# Orchestrating a successful cost transformation

Securing business performance when top- and bottom-line crumble

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# Introduction

In the current economic environment, many companies face contracting demand and cost inflation leading to margin pressure and challenges to make required investments. A natural response is to resort to cost reduction for remedy. However, many cost programs fall short of their objectives. Cost programs are by nature demanding, with conflicting wills and agendas. Management teams often air frustration over efforts being narrow-minded, fragmented, and lacking execution rigor to deliver on intended ambition.

In working with our clients on cost effectiveness, we address these shortcomings. OPX Partners has extensive experience from cost transformations, from the aftermath of the financial crisis, through Covid-19, and the turmoil of the past years. We believe it is important to approach a cost base transformation holistically, investing time upfront to chart a path towards a more sustainable cost base, followed by rigorous planning and execution. What distinguishes successful cost transformations, from those achieving average outcomes, often boils down to the ability to engage and inspire the organization towards a future state of changed behaviors and culture. Success is not merely about removing costs. It is about getting through a deeply difficult human endeavor preserving energy and looking ahead to strengthen the platform for growth.

In the following article we synthesize our three-step approach to cost base transformation: ambition & target setting, planning & design, and execution & tracking. We also explore how to effectively lead and inspire with purpose, showcasing the key elements that set successful transformations apart.

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# The Basic Mechanics

Our three-step approach (Figure 1) starts with ambition & target setting, where the objective is to define and align on the program's strategic ambition and identify key areas to address.

The strategic ambition, typically set by the CEO through top-down analysis, serves as a guiding force for subsequent phases. The following phase, planning & design, should deliver a hard-wired cost reduction plan co-developed with select managers. It is paramount to invest significant effort in planning to improve the odds of successful execution, and to minimize the risks of slipping on targets and confusing the organization.

The final phase, execution & tracking, is all about achieving bottom-line impact and minimizing risks. This often involves thoughtful orchestration of multiple parallel activities, requiring consistent tracking and follow-up as well as flexibility in adapting to new opportunities along the way.

**1) Ambition & target setting**

Ambition and targets are set at the outset of the process, typically by the CEO and board. We recommend doing it swiftly, in a matter of a few weeks, to quickly move into the planning & design phase. Top-down high-level targets can always later be broken down further, and actual initiatives will need to be verified.

Setting targets can be a challenging task as it requires you to balance ambition with risk, and there are often different opinions on how much costs to take out in different parts of the business. Uniform targets across functions are rarely the way to go. Cost cutting in the wrong areas may bring immediate savings but is likely to have detrimental long-term effects.

We recommend a fact-based approach to target setting, accounting for three perspectives; (i) a clear view on where the business needs to be, (ii) an assessment of the financial starting point and trajectory, and (iii) a pragmatic evaluation of potential improvement opportunities (Figure 2).

*Figure 1: Approach to cost base transformation*

*Figure 2: Typical lenses to set cost program ambition*

**i — Where the business needs to be**
- Strategic and financial ambition
- Peer benchmarking
- Owner expectations

**ii — Starting point & trajectory**
- Financial performance
- Cost base and drivers
- Ongoing/ planned cost initiatives

**iii — High-level improvement opportunities**
- Cost reduction levers
- Costs not linked to priorities
- Feasibility & risk management

Target setting needs to account for inevitable leakage, e.g., unforeseen cost increases or initiative failures. In our experience, a buffer of ~20% is often reasonable, to improve chances of delivering on committed savings without setting unrealistic expectations on the organization (Figure 3). The CEO also needs to be mindful of the 'corporate balloon squeezing effect' to avoid savings in one area being offset by cost increases in another, e.g., required reinvestments.

Establishing an unbiased top-down view within management alone can be challenging, e.g., as line managers inherently advocate for resources within their respective areas. This is where external advisors can play a crucial role in providing objectivity and facts in preparation for the CEO's/ board's decision.

**2) Planning & design**

Next phase after distributing top-down targets to key stakeholders consists of developing bottom-up cost reduction plans per function. It is important to strike the right balance between initiative risk and reward, and to balance measures with short- and long-term impact.

*Figure 3: Target and impact ladder*

## Planning is often best done through a bottom-up iterative approach coupled with a robust debate about priorities and risks.

The importance of the planning phase is often underestimated. Rushing through this step can lead to chaotic implementation and missed cost-out targets. Conversely, letting the planning phase drag on for too long will delay impact and create rumors and confusion in the organization. In our experience, a focused 4-5-week planning phase with high management attention is often needed before starting implementation, although quick-wins can be launched as soon as identified.

Planning is often best done through a bottom-up iterative approach coupled with a robust debate about priorities and risks within the management team. Line managers can often generate a long list of cost-reduction ideas given they are closest to the business. However, they tend to be risk averse and often miss structural opportunities requiring cross-functional collaboration.

External perspectives are often useful in finding new ways to address cost, stretching the ambition, and validating the initiatives. Helpful questions to probe for cost potential include, e.g., 'What should we stop doing?', 'What can we do more cost efficiently?', and 'What is critical to protect?' Lists of best-practice cost reduction levers and benchmarks can provide inspiration but need to be adapted to the situation at hand (Figure 4).

Ideas are sized and prioritized in line with strategy. Dismissing one idea means you need to find another better opportunity elsewhere. If, after thorough iteration, the savings targets are not met, the CEO must challenge division and functional heads on their targets, backed by robust logic and data, and close the gap through top-down decisions. This underscores the loneliness of the CEO in achieving mandated cuts.

*Figure 4: Typical cost reduction levers*

| | |
|---|---|
| **Organization** | • Right-sizing<br>• Eliminate roles and functions<br>• Delayering (span of control) |
| **Operating model & footprint** | • Shared service center<br>• Footprint consolidation<br>• Make vs buy |
| **Process** | • Process automation<br>• Service level adjustments |
| **Purchasing** | • Renegotiate with suppliers<br>• Pool volumes<br>• Control consumption |
| **Product** | • Reduce complexity<br>• Cut the tail/ exit low margin<br>• Adjust specification/ quality |
| **Cost management** | • Cost and budget control<br>• Policies (expenses, travel)<br>• KPIs and follow-up |

## Not all initiatives will unfold as anticipated, and the organization's ability to adapt and capitalize on evolving dynamics is central to success.

### 3) Execution & tracking

The execution phase requires decisive action and openness to constantly adapt and track progress. The wisdom of 'plans are of little importance, planning is everything' applies well. Not all initiatives will unfold as anticipated, and the organization's ability to adapt and capitalize on evolving dynamics is central to success. Unforeseen opportunities may surface, and new avenues for optimization may emerge.

Decisive initiation of execution typically involves broad communication and headcount reduction announcements. This initial communication is important to set the tone for the cost base adjustment, sending a clear message of intent and commitment to the organization.

Line managers must lead the implementation, but a Project Management Organization (PMO) with dedicated resources to support the efforts is often helpful. With a mandate to not only track progress but also support initiatives where necessary, a PMO can serve as an 'ambulating' force, providing valuable assistance in navigating the execution. Progress tracking should be pragmatic but detailed enough to drive accountability. It too will likely need to be adjusted as the process moves along but be wary of excessive flexibility as it might lead to unwanted deviations from targets.

> **It's important not to lose focus during an exercise like this. External support for the management team was really helpful**
>
> \- PE professional

# Leading with purpose

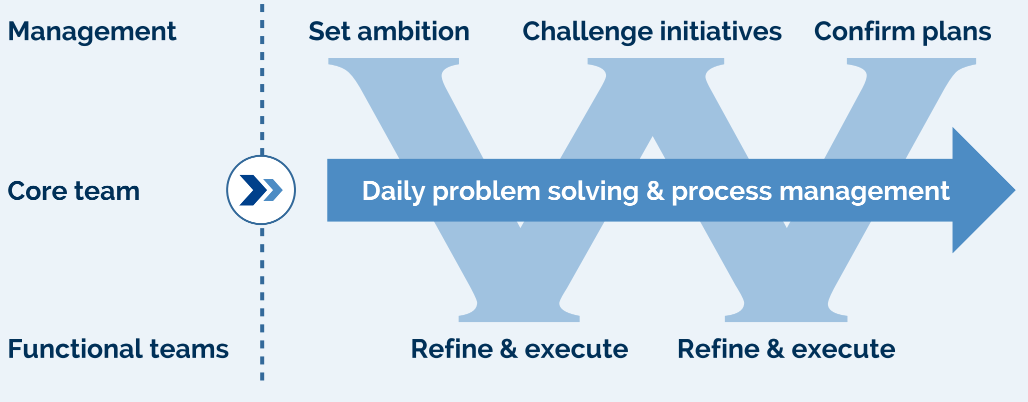
Succeeding with a cost base transformation fundamentally hinges on leadership and the ability to convince people to change their ways of working and culture.

The process needs to be tight with a rigorous plan, supporting analysis, KPIs, communication etc., but at the end of the day, it will fall flat unless people are onboard for the vision of the future.

The organization needs to shift its mindset from 'cost challenges' to the 'good' that will result from the outcome of a successful program, such as a stronger position for growth. To achieve this, we believe there are a three crucial elements that you need to get right:

1. Define an **inspirational case for change** to instill a sense of urgency and provide a vision for the future that resonates with people. Leaders must invest time and effort to give the program meaning and explain implications at each level.
2. Drive an **iterative working process** moving up and down in the organization to drive alignment across layers and functions (Figure 5). Management should challenge ambition, apply pressure, and decide on risk appetite. The core team should work at a high pace to drive the process. Line managers should lead the design and execution within their respective fields.
3. Continuously **assess risks and mitigating actions** to get all key people onboard and optimize risk profile across the initiative portfolio.

*Figure 5: Iterative working process*



# Recent OPX Partners' case examples on cost transformation

**Client:** Homecare conglomerate owned by PE fund with annual revenue of 600 MEUR and ~2 300 employees

**Background:** Top line pressure due to lost market shares, deteriorating margins because of inflation and no share of integration of historical M&A

**Approach:** Focused on overhead with FTE reductions in two waves. Additional reductions in sales organization during second wave. Led PMO for price increase initiatives

**Impact:** Realized 14 MEUR run-rate EBITDA effect within 8 months of project initiation. Further 4 MEUR run-rate EBITDA effect from price increase initiatives

**-14 MEUR**

**Client:** PE-owned company within Payments with annual run-rate revenue of 1 200 MSEK and ~600 employees

**Background:** Historical strong top-line growth stopped and revenue dropping >30% in a single quarter

**Approach:** Organizational restructuring with significant FTE reductions in two waves. Consolidated supplier base and conducted broad price reduction negotiations through a procurement effort. Slimmed non-staff costs e.g., Marketing

**Impact:** 9 MSEK monthly OPEX run rate improvement within 9 months of project initiation (~100 MSEK annually)

**-100 MSEK**

**Client:** Global, public manufacturer of equipment for heavy vehicles

**Background:** Difficulties reaching scale in critical functions such as R&D, Sales & Marketing and Customer Service. Stagnated revenue growth because of Covid-19 creating urgent margin and cash flow issues

**Approach:** Detailed short-term non-personnel savings targets which could be implemented immediately. Costs related to personnel included in long-term savings plan

**Impact:** Accumulated savings target of 200 MSEK (~14% of total cost). Frontloaded action plan with execution of 80% of savings actions within 4 weeks after launch

**-200 MSEK**

**Client:** PE-owned company within road safety and infrastructure with revenue of ~4 500 MNOK and ~2 600 employees

**Background:** Buy-and-build case that had fallen behind the investment case timeline and as a result breached bank covenants

**Approach:** Main potentials in central costs and footprint. Program designed covering: (i) HQ and divisional overhead restructuring, (ii) OPEX reductions in divisions and (iii) footprint rationalization. Led PMO setup to drive process

**Impact:** 17 MEUR EBITDA improvement (+50%) within 9 months from project initiation. Cost effectiveness targets exceeded

**-17 MEUR**

# Concluding remarks

Cost transformation programs are inherently complex with conflicting wills and agendas, and often high emotions. If done right, the benefits are twofold – reshaping the cost base to a sustainable level as well as bringing the team together and instilling a winning culture. At OPX Partners, we often support our clients in cost transformations, facilitate tough decisions and orchestrate the change journey. If this article has triggered any ideas on your side, please do let us know. We would be more than happy to engage in a discussion on these topics.

**About OPX Partners**

OPX Partners is a Nordic management consulting firm. We support our clients in solving complex strategic and operational problems, from diagnosis to implementation – across a range of business topics.

Our approach has been shaped through working extensively with PE-owned companies across a variety of industries. Our approach is characterized by 3 factors:

**Smart:** By bringing experienced teams that know, and have first-hand experience of the problem at hand, but also have top-tier management consulting experience, we can hit the ground running, quickly understand and design the solution, and then move into implementation mode.

**Pragmatic:** Our extensive line experience and senior teams ensure that solutions are pragmatic, implementable and tailored to the client's specific environment.

**Collaborative:** We take a partnership approach with our clients and are normally present on the ground for the duration of the project, and especially during implementation to help ensure successful change. We work together to build our clients' capabilities and ensure ownership at all levels and functions of the organization.