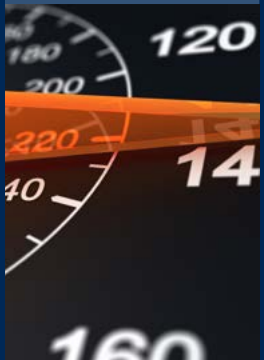
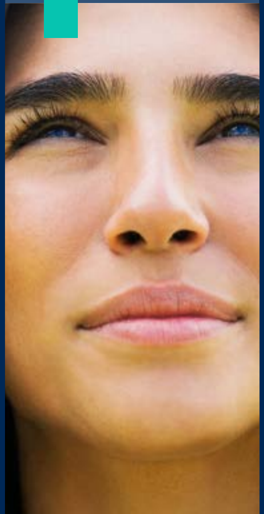
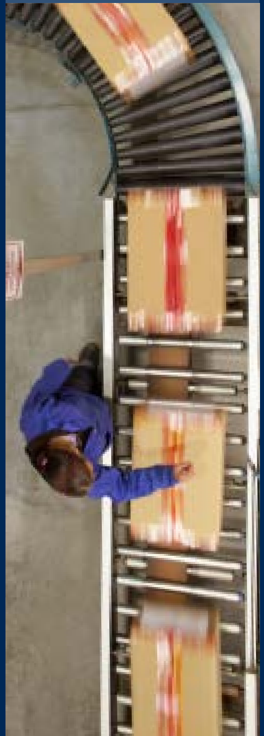
Gartner

Executive Guide

Driving Business Performance With Strategic Cost Optimization







Drive business performance with more effective cost management

Despite overwhelming evidence that effective cost management supports enterprise performance, many organizations have yet to establish three key drivers of success in strategic cost management: clear measures of success, consistent frameworks and cross-functional collaboration.

Our research shows that how well you managed costs before COVID-19 helped to determine how good your business performance was during the pandemic — and how ready you are to rebuild postpandemic.

A rigorous approach to strategic cost management harmonizes cost categorization across the organization, providing a shared cross-functional understanding of cost-to-value relationships. This focus on optimizing value makes it easier for all business leaders who own a budget to prioritize which costs to cut and which initiatives to fund to preserve and create investments in digitalization and growth.

Srinath Sampath
Senior Director Analyst, Gartner

Organizations that were meeting their cost management goals pre-COVID-19 were 1.4 times more likely to see positive impacts on their enterprise key performance indicators during the pandemic.

Three pillars of success in strategic cost management

01

Define success clearly

Outcome:

You're more likely to succeed in your cost management goals.

02

Adopt a consistent framework

Outcome:

You'll face fewer arbitrary budget/cost cuts going forward.

03

Leverage cross-functional collaboration

Outcome:

You're more likely to report better business performance.

Source: Gartner 2020 Business Cost Optimization Through a Crisis

01 Clearly define cost management success

Only 43% of leaders achieve their cost-saving targets in the first year of cost reduction. Even fewer (only 11%) sustain cost savings for three consecutive years. The problem? Poorly designed, ad hoc cost initiatives.

Our research shows that before the pandemic, most organizations used multiple success metrics, but the most popular (used by 66%) defined success in terms of achieving specific predetermined cost savings.

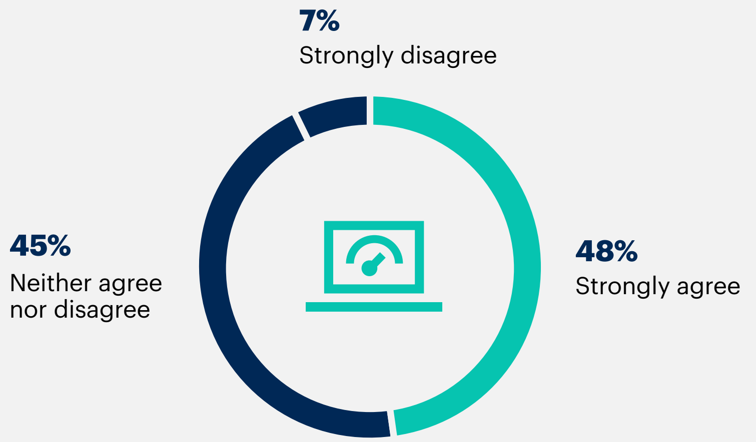
Best-in-class organizations don't think of cost management in this way; they see it as a continuous discipline. They set realistic cost targets, avoid across-the-board cost cuts in favor of strategic divesting, and drive behavior change to support a climate of cash consciousness and smarter spending across the organization.

To do this, start by defining clearly what success looks like. Identify clear targets for your cost management initiatives — whether that's savings goals or, better yet, increasing cost productivity/yield.

If you have clear measures of success, you are 2.6 times more likely to be effective at cost management.

More Than Half Don't Have Clear Measures of Success Assigned to Their Cost Management Initiatives

Percentage of Respondents Who Had Defined, Clear Measures of Cost Management Success



n = 314
Q: Thinking about your organization's cost management initiatives prior to the COVID-19 pandemic, to what extent do you agree or disagree with "We had clear measures put in place to measure the success of our cost management initiatives"?
Source: 2020 Gartner Business Cost Optimization Through a Crisis Study

Think of costs in terms of yield, not absolutes

It's common for organizations to define the success of their cost management initiatives in terms of predetermined cost savings — often because senior management mandates blanket cuts — but it's potentially counterproductive.

To say you have met your target because you cut the amount of cost you said you would doesn't differentiate those costs in any way.

In fact, indiscriminate cuts penalize the more efficient parts of your organization and can erode important sources of value, such as high-impact innovation projects — which, in turn, demotivates these important groups and puts them in an unwinnable situation in terms of meeting their own performance goals.

It's more productive to use a unit of productivity or a yield on costs. With this approach, your costs may rise in absolute terms, but are more than offset by a faster rise in the returns on those costs.

Executive leaders, along with their direct reports, should develop a single, value-based view of the business lines to determine the role of each within the organizational strategy — and get a portfolio view that helps avoid cutting into areas that drive a positive outcome.

Think of costs in terms of yield, not absolutes (continued)

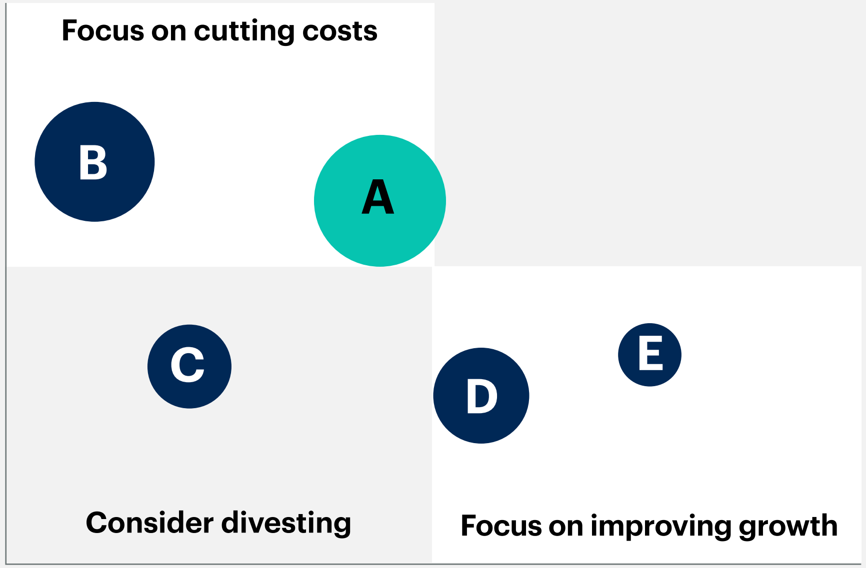
Use a Value Framework to Prioritize Across the Portfolio

Business line assessment matrix

Revenue Growth

Other Options

1. Market attractiveness
2. Strategic fit



ROIC

Other Options

1. Ability to compete
2. Stacked gross margins

Size of Bubble: Invested Capital

Other Options

1. Size of business
2. Total addressable market

Segment tactics for cost cutting based on the relative contribution of each business to long-term financial goals.

Source: Gartner

02 Adopt a consistent cost management framework

Gartner research shows that organizations using a cost management framework consistently across functions were less likely to report that they faced budget/cost cuts in response to the 2020 crisis.

Why would that be? Likely because a consistent framework grounds the organization in a shared understanding of which costs need to be cut and optimized and which must be protected to drive strategy.

Organizations that continuously use this type of systematic and rigorous approach find it easier to defend their budgets, which are already more transparent to other stakeholders.

Despite the benefits, only 35% of surveyed organizations deploy such frameworks.

A framework — whichever one you choose — must provide a consistent set of cost categorizations to use in budgeting, target setting and reporting on costs.

90% of marketing respondents say they were asked to cut costs in response to the pandemic, compared to 60% of IT respondents.

Usage of Cost Management Frameworks

n = 312, all respondents, excluding not sure
Q: Prior to the COVID-19 pandemic, did your organization consistently use a framework for cost management?
Source: 2020 Gartner Business Cost Optimization Through a Crisis Study

Prioritize Your Strategic Cost Optimization Initiatives

Adopt a consistent cost management framework (continued)

This tool reflects the kind of framework that business stakeholders need to create a prioritized list of promising cost optimization opportunities. It weighs a range of factors, from financial benefits to the impact on employee experience.

Benefits and Impact				
Strategic Relevance: • How critical is the opportunity for achieving our strategic goals? • How well does this opportunity align with our organization's overall strategy and objectives?	10%	**Low** The opportunity does not align with or is not critical for achieving strategic objectives	**Moderate** The opportunity somewhat aligns with and is critical for achieving strategic objectives	**High** The opportunity aligns with and is critical for achieving strategic objectives
Cost Savings and Productivity Gains: • How much will the organization save if we act on this cost optimization opportunity? • How does the opportunity affect the organization's productivity?	40%	**Small** The opportunity minimally generates savings or improves organizational productivity	**Medium** The opportunity moderately generates savings or improves organizational productivity	**Large** The opportunity significantly generates savings or improves organizational productivity
Business Impact: • What impact will this opportunity have on business outcomes? • How does this opportunity affect the business's day-to-day operations?	30%	**Negative** The opportunity will have an adverse impact on the business	**None** The opportunity will have neither a positive nor negative impact on the business	**Positive** The opportunity will have a positive impact on the business
Impact on the Employee Experience: • What impact will this opportunity have on employee experience? • How does this opportunity affect employees' day-to-day work?	20%	**Negative** The opportunity will have an adverse impact on the employee experience	**None** The opportunity will have neither a positive nor negative impact on the employee experience	**Positive** The opportunity will have a positive impact on the employee experience
	100%			

⟶ Weight — For each criterion, enter a relative weighting factor in relation to your organization's overall strategy and current business priorities, ensuring they total 100%.

Adopt a consistent cost management framework (continued)

Investment, Time and Risk				
Investment Requirement: • Does the opportunity require a large, upfront investment before savings can be realized? • Is the organization willing to make an investment at all? And if so, how can investments be minimized?	10%	**Low/None** The opportunity requires little to no upfront investment before savings can be realized	**Moderate** The opportunity requires a moderate, upfront investment before savings can be realized	**High** The opportunity requires a large, upfront investment before savings can be realized
Time Requirement: • What is an acceptable time frame to realize savings? • What prerequisites need to be met to realize cost savings within the set time frame?	40%	**Short Term** Expected savings can be realized within weeks of full implementation	**Intermediate Term** Expected savings can be realized within months of full implementation	**Long Term** Savings may be realized either within a year or not at all upon full implementation
Risk Exposure: • What is the degree of organizational risk involved (staff reduction, changes in organizational structures and processes)? • Does this opportunity risk damaging organizational relationships (cross-functional relationships, value chain partnerships, etc.)?	30%	**Low** No staff reduction or changes in organizational processe	**Moderate** Limited change in roles, structures and processes	**High** Staff redundancies, reengineering of processes and structures
Stakeholder Buy-In: • Will key stakeholders such as business leaders, functional leaders and the CFO sponsor and support the opportunity? • Does this opportunity risk damaging the relationship with the business?	20%	**Low** The opportunity was initiated top down by the board with no business leader or C-suite involvement	**Moderate** The opportunity was initiated by strategy with limited business involvement	**High** Strategy initiated, sponsored by the board and strong business involvement to define the opportunity
	100%	→ Weight — For each criterion, enter a relative weighting factor in relation to your organization's overall strategy and current business priorities, ensuring they total 100%.		

03

Leverage cross-functional collaboration

Cross-functional collaboration is critical to keep driving impact (and is more common when a standard framework is in place).

Start by identifying instances where functions depend on — or need to collaborate with — their peers to manage their cost drivers and address the areas of poor interfunctional collaboration.

Enterprises with better cross-functional collaboration were 1.5 times more likely to report better performance on indicators of enterprise performance through the pandemic.

Leverage cross-functional collaboration (continued)

Cross-Functional Cost Management Collaboration Matrix

Percentage of Respondents Rating Their Cost Management Collaboration as High

- Relatively Low Collaboration Perceived Between Functions
- Moderate Collaboration Perceived Between Functions
- Relatively High Collaboration Perceived Between Functions

A's perception of collaboration with B	Finance	Supply Chain	IT	Customer Service	Marketing	Sales	Human Resources	Operational Roles
Finance	-	69%	83%	81%	65%	65%	78%	74%
Supply Chain	55%	-	58%	62%	42%	54%	54%	46%
IT	51%	42%	-	66%	48%	30%	68%	55%
Customer Service	50%	31%	62%	-	48%	44%	44%	56%
Marketing	47%	31%	55%	32%	-	58%	38%	40%
Sales	43%	33%	53%	43%	54%	-	32%	38%
Human Resources	59%	42%	60%	53%	45%	54%	-	50%
Operational Roles	67%	75%	68%	59%	51%	41%	65%	-

n varies, excluding not sure

Q: How would you rate the level of alignment and collaboration between your function and each of the following functions in support of cost management?

Source: 2020 Gartner Business Cost Optimization Through a Crisis Study

Collaboration is key to finding funds to drive growth

Strategic cost management can free up funds for innovation and other growth projects through cost reduction and productivity improvements. But that approach is most successful when heads of business units and functions collaborate to eliminate redundant or unnecessary activities and shift resources toward value-added activities — and together create a culture of cost transparency and accountability.

Many business leaders are now using zero-based budgeting (ZBB) as a tool to systematically reassess the services and capabilities they resource in their postpandemic strategies. This template documents the cross-functional cost-saving pool for ZBB.

Cost-saving pool to fund innovation

Instructions: Use this template to document the cost-saving pool created from the identified cost-saving opportunities by each business unit and function during the zero-based budgeting process. Provide the innovation project(s) to be funded through the cost-saving pool.

Use the space below to document cost-saving opportunities created by the business units and functions through the zero-based budgeting process.	
List the redundant or unnecessary activities eliminated to free up resources	

Use the space below to document the innovation projects to be implemented for the year. Include the following information: • **Project need** • **Proposed project achievements/solutions** • **How will it support our strategic objectives** • **Funds allocated**	
Innovation Project 1	
Innovation Project 2	

- Establish organizations' accountability for activity spend and cost reduction.
- Create visibility for activity-level fund allocation.
- Identify cost-reduction opportunities to free up resources for innovation projects.

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