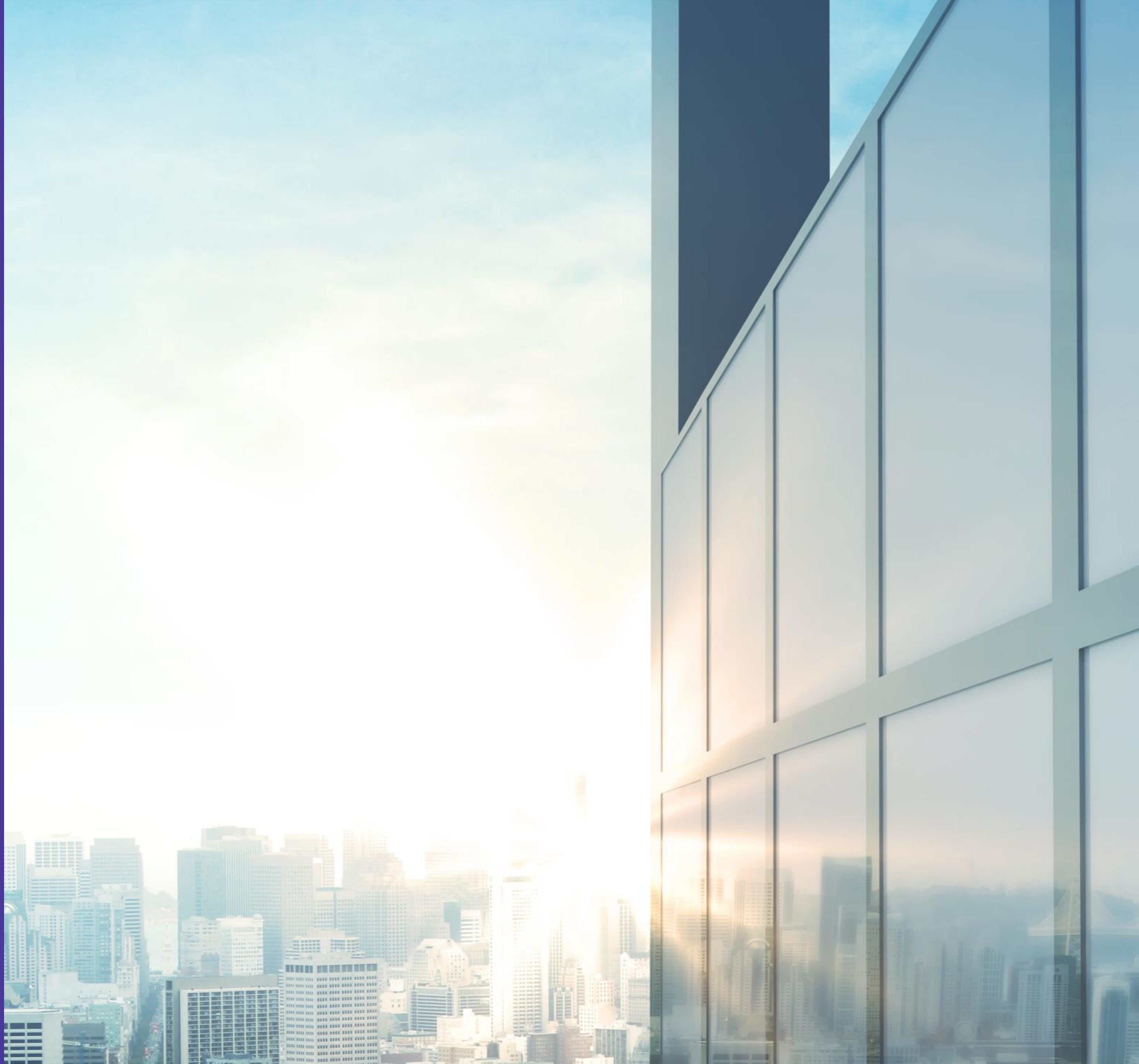
KPMG | 150 years supporting the UK

Cost Transformation

Prepare for success in the New Reality by transforming your cost base

October 2020



Now is the time for cost transformation

Ed Boulton
Associate Partner
T: +44 (0)20 7311 3100
E: edward.boulton@kpmg.co.uk

The Cost Challenge

The world has changed forever, the pandemic has, in many cases, fundamentally re-set market economics and the future business model in many sectors. This has driven a need for organisations to re-set their cost base in line with affordability and re-prioritise spending in line with their emerging strategic priorities

Optimising scarce resources

Once you are over the initial fight to survive, bring together the insight into what is needed to be successful in your new reality and have a robust understanding of your current cost base to build plans to make best use of your scarce resources. Don’t under-estimate the importance of engaging the organisation in this agenda, you need both a great plan and an engaged organisation to be truly successful

Radical solutions and optionality

In addressing the cost agenda two clear trends have emerged. Firstly, many organisations are pursuing radical options for change that they would have previously considered too risky. Secondly, organisations are now developing a range of scenarios to ensure they have their 'break glass' options available in case of further market decline or change

Lessons for success

This eBook looks at the some of the key questions organisations need to ask themselves to set up for successful cost transformation. Drawing on a number of our leading subject matter experts in this area and our collective experience of supporting 100’s of clients globally in this journey, we answer the questions you’re asking on resetting your cost base

Q&A topics

01 In the current climate, many companies are having to focus on cost savings to survive. Where should they start when looking to take cost out of an organisation?

02 Is it more important to take out costs or optimise costs?

03 To manage costs, businesses need to fully understand the costs they’re currently incurring. How do they gain a clear view of costs?

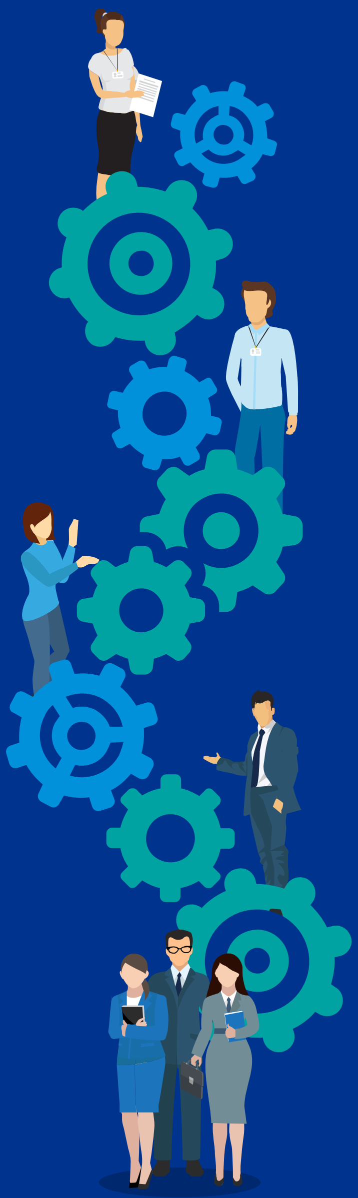
04 How can organisations motivate their teams to engage in the cost agenda?

05 One potential area for cost savings/cost optimisation is the use of suppliers. How can businesses take costs out of their contracts? (Cognitive Contract Management)

06 Environmental, social and governance (ESG) considerations are rising up the corporate agenda. How can businesses strengthen/maintain their ESG credentials while managing their costs?

07 Technology – automation, cloud, AI – is increasingly heralded as a means of delivering operational efficiency. What is the role of technology in managing costs?

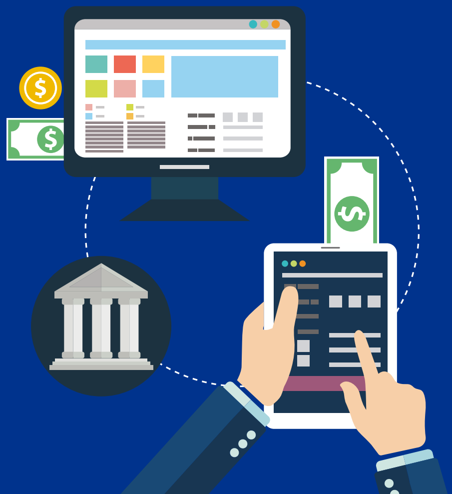
08 What role does tax play in improving cash flow and supporting the working capital position?



Q

In the current climate, many companies are having to focus on cost savings to survive.

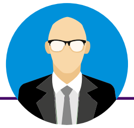
Where should they start when looking to take cost out of an organisation?



A

Is there any low-hanging fruit they should target first?

 [Ed Boulton]

 [Jon Richards]

Low-hanging fruit tends to be linked to where you can make decisions to turn off or reduce services rapidly. What we saw early in the pandemic was organisations taking quick short-term decisions to reduce costs, as they saw revenues falling, in any *'discretionary'* cost area. For example making significant reductions in marketing spend, reducing (or eliminating) travel, office related costs and often challenging suppliers.

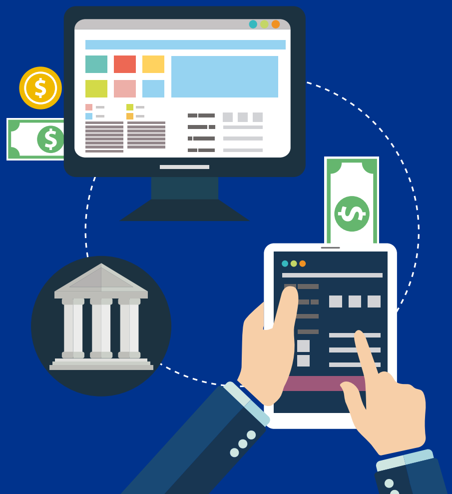
As we move through to recovery and new reality phases, organisations are looking at what they've learnt from these short term changes, and what they need to do to apply these learnings in the longer term. For example, a number of consumer product organisations made an initial decision to simplify their SKU range at the start of the pandemic and are now carefully considering what, if any, of those SKUs they need to re-introduce.

Whilst going after low-hanging fruit is great to protect short-term profitability, most organisations are now taking a more transformational view of costs, fundamentally re-aligning their cost to affordability and to the areas of strategic priority (such as digital) that they need to prioritise funding for to be successful.

Q

In the current climate, many companies are having to focus on cost savings to survive.

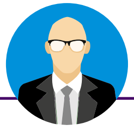
Where should they start when looking to take cost out of an organisation?



A

What’s the best approach for determining what costs can be cut?

 Ed Boulton

 Jon Richards

The most successful cost programmes use a mix of ‘top down’ and ‘bottom up’ thinking and consider a range of options before deciding on the optimum change portfolio, through understanding the benefit – cost to achieve – risk trade off.

— All cost programmes typically start with a drill down into the organisations cost baseline:
  - testing the alignment with strategic priorities
  - using internal and external comparators to bring insights

— ‘Top down’ thinking challenges where to invest resources to achieve business goals whereas ‘bottom up’ (often using zero based approaches) focuses on the level of output needed and how that can best be delivered

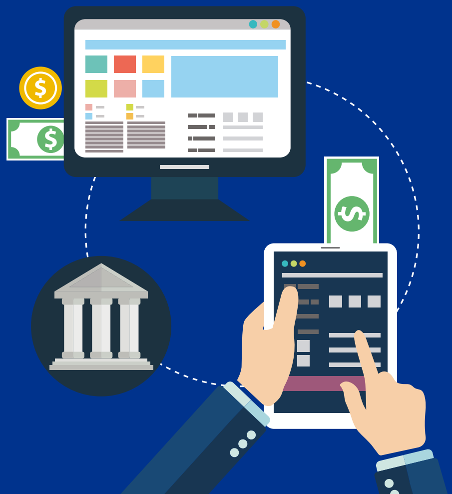
— Developing a range of options through the process helps organisations develop a bolder and more balanced portfolio rather than narrowing down options too early

— Few, if any, cost opportunities come without some level of end state or transition risk, so a rigorous and consistent approach to risk assessment, alongside a clear decision making process is critical to success

Q

In the current climate, many companies are having to focus on cost savings to survive.

Where should they start when looking to take cost out of an organisation?



A

If they take out costs now, will they have to incur them again in the future? How can they avoid that?

[Ed Boulton] [Jon Richards]

Successful organisations set themselves up to sustain cost efficiencies in two ways:

— Firstly in the way that they make well-thought through changes to:
  - the demand level (driven by external and internal customer perspectives)
  - the supply side to how these are delivered be it through (for example) increased automation or alternative sourcing arrangements.

  What they don't do is try to do the same things in the same way with less resource.

— Secondly they make targeted changes to the 'enabling' processes, such as controls, accountabilities and management information so can lock in cost savings.

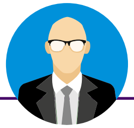
Q

Is it more important to take out costs or optimise costs?

A

To what extent are businesses looking to get more from their money rather than take costs out?


Ed Boulton


Jon Richards

Most cost programmes involve both reducing the overall cost base, looking to drive more output from the same resources and reallocating costs to the highest priority areas. The balance between these will vary by organisation, sector and spend area.

In our experience the most important thing in managing this balance is to ensure absolute transparency and traceability of the options selected and that the reduction and re-allocation decisions are made separately. This latter point avoids local 'misappropriation' of savings - where individual functions re-allocate cost savings to their own priorities – enabling an organisational wide view of re-allocation priorities to maximise impact.

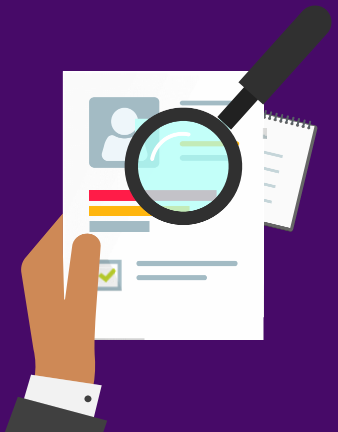
Does this vary by industry/type of organisation/situation?

The short answer is yes, the balance will be different between different sectors and organisations. For example technology organisations which have experienced rapid growth as a result of the pandemic are likely to be more focused on getting more output for the same cost, hence increasing profitability; whilst sectors such as high street retailers will be looking more to reduce costs in line with their reduced revenue levels and re-allocating funds to their digital channels.

Q

To manage costs, businesses need to fully understand the costs they're currently incurring.

How do they gain a clear view of costs?



A

What tools can they use to gain and maintain transparency around costs?

Ed Boulton

Jon Richards

In our experience, organisations can get a good view of costs to drive a cost review by using simplified models of the business. We typically look across four areas:

— Cost

— Organisational

— Supplier spend

— Activity

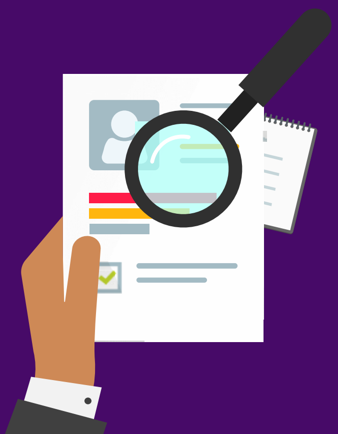
We use advanced analytical and visualisation tools to bring together data from different sources and views to provide new insight on costs.

Maintaining transparency of costs on an ongoing basis and enabling budget owners to more actively manage costs requires investment in the right supporting technology.

Q

To manage costs, businesses need to fully understand the costs they’re currently incurring.

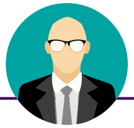
How do they gain a clear view of costs?



A

How can businesses measure the true cost of something? And how do they compare costs?

Ed Boulton



Jon Richards

The key to getting a 'true' cost is understanding input costs and matching those to the outputs of the organisation. This is never as simple as it sounds, particularly where organisations have increased levels of shared infrastructure and services, resulting in input costs and outputs often being mis-aligned.

Picking through the complexities of internal costing is often one of the biggest baseline challenges in a cost exercise, however it is time well spent as it enables a much greater understanding of costs than the organisation typically gets through it’s BAU reporting.

Both internal and external benchmarks provide interesting information to compare costs, but are only truly insightful and actionable if they are sufficiently normalised to bear scrutiny. Benchmark differences should be treated as indicators of somewhere to look rather than an answer in themselves, and are only truly valuable if they drive option generation of what could be done differently to address identified gaps.

Q

How can organisations motivate their teams to engage in the cost agenda?

A

Lesley Coutts

Tolu Ajayi

Motivating employees to engage in the cost agenda is often seen as a challenge and many organisations shy away from it, particularly where the end result may impact peoples roles. However, our experience is that investing time and resource in this is as important as developing the portfolio of options. Being open and transparent at an early stage will reap benefits in the long run

- The first activity to motivate and engage teams is to develop a clear “case for change” which explains the ambition of the transformation, how the cost agenda underpins the future success and strategy of the business, explaining the ‘why’ in a way that will resonate with teams. Developing this is a key step in aligning the leadership team on the agenda, before they cascade to team members. It is critical that they line up behind the ambition from day 0.
- A second activity is to help teams understand what the changes mean for them day to day. Answering these key questions is critical to taking them on the journey. We do this through change impact assessments and involving appropriate team members in building the detailed solutions thus creating ownership, motivation and change agents.

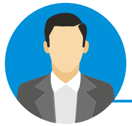
Our experience is that getting the right level of involvement from teams at each stage of the journey is a fine judgement call but the more you are able to involve those with an open mind and a willingness to challenge the better the answer and the greater the ownership of the solutions within the organisation.

Q

One potential area for cost savings/cost optimisation is the use of suppliers.

How can businesses take costs out of their contracts?

A



Matt Rose

The current environment provides a unique opportunity, as well as a compelling need, to review your supplier arrangements.

As your business adapts to new ways of working and servicing clients, so your mix of suppliers and the services they provide needs to adapt to meet these new requirements. This presents an opportunity to review your supply base – changing scope to take cost out, resetting demand, reworking joint processes to drive efficiency and reviewing the mix of suppliers.

For example:

— Pivoting marketing spend toward digital agencies and challenging retainers

— Reviewing facilities service and maintenance schedules to reflect increased remote working

— Renegotiating materials spend to reflect reductions in energy input prices

And it's not just a cost saving opportunity, it's essential that you pro-actively review your supply base to better foresee and mitigate potential supply risks. Now, more than ever, you need to be thinking about resilience.

Q

One potential area for cost savings/cost optimisation is the use of suppliers.

How can businesses take costs out of their contracts?

A

How can they be sure contracts are delivering the best value?

Matt Rose   Paul Desrosiers   Harry Tizard

Typically 3-5% of total supplier spend is lost through overpayments. This ‘commercial leakage’ is recoverable at scale and is a great way to inject cash back into your business and reduce long term supplier costs. The challenge has always been that this leakage is locked behind a complex web of commercial documentation, including detailed contract clauses, POs and invoice backups.

Traditionally this was addressed through supplier audits, where supplier audit experts forensically assessed commercial documentation to identify where things were going wrong. These supplier audits are often fruitful, but they are time consuming and can only cover part of your spend.

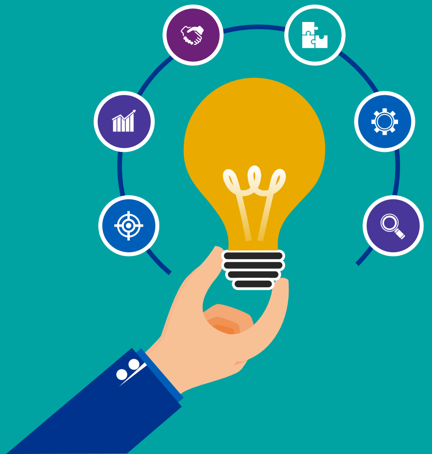
With advances in cloud maturity we are now able to unleash the full potential of technologies like OCR, NLP and other unstructured data techniques in a cost effective way. This enables us to codify the supplier audit checks and execute them cheaply at scale.

We have worked with a number of clients to shape this new way of uncovering leakage and ultimately to build automated measures to prevent the cash from even leaving the door. We call this Cognitive Contract Management.

KPMG

Q

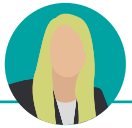
Environmental, Social and Governance (ESG) considerations are rising up the corporate agenda. How can businesses strengthen/maintain their ESG credentials while managing their costs?



A

Are there any benefits to pursuing an ESG agenda in terms of cost or cashflow management?

[Josh Hasdell]



[Alexandra Skeggs]

We encourage clients consider ESG as complementary to, and able to strengthen their other agendas, by considering what additional opportunities can be captured (for example):

i. due to ESG-inspired changes in the market (expectations of consumers and employees, law and regulatory requirements etc);

ii. by utilising a time when change is already required to build a more sustainable business

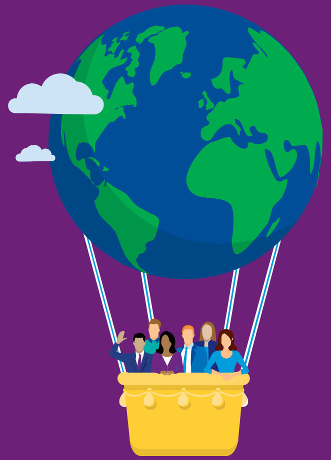
In a number of areas there is a clear link between ESG and cost agenda. For example ESG often champions the principles of minimising waste and extracting the maximum value from existing assets and resources. These align with the ethos of a cost conscious operating culture, creating a collective sense of re-use where possible, thus meeting both the ESG and cost agenda.

Equally, ESG considerations are part of an effective risk management strategy, helping protect from false cost savings. As we work with clients to generate options for cost transformation we are now often including a specific assessment of those options with an ESG lens, to minimise the risk of conflicts between the cost and ESG agendas.

Q

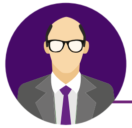
Technology – automation, cloud, AI – is increasingly heralded as a means of delivering operational efficiency.

What is the role of technology in managing costs?



A

How do they make good technology investments?



James Wilson

Organisations are increasingly turning to technology as a way to drive operational efficiency. In order to become more agile and digitally enabled, the right technology needs to be place to support that change in delivery approach. Cloud based solutions (both software and infrastructure), automation and others can drive significant benefits both in terms of productivity and agility.

However, there is a risk that organisations lose sight of the benefits that technology is meant to deliver. Organisations should focus their investments around solving their business issues and invest in technology and solutions that align with this.

Areas to consider when making technology investments should include

— Look for off the shelf, or standard solutions and adapt your processes if possible - keep customisation to a minimum as this drives up cost of implementation and support.

— Develop a ROI / benefits plan around your needs and track taking into account both cost and time invested as much as benefits generated across the whole lifecycle – technology has ongoing costs as well

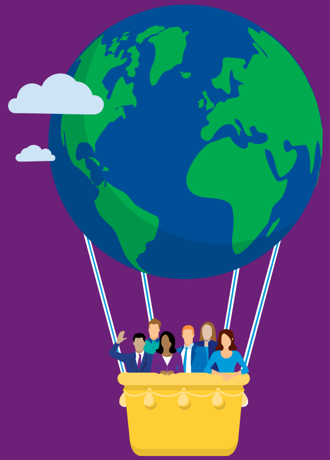
— Include the end user from the start when shaping the features of digital solutions to make sure any investment meets the needs of the business.

— Build incremental implementation of your solution through an MVP approach to prove value early on – if the value doesn't materialise don't be afraid to change approach / solution

Q

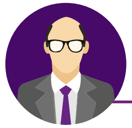
Technology – automation, cloud, AI – is increasingly heralded as a means of delivering operational efficiency.

What is the role of technology in managing costs?



A

What tech should companies invest in to help them manage/reduce costs?



[James Wilson](#)

Technology can provide organisations with a greater level of transparency over their costs than ever before. Insights into process inefficiencies, invoice discrepancies, cost duplication and others are now much more readily available which can then drive a greater focus of cost reduction.

The key is understanding what your cost drivers are and what inefficiencies are present that can be addressed. This should be considered across three lenses:

- Cost out – removal of low value parts of the business (e.g. removal of redundant processes, duplication applications, manual activities, legacy technology etc.)
- Cost optimisation – ensure that value adding areas are operating efficiently (e.g. licence spend, cloud spend, 3rd party contract spend, process mining insights, remove customisation etc.)
- Cost leakage – stop incorrect spend (e.g. mismanaged contracts, invoice overpayment, process loops etc.)

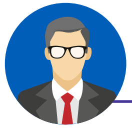
Technology investments to help control costs should resolve / support findings that are identified across these three areas. Example initiatives could include:

- Automation simple processes and tasks, leading to quicker and more integrated processes
- Software Asset Management to control licence spend
- Usage of Artificial Intelligence and Natural Language Processing to identify invoice overspend rapidly and at scale

Q

What role does tax play in improving cash flow and supporting the working capital position?

A



Rakesh Lad

The government has announced a series of Tax measures to support businesses through this uncertainty as a temporary relief, however these tax liabilities will need to be paid back in the future.

The Tax function can play a pivotal role to help their organisations reduce the liabilities or further improve cash flow through tax incentives, reliefs and process improvements.

Businesses should consider whether Tax could help reduce the cost of innovation and capital investments.

- From investments in technology, new or existing products or processes, or finding new markets for growth, the support available from tax reliefs and incentives is often overlooked.
- Innovation tax incentives (e.g. R&D tax credits) and capital allowances were introduced by the Government to help incentivise innovation and investment by reducing the cost of a wide range of expenditure, from staff costs to new machinery and in some cases buildings.

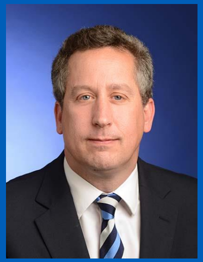
Additionally, VAT is often the third largest throughput after sales and cost of sales, the daily inflows and outflows of VAT can have a significant impact on cash available to the business and financing needs. Likewise, finance processes can be inefficient which lead to a hard cost where VAT is expensed. Simple changes, designed to ensure your business keeps pace with current best practice can have a dramatic impact.

Better management of VAT cash flows, for example, can typically increase working capital by 5%- 20% of VAT throughput.

Contact us

Jon Richards
Director
T: +44 (0)20 7694 3353
E: jon.richards@kpmg.co.uk

Jeremy Kay
Partner
T: +44 (0)20 7694 4540
E: jeremy.kay@kpmg.co.uk



Ed Boulton
Associate Partner
T: +44 (0)20 7311 3100
E: edward.boulton@kpmg.co.uk

Lesley Coutts
Senior Manager
T: +44 (0)20 7694 2638
E: lesley.coutts@kpmg.co.uk