NEO Collection 2025

on Cost Transformation

Top 10 Insights

from Boston Consulting Group (BCG)

NEOFORM BUSINESS PARTNERS

Table of Content

What is Cost Transformation?

Cost Transformation is a strategic, holistic, and continuous effort to fundamentally redesign a company's cost structure, enabling it to fund growth initiatives, improve competitiveness, and increase financial resilience. It goes beyond simple cost-cutting to embed efficiency into the company's culture and operating model.

1. Foundational Philosophy & Approach

- **Strategic Imperative, Not Just Tactical Cutting:** Cost transformation is linked to business strategy (e.g., funding R&D, digital transformation, entering new markets). It's about spending smarter, not just spending less.
- **Sustainable Efficiency:** Focus on creating a permanently lower cost base and an agile operating model, avoiding the negative impacts of one-time "slash-and-burn" exercises.
- **Zero-Based Mindset (ZBB):** A principle of justifying all expenses for each new period, starting from a "zero base," rather than basing budgets on previous years. This challenges legacy spending and instills fiscal discipline.
- **Value-Driven:** Efforts are prioritized based on where they create the most value for customers and shareholders, eliminating low-value activities.

2. Core Methodologies & Frameworks

- **Zero-Based Budgeting (ZBB):** A full implementation methodology that rebuilds budgets from zero, requiring justification for every cost element.
- **Spend Analysis & Category Management:** Categorizing all expenditures (e.g., IT, marketing, raw materials) to analyze spending patterns, identify savings opportunities, and leverage centralized procurement.

- **Process Optimization & Lean Six Sigma:** Using frameworks like Lean (eliminating waste) and Six Sigma (reducing variation) to streamline operations, improve quality, and reduce process costs.
- **Activity-Based Costing (ABC):** Understanding the true cost of business activities and the resources they consume to make more informed decisions about pricing, outsourcing, and process improvement.
- **Target Operating Model (TOM) Design:** Redesigning the organizational structure, processes, technology, and capabilities to deliver strategy in the most efficient and effective way possible.
- **Digital Transformation & Automation:** A key enabler, using technology (RPA, AI, SaaS platforms) to automate manual tasks, improve data analysis, and reduce long-term operational costs.

3. Key Functional & Operational Levers

This is where concepts are applied to specific areas of the business.

- **Organizational Design & Workforce:**
    - **Span of Control / Layers:** Reducing management layers to accelerate decision-making.
    - **Strategic Sourcing & Outsourcing:** Evaluating which functions are core (to be kept in-house) and which are non-core (to be outsourced for cost and efficiency gains).
    - **Right-Sizing:** Aligning workforce size and skills with strategic needs.
    - **Total Rewards Optimization:** Reviewing compensation, benefits, and incentive structures for competitiveness and efficiency.
- **Supply Chain & Operations:**
    - **Procurement Optimization:** Strategic sourcing, supplier consolidation, negotiation, and total cost of ownership management.
    - **Manufacturing/Production Efficiency:** Improving yield, reducing waste (e.g., lean manufacturing), and optimizing factory footprint.
    - **Logistics & Distribution Network Optimization:** Redesigning the network of warehouses and transportation for minimal cost and maximum speed.
- **General & Administrative (G&A) Functions:**
    - **Shared Services Centers (SSCs):** Centralizing routine, transactional services (e.g., HR, Finance, IT helpdesk) to achieve economies of scale.

    - **Global Business Services (GBS):** An evolution of SSCs, integrating multiple functions into a more advanced, value-added service delivery model.
    - **Process Standardization:** Harmonizing and standardizing processes across business units and regions to reduce complexity and cost.
- **Commercial & Go-to-Market:**
    - **Sales Force Effectiveness:** Optimizing territories, incentives, and tools to improve ROI on sales spend.
    - **Marketing ROI & Channel Optimization:** Shifting spending to the highest-performing marketing channels and measuring return on investment rigorously.

4. Enabling Technologies & Tools

- **Data Analytics & Visualization Platforms (e.g., Power BI, Tableau):** Critical for spend analysis, tracking savings initiatives, and providing management visibility.
- **Robotic Process Automation (RPA):** Automating repetitive, rule-based tasks in functions like Finance, HR, and Customer Service.
- **Cloud Computing (SaaS, IaaS, PaaS):** Reducing capital expenditure on IT infrastructure and moving to a more flexible, pay-as-you-go operational cost model.
- **Enterprise Performance Management (EPM) & Spend Management Software:** Tools that facilitate budgeting, forecasting, and controlling expenditures.

5. Governance, Execution & Change Management

- **Program Management Office (PMO):** Centralized governance to track initiatives, report on savings, manage risks, and ensure accountability.
    - **Savings Tracking & Validation:** Rigorously quantifying and validating achieved savings to ensure they are real and sustainable.
- **Stakeholder Engagement & Communication:** Gaining buy-in from leadership and employees across the organization.
- **Change Management:** Actively managing the people side of change to overcome resistance, train employees on new processes, and embed new behaviors.
- **Performance Metrics (KPIs):** Establishing the right metrics to track success beyond just savings (e.g., process cycle time, employee productivity, customer satisfaction).

6. Strategic Outcomes & Goals

The ultimate objectives that cost transformation aims to achieve.

- **Improved Profitability (EBIT / EBITDA Margin):** The direct financial impact.
- **Increased Free Cash Flow:** Reducing costs to improve liquidity.
- **Enhanced Competitive Advantage:** Ability to price more aggressively or invest more in innovation than competitors.
- **Strategic Agility & Resilience:** Creating a flexible cost structure that can adapt quickly to market changes or economic downturns.
- **Funding the Future:** Reallocating savings to strategic growth areas like digital transformation, M&A, or product development. ■

Executive Summary

The Foundational Philosophy of Successful Cost Transformation

The Core Challenge: Grow and Cut Simultaneously

Companies face a perennial challenge: driving revenue growth while managing costs. BCG analysis reveals that for over a third of public companies, costs are growing faster than revenue, eroding profitability. Traditional, isolated cost-cutting provides only short-term relief, as costs often creep back, weakening the company's ability to invest in future growth.

Truly successful transformations are dual-mandate efforts designed to **reduce costs** throughout the organization while simultaneously **turbocharging revenue growth**.

Three Core Principles for Success

Based on extensive research, top-performing companies that balance sustainable cost reduction with long-term growth consistently focus on three principles:

1. **Go Big and Go Fast:** Bold, ambitious targets set from the top are crucial. High-performing organizations are 80% more likely to have senior leaders directly communicate transformation ambitions. Moving quickly—delivering 20-40% of target value in the first year—generates crucial financial "oxygen," builds momentum, creates early wins, and overcomes internal resistance. This is not about being reckless but about setting a pace that keeps the organization leaning forward.
2. **Set Clear Boundaries Between Cost and Growth:** A common pitfall is blurring the lines between cost savings and growth reinvestment. Without clear separation, savings are often reinvested prematurely or without impact, diluting both cost discipline and growth ROI. High performers draw a hard line, managing both with equal diligence. They establish dedicated governance (e.g., an investment board) to ensure freed-up resources are allocated to the highest-return opportunities, such as AI, salesforce productivity, brand building, or innovation.

3. **Ensure Lasting Results Through Organizational Change:** Delivering results is only half the battle; sustaining them is the real challenge. Long-term winners embed financial discipline through structural changes that remove work, not just redistribute it. They implement robust performance management systems, linking incentives to personal success metrics (increasing success likelihood by 40%). Continuous review cycles create real-time transparency into cost and revenue metrics, allowing for rapid course correction.

The Three-Phased Approach

A structured approach is critical for success, especially in a constrained environment:

1. **Fund the Journey:** Launch rapid-impact initiatives (cost reductions, pricing adjustments) to quickly generate P&L "oxygen" and create visible momentum.
2. **Win in the Medium Term:** Use initial savings to change the organization's trajectory by strengthening the brand, reinforcing category leadership, and—crucially—investing in innovation. Companies with above-average R&D spending achieve a 6-percentage-point higher success rate.
3. **Make Sustained Improvements:** Undertake deeper "big rock" initiatives to revamp ways of working and instill the right culture. The goal is continuous performance improvement where efficiency gains perpetually fuel growth investments.

Key Methodologies, Pitfalls, and Human Factors

Methodologies: The Zero-Based Mindset

The **Zero-Based Organization (ZBO)** approach is a powerful methodology for reviewing people and people-related costs. Instead of applying across-the-board "haircuts," ZBO involves:

- Setting a cost baseline for each activity from scratch.
- Pinpointing the company's strategic ambition.
- Creating a Minimum Viable Product (MVP) for each service.
- Challenging the resource baseline with cross-functional teams.
  This collaborative, bottom-up approach makes managers invested in cost consciousness, ensuring sustainable change and freeing up funds for strategic bets like AI talent, rather than sacrificing them.

The Four Evergreen Organizational Cost Challenges

Most cost programs fail because they don't address underlying organizational dynamics. Lasting success requires tackling four pervasive challenges:

1. **Lack of P&L Accountability:** Leaders often don't have direct responsibility for their P&L, making cost "someone else's problem." Solution: Redesign operating models to assign clear P&L accountability and strong incentives.
2. **Overhead Generates Overhead:** Support functions become inflated and bureaucratic over time. Solution: Aggressively cut bureaucracy, increase managers' spans of control, and thin out layers of middle management.
3. **Hiring vs. Redeploying:** The impulse is to create new roles for new priorities rather than repurpose existing ones. Solution: Revamp governance to make it easier to shift resources to higher-priority areas and invest in upskilling.
4. **Failing to Capture Productivity Savings:** Investments in digital and AI often don't translate into a leaner organization because leaders don't eliminate superfluous positions. Solution: Redesign processes and roles to incorporate new tech and develop concrete plans to capture hard savings.

The Human Element: Building an Emotionally Resilient Workforce

An often-missed essential is the emotional strength of the workforce. During turbulent transformations, meeting four fundamental human needs is critical:

- **Clarity:** People need to understand the issue and the required actions.
- **Trust:** They must believe leaders have their best interests at heart.
- **Meaning:** They need to feel their work contributes to a worthwhile cause.
- **Belonging:** They must feel accepted and part of a group.

Companies that proactively instill resilience by connecting the transformation to purpose, vision, and values see less performance drop from external shocks, faster recovery times, and better overall outcomes.

Conclusion: A Balanced, Disciplined Approach

Successful cost transformation is a balancing act: cutting with precision to protect margins while investing with purpose to grow. It requires:

- **Disciplined financial oversight** to manage "leakage" (where 10-20% of savings are eroded by factors like inflation and reinvestment before reaching the P&L).

- **A holistic view** that goes beyond simple cuts to improve productivity, optimize supply chains, and make strategic trade-offs, such as carefully extending supplier payment terms without triggering hidden price increases.
- **Acknowledging that everyone owns the cost agenda.** Good cost management, like good strategy, is everyone's responsibility.

By moving boldly, setting clear governance, embedding performance management, and taking a human-centric approach, companies can emerge from transformations leaner, stronger, and poised for sustainable, market-leading growth. ■

★★★★★

Reduce Costs or Grow? Successful Transformations Achieve Both.

By ***Christian Gruß, Andreas Holmbom, Hugo Garnier, Justin Lim,*** and ***Mateo Decormis***

From Boston Consulting Group (BCG)

May 2025

Key Takeaways

Companies must **reduce costs and grow revenue simultaneously** for a successful transformation. Lasting success requires three things:

- Acting **boldly and quickly** to secure early wins;
- Maintaining **strict separation** between cost savings and growth reinvestments;
- **Embedding organizational changes** like performance management to make results sustainable.

This balanced approach creates a leaner, stronger company poised for long-term growth.

Reduce Costs or Grow? Successful Transformations Achieve Both.

Companies across markets face a perennial challenge: how to drive revenue growth while managing costs. BCG analysis of more than 1,000 companies across major global indices found that one-third are seeing costs grow faster than revenue, ultimately eroding profitability. As Exhibit 1 illustrates, that is true for both major categories of cost:

- Sales, general, and administration
- Cost of goods sold

Traditional cost-cutting efforts may deliver short-term relief, but costs often creep back, weakening the company's ability to reinvest in the capabilities and innovation needed for long-term growth. BCG's extensive data on value creation shows that over a five-year time period, revenue and costs are the two biggest drivers of financial performance, driving three-fourths of total shareholder return. (See Exhibit 2.)

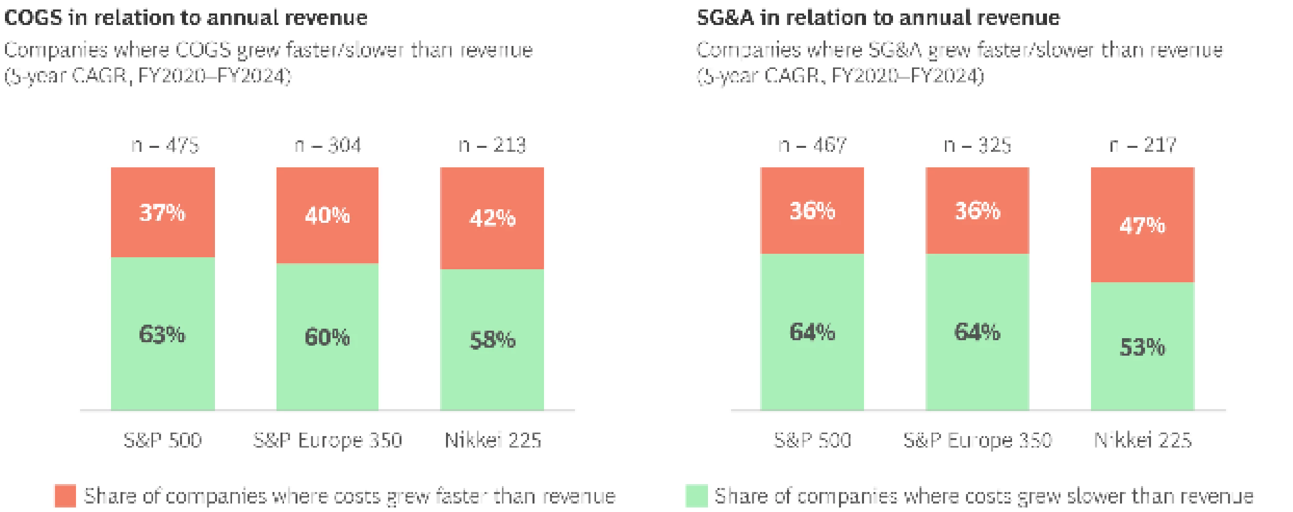
Top-performing companies meet the challenge by launching transformations with the dual mandate to reduce costs throughout the organization while also turbocharging revenue growth. Structured correctly, this kind of transformation helps companies achieve both objectives, leaving them better equipped to unlock investment capacity and grow profitably and sustainably over the long term.

Three Core Principles to Cut Costs and Grow Sustainably

Based on our experience and research, companies that outperform peers in balancing sustainable cost reduction with long-term growth consistently launch transformations that focus on three principles.

EXHIBIT 1

Revenue Lags Behind Costs for More Than a Third of Public Companies



Sources: S&P Capital IQ; BCG analysis.
Note: COGS = cost of goods sold; SG&A = sales, general, and administrative costs; CAGR = compound annual growth rate; n = 992 for COGS data; n = 1,009 for SG&A data.

Go big and go fast. Companies that are bold and fast at the outset of a transformation are more likely to sustain bottom-line impact over time. This bold ambition needs to come from the top.Among the most efficient, high-performing organizations, more than 80% communicate their ambitions directly from senior leaders. Such involvement significantly increases the likelihood of realizing a transformation's full impact.

Many executives feel pressure to avoid risks, with the reasonable concern that cost programs may adversely impact critical capabilities or profit drivers. This conservative approach may ease short-term pressure, but it significantly limits the value a transformation can unlock.

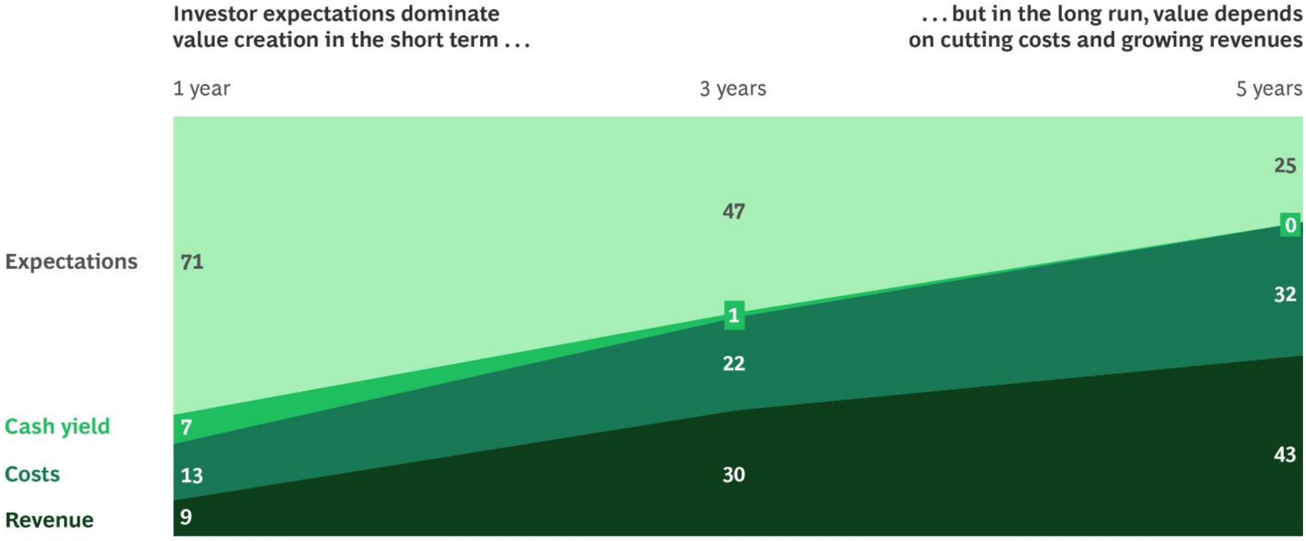
Moreover, as cost efforts unfold, C-suites often regret not setting more ambitious targets early on—especially when macroeconomic and various business factors dilute a transformation's impact. Up to 20% of value can leak out of the P&L even before accounting for inflation, currency volatility, and other market headwinds.

In contrast, top performers start with stretch targets to reset cost expectations from the ground up using a zero-based organization mindset. This approach prevents costs from creeping back and ensures that every dollar spent is tied to an explicit purpose.

Speed is equally critical—not just in capturing value, but in setting the tone. It is tempting to spend significant time at the beginning of a cost program to nail down every detail, but that approach keeps the organization suspended in uncertainty and often results in worse, more complex plans.

EXHIBIT 2

The Drivers of Long-Term Total Shareholder Return Following a Transformation



Drivers of TSR outperformance (%) among top 30% of companies that outperform their industry after a transformation

Sources: Capital IQ; BCG Henderson Institute analysis.
Note: Based on TSR growth relative to industry over given timeframe from turnaround sample; revenue contribution = sales growth; cost contribution = earnings growth – sales growth; expectations contribution = share price growth – earnings growth; cash yield contribution = dividend yield including share repurchases. All benchmarked to industry averages; based on 70th–100th percentile performers. Global sample size: 1,801 downturns. Graph excludes negative contributions.

Conversely, acting quickly builds organizational momentum and sends a clear signal that change is real. It energizes teams, creates early wins, and helps overcome internal resistance. When companies move with urgency, they are able to unlock benefits faster, giving them the breathing room and credibility to tackle deeper, structural changes.

Organizations typically need to deliver 20% to 40% of a transformation target value to the P&L within the first year to generate the financial "oxygen" required to fund the broader journey.

Moving fast isn't about being reckless—it's about celebrating quick wins, removing friction, and creating the kind of pace that keeps everyone leaning forward.

Set clear boundaries and governance between cost and growth levers. One of the most common pitfalls is blurred lines between cost reduction and growth reinvestment. Without clear separation, savings are often reinvested prematurely or without impact—diluting both cost discipline and growth ROI.

High-performing companies draw a hard line between cost initiatives and reinvestments and manage both with equal diligence. They establish dedicated governance—often through an investment board that reviews and approves reinvestment decisions.

In this way, they ensure that freed-up resources get allocated into the highest-return opportunities, such as AI-powered marketing, salesforce productivity, brand building, or innovation.

This separation allows teams to stay empowered and accountable, with a sharp focus on delivering savings against the addressable base. At the same time, it provides leadership with visibility into whether reinvestments are translating into measurable growth or productivity outcomes.

Ensure lasting results through organizational changes. Delivering cost reduction and top-line growth in a transformation is only half the battle; sustaining results is the real challenge. Companies that succeed over the long term embed financial discipline through structural changes, such as rethinking activities and processes to remove work—not just redistribute it.

A robust performance management system is also crucial in ensuring that costs don't creep back. Linking incentives to personal success metrics increases the likelihood of transformation success by 40%. Top performers implement clear KPIs and accountability structures, and they reconsider established compensation schemes like annual salary increases and/or merit increases to align incentives to reinforce desired behaviors—not just for cost, but also for growth.

They also introduce continuous review cycles that create real-time transparency across cost and revenue metrics. These checkpoints help company leaders track savings realization, monitor reinvestment performance, and allow for rapid course correction.

It is important to put guardrails around reinvestment to ensure that new initiatives stay on budget and don't lead to subsequent cost issues.

A Three-Phased Approach to Transformation

One of the most critical challenges in any transformation is knowing where and how to start the journey—especially in a constrained, high-pressure environment with limited capital. In our experience, companies that sustain success follow a three-phase approach.

1. Fund the journey. Sustainable transformation starts with funding the journey—rapid impact initiatives that quickly generate "oxygen" in the P&L. These early moves may include cost reductions, pricing adjustments, or cash-generating measures that break through typical budget silos, free up trapped resources, and create visible momentum across the organization.

This early traction is essential—not just for morale, but for creating the financial flexibility to reinvest in growth.

2. Win in the medium term. With quick wins in place, the next phase focuses on winning in the medium term. The most successful companies use cost savings to change the trajectory of the organization—by strengthening brands, reinforcing category leadership, and investing in innovation.

Looking beyond quarterly results boosts the odds of a successful growth transformation by three percentage points. Crucially, this orientation has to go beyond words: Leaders need to put their money where their mouth is by investing in innovation. Companies with above-average R&D spending achieve a six-percentage-point higher success rate in growth transformations.

For example, a global beverage company streamlined its portfolio by divesting low-margin brands and expanded into premium offerings. A food manufacturer reshaped its portfolio by aligning investments with long-term growth trends such as health-focused food.

Another CPG company reinvested the savings from a cost transformation into automation and AI-driven supply chain tools to become more resilient. In all cases, efficiency gains enabled companies to lead their category and become more resilient—not simply more profitable.

These reinvestments begin to shift the company's competitive positioning, setting the foundation for a fundamentally stronger market presence.

3. Make sustained improvements over time. In parallel, organizations must take on more ambitious, "big rock" initiatives to put the right culture and organization in place to revamp ways of working and ensure that changes stick. These deeper changes are critical to avoid short-term improvements that quickly fade.

The goal is sustained performance improvement, in which efficiency gains continually fuel growth investments in areas like innovation to develop new products and services, expansion into new markets, enhanced brand equity, and advertising and promotion.

Successful transformation is a balancing act: it requires cutting with precision to protect margins while investing with purpose to grow.

By moving boldly and quickly, setting clear boundaries between savings and reinvestment, and embedding performance management to sustain impact, companies can create the momentum and financial capacity needed to succeed. These companies will emerge from the transformation leaner, stronger, and poised for sustainable, market-leading growth. ■

★★★★☆

Zero-Based Organizations Free Up Funds to Make Strategic Bets

By ***Donat Wunderlich***, ***Karin von Funck***, ***Constantin Probst***, and ***Jackie Inglesby***

From Boston Consulting Group (BCG)

Oct 2024

Key Takeaways

The **zero-based organization (ZBO)** approach offers a solution to review people and people-related costs to help companies reallocate funds to the capabilities that count.

- The **collaborative, bottom-up nature** of this approach makes managers more invested in cost consciousness, ensuring sustainable change.
- ZBO methodology helps overcome two traditional challenges: **making cuts stick** and **ensuring that the quality of work doesn't suffer**. So critical investments, such as in AI talent, aren't sacrificed as they would be in the typical "haircut" approach to cost management.
- The ZBO approach requires **setting a cost baseline for each activity**, pinpointing the company's ambition, creating a minimum viable product for each service, and challenging the resource baseline.
- With **greater resource resilience**, a ZBO can respond quickly to sudden adversity or newfound opportunity.

Zero-Based Organizations Free Up Funds to Make Strategic Bets

"How can I cut costs and still compete for high-priced talent and finance investments in new capabilities and opportunities?" Virtually every business leader today wrestles with this fundamental dilemma. So how do you navigate these financial decisions—especially in a volatile economy—without shortchanging the resources and activities needed for future growth?

With the intense cost pressures of the current environment, you're undoubtedly scrutinizing people costs more rigorously. Perhaps you're seeking ways to afford AI talent or offset salary inflation to keep these costs flat. Or trying to reconcile the constant requests to add personnel with the less frequent, but still recurrent, prodding to trim people costs.

Maybe you're struggling to find synergies in the company's people-cost ratio. If challenges like these seem daunting, the zero-based organization (ZBO) approach—the people-related subset of zero-based transformation—offers some solutions.

The Trouble with Traditional Approaches to Cost Management

Cost management is a top priority among executives, as a recent BCG global survey shows. But successfully reducing costs doesn't mean those cuts will stick. More than a third of the leaders we surveyed said costs eventually creep back. And more than 25% reported that cutting costs hurts their business, dampens growth, or is simply untethered to the company's strategy.

A major people-cost challenge that companies routinely cite is that while workforce can be reduced, the volume and complexity of work does not change. As a result, the quality of work suffers.

No company can control challenges arising from external forces, such as the macroeconomy, the labor market, or technological advancement.

But they can approach these challenges in a smarter way. Important talent and organizational capabilities can easily get sacrificed in the typical "haircut" approach to cost cutting—and at a time when generative AI and other groundbreaking technologies are transforming business, that typical approach can sabotage a company's ability to compete.

Instead of reactive moves, like across-the-board layoffs or budget cuts, companies can differentiate between costs that add value and those that add little or no value. Then, they can identify places to cut and redirect the freed-up resources to meet strategic priorities.

Take data analysis and data mining, for example. Because these are seen as key capabilities, the value of data scientists is obvious.

However, the value of, say, performance management professionals may be less apparent. This would make it harder to justify funding these positions, even though they are instrumental to talent retention.

Companies can also differentiate between strategically critical capabilities and activities that should remain in house—and those that can be outsourced more cost-effectively.

Greater Visibility, Better Decision Making

ZBO is a fact-based methodology for reviewing an organization's resource base. It's also a cost philosophy, in which the organization essentially establishes a cost baseline from scratch rather than based on historical data or previous cost levels. Working with a cross-disciplinary group—internal customers, experts from the relevant functional areas, and their own team members—cost owners challenge the existing resource base.

So instead of being on the receiving end, managers are agents of change. This bottom-up approach ensures that savings are realistic and in sync with business requirements. It also alters the ways of working because people are more invested in cost consciousness—and ZBO companies incentivize this way of thinking. In this way, the approach ensures sustainable change.

By pinpointing cost drivers, ZBO promotes data-driven decision making and infuses objectivity, discipline, and transparency into the resource allocation process. Companies can thus leverage their workforce as effectively and efficiently as possible.

ZBO also reduces complexity, supporting faster decision making and action. Most critically, it goes a long way toward solving the problem of having many opportunities to invest, but limited resources.

A Service MVP Is Central to the ZBO Approach

Deploying a ZBO approach entails clarifying cost and value drivers, following a four-step process that produces a minimum viable product (MVP) of services for each activity or process. From this MVP, you build up your resource baseline, adding services that offer a positive ROI. The process is as follows:

Set a cost baseline for each activity.

To get a clear picture of the full costs of an activity, cluster resources by activity, examining people- and people-related costs, whether for internal or external resources. For each activity, look horizontally across organizational borders.

For example, finance costs would include not just those of the central finance organization but also those associated with country-level controllers and others beyond corporate headquarters. (It might even include costs overseen by unofficial controllers throughout the business whose efforts often undermine the ability to standardize and optimize processes.)

Pinpoint the company's ambition.

Senior leadership can use benchmarks and hypotheses about cost levers to determine where the company should land financially in accordance with its strategic ambition and priorities. This deliberate decision is validated through many deep discussions among executives and managers from across the ranks.

Create an MVP for each service.

In this step, current services should be reset to the most skeletal yet functional level before defining an efficient, desired future level. Determine minimum service requirements—those activities either required by law (say, for the finance function, preparing 10-K filings) or essential for operating the business (such as calculating commercial offers).

More activities can then be added, but only if you can demonstrate that they produce a positive ROI—such as filling a capability gap.

Challenge the resource baseline.

To identify value, fundamentally rethink existing cost structures. Cost owners and cross-functional teams work together to identify potential opportunities and initiatives, refining the list with the help of a steering committee.

How ZBO Funded an Energy Company's Shift to Renewables

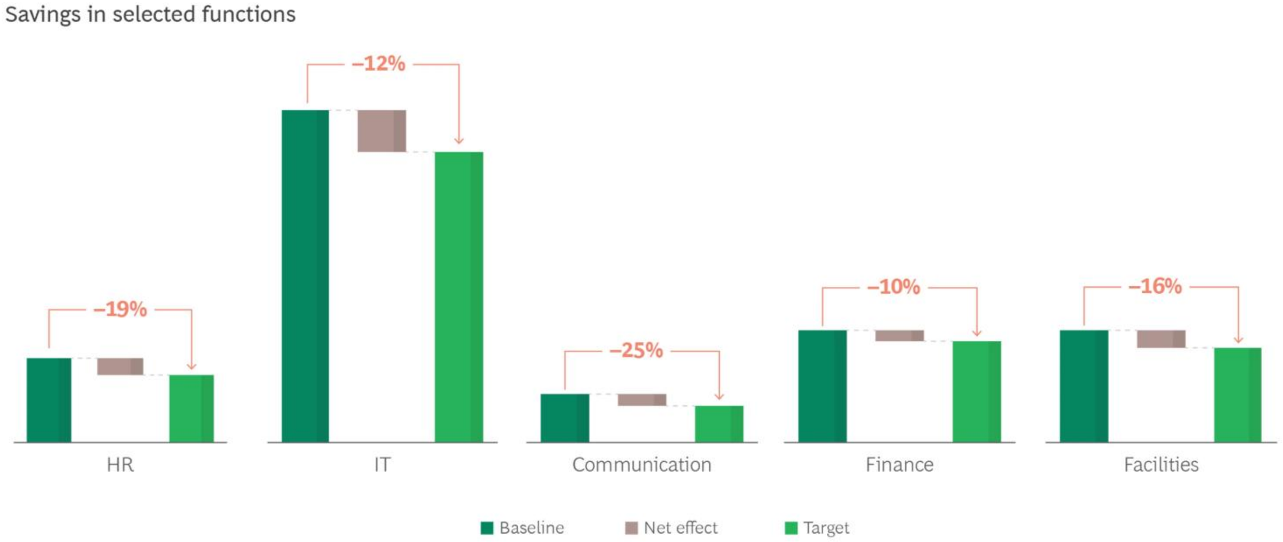
To appreciate the impact a ZBO program can have, consider the experience of a large European utility conglomerate we worked with that launched its program simultaneously with a major transformation: transitioning from nuclear and fossil-fuel power generation to renewables.

This required a substantial investment, and although the company's business was growing and strategic opportunities were abundant, funds were more limited.

The conglomerate's support functions were not only costly, they were not organized efficiently to support future growth. They often failed to provide critical services that met the high quality demands of the business.

Leaders knew they needed to reduce SG&A spending—but judiciously—in order to generate investment capital for growth. Equally important was fostering a performance culture that would inform daily

Exhibit 1 - Precision-Targeted Cuts Across Functions Uncovered Funding to Support the Enterprise Strategic Shift



Source: BCG client example.

resource decisions while bolstering internal zero-based proficiency, thus making the impact stick.

Leaders followed the ZBO process, from defining MVPs and imagining the future states to developing an implementation roadmap, complete with initiatives, and pinpointing capability gaps.

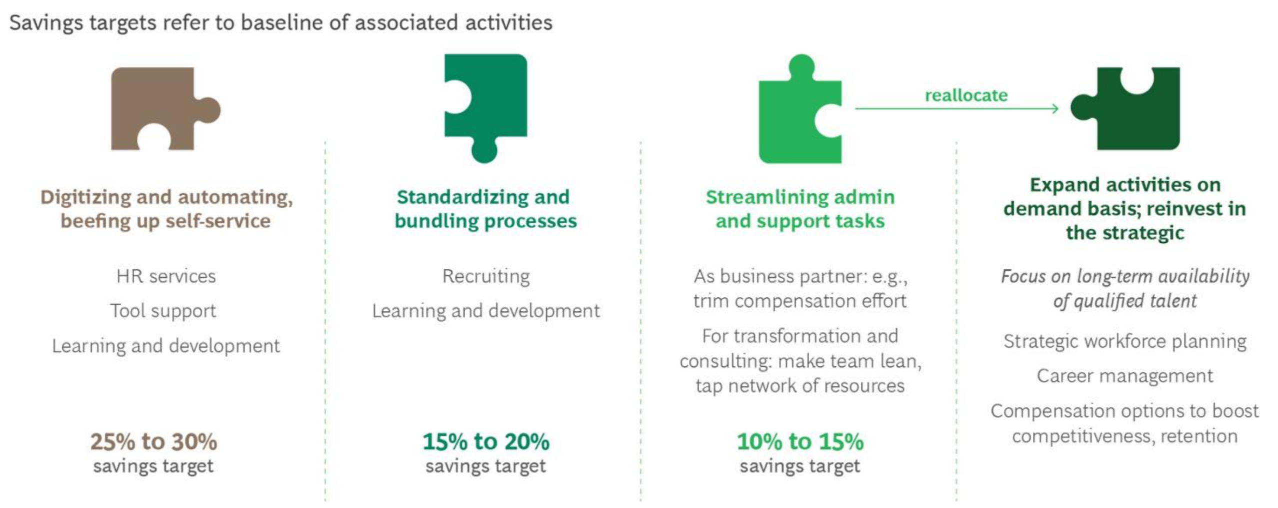
They tracked the results of the initiatives they launched, conferring with functional experts for guidance on the volume drivers for the service-level contracts with the functional areas, as noted below. (See Exhibit 1.)

- **HR** developed a new performance contract with the business. For example, it launched digital self-service tools and online training and also standardized and bundled some recruitment processes.
- **Finance** digitized some processes, cut the frequency of its budgets and forecasts, streamlined closing and annual report activities, outsourced invoicing, and standardized billing and risk management guidelines.
- **IT** instituted purchasing efficiencies, such as shifting to modern modular systems (which also reduced maintenance costs). It also nearshored mature processes and implemented more self-service applications.

Together, these actions cut total personnel costs by 11% and non-personnel costs by 16%, net of the funds reinvested within the support functions. Achieving 19% savings, HR was able to concentrate on more strategic activities, such as workforce planning and learning and development programs for new capabilities.

The IT department realized a significant 12% savings from its multiples-greater resource baseline budget and funneled the investment into insourcing critical activities like analytics, the cloud, and IT architecture. (See Exhibit 2.)

Exhibit 2 - In HR, Three Key Measures Freed Up 19% of Total Budget to Reinvest in Strategic, Value-Creating Activities



Source: BCG case example.

Making the Zero-Based Concept Stick

The ZBO approach requires new ways of thinking and acting from everyone in the organization. How do you embed the ZBO practices and policies to produce lasting behavior change? Our recommendations include the following:

- **Craft service-level contracts.** By formalizing the new service levels with internal customers, the functions lock in the new ways of working that will keep the "fat" out of their budgets.
- **Define cost drivers.** This allows you to readily see how future business changes might affect the budget. For example, if "number of hires" is the basis for your recruitment budget, HR could only hire more recruiters if it could prove that the number of new company hires will increase. No other variables need be considered, which means budget discussions remain fact-based and straightforward.
- **Establish clear accountabilities.** Appoint global process owners with a mandate to push improvement across the organization. Create mechanisms such as performance meetings and reports that will help them carry out their role.
- **Create operational KPIs.** These are essential for tracking performance. Using the HR example, "number of hires per recruiter" would indicate recruiting efficiency.
- **Document everything.** Behavior change needs to happen in everyday actions. To make it stick, be rigorous in both implementation and execution. Document drivers, milestones, expected savings, responsible parties, and any other relevant details so that the company can track and execute with precision.
- **Communicate.** Use a variety of channels to explain the ZBO program and its purpose. Reinforce the necessary changes. Broadcast success and celebrate cost-conscious behavior, and highlight the re-investments that are made.

The ZBO approach is not a cost-cutting program in disguise. First and foremost, it is about actively managing and challenging current spending to reinvest for the greatest strategic impact. Companies become not only more capable and future-facing, but leaner and more effective as they relentlessly remove inefficiencies and waste.

ZBO is about achieving resource resilience, which allows a company to respond quickly, whether to sudden adversity or newfound opportunity.

ZBO helps secure the capabilities and talent a company needs to achieve its strategy in a fast-changing, volatile world. By fostering cost-consciousness, a spirit of cross-organizational cooperation, and a rigorous set of practices, companies gain the transparency, objectivity, and decision-making agility that will get them there.

In the current economic environment, margin pressures are intense, and managing costs is at the top of every C-suite leaders' to-do list. Deploying a ZBO approach can help your organization today and in the future. ■

★★★★★

The Four Biggest Organizational Cost Challenges and How to Solve Them

By ***Kevin Kelley, Travis Meyer, Sarah Baxter,*** and ***Miyabi Honda***

From Boston Consulting Group (BCG) Mar 2025

Key Takeaways

- **Only 25%** business leaders and managers describe their most recent cost program as "very successful." Roughly half say their companies launch cost programs **every one to two years.**
- Measures to reduce costs, like budgeting and stricter spending controls, are well known. But companies fail in the long run because they don't change the organizational context to help employees and managers act in line with the company's overarching cost goals.
- To create cost programs that last, companies need to **give business leaders more accountability over their P&L, attack overhead, redeploy resources and talent to new priorities**, and **capture the promised savings from productivity investments**.

The Four Biggest Organizational Cost Challenges and How to Solve Them

For most CEOs, cutting costs is relatively straightforward. It's far harder to prevent those same costs—or new ones—from rising again over time. We recently surveyed nearly 2,100 business leaders worldwide, all of whom had undergone a cost transformation in the past five years.

The results are sobering. Costs are the top organizational priority, yet three-fourths of respondents say their cost program didn't hit its goals. Most have launched programs repeatedly, putting stress on the organization and undermining management's credibility.

Why? Often, it's because cost initiatives look at superficial measures without addressing the underlying organizational causes—akin to treating a patient's symptoms, rather than the disease.

As a result, roles that are supposed to go away don't, administrative processes multiply, and a year or two later, companies need to launch yet another cost program.

Addressing costs in a more sustainable, holistic way requires changing behaviors and organizational dynamics—the real issues that lead to costs creeping back. More specifically, companies need to address four evergreen cost drivers that we see again and again in our work with clients, all grounded in rational behavioral economics.

Many of the practices that undermine sustained cost savings programs may make sense at a micro level for individuals and managers across the workforce, but they don't support the programs' overarching goals.

The good news is that companies that confront these four issues head-on are far more successful in reducing costs sustainably.These firms emerge from their cost transformation programs with a streamlined organization, fewer management layers and bureaucracy, and the agility to pivot resources to fuel growth and meet other demands in the future. In other words, they no longer need to launch cost programs every few years.

Instead, they have a hardwired operating model that gives them a competitive advantage.

Key Survey Findings

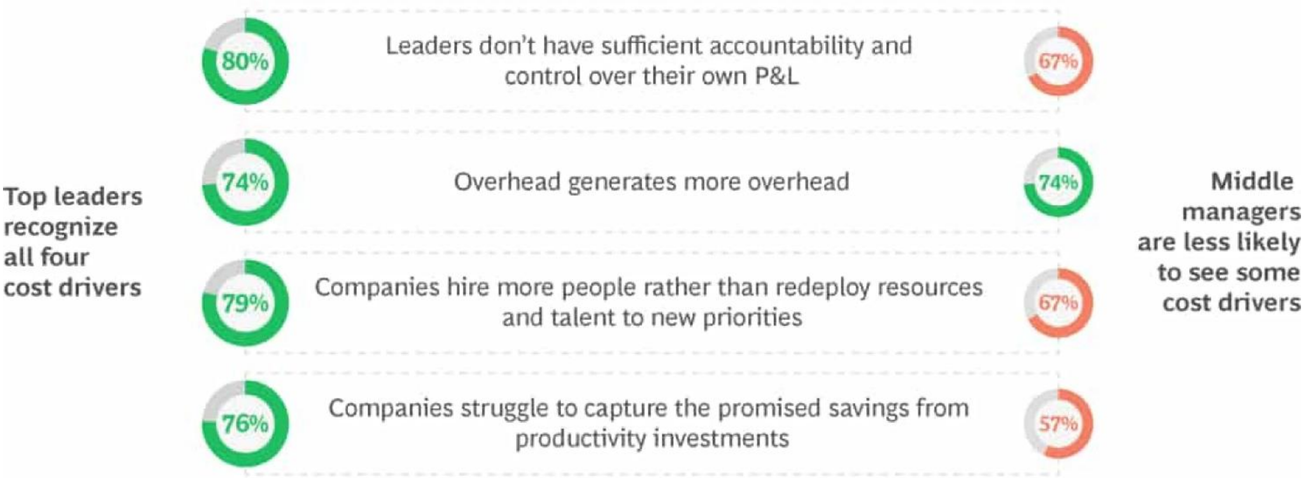
Our survey of business leaders and managers around the world revealed several key findings:

- Cost was the top organizational priority, ranked first by 35% of respondents, followed by productivity enhancement (21%), top-line growth (20%), and adopting new technology, including GenAI (16%).
- Only one-fourth of respondents described their cost program as "very successful."
- Half of all respondents said that their companies pursue cost programs every one to two years.

These findings are not outliers; other BCG research has reached similar conclusions, with only about half of C-level executives saying that cost efforts created lasting

EXHIBIT 1

The Four Main Drivers of Organizational Costs



Source: BCG Org Cost survey 2024 (n = 2,080 total respondents).
Note: Top leaders include C-suite, SVP/VP, division/BU heads.

change at their company. Yet they are still surprising, given that the basic elements of a cost reduction program are widely recognized. Companies know how to reduce costs—measures like stricter budgeting, first-order control mechanisms over spending, and reducing headcount are hardly new.

But these actions will fail in the long run if firms don't change the organizational context so that individuals make decisions in line with the program's goals.

Otherwise, as soon as the program is complete, leaders revert to their previous, rational behaviors, such as adding incremental positions to solve new business challenges—and costs creep upward once more.

To shift the context and create new behaviors, companies need to undergo an organizational reset. In other words, they need to focus on both the "what" and the "how" of a cost transformation.

Four Evergreen Cost Drivers

From our client experience—confirmed by the quantitative research—four pervasive organizational dynamics create persistent cost pressure that cannot be overcome by simplistic, control-based measures. These drivers were identified by both senior leaders and middle managers in our survey. (See Exhibit 1.)

The findings underscore an uncomfortable truth: no cost program can sustainably succeed unless companies address the underlying behaviors that lead to cost creep.

Leaders don't have sufficient performance accountability for their P&L. The first reason that so many cost programs fail is that many leaders don't have direct P&L responsibility. They have their own objectives, and a persistent desire for resources to meet those objectives—making absolute cost someone else's problem.

In our survey, the lack of P&L responsibility was cited by 80% of senior leaders and 67% of middle managers as a driver of cost creep.

For example, one manufacturer runs programs to reduce general and administrative (G&A) costs every two years. But regional business leaders have learned this cadence and work around it, continuing to hire new people and building up a buffer for the next cost program, which they know is coming soon.

To solve this issue, companies should assign clear P&L accountability, including both profit and cost reduction goals, to business leaders, along with the reasonable autonomy to achieve those targets according to their judgment.

At most organizations, this will require redesigning the operating model and instituting strong incentives to motivate leaders to secure absolute savings rather than perform against negotiable targets. In addition, performance accountability needs to cascade from top leaders to lower levels; this will embed cost awareness and give people the proper incentives and decision rights to support the company's overall profit and cost targets.

Overhead generates more overhead. The second main cost driver is the way that leadership layers and support functions become more inflated and bureaucratic over time—a process that 74% of both senior leaders and middle managers in our survey observed. In many cases, solutions tend to make the problem worse. Companies tend to address emerging issues by creating new committees, processes, and managers, leading to more costs and complexity.

Often, these actions reflect internal competition—supervisory or compliance roles trigger business units to respond by creating their own mirror roles, and the bureaucracy spreads.

For example, a services firm froze non-critical hiring, but it instituted a formal approval process so that the CHRO and CFO could determine critical versus non-critical hires. The company created a new central team to evaluate approvals, and business units in turn created their own teams to justify bringing new people on board.

Ultimately, most business teams ended up hiring the people they wanted and the company was left with a new layer of bureaucracy, a new time-consuming core process, and no sustained progress toward the original goal of reducing the size of the workforce.

To avert this outcome, companies need to aggressively cut bureaucracy, overhead, and low-value work. That entails disproportionately shrinking the size of support functions through staffing reductions or assigning those resources directly to P&L owners, creating more transparency for decision makers. They also need to increase the managers' spans of control, thin out layers of middle management, and take a hard look at all overhead work processes to determine which of them can simply be stopped.

Companies hire more people rather than redeploy resources and talent to new priorities. When companies pursue a new opportunity, their initial impulse is to create incremental roles and structures rather than transferring or repurposing positions and funding from existing work groups. Among survey respondents, 79% of top leaders and 67% of middle managers identified this issue in their company. The organizational model at most companies isn't built to flexibly pivot resources.

Moreover, leaders often benefit from empire building, so it's irrational for them to actively cooperate in resource transfers.

One large consumer goods company implemented a new product strategy focused on digital and data-driven features. But the business units developing legacy products weren't willing to reduce their pipeline to offset the needed investment. Rather than shifting budget and positions to the new priorities, the company added significant headcount spend.

To address this issue, companies need to revamp the operating model and governance processes to make it easier to shift resources to higher-priority areas. Leaders must be able—and incentivized—to put the brakes on activities that no longer align with the company's direction and follow through to ensure the work is removed and resources reduced.

In addition, employees need to be enabled and supported to move into new roles. Firms can do this by developing strong upskilling and reskilling capabilities, as well as maintaining an up-to-date inventory of employee skills, to enable talent mobility.

Companies struggle to capture the promised savings from productivity investments. Organizations in all industries are investing in productivity solutions, including new technologies like digital, AI, and automation. These initiatives hold massive savings potential, but often the gains don't materialize and translate to a leaner organization—a pattern reported by 76% of senior leaders and 57% of middle managers in our survey.

EXHIBIT 2

Companies That Address All Four Cost Drivers Significantly Improve Their Odds of Success

Action	Increased odds of building a long-term cost capability	Increased odds for companies that address all four
Make leaders accountable for cost performance in their P&L	1.7x	11x
Attack overhead	2.8x	
Strategically redeploy resources and talent to new opportunities	2.7x	
Redesign roles to capitalize on productivity investments and eliminate redundancies	2.3x	

Source: BCG analysis.

One large technology company repeatedly tried to launch productivity and cost-savings initiatives without success. It invested to implement productivity-enhancing systems and processes, but spending did not decrease.

A key reason was that after labor productivity increased, leaders did not follow through and eliminate superfluous positions; instead, they used those freed-up man-hours on other priorities. Only when leaders performed a detailed organization redesign—eliminating positions and reshaping roles and accountabilities—did the company capture expected savings.

To more effectively lock in the benefits from productivity investments, companies should look beyond projections and develop concrete plans to capture hard savings, along with measures to track and monitor the realization of those savings. Companies should also redesign processes and roles to incorporate the new technology, reducing or redeploying resources as needed.

In our survey results, companies that address each of the four evergreen cost drivers can improve their odds of building a long-term cost capability by a factor of two to three. And addressing all four simultaneously creates a significant multiplier effect. (See Exhibit 2.)

Addressing the "How" of Sustained Cost Transformation

Across all four cost drivers, companies need to focus on the “how” as much as the “what.” One priority is organizational alignment. Our survey data shows frequent misalignment between senior leaders, who generally understand the need for a cost program, and middle management, who often feel that cost initiatives are “being done to them.” To the degree possible, middle managers should have ownership in the process of redesigning the organization, along with real accountability for targets and future costs.

In addition, companies should identify a minimally sufficient set of KPIs that drive value and spur cost-oriented behavior. These need to be clear, quantifiable, and transparently reported, so that managers and employees understand how the company and each unit is performing relative to its cost targets.

The redesign should establish clear accountabilities and decision rights with a focus on enabling cost-conscious decisions and addressing tradeoffs. And finally, companies should incorporate a cohesive change-management program to articulate and embed value-oriented mindsets and generate employee engagement during and after the process.

How One Company Generated $1 Billion in Savings

Consider a global health care company that had seen a substantial decline in revenues. It launched an ambitious program to reduce its costs and reallocate some of those resources toward several promising new product lines. Achieving that goal entailed developing changes to the operating model, shifting resources out of legacy businesses into growth areas, and upgrading talent throughout the company, among other priorities.

To ensure that the program would succeed, leaders addressed all four of the major evergreen cost drivers:

- To bolster value and financial ownership, the company made changes to the operating model to enhance P&L accountability and resource control of the business units. It also redesigned roles and accountabilities deep into the organization so that middle managers would understand their role in achieving the strategic agenda and value objectives.
- To preclude growth in overhead, the company moved some resources and decision rights away from centralized functions and into the business units. As part of that process, the firm concretely reduced low-value-add activities, took out two management layers, increased spans of managerial control, and streamlined G&A.
- Leaders cut resources substantially in legacy-product businesses and the functions that supported them, with some work-groups being reduced by as much as 50%. To support the new strategic direction, the firm redeployed existing talent to staff the new teams, planning to selectively hire from the outside to fill the most critical skill gaps. The HR function developed a baseline of employee capabilities that enabled managers to identify high-potential talent across functions and countries to fill roles.
- In the detailed design phase of the program, executives and managers rigorously reviewed every position in every work group to ensure savings would be secured through reducing activities and enhancing productivity. Throughout the implementation, leaders followed through on headcount initiatives to ensure staffing levels aligned to business-case commitments.

In the program's first year, the company has exceeded management's cost and margin objectives, delivering more than $1 billion in gross cost savings, of which 25% was reallocated into growth areas. Equally important, the organization is more efficient, agile, and responsive to changing market dynamics, with more autonomy pushed down to the local level.

The imperative to reduce costs is only growing, and companies using the approaches they have relied on in the past will fall short. To successfully curb costs, they need to address the four drivers we've identified and focus both on what they change and how they change it.

In that way, they can alter the underlying behaviors and processes, make sustainable cost reductions, and give themselves a lasting advantage over the competition. ■

Key Functional & Operational Levers

Enabling Technologies & Tools

★★★☆☆

Five Ways to Make Supply Chains More Cost Efficient

By ***Dustin Burke, Jacopo Brunelli,*** and ***Ashish Pathak***

From **Boston Consulting Group (BCG)** Mar 2025

Key Takeaways

Companies have already taken steps to reduce costs along the supply chain. Further reductions require tougher decisions in several key areas.

- It's critical to **link the cost agenda for the supply chain to the company's overall growth outlook** in order to determine which costs should be targeted.
- **Modeling** can help operations leaders anticipate how specific measures will impact costs before they're implemented.
- Companies need to develop a **cost-aware culture and to build agility and resilience** into the supply chain—particularly in a volatile business environment like today's.
- **Analytics and AI** (including GenAI) can transform production and distribution models and processes—leading to lower costs and better service.

Five Ways to Make Supply Chains More Cost Efficient

For any company that makes or moves products, supply chain costs are a large share of overall operating expenses—making them a high-priority target for cost efficiency measures. That's particularly true today, with inflation, shifts in global trade routes, potential tariffs, and other factors all squeezing margins.

Since the pandemic, many operations leaders have already taken steps to reduce costs along the supply chain—such as clawing back price increases from their suppliers. But those tend to be the easier measures. Companies now need to make harder and more substantive decisions about people and physical assets, where the stakes are higher and potential mistakes are harder to unwind.

How to start? Our experience working with operations leaders across a wide array of industries suggests that five measures should be priorities.

1. Base the Cost Agenda on the Company's Growth Outlook

Companies in lower-growth, lower-margin industries—or those with internal stressors unique to their organization—likely need to reduce costs by consolidating their footprint, closing plants, streamlining distribution networks, and rethinking processes. They also may face acute time pressures that push them to implement rapid measures that yield results quickly to shore up their financial position.

Conversely, companies in growth mode with a wide range of new products and geographic markets may reallocate the savings to growth or innovation (a priority for roughly two-thirds of business leaders in BCG's recent executive survey on costs and growth). They may also opt to invest in supply chain initiatives to increase efficiency. These organizations can be more proactive and forward-looking, since they have more time to make structural improvements that have a longer implementation timeline and lag in ROI.

In both cases, companies should initially focus on a manageable number of projects and track results over time. In our experience, companies can sometimes be overly broad in their cost agenda; they launch a large number of projects and quickly get overwhelmed by complexity and are unable to ensure value.

Instead, they should take a portfolio approach, ranking potential projects by ROI and staggering their implementation to capture the full financial value of each solution before shifting to the next one—while also balancing demands across the company.

2. Increase Transparency Through Modeling

Companies can't improve their supply chain costs until they understand those costs. It's a big challenge, given the complexity of supply chains at large organizations. To address it, cost leaders build detailed, dynamic models that quantify costs across specific steps and processes of the supply chain, giving them greater visibility into costs and enabling them to monitor performance more effectively.

Building this type of model is a data management challenge. Companies need to gather accurate information from across the supply chain, aggregate it into a single model that continues to draw real-time data, and run analytics to identify problem areas.

But such a model yields key insights to help operations leaders understand the company's current cost position—and where they can influence or control costs.

Critically, modeling also enables leaders to run simulations of different scenarios, such as a spike in demand, a decrease in supply for key inputs, or the cost implications of reorganizing distribution networks to service a fast-growing market. Addressing today's cost challenges is important, but COOs can't assume that the future will look like the present.

Scenario planning can assess how the cost structure will perform under meaningfully different, plausible conditions. Companies can also plan three- and five-year targets and consider make-versus-buy decisions more effectively.

For example, one company built a cost model with short- and long-term projections, categorizing costs as controllable, influenceable, or static. Controllable costs, such as productivity rates, can be directly improved, while influenceable costs, like freight rates, can be managed through procurement strategies.

Fixed costs, such as lease payments, are considered static and remain constant over time. The company is also developing three- and five-year plans to reduce costs, manage supplier margin pressures, and ensure long-term profitability.

3. Create a Cost-Aware Culture

Many companies treat cost efficiency measures like a crash diet—a discrete, disruptive event that realigns the organization's priorities for a short period of time, after which everyone reverts to their previous ways of working and costs slowly creep back.

In contrast, leading organizations approach these measures like a healthy lifestyle. They make deliberate choices as part of day-to-day work across the supply chain, with the entire workforce bought in and aligned around cost metrics.

BCG's research shows that firms that align culture with cost goals achieve up to 11% greater long-term cost reduction, and 62% of these "cost pioneers" report positive impacts from embedding cost consciousness into the company's DNA.

Building a cost-aware culture like this requires companies to make a clear case for change, helping the workforce understand how cost savings fit into the overall success of the organization.

Leaders and middle managers communicate this consistently through town halls, daily team huddles, and other channels, all focused on a coherent story about why the organization needs to change. They also set clear metrics and KPIs and track performance, so that employees at every level understand what's being asked of them and what success will look like.

4. Make Supply Chains More Agile and Resilient

As volatility in the business environment increases, supply chains must be built to change over time. There are clear cost implications: companies need to invest intelligently and avoid overspending, and the cost of getting it wrong can be steep in terms of business disruptions and other factors.

In the short term, companies need to build stronger crisis response capabilities, so they can respond to disruptions and mitigate negative impacts faster than their competitors can. Dynamic modeling is a critical prerequisite, helping companies make faster decisions and execute more effectively. Modeling can also help organizations simulate disruptive events in order to understand their supply chain implications and develop response plans in advance.

Companies can also create redundancies—through dual sourcing, buffer inventories, and local supplier partnerships, for example—to secure critical supply chains.

In the longer term, companies need to build more resilience along the supply chain, developing systems and strategies to withstand future uncertainties. That demands comprehensive scenario planning to mitigate tariff and geopolitical risks, as well as consideration of near-shoring and regional partnerships to reduce reliance on vulnerable global routes and consideration of export challenges and margin pressures in key markets.

5. Harness AI and Analytics to Optimize the Supply Chain

Digital and automation solutions are now table stakes for supply chain leaders, and AI holds tremendous potential to further reduce costs by helping companies develop innovative production and distribution models and processes.

In a recent BCG survey of companies in 21 countries, 19% were cost leaders, and this group cited AI as the most important tool to reduce supply chain costs.

Some organizations have struggled to capitalize on AI owing to outdated processes, legacy IT systems, disconnected data systems, and other factors. But GenAI can reduce complexity and help companies capture many of the previously untapped benefits of AI along the supply chain.

Notably, investments in advanced technologies like automation and AI don't just improve efficiency—they also lead to better service. GenAI can automate end-to-end processes with smart bots to improve speed, reduce manual tasks, and increase cross-functional collaboration.

For example, a food distribution company automated delivery routing, balancing cost reduction with high-touch customer service.

These new solutions also challenge the perception of many employees that companies will use GenAI merely to reduce headcount. In our experience, talent is scarce in most supply functions, making GenAI a critical tool for improving productivity. Capturing those gains requires that operations leaders strike the right balance between efficiency investments (those aimed at using AI to do work faster) and effectiveness investments (aimed at improving outcomes like quality, delivery speed, or carbon reduction).

When implementing automation and analytics solutions, leading organizations start small—focusing initially on a limited number of high-impact applications before embarking on an end-to-end supply chain transformation.

For example, they deploy AI in demand forecasting, replenishment, and predictive analytics to manage inventory and stabilize operations. We have seen a 10% to 20% reduction in manufacturing, warehousing, and distribution costs from AI implementation in supply chains.

Companies also start by adopting proven solutions that are commercially available. As they develop capabilities and build momentum, they advance to tailoring solutions to their needs—a more complex undertaking but one that yields correspondingly greater benefits.

Eventually, they partner with suppliers and tech providers to co-develop innovative solutions and smarter ways to reduce costs, such as automation-as-a-service or a greater reliance on contingent workers.

Regarding the workforce, leading companies understand that the best technology will not work if employees don't willingly adopt it. These companies understand that the vast majority of benefits from a new solution come not from the technology itself but from new ways of working that the technology enables. They therefore invest the resources needed to upskill employees, ensuring a smoother transition to smarter and more cost-efficient processes.

Supply chains account for the bulk of operating costs for many companies, making them a clear priority for cost reduction measures. By focusing on the five measures discussed here, companies can not only reduce costs but build a smarter and more responsive supply chain—one that mitigates potential disruptions and capitalizes on emerging opportunities.

Some companies may opt to reallocate the savings to fuel growth and innovation, while others will send them directly to the bottom line. The common thread is the competitive advantage that cost efficiency affords. ■

★★★☆☆

Making Transformation Count Where It Matters—the Bottom Line

By ***Christian Gruß, Simon Weinstein, Hugo Garnier, Jesper Lovenholdt,*** *and* ***Justin Lim***

From Boston Consulting Group (BCG)

Mar 2025

Key Takeaways

Leaders must apply disciplined financial oversight to turn ambitious targets into tangible business outcomes.

- Investors expect a **measurable link between transformation impacts and the profit and loss outcomes** that drive their investment returns.
- Some of a transformation's financial impact is lost before it reaches the bottom line owing to **price and wage increases, demand fluctuations, underperformance against KPIs, reinvestment decisions, and market adversities**.
- To bridge the gap, leaders must take five critical actions that enable precise tracking, drive accountability, and foster a value-driven culture.

Making Transformation Count Where It Matters—the Bottom Line

Corporate transformations are ultimately judged by their impact on shareholder value. Investors expect a measurable link between a transformation's effects and the profit and loss (P&L) outcomes that drive their investment returns. When cost savings and other benefits do not materialize in the bottom line, investors demand answers from company leaders. With scrutiny now at an all-time high, failing to deliver on a transformation's promises can erode market valuation and weaken C-suite credibility.

Yet even well-planned transformations face a sobering reality: some of the expected financial impact is lost before it reaches the bottom line. This "leakage" is caused by wide-ranging business factors external to the transformation program, such as price and wage increases, demand fluctuations, underperformance against operational KPIs, and reinvestment decisions

Even before currency volatility, inflation, and other market adversities are taken into account, these factors typically reduce realized P&L savings by 10% to 20%. While some erosion is unavoidable, disciplined financial oversight can help mitigate much of it.

For CEOs, CFOs, chief transformation officers (CTOs), and other C-suite executives, managing leakage is a fundamental financial capability that drives executional certainty and determines the success of transformation initiatives. Addressing leakage early, embedding disciplined execution, and setting realistic targets with a buffer can help organizations avoid or absorb setbacks.

To bridge the gap between transformation impacts and net P&L outcomes, leaders can take some critical actions that enable precise tracking, drive accountability, and foster a value-driven culture.

Why Transformation Impact Fails to Reach the P&L

As executives seek to change their business through a transformation program, they must also contend with headwinds from macroeconomic pressures and internal challenges. These external and internal forces can create a gap between the projected financial impact set out in the transformation plan and the actual results that materialize in the P&L statement.

A transformation's projected impact is based on assumptions about volume, pricing, and operational efficiencies. However, the net impact—the portion that ultimately reaches the P&L—can be lower owing to various forms of leakage.

For example, the anticipated impact from a renegotiated vendor contract may be eroded by inflation, changes in product mix, or shifting demand. Operating model changes and organization redesigns may not deliver the savings expected if delays, rehiring needs, or reinvestments in strategic projects or growth are greater than expected. Similarly, efficiency-driven cost reductions may fail to fully materialize because of macroeconomic developments or internal organizational constraints.

Investors closely scrutinize financial results for signs of program leakage. For example, a recent investor report cited "doubts over the achievability of *net* productivity savings" as a key concern. It noted that despite reported improvements, some expected impacts had not reached the P&L bottom line.

At the same time, companies must acknowledge that a gap between a transformation's impact and net P&L outcomes is inevitable. Organizations that manage this well analyze the drivers of the disparity and ensure accountability across different levels. By maintaining end-to-end visibility of the transformation's impact on P&L, the CEO, CFO, CTO, and other leaders can proactively mitigate leakage and ensure better decision making at all levels.

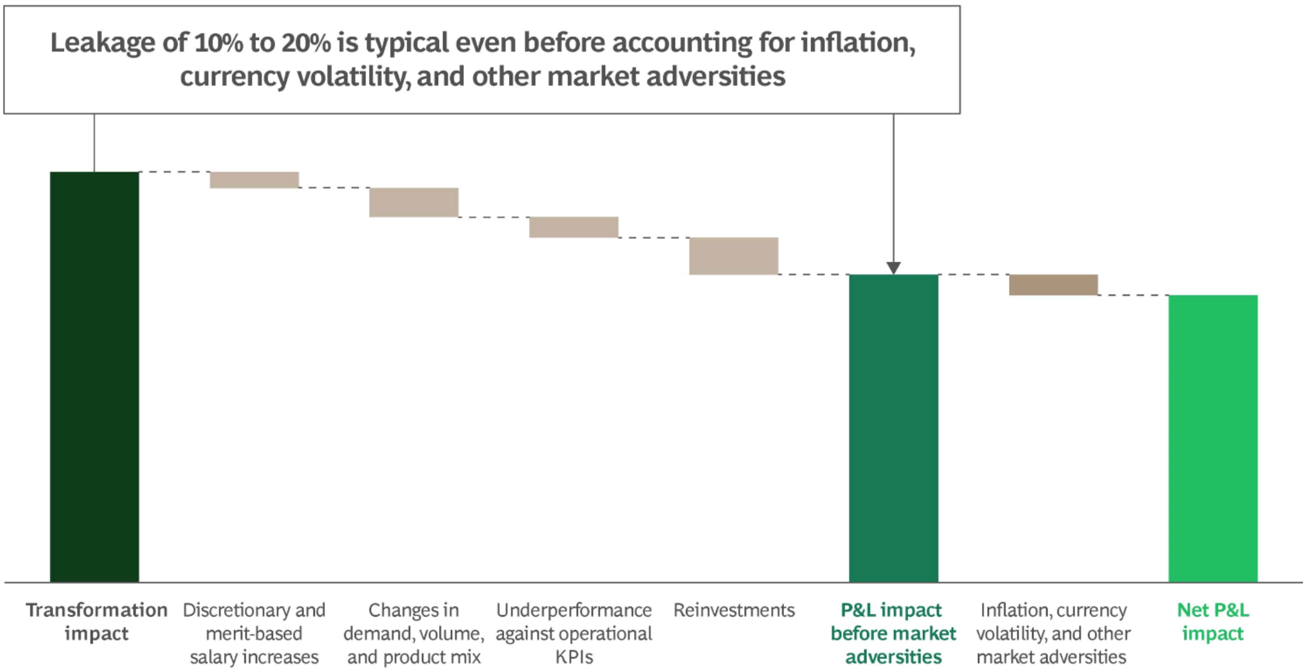
A Closer Look at the Sources of Leakage

Leakages in transformation programs are not one-time effects; they are recurring impacts that vary across transformation types, value levers, and business units.

The extent of leakage depends on organizational context and external market conditions. The link between transformation impact and P&L results is typically assessed at the portfolio, business unit, or functional level. As shown in the exhibit, several factors contribute to transformation leakage.

Discretionary and Merit-Based Salary Increases. Rising costs from discretionary and merit-based salary increases can erode the expected benefits of a transformation. In operating model transformations or organization redesigns, companies may decide to raise salaries companywide in response to cost-of-living increases or implement merit-based salary increases to retain specific employees, outpacing initial assumptions about workforce cost reductions.

Several Factors Contribute to the Gap Between a Transformation's Impact and Net P&L Outcomes



Source: BCG analysis.

At one company, annual wage inflation of 5%—higher than the Consumer Price Index—combined with merit-based wage increases significantly raised organizational costs in the years following a reorganization, partially offsetting its benefits.

Changes in Demand, Volume, and Product Mix. Fluctuations in customer demand, sales volumes, or product mix can undermine projected savings. This often occurs when transformation initiatives target gross margin improvements through sourcing, procurement, or packaging.

For example, a consumer goods company experienced a shift toward lower-margin products, reducing the profitability of its sales mix and diminishing the expected impact of cost-saving initiatives. Additionally, volume declines may challenge efforts to optimize procurement costs or leverage economies of scale, widening the gap between the transformation's impact and P&L savings.

However, changes in the product mix can also have a financial upside. If demand for higher-margin products increases, the P&L impact may exceed initial forecasts, delivering greater than expected profitability gains.

Underperformance Against Operational KPIs. Underperformance in execution can weaken savings realization. In one case, a productivity improvement initiative achieved only 80% of its targeted savings owing to operational inefficiencies. Improvements, such as a step change in overall equipment effectiveness (OEE), are often expected to drive workforce efficiencies. However, leakage frequently occurs when these gains fail to translate into actual savings.

Reinvestments Outside the Transformation. For C-suite leaders, reinvestment decisions are among the most consequential tradeoffs affecting a transformation. Strategic reinvestments and shifting business priorities can dilute or delay a transformation's immediate financial impact, creating tension between short-term P&L delivery and long-term competitive advantage. In many cases, cost savings and efficiencies are intentionally redirected toward high-growth initiatives, digital acceleration, capability-building efforts, or other big bets.

Although these reinvestments strengthen future competitiveness, they also push out the visible financial benefits of a transformation, leading to investor skepticism and the perception that savings have not been fully captured.

This challenge is particularly pronounced in industries such as pharmaceuticals, technology, and fast-moving consumer goods. In these sectors, reinvestment in R&D, digital transformation, sustainability, and supply chain resilience often takes precedence over immediate cost savings.

Inflation, Currency Volatility, and Other Market Adversities. Factors beyond a company's control—such as inflation and foreign-exchange volatility—can erode a transformation's bottom-line impact. Inflationary pressures often exceed initial forecasts, diminishing actual savings. In one manufacturer's cost-out program, for example, rising raw-material costs and unexpected inflation reduced anticipated savings by 3%, forcing additional cost-cutting measures.

Five Actions to Maximize a Transformation's P&L Impact

Leaders must take a disciplined approach to ensure that a transformation's benefits fully materialize in the P&L. Gaining clarity into how transformation efforts drive financial performance enables more informed decision making, stronger accountability, and sustained results.

Leaders should begin developing this understanding early in the transformation, as the necessary infrastructure and mechanisms take time to build and embed within the organization.

Five key measures can help organizations minimize leakage and build long-term financial resilience.

Partner with finance to build a methodology and set targets with a buffer. The transformation office must work closely with the finance function to define how transformation impacts are tracked, allocated, and sustained. Establishing clear financial controls upfront and setting expectations early facilitate a structured approach to monitoring financial results and minimizing leakage. In particular, setting realistic targets with a buffer at the start of the program provides a safeguard against unforeseen fluctuations, ensuring that any gaps between the transformation's impact and P&L outcomes are proactively managed.

Build infrastructure to track net P&L delivery. A robust financial tracking system is essential, but its real value comes from fostering collaboration across functions to systematically review the monthly P&L impact. While this process can be complex, it is critical to understanding how transformation efforts translate into bottom-line results and ensuring that the projected savings materialize.

To address this complexity, organizations often assess P&L impact at the portfolio, business unit, or functional level. For example, a consumer goods company tracked actual P&L results against forecasts monthly at the portfolio level, allowing the transformation's leaders to course correct and ensure that it remained on track.

A structured approach—monitoring underperformance against annual plan targets, for example, and identifying deviations in efficiency improvements—can also help in addressing potential leakage before it has an impact on financial results.

For example, a manufacturing excellence and productivity program used OEE and waste reduction KPIs to flag risks before they affected the P&L, allowing for timely corrective action.

Cascade awareness throughout the organization to drive accountability. For transformation efforts to deliver lasting financial impact, awareness of the gap between impact and net P&L results must be embedded in the organization. Teams at every level should understand why this gap exists, what drives it, and how their actions influence financial outcomes.

For example, a manufacturing company strengthened collaboration between operations and finance by fostering open discussions and awareness about the financial impact of its transformation initiatives. The improved coordination and understanding that resulted allowed teams to proactively adjust strategies as needed.

Align incentives with transformation objectives. Performance incentives should be directly tied to transformation goals. Incentive structures should not only reward execution but also encourage leaders and teams to drive measurable financial results.

By aligning incentives with net targets in the realized P&L impact, rather than with gross transformation targets, organizations can motivate employees to take ownership of sustainable financial performance.

This means shifting from traditional transformation metrics to a focus on how well teams close the gap between projected and actual outcomes, ensuring that the impact is fully captured and does not erode over time.

Embed a value-driven culture to sustain impact. Sustaining a transformation's bottom-line impact requires a behavioral and mindset shift that encourages teams to take ownership of financial outcomes. The company's leaders should reinforce this culture by serving as role models, setting clear expectations, and embedding value realization into daily decision making. Tying a transformation's success to how people think, act, and are rewarded will ensure its long-term sustainability.

C-suite leaders are responsible for ensuring that the impact of a transformation fully materializes in the P&L. Investors expect measurable financial results, and failure to deliver promised savings can undermine valuations and reputations. As part of a comprehensive approach to driving executional certainty, disciplined financial oversight is a critical enabler for turning ambitious targets into tangible business outcomes.

To unlock a transformation's full value, leaders must embed financial discipline at every stage, proactively managing leakage that erodes impact. Now is the time to take decisive action to bridge the gap between forecasts and outcomes, strengthen accountability, and ensure that transformation efforts drive sustained financial success. ■

★★★★☆

Five Truths (and One Lie) About Corporate Transformation

By ***Martin Reeves*, *Christian Gruß*, *Kristy Ellmer*, *Adam Job*, *Gabe Bouslov*,** and ***Paul Catchlove***

From Boston Consulting Group (BCG) Apr 2024

Key Takeaways

In an increasingly turbulent world, the need for and the challenges of corporate change remain remarkably persistent. Empirical insights reveal how change leaders can beat the odds.

- A new global BCG study reveals that during the past two decades, **only 26%** of corporate transformations successfully created value in **both the short and long terms**.
- We highlight five truths about corporate transformation—and refute one lie that executives like to tell themselves.

Five Truths (and One Lie) About Corporate Transformation

In an era of technological advancements, geopolitical tensions, and economic turmoil, standing still is akin to moving backward. As the durability of competitive advantage has dwindled, the average tenure of companies on the S&P 500 index has more than halved since the late 1970s.

But changing with the times is difficult: A new global BCG study reveals that during the past two decades, only 26% of corporate transformations successfully created value in both the short and long terms.

So how can change leaders beat the odds? We use our empirical insights to highlight five truths about corporate transformation—and refute one lie that executives like to tell themselves.

Truth #1: You Can (and Should) Fix Things Before They Break

In transformations, timing matters: Pre-emptive transformations are initiated while total shareholder return (TSR) is in line with or ahead of industry averages. These transformations create significantly more value in the medium and long run (+2.7 percentage point TSR over a three-year horizon) than reactive transformations (initiated after TSR has already dipped below the peer group).

Transforming preemptively—before a performance gap has opened up—means transforming from a position of strength, subject to less pressure and scrutiny: leaders are empowered to focus on identifying options for future advantage, rather than on purely defensive moves, such as divestments.

Consider, for example, Microsoft's remarkable trajectory over the past decade: After stagnating performance from 2009 to 2012, the company managed to achieve some momentum between 2012 and 2014 (achieving 36% annualized TSR).

Not content with this recovery, Microsoft's then-incoming CEO Satya Nadella made changes to lay the groundwork for future success: He oriented the company toward the new dominance of cloud, even though this trend had not yet damaged the bottom line. This move set Microsoft up to nearly triple its stock price in the first four years of Nadella's tenure.

Nevertheless, he announced yet another restructuring in 2018, setting up an AI division, which was soon bolstered by Microsoft's early $1 billion investment in OpenAI. Today, Microsoft is the most valuable company in the world—illustrating how preemptive transformation with heavy investment allows sustaining performance in an evolving competitive environment and amid significant technology changes.

Truth #2: Leadership Will Make or Break Your Transformation

Microsoft's story also highlights the importance of leadership. The firm's successful transformations were not only driven by Nadella's anticipation of future trends, but also his willingness to question and change the mental models and organizational structures that underlay the company's historic success.

For example, since the 2018 restructuring, Microsoft no longer has a division dedicated to its Windows operating system.

Contrast this with Blockbuster's leadership rejecting the opportunity to acquire a fledging Netflix, Swissair continuing to invest in its failing airline, or Kodak not embracing the digital photography technology it pioneered—and the importance of leadership commitment to change becomes crystal clear.

When leaders present an obstacle to change, their removal can improve transformation outcomes.

- Our data shows that a leadership change during a transformation is associated with a 4.1 percentage points higher TSR performance over the five-year time horizon (compared to the previous downturn period).
- The positive TSR impact is even higher (an additional 3.7 percentage points over the five-year period) if the new leadership comes from outside of the company.

However, a change in leadership is not a guaranteed success driver; it is also associated with a high variance in TSR outcomes. As such, this effect is less driven by the leader per se than by their willingness and commitment to making a change—particularly at a time when leadership engagement in transformations is on the decline.

Consistent with this, we find that preemptive transformations—in which leaders act to fix things before they break, demonstrating their initiative and commitment—are associated with higher leadership stability than reactive ones (4.7 percentage point lower frequency of CEO change during the transformation period). Moreover, we know from other research that stability in leadership teams can also drive a company's long-term growth potential.

Truth #3: You Cannot Cut Your Way to Greatness

Our analysis shows that, in the short term, investor expectations are the most significant driver of value creation in a transformation contributing more than two thirds of TSR outperformance over industry peers in the first year after a transformation is initiated. (See Exhibit 1).

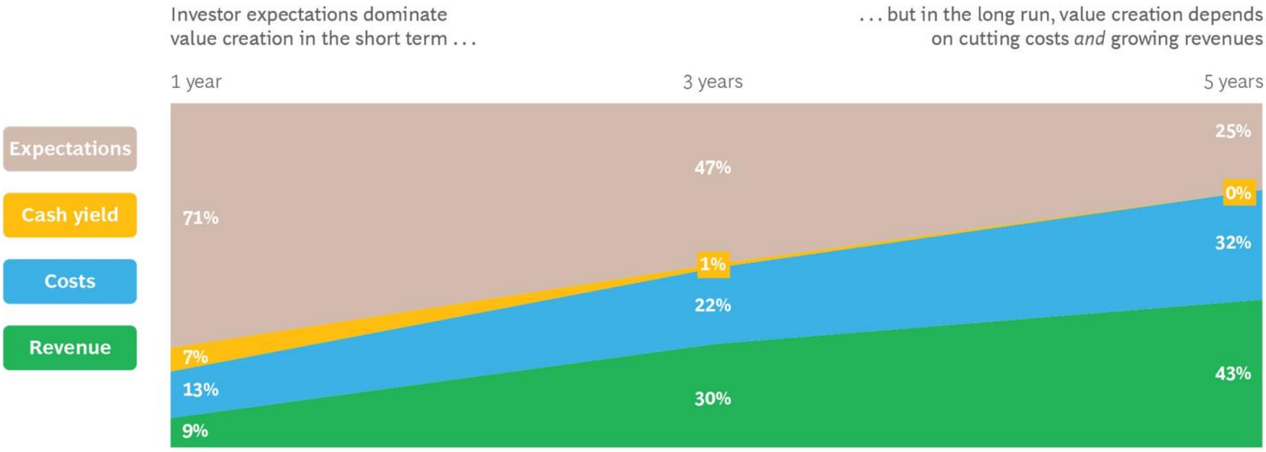
Efficiency improvements drive 13% of the outperformance, while the remaining factors (revenue growth and margin improvements) play even smaller roles.

As such, it is crucial for companies to craft a compelling transformation plan and narrative at the outset of their journey, and to define a clear communication agenda toward their shareholders. Moreover, firms must signal discipline and momentum by executing on quick wins for cost reductions.

In the long term (five years), value creation drivers are flipped, such that the lion's share of TSR outperformance is driven by successful cost reductions (32%) *and* revenue growth (43%), while investor expectations play a smaller role (25%).

This indicates that, in the long-term, execution is key, as investors will keep executives to their promises. Moreover, it shows that you cannot cut your way to greatness: differential growth is critical to sustained value creation.

Exhibit 1 - To Create Long-Term Value in Transformations, Firms Must Deliver on Cost Cutting *and* Revenue Growth



Drivers of TSR outperformance (%) among top 30% of firms that outperform their industry after transformation[1]

Sources: Capital IQ; BCG Henderson Institute analysis.

Note: Graph excludes negative contributions.

[1] Based on TSR growth relative to industry over given timeframe from turnaround sample revenue contributions = sales growth; cost contributions = earnings growth – sales growth; expectations contributions = share price growth – earnings growth; cash yield contributions = dividend yield including share repurchases. All benchmarked to industry averages and based on 70th–100th percentile performers. Global sample size = 1,801 downturns.

Truth #4: Transformations Require a Long-Term Orientation

Achieving sustainable growth and a future-proof operating model requires entering transformations with a long-term orientation, rather than merely focusing on addressing performance woes or catching up to peers in terms of technology stack or organizational best practices.

Our data shows that having a long-term strategic orientation exhibits a strong positive impact on transformation performance, being associated with a 12.5 percentage points higher TSR impact over a five-year horizon.

A long-term orientation can be achieved by creating an entrepreneurial culture, in which new ideas are constantly developed and leaders are willing to take chances on unproven models. To support a forward-orientation, companies need to complement traditional, backward-looking performance metrics with future-oriented ones. For example, 3M pioneered the New Product Vitality Index (NPVI), a metric that tracks the share of sales from products that didn't exist five years ago.

Beyond mindset, culture, and metrics, a long-term orientation also means investing in the exploration of new ideas that could be the basis of future advantage: above industry-average R&D spending is associated with a 2.9 percentage point improvement in TSR performance over the course of a transformation.

Above industry-average capital expenditures are also linked to better transformation outcomes—to the tune of 3.7 percentage point TSR over a five-year horizon. This indicates that leaders must find the right balance between identifying new sources of growth and improving their existing model, for example, by upgrading production machinery. It also underlines that operational effectiveness needs to be tied not only to cuts, but also to selective investments.

Truth #5: You Cannot Make Things Up as You Go

Transformations are complex and require simultaneously delivering on several objectives—usually under immense pressure from the outside and inside. As a result, companies cannot make transformation up as they go.

Putting a formal transformation program in place—which we identify based on a combined analysis of corporate announcements and restructuring spend—has a positive impact (5.9 percentage points) on long-run TSR during transformation periods.

Moreover, the scale of the program and the willingness to invest in change matter, with our results further showing a strong, positive correlation between above industry-average restructuring spend and TSR outcomes (+5.7 percentage points over five years).

Formalizing the transformation entails defining a clear governance and process—or setting up a dedicated transformation office—for coordinating and tracking progress on change initiatives, as well as regularly communicating it to the executive leadership team so that roadblocks can be addressed promptly.

Moreover, it may mean putting in place a chief transformation officer to helm an ambitious change effort, which our prior research shows can improve transformation odds significantly. However, simply having a CTO on staff is not a panacea. The role must be designed appropriately and filled by someone who is persistent, vigilant, and flexible—and who is trained for the job.

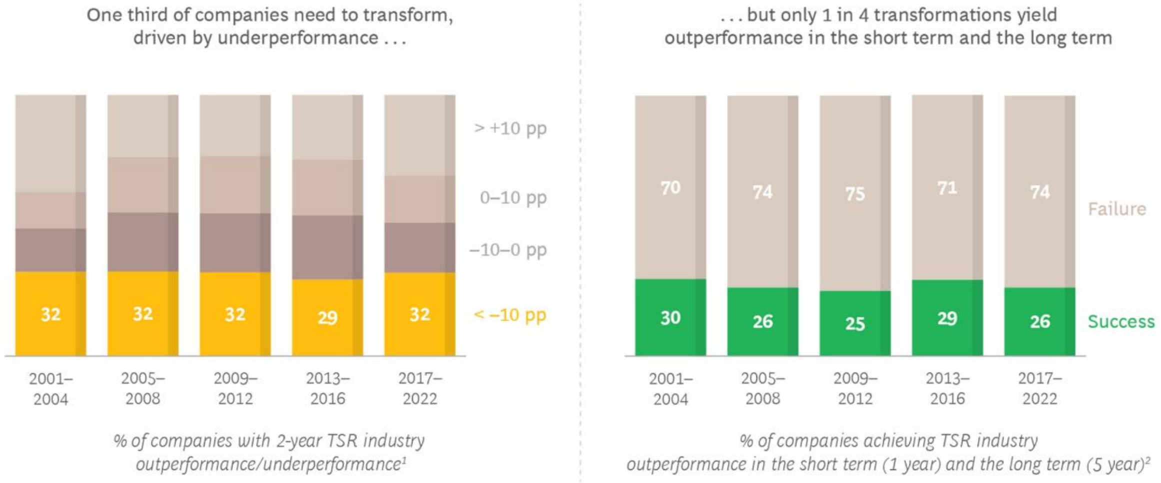
A Lie: You Are Special—and These Insights Don't Apply to You

The empirical patterns of transformation are quite stable: At any point in the past 20 years, roughly 30% of companies significantly underperformed their sector for a period of multiple years, making transformation a necessity for performance reasons. (See Exhibit 2.)

However, successful transformations are the exception, rather than the norm, even when measured on very modest criteria. More than 70% of companies fail to outperform their industry peer group average in both the short (one year) and long term (five years), after a previous performance downturn period.

These numbers are quite similar to the findings in our 2018 report—showing that while the world has changed significantly in the last few years, the challenges of keeping up with that change have remained remarkably persistent.

Exhibit 2 - High Need for Transformation *and* Low Odds of Its Success—a Stable Pattern for More Than 20 Years



Sources: S&P Capital IQ; BCG Henderson Institute analysis.

Note: Includes US public companies ex-energy with $10B+ market cap; based on 2-year performance samples from 2000 to 2022.

[1] Two-year outperformance (CAGR) compared to prior 5-year average.

[2] TSR outperformance relative to industry over following 1-year and 5-year periods.

Just as crucially, these patterns are remarkably universal, with our data showing that no region, sector, or size group is an outlier on transformation need and success rates. The success factors of transformations discussed throughout this article also have directionally similar effects across all subgroups of our sample.

Put briefly: When it comes to transformations, no one is special. Change leaders have no reason to be overconfident, given that only half of the companies we studied employed more than two of the key success factors we identified. Sustainable value creation through transformation remains so rare. ■

★★★★☆

The Cost Transformation Essential You May Be Missing

By ***Cristina Lilly, Andra London,*** and ***Kevin Kelley***

From Boston Consulting Group (BCG) Feb 2024

Key Takeaways

Having an **emotionally strong workforce** makes it likelier that organization-wide changes will succeed. Cultivating it means helping people fulfill four fundamental human needs.

- When workers' **needs for clarity, trust, meaning, and belonging** are met, they're better able to confront challenges and adapt to changing times.
- Helping people **become more resilient** doesn't just create a solid workforce—it produces better outcomes for the organization by reducing the time people need to recover from external shocks and increasing the extent of their recovery.

The Cost Transformation Essential You May Be Missing

A company's biggest asset isn't its products, brand, or real estate holdings. It's the emotional strength of its people.

Companies need an emotionally strong workforce to withstand the ups and downs of business, a seesaw that many have experienced over the past four years. Organizations are tapping their people yet again to address financial pressures that are stemming from changing market dynamics, supply chains, and customer preferences.

Such pressures also arise from the need to invest in new technologies, such as generative AI. Many companies are cutting costs to be more in line with what's needed to stay resilient and to fund initiatives for the future.

Having an emotionally strong workforce makes it likelier that an enterprise-wide cost management initiative will succeed. But that strength doesn't materialize out of thin air. It is the result of a company helping its people fulfill four fundamental human needs—the need for clarity, trust, meaning, and belonging.

When these basic needs are met, people are better able to confront challenges and adapt to changing situations.

Companies that proactively instill emotional resilience in their people do more than create a solid workforce; they produce better outcomes than do organizations that are purely reactive.

Our research shows that emotional strength lessens the impact of external shocks on employees' performance, reduces the time it takes for them to recover, and increases the extent of that recovery.

The Four Fundamentals of Emotional Strength

Organizations can use quick pivots or drastic cost cuts to weather a financial storm or other setbacks. But those actions can be demoralizing and cause burnout, leaving the business vulnerable when the next crisis strikes.

When faced with uncertainty, people worry and lose focus. They become less productive and less creative. And when people are paralyzed by fear or anxiety, it can hurt even the most well-conceived processes and strategies.

Leaders who don't consider the emotional aspects of a cost transformation could lose the very high-performing talent they were counting on to help bring them into the future. In addition to institutional knowledge walking out the door, companies incur costly investments in recruiting, onboarding, and training talent to replace them.

Given what's at stake, it's plain to see the benefits of boosting the emotional strength of the workforce. Doing so requires meeting four fundamental human needs. (See the exhibit.)

The Need for Clarity. People need clarity. When a business has to change quickly, it's easier for people to respond if they understand the issue and the actions required to address it.

Leaders can calm people's fears about the uncertainties associated with change by focusing on what is certain, namely the company's purpose, vision, and values.

Meeting Four Basic Human Needs Helps Employees Gain Emotional Strength

Source: BCG analysis.

Leaders can create clarity by communicating what the company will look like in the future and how that future state builds on the organization's past relationship with its people.

At the same time, limiting the number of distinct messages, behaviors, frameworks, and principles that employees must remember and use can also help create clarity.

The Need for Trust. People need to trust that leaders have the best interests of the workforce at heart, especially during times of change. To build trust, leaders must act in a way that allows people to see them as a secure base, someone who can be counted on for direction and support.

Leaders also must make people feel that they can ask questions and be heard without fear of retribution, regardless of their role or standing in the organization.

To create space for employees to have difficult or emotional conversations, leaders must actively seek feedback and gracefully acknowledge criticism. Answering people's questions and addressing their concerns builds the kind of trust that underpins resilience. By listening, leaders also can identify and address barriers that could stand in the way of change.

The Need for Meaning. In difficult times, people need meaning to persevere through challenges and focus on goals. They need to feel that what they do matters and that they are contributing to a worthwhile cause.

When employees have time to reflect on their feelings and motivations, it can help them see the value of their work, alleviate stress, and learn from their mistakes.

Leaders can support cost transformations by connecting the personal meaning that people find in their work to the organization's purpose, vision, and values.

Leaders can use a shared purpose and set of values to guide decisions related to the transformation, explain those decisions to the workforce, and move the company toward its vision for the future.

Focusing on a shared purpose, vision, and set of values can help the workforce shift from focusing on the problems of the past to the possibilities of the future.

The Need for Belonging. If meaning gives people a reason to work, belonging inspires them to work together. Belonging means feeling accepted and supported and having a shared identity. Including employees in rituals that maintain shared social structures helps foster a feeling of belonging.

Instilling a sense of belonging in the workforce is especially important during turbulent times. Faced with tough situations, employees tend to isolate themselves into familiar groups for security, which can erode trust, make people feel left out, or lead them to make mistakes as they fall into old habits.

By cultivating a sense of belonging, leaders can soothe insecurities and help people feel more confident when change strikes. Part of creating a sense of belonging is communicating about what's happening with the entire the enterprise, rather than limiting information to a select few.

Use Purpose, Vision, and Values to Build Emotional Strength

When companies fail to promote the four sources of emotional strength in a cost initiative, business turnaround, or another type of transformation, employees don't trust the proposed solutions and aren't aligned with the reasons for the change. They no longer feel that they are part of the organization and don't fully understand what's happening.

Companies that implement transformations successfully are intentional about supporting people's emotional strength. They show that support by:

- **Embedding Purpose into Their Strategy and Ways of Working.** Purpose is the driving force behind why an organization exists and the role it plays in the world. It serves as the foundation for a successful transformation because it inspires people to think long term instead of simply responding to the latest disruption.

  Leaders need to frame a transformation's impact as being central to the company's purpose—delivering value to stakeholders, for example, or providing societal benefit.

  A BCG study of close to 1,000 companies considered to be transformation leaders found that one of the top three factors that contributed to their success is a clear purpose that leaders agree on and define early in the transformation process.

- **Building an Emotional Case for Change.** Along with incorporating purpose into their actions, organizations must build an emotional case for change for a transformation journey. Explaining the why behind a change and setting out a clear vision of the company's post-transformation future can help employees feel represented and that they belong, which can kindle positive attitudes toward the change.

  In successful transformations, employees consistently hear why changes are being made in a way that links changes to the organization's purpose, vision, and values. Just as important, leaders can address employees' concerns by sharing what's not changing.

Putting Support for Emotional Strength into Practice

We've found that when companies' purpose is in sync with their vision of the future, they inspire and empower their people. What's more, the vast majority (96%) show sustained performance improvement after a transformation.

Two examples show how purpose, in particular, is not only key to fulfilling a fundamental need such as trust but also critical to leading through a crisis.

Instilling Trust. During a decade of near-constant disruption in the health care and retail industries, CVS Health used a well-established purpose of helping people to get and stay healthy to build trust among customers and employees, with lasting results.

CVS Health's purpose-led actions started in 2014 when the company became the first US pharmacy chain to stop selling tobacco products, forgoing $2 billion in annual revenue.

In the ensuing years, the company championed a nationwide antismoking campaign, targeted the use of e-cigarettes among young people, and stopped stocking sunscreen with less than an SPF of 15 as part of its stance to promote better skin health.

CVS Health continued putting purpose into practice by opening walk-in clinics to provide more accessible health care services. At the height of the COVID-19 pandemic, the company opened approximately 2,000 US testing locations and updated its website to make it easier for customers to make vaccination appointments and buy test kits.

Clear decisions made in service of its purpose have helped CVS Health consistently rank among the top 100 most admired companies and brands in the world.

A Purpose-Led Pivot. When The North Face adopted a more inclusive purpose—dare to lead the world forward through exploration—the outdoor equipment maker didn't anticipate it would mean leading people through the early days of a global pandemic that curtailed most nonessential travel.

When initial health and safety lockdowns kept people at home, North Face leaders acted on the idea that empathy is a key component of exploration. They made an archive of exploration videos free to watch online and donated $1 million to outdoor communities.

"We believe that distancing shouldn't mean disconnection," said Arne Arens, the president of North Face at the time. The company also donated more than 60,000 protective gloves to health care professionals and first responders.

These and other purpose-driven actions helped North Face expand its market share, attracting urban explorers who may not have been part of its customer base. A strong purpose is also a reason why North Face's parent company, VF, has been honored by multiple organizations as a top company for diversity, equity, inclusion, ethics, and sustainability.

Business disruptions are happening more frequently, forcing companies to evolve from bracing for change to embracing it. Having an emotionally resilient workforce can speed up a transformation required to embrace change and reduce the turnover associated with it.

Cultivating emotional strength requires meeting people's essential needs for clarity, trust, meaning, and belonging. When support for people's emotional strength is connected to purpose, vision, and values, it's a win for the company and the workforce. ■

★★★☆☆

Cost Transformations in Turbulent Times

By ***Tuukka Seppä, Jacopo Brunelli, Enes Oelcer,*** and ***Astrid Vikström***

From Boston Consulting Group (BCG) May 2023

Key Takeaways

When turbulent times strain profits, companies will often cut costs. But few cost transformations deliver sustained performance. Four challenges—**narrow ambition, fragmented efforts, complacent culture, and execution uncertainty**—are common hurdles to a successful initiative. Companies should plan for a three-phase transformation process:

- Define ***what*** to transform by determining the **root causes of problems** facing the company.
- Map ***how*** the transformation will occur by **creating the case for change**, **explaining new ways of working**, and **equipping leaders and the organization** to drive and deliver the changes.
- To realize full value, make these mechanisms part of the **organization's way of life**.

Another key challenge is that **people are hard-wired to resist change**. Leaders must help employees feel supported and engaged and set them up to succeed.

Cost Transformations in Turbulent Times

It's tough to be a CEO in turbulent and uncertain times. Global disruptions are straining profits and testing the financial and operational capabilities of many companies. As consumer purchasing power erodes and inflation continues, senior leaders around the globe rank building flexibility and resilience as their number one priority.

Companies naturally launch cost-cutting initiatives at times like these. But many efforts to reduce expenses are ineffective and unsustainable, failing to achieve real impact.

In fact, only 25% of transformations deliver the sustained performance targets expected by the board. Moreover, a recent BCG survey found a continuing downward trend in the value realized from a transformation.

A more effective approach to cost transformation is holistic and programmatic: using the impetus of immediate savings to build long-term resilience while also addressing the organization's existing structural issues.

BCG research has found that this approach can help companies deliver quick impact while improving their ability to respond to future crises. The top quartile of companies we studied improved performance relative to their industry by 25 percentage points, compared to a decline of 20 points among companies in the bottom quartile.

Case Studies in Overcoming Challenges to Transformation

The goal in cost transformation is to achieve sustained, long-lasting effects that reduce expenses and make the company stronger. This may be difficult to achieve, but it is feasible for any company willing to commit. The process starts by recognizing the four challenges of cost transformation:

- **Narrow ambition.** The company focuses on a singular symptom or problem instead of addressing the root causes of underperformance.
- **Fragmented efforts.** The drive to deliver results leads to too many initiatives with limited value, while spreading executive attention and resources too thin.
- **Complacent culture.** Leaders and the workforce are disengaged, and not enough people accept ownership or accountability for implementing the cost transformation.
- **Execution uncertainty.** Without established practices for transparency and program management, there is no consistent way to drive, enable, and deliver impact.

The first two challenges focus on *what* expenses to cut: ensuring strategic soundness and focusing on activities that will genuinely deliver value. The other challenges address *how* to make program delivery happen: implementing the program in a way that makes the results stick. When a cost transformation fails, at least one of these challenges is at play.

To demonstrate that it is possible to get a transformation initiative back on track, we take a closer look at the four challenges and companies that overcame them. In each case, they were able to successfully transform their structures and operations as they cut costs—and consequently deliver tangible impact and sustained results.

Narrow ambition

The impact of an external shock, such as a supply chain crisis or a disruptive competitor, may at first glance seem to be limited to one part of the company. Many leaders instinctively respond by trying to address the most obvious pain point in isolation. Too often, this only provides a temporary fix. The expected performance improvements do not materialize, and costs start to creep back up.

The better alternative is to identify what underlying issues are causing the problem. If that initial shock is only a symptom of a more complicated, multi-layered issue, then the solution calls for a transformation with a broader scope and ambition.

A luxury retail company had been growing market share by opening walk-in stores in upscale shopping malls around the world. When shareholder return leveled off, the retailer commissioned an external review.

The report was candid—and bleak. The company had systematically neglected its marketing operations and now faced increased competition. Profitability was down 10% year-on-year, and the company's premium brand value was eroding.

Company leaders had originally planned a relatively narrow effort: to trim EBITDA margins by closing stores and moving the core retail business online.

However, upon full review it became clear that such moves would hamper future growth and impair long-term performance. They would no longer be able to count on the foot traffic and halo effect from shopping mall placements next to luxury brands.

Instead, the company adopted a more ambitious idea: decentralize its operating model and rebuild the brand. Merchandising authority moved to regional decision-makers, who were more attuned to local customer preferences and could source locally at less expense.

To cut costs, the company streamlined its distribution and order-taking processes. Savings were reinvested in efforts to regain the brand's emotional impact.

Ultimately, with a holistic cost transformation, the company shaved $400m off its run rate costs within a year. It put away $100m in savings and improved the topline enough to reinvest $450m in growth efforts for two consecutive years thereafter.

Fragmented efforts

Deploying a high number of transformation initiatives might seem like a sign of momentum, but it more likely indicates fragmentation.

Leaders try to accomplish everything at once, without consensus about which initiatives to prioritize and why. This results in the most impactful bets getting lost. For every dollar spent on a successful initiative, three are spent on initiatives that get side-tracked or fail to meet their targets.

Only a few months after their IPO, the leaders of a technology hardware company were stressed. They had set ambitious targets in their prospectus, promising B2B and B2C revenue growth. After missing those targets in two consecutive quarters, company share price dropped 40%.

The company responded by rolling out a busy portfolio of initiatives targeting improvements in various parts of the balance sheet, but gained little traction in any of them.

The team recognized that their efforts would always be fragmented unless they could focus on a few priorities. They held a facilitated two-day meeting to collectively take a step back, think strategically, and make those difficult choices. Analysis showed they could not do justice to both consumer and industrial applications.

The design and sales efforts were too different; each required distinct expertise and activities. The answer was to dial up their ambition for home security products and deprioritize their B2B offerings. With this decision made, they could finally work through the long list of initiatives and focus only on those with greatest impact on the consumer market.

This new direction calmed investors and bought time to plan an eventual B2C expansion. Meanwhile, the company developed a short-term roadmap that included action steps for the prioritized initiatives, a team in charge of each, and charters that laid out deliverables.

The improved focus catalyzed support from the organization and helped build momentum for the revised program. At the end of the year, the share price had bounced back, increasing seven-fold.

Complacent culture

It is not uncommon for companies to be aware of a clear need for transformation, yet nobody takes the lead in determining how that will happen. Top executives seem to lack motivation to act, and others don't engage at all. The company's culture feels complacent and difficult to change.

As people miss their targets, or options seem exhausted, the sense grows in the company that no one really knows how to accomplish the cost transformation—and that maybe those grand ambitions aren't so important.

In this situation, the challenge for senior leadership is to step up and make a case for changing behaviors and capabilities. They must demonstrate their own accountability, provide an example of owning the new ways of doing things, and give the rest of the company a reason to join them.

A private equity (PE) firm had been trying for some time to spark momentum at a global consumer product manufacturer where it held a controlling share. The manufacturer was underperforming on key indicators; profitability had stagnated and employee morale was deteriorating.

The company's CEO and top team initiated a cost management transformation, but it did not gain traction. An employee survey showed frustration. People did not trust the leaders or their colleagues to "walk the talk." Why should they risk their careers on an initiative that might be forgotten by next quarter?

Finally, one of the PE leaders called the CEO and gave him an ultimatum to get the organization on board. They got together with the leadership team to build a new way of working, instill a sense of ownership, and develop mechanisms for accountability.

The CEO articulated a clear and compelling case for change that was communicated throughout the company. He met with hundreds of employees in face-to-face groups, explaining how to achieve cost transformation and answering questions about what this would mean on the job.

Employees also took part in extensive, collaborative training sessions that taught agile practices, and they redesigned their work to waste less time and effort.

New performance metrics holding people accountable for their role in the transformation effort were applied at every level of the organization. New incentives and stringent performance reviews were launched, with everyone held to similar standards.

The company also streamlined its organizational structure. People were reassigned to roles based on their capabilities and potential, not just their past performance.

The result was an organization with a fundamentally reset operating model and far less everyday frustration. Within two years, the shift led to a 30% improvement in new net run rate revenue and a 54% year-over-year improvement in earnings.

Executional uncertainty

A company undergoing cost transformation must stay laser-focused on enabling implementation of the program. This requires clear-cut priorities, rigorous progress tracking, removal of roadblocks, and reallocation of resources.

Execution uncertainty—a lack of both confidence in the ability to implement and knowledge of how best to proceed—often prevents a company from realizing transformation results.

A heavy equipment manufacturer had just launched an ambitious transformation when the COVID-19 pandemic began. The offices closed and site activity dropped drastically.

When lockdowns subsided, this programmatic initiative was still officially underway. But it was incomplete. The old hierarchical structure had been dismantled, and it was no longer clear how they would reach their initial transformation targets.

Meanwhile, the company's momentum was fading. At the end of the second quarter, a 5% year-on-year EBITDA gap led the top team to re-evaluate the focus and scope of their program to get things on track.

These leaders put an activist Transformation Office (TO) in place to accelerate the program. The TO, a central body with a full view of all efforts relating to the transformation and with authority to mandate action, initiated a set of workstreams such as streamlining procurement, improving energy use in the field, and so on.

It set up shared governance and measurement practices, guaranteeing "one source of truth"—common key performance indicators for the company's many facilities around the world. With real-time dashboards in place, executives could track operational changes and progress. They could also act quickly if an initiative stalled.

The KPIs were specific, easily measurable, and transparent, giving employees clear guidance on how to meet them. Culture and change milestones—such as pulse checks, trainings, and retros to evaluate success of new tools and practices—were woven into the program to help embed the new approach over the long term.

The TO adopted more formal transformation governance and processes, all supported by a digital program management tool.

The tool flagged bottlenecks and enabled the team to identify causes of delays and redirect resources to resolve them if needed.

All this drove a 45% EBITDA uplift and a $40m cost reduction during 2020, far exceeding the company's original ambitions.

The Role of Leadership in Cost Transformation

The preceding examples looked at cost transformation hurdles based in the organization and its practices. But change of this sort does not automatically unfold as an organizational process. It relies on people learning to do things differently—and most people are hard-wired to resist change.

Therefore, in every transformation activity, the company leaders need to recognize this issue and address it. They must forge thoughtful and deliberate connection with people to motivate changes in habits and behaviors.

The most successful transformations are those in which top leaders take the human-centric nature of their organizations seriously. For example, it is essential for leaders to state a clear and compelling case for change up front. Beyond articulating the outside pressures, they must establish a vision of how the company will work when the transformation is complete.

People across the organization need to understand and be energized by the vision. Developing this case for change also ensures the alignment and motivation of top leaders themselves.

Leaders must also take the human side seriously during the transformation process. Employees should feel supported and engaged and be set up to succeed.

This focus on people is also important in the long run, enabling the organization to sustain improvement beyond completion of the initial program.

The plan for undertaking a cost transformation recognizes how these elements will play out over time. (See "Three Phases in a Cost Transformation.")

Three Phases in a Cost Transformation

In the urgency of reacting to outside events, the planning process for a cost transformation can be short-sighted—making it difficult to recognize challenges affecting the company and to marshall resources effectively. One way to manage this is to plan for three phases, playing out over the next 12 months:

Taking stock. A deep and honest review to define the *what* to transform. The transformation team determines the root causes of the problems the company is facing, and then considers these questions:

- How much value can be delivered through this transformation?
- How will we realize that value?
- In which parts of the business should we move aggressively to reduce costs?
- Conversely, which processes, capabilities, and assets are fundamental to our business and may require protection or even greater investment?
- Where should we reinvest the savings that are unlocked?

Mapping the journey. In the first 100 days, the company moves to set up the *how:* creating the case for change, explaining what new ways of working will be needed, equipping leaders to drive these changes, and establishing the infrastructure (such as a Transformation Office) to engage the organization and enable it to deliver impact.

BCG's research has found that the early months make or break a cost transformation. Companies define their new purpose, align around a common goal (making leaders the advocates for change), set up a strong central transformation management office, mobilize best resources and capabilities, and establish effective communication with employees and shareholders.

Realizing full value. Sustained performance improvement is contingent on the disciplined execution of initiatives, on building capabilities among leaders and in the workforce, and on sustaining employee engagement levels. Once defined, these mechanisms need to be maintained and embedded in the organization's new way of being.

This longer process of culture change continues beyond the delivery of immediate initiatives. It requires functional excellence, cost and execution discipline, cross-functional collaboration, and relentless management support to remove roadblocks. Gradually, the effective use of resources, resilience, agility, and growth becomes "the way things are done around here."

Gradually, the new way of operating will become a way of life. Leaders will become visible role models for the desired behaviors. They will also develop organizational reinforcement—for example, by setting up a Transformation Office designed to support transparency and rigor.

The TO fosters accountability by rewarding the right behaviors and outcomes. It redirects resources where they are most needed, clearing the path for the organization to achieve its full potential.

Human-centric, programmatic transformations that successfully engage the organization have a long-term success rate that is 48% higher than other cost-reduction efforts. They achieve additional impressive results, including on average a 1.9x reduction in cost overruns, a 1.7x increase in realized value, and a 1.6x decrease in time delays.

In short, instead of seeking cost savings to survive, look at them as a high-leverage way to make fundamental improvements in the business. ■

The authors would like to thank Paul Catchlove, Ib Lofgren, and Eetu Isto for their contributions to this article.

★★★☆☆

Avoid the Hidden Costs of Extending Supplier Payment Terms

By ***Mike Bentson***, ***Jeremy Kay***, ***Tom Rapp***, ***Christine Young***, and ***Niels Haenisch***

From Boston Consulting Group (BCG) Jun 2024

Key Takeaways

By taking a pragmatic approach, companies can **make informed tradeoffs** that optimize both **cash flow** and **earnings**.

- Many CFOs have set clear mandates for procurement teams to **extend their payment terms** beyond regional or industry norms.
- To maximize enterprise value, CFOs must define tailored strategies that consider supplier and category nuances.
- They must also **equip procurement teams with tools, insights, and training** that allow them to make informed tradeoffs during negotiations.

Avoid the Hidden Costs of Extending Supplier Payment Terms

Extending payment terms is an effective way for companies to generate and preserve working capital and cash flow. But to truly maximize enterprise value, companies must avoid the hidden costs of this strategy. By taking a pragmatic approach, CFOs can enable their company's procurement teams to make informed tradeoffs that optimize both cash flow and earnings.

During the pandemic, many CFOs asked their procurement colleagues to prioritize payment term extensions to conserve cash in the volatile economy.

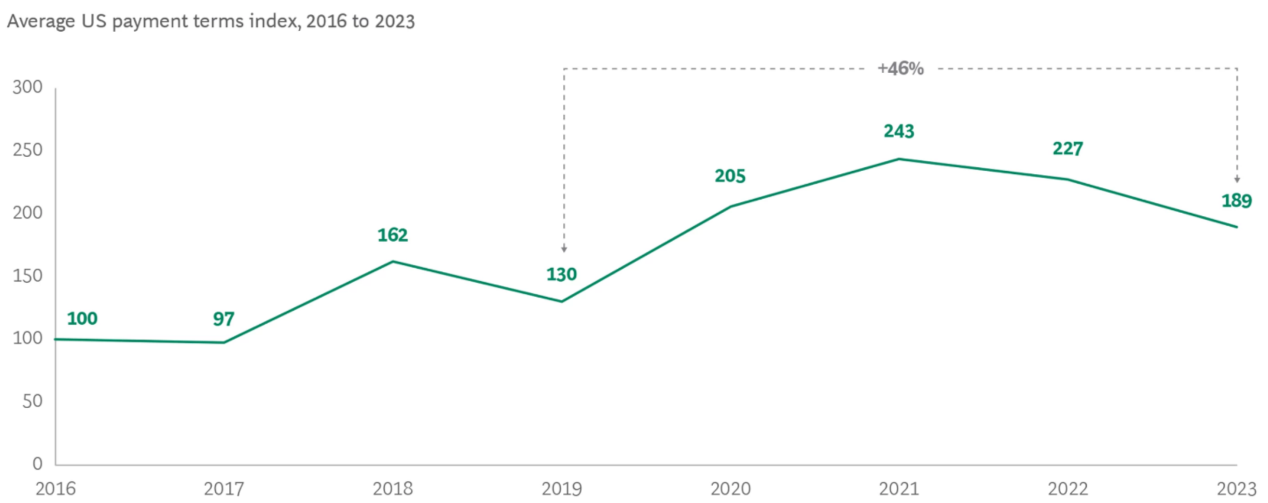
Indeed, Atradius Payment Practices Barometer confirms that the average duration of US payment terms nearly doubled from 2019 to 2021. In the current environment of sharply higher interest rates that began in 2022, payment terms have continued to be a vital tool for relieving pressure on companies' working capital.

Although payment terms have receded from their pandemic highs, they are still nearly 50% longer, on average, than prepandemic levels. (See Exhibit 1.)

Some suppliers have responded to payment term extensions with price increases, either overtly or discreetly. This has placed procurement professionals in the difficult position of deciding when to ask suppliers for extensions in order to improve cash flow and when to push back on the resulting price increases to maintain earnings.

Such decisions frequently rest with category managers or commodity buyers who may lack the clear guidance or robust tools required to make informed tradeoffs.

Exhibit 1 - Payment Terms Have Receded Slightly After Rising Sharply During the Pandemic



Source: Atradius Payment Terms Barometer (2016-2023).

Note: In 2016, the average payment terms were 19 days. This average includes non-controllable expenditures requiring immediate payment, such as utility bills. Average payment terms for suppliers with controllable spending would likely be higher than the average shown in this chart.

Instead, many procurement organizations depend on blanket policies that fail to consider the subtleties of individual supplier relationships or the arbitrage opportunities arising from differences between the parties' marginal cost of capital.

To help procurement teams decide how hard to push for payment term extensions, CFOs must define tailored targets and strategies that consider supplier and category nuances. Companies must also equip these teams with the tools, insights, and training needed to negotiate longer terms while limiting reciprocal price increases.

The Value and Tradeoffs of Extending Payment Terms

To justify extension of payment terms, many CFOs would argue that cash is king. But if a company is operating with adequate cash levels, the value of holding an additional dollar of cash for 30 days may not outweigh a subsequent price increase from suppliers.

The true payoff from improving cash flow is the opportunity to redeploy capital in order to deliver value for the organization. This may include investing in internal projects that generate returns, placing the money in a market account and earning interest, or receiving a discount by paying off debt or other suppliers early.

Maintaining adequate cash levels also allows the company to avoid violating debt covenants and jeopardizing credit ratings.

All of these actions deliver real value. For instance, paying down debt early may provide 1% to 2% savings based on the weighted average cost of capital (WACC), while paying suppliers early could lead to a 2% to 3% discount on the original price.

For suppliers, on other the hand, extending terms could have a negative financial impact. A supplier still must pay its vendors and employees within their agreed-upon terms.

If those terms are shorter than its terms of payment with customers, the supplier incurs costs. It may be charged late-payment fees by its vendors or be required to take out a short-term loan (at a hefty interest rate) to pay employees on time.

To compensate for these tangible costs, suppliers raise prices. In some cases, they may do so overtly through direct price increases. In other cases, they may increase prices discretely, such as via surcharges, additional labor hours in the cost estimate, or more change orders during the project. (See "Circumstances That Carry the Highest Risk of Hidden Costs.")

Circumstances That Carry the Highest Risk of Hidden Costs

Our recent discussions with suppliers confirmed that their reactions to longer payment terms are often more subtle than a specific price increase. In the absence of diligent monitoring, there are many situations in which suppliers seek to increase prices aggressively yet discreetly.

Some of the highest-risk circumstances are:

- **Transactional Spot Buys.** These one-time purchases usually entail short-duration contracts without established terms and conditions, thereby enabling suppliers to adjust prices in real time. Buyers also tend to lack the capabilities to ensure granular visibility and tracking.
- **Custom or Project-Based Purchases.** The scope changes from project to project, making it difficult to

benchmark and compare costs across similar purchases.

- **Inadequate Category Management or Supplier Engagement.** Limited oversight allows suppliers to increase prices.
- **Sole-Source Environments.** Suppliers may have more power in the relationship while purchasers may find it harder to identify and deploy levers to influence suppliers.

During a recent client engagement, we conducted a double-blind survey across the client's industry to gauge how suppliers would respond to requests for extending payment terms. The majority of suppliers stated that they would not increase prices if the payment terms remained within industry norms.

However, if terms were extended 15 to 30 days beyond those norms, suppliers said they would consider raising their prices by 5% to 8%, either directly or through various subtle mechanisms.

It can be difficult for a buyer's procurement teams to make immediate tradeoffs between payment terms and prices. The tradeoffs are especially risky for companies that must manage a large number of low-volume suppliers—a situation that became more common during the pandemic. Having such a "long tail" of suppliers can complicate the monitoring of price adjustments related to extended payment terms.

Moreover, many companies do not possess the sophisticated analytics needed to track and measure price increases or a process for scrutinizing every purchase. Without detailed insights, procurement teams find it challenging to negotiate optimal payment terms with suppliers.

Companies should also consider the potential nonfinancial downsides of extending terms. For example, requesting payment term extensions could have a detrimental impact on supplier relationships, and gaining a reputation for taking a hard line on payment terms could deter other vendors from doing business with a buyer.

In addition, devoting too much attention to payment terms could distract procurement teams from focusing on other critical value-adding activities, such as negotiating prices.

Best Practices for Extending Terms While Limiting Price Hikes

Many CFOs have set clear mandates for procurement teams to extend their payment terms beyond regional or industry norms, and many companies that have already extended terms seek to maintain or further increase them.

However, most companies have exhausted the blunter levers to increase terms, such as a standard letter to all suppliers or organization-wide mandates for buyers. CFOs now need to explore more nuanced and tactical strategies that account for the differences among categories, regions, and suppliers. (See Exhibit 2.)

For example, when developing their payment terms strategy, companies should apply a de-averaged approach that considers the buyer-supplier power dynamics. This means treading carefully with suppliers that may have more leverage or are strategic partners. It also entails avoiding sudden shifts in terms that could cause financial instability for suppliers, such as those that depend on the buyer for a large share of their revenue.

Exhibit 2 - Payment Term Strategies Should Be Customized for Various Factors

Source: BCG analysis.

To assist in analyzing these and other risks, companies can use GenAI tools, such as BCG's Savings Radar.

By deploying the following set of best practices, CFOs can ensure that their company extends payment terms thoughtfully.

Establish governance and targets. Form a cross-functional team to set a clear strategy, mandate, and targets for payment terms applicable to the broader organization. The team should include procurement, contracting, finance, and business unit leaders.

Develop tailored strategies. Customize payment term strategies for specific supplier segments. Identify which segments and suppliers may be off-limits for term extensions because of supplier power or risk.

Prioritize extending terms for those suppliers with which you have the greatest influence. Consider excluding at-risk suppliers, such as small and diverse businesses, from term extensions, or implement extensions in ways that avoid a financially harmful cash crunch. For example, a financing program can help suppliers overcome cash flow constraints.

In tailoring a strategy, it's important to consider where the supplier is positioned in the value chain. Suppliers further upstream often face more financial risk and, consequently, higher WACC.

The key reasons include less predictable demand (for example, large batch orders versus continual demand); more fixed assets, which require significant capital investments; less flexibility to adjust near-term prices in response to market changes (for example, rigid long-term contract pricing); and susceptibility to bullwhip effects from sudden demand changes downstream, which can cause major inventory fluctuations.

Find creative ways to structure terms. Devise ways to structure terms that offer flexibility in addressing current business needs. For example, negotiate early-payment discounts, such as 2% off for paying within ten days. This allows the finance function to either take savings via early payment or improve cash flow through later payment.

Consider nonstandard approaches to extending terms without overtly changing the number of days. For example, maintain a 30-day term but stipulate that all invoices due and payable will be settled on the first Tuesday of each month.

Leverage best-in-class tools. Set up systems and processes to take full advantage of the extended terms. For example, don't start the payment clock too early, and ensure that the accounts payable system can handle nonstandard terms.

Equip negotiators with digital tools and spend analytics that enable informed decisions, create transparency, and optimize payment terms. Such tools can, for example, identify companies with outlier payment terms that should be harmonized.

Utilize GenAI to improve supplier outreach and increase the time buyers can spend on value-adding activities. For example, the technology can assist in extracting payment terms from contracts and harmonizing them across suppliers.

Develop robust analytics and a regular governance forum that enable leadership to track progress and resolve issues, including the identification and removal of any barriers.

Elevate negotiation tactics to reduce resistance. Negotiate payment terms after agreeing to the price. This sequencing minimizes supplier pushback and facilitates quantifying the impact if the supplier responds by increasing costs. Adjust payment terms in small increments over time, rather than pushing for a large increase.

For example, request annual increases of 10 to 15 days for two to three years, and build progressive increases into long-term contracts.

Although CFOs can improve cash flow by extending the duration of payment terms, they must be mindful of the associated costs—whether overt or hidden. To avoid hurting the bottom line, CFOs must equip procurement teams to make informed payment term decisions.

This requires tailoring targets and strategies to the nuances of each supplier and category, as well as supporting teams with best-in-class tools, insights, and training.

By making the right tradeoffs, companies can optimize payment terms and achieve the best outcomes for both cash flow and earnings. ■

★★★★☆

Productivity Pays Off in the Process Industries

By ***Cory Kaplin***

From **Boston Consulting Group (BCG)** Jul 2024

Key Takeaways

When companies think about cost management, all too often they default to workforce cuts or spending reductions. But in process industries like metals and mining, or forestry products, paper, and packaging, that's a half-solution at best.

Cory Kaplin, who leads BCG's Operations practice in Canada, says that **the real, sustainable gains come from improving productivity and changing behaviors**.

What are the latest cost trends for companies in the process industries right now?

Cory Kaplin: Cost has been top of mind for a while. What's unique now is that inflation and other issues like labor retention and the race to win top talent have been exacerbated. When you overlay those issues on top of a commodity cycle, you get a situation where cost has become increasingly critical for most companies in process industries. Their inputs have become more expensive—especially things like fuel—and they can't pass those price increases along to customers. They're getting squeezed.

What are the biggest misperceptions that leaders have about costs?

Leaders often think in terms of cuts and short-term wins, and they don't take a long-term view on how to make the changes sustainable. There are lots of cost levers to pull.

But tackling cost more holistically through fundamental business practices—better governance, a certain level of technology and investment, and driving productivity—leads to greater change, deeper change, and more sustainable change if you can get it right.

To be clear, short-term, quick cuts are sometimes necessary. But the common mistake is stopping there and thinking you're done.

Are companies focused on reducing costs along the supply chain?

That's one part of it. A lot of companies are trying to improve procurement by focusing on the supply side—how they manage their suppliers. Those measures are pretty straightforward, through things like renegotiating contracts, and they're sticky, in that the gains last for the duration of the new contract.

But if you really want to make fundamental changes, you also have to address the demand side—the people who do the buying. That could be a formal procurement function or it could be frontline employees authorized to make purchases.

Either way, improving the demand side is a more complex task because you're talking about changing people's behaviors. You're up against culture, momentum, legacy systems, existing ways of working, and other issues. There's a lot more inertia.

Is there an example of these ideas in practice?

We did a major transformation with the Canadian unit of a global mining company. Costs had risen at the company because there were few control systems over procurement. Contract structures and terms were largely *ad hoc*, with few standardized terms or established best practices.

To reduce costs, the company divided the entire cost base into core buckets. It identified the categories with the biggest overruns and renegotiated those contracts.

More important, it put governance mechanisms in place, such as a monthly forum for conducting postmortems on anything that was over- or underbudget.

Management designated contract owners—individuals who were personally responsible for the verification and adherence of that contract. These measures had teeth: bonuses and penalties were assessed based on performance.

In all, the effort led to the company saving $100 million in the first 18 months of the transformation, with another $100 million in savings identified for future gains.

What else should leaders think about?

Another way to tackle costs is to go on the offensive and improve productivity. That's one of my favorites. Productivity, of course, helps on fixed costs. But it also helps lower labor costs because it allows you to produce more with the same workforce or maintain the same level of production with a smaller one.

It really comes down to business fundamentals—things like sound operating practices, effective scheduling, and good maintenance strategies, often brought together in a lean production system. These measures help companies boost throughput and drive the efficiency of the assets they have through new practices and behaviors.

Even simple solutions, like standardized work and effective inspections, are surprisingly inconsistent across the industry, across businesses, and even across assets within the same business.

The other element is making technology investments in new assets: faster trucks, bigger shovels, and so forth. These sorts of solutions can also drive productivity. Making those moves thoughtfully—with an eye on their usefulness for frontline teams and a view of which use cases really move the needle—is a key consideration as well.

Unsurprisingly, these investments increasingly include AI, which can deliver impact via real-time spending analytics and contract management. AI can further boost productivity via schedule optimization, setpoint tuning, predictive maintenance, production simulation, and many other applications.

My favorite example is a US-based company that is now using a GenAI-enabled maintenance system to support field technicians in diagnosing and troubleshooting issues. The company has seen increased schedule adherence, decreased maintenance rework, and overall higher equipment availability.

You mentioned maintenance? How does that factor into costs?

If you decrease the time that assets are down for repairs or maintenance, you can boost the **overall equipment effectiveness (OEE)** of those assets. Many businesses in the process industries are stuck in a 1980s mindset about maintenance—you run an asset until it fails, and the person who swoops in to fix it gets rewarded.

The reality is that preventive and predictive maintenance are almost always easier and less expensive than corrective maintenance. But they require very fundamental behavior changes and a certain level of foresight.

We worked with a large mineral processing plant in the US to improve the maintenance and reliability of its key equipment, and we developed a mantra for them: ***A good shift is a boring shift***. We put it on posters all over the facility. The ideal day is a routine day, during which everything runs like clockwork, and nothing requires a rush repair.

It's boring, and it doesn't produce obvious heroes, but it pays off. At that facility, shifting the focus to preventive maintenance increased OEE by about 7%, and the increased productivity worked out to more than $50 million in reduced costs.

Who owns the cost agenda?

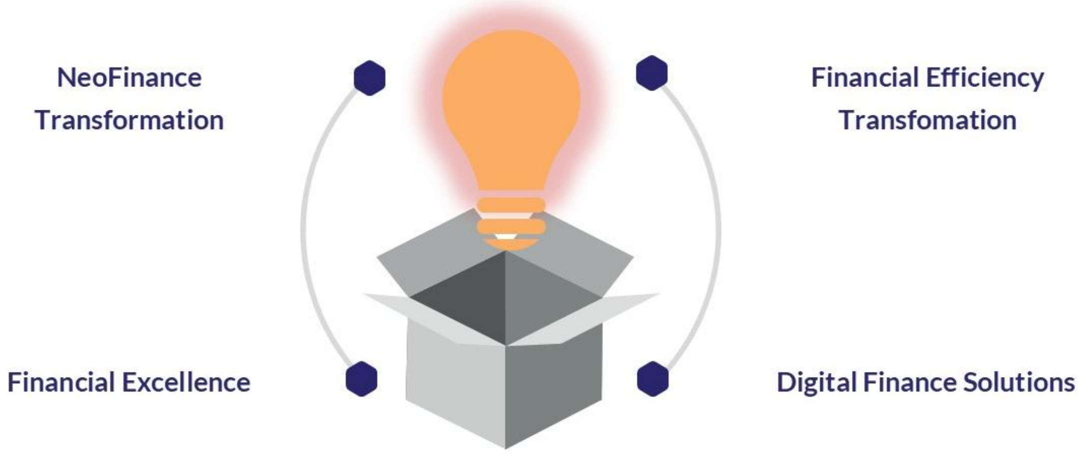
Everyone. People sometimes want to say that cost is someone else's problem. *It's not me, it's a maintenance issue, or a procurement issue, or a finance issue.* **Good cost management is like good strategy. Everybody owns it, and everybody is accountable to deliver it**. ■

About NeoForm

“**NeoForm Business Partners**” is a Transformational CFO Service Provider, Strategic Finance Business Partner and Skin in the Game Growth Partner.

At **NeoForm**, we empower enterprises to maximize **sustainable growth** and **profitability** through **financial efficiency & agility** with our transformational CFO services and strategic finance business partnering.

NEO Services



Contact Us

www.neoform.partners   info@neoform.partners

NEO FORM BUSINESS PARTNERS