how they connect spending to strategy. The most effective companies find ways to improve both efficiency and growth, creating a flexible, adaptable organization that can better withstand competitive threats and changing market conditions.

About Catalant

Catalant is a software platform for connecting strategy to execution. Our software helps organizations better understand their organization's skills and capabilities, match the right people to the right work at the right time, and surface highly-actionable insights. More than 30% of the Fortune 1000, including companies like Anheuser-Busch InBev, GE, and Unilever partner with Catalant to get their most important work done faster and more efficiently.

The Catalant platform fills the gaps between strategy and execution, connecting strategy to the work and capabilities required to deliver results.

Smart Resource Allocation
Match the right capabilities to the right work, dynamically adjust teams as needed, reduce redundant work, and enable shared insights among multiple functions.

Control External Spend
Better utilization of existing employees, plus access to more than 55,000 experts through the Catalant marketplace helps reduce external spend.

Greater Visibility Into Work
With Catalant, business leaders can track the most important strategic initiatives across the organization. Fast, attractive dashboards track not only the status, but the impact of individual projects against the initiative's overall goals.

Empower Centralized Teams
Streamline access and deployment of centralized teams across business lines, functions, and geographies.