

# BCG

OPPORTUNITIES  
for ACTION

OPERATIONS



■ As the global downturn deepens, companies must find new ways to quickly cut costs and generate much-needed cash without hurting future viability. The key is to take action on a number of fronts in a top-down effort driven by senior management.

■ Companies should first build a series of downturn scenarios and then create a cost reduction target for each scenario based on their current cost structure.

■ Top management should establish SWAT teams of people to focus on specific functions and then set an ambitious cost-cutting target for each team.

■ Finally, companies need to create a prioritized action plan and use a structured approach supported by a project management office to ensure that the plan becomes a disciplined cost-savings program.

## Winning in a Downturn

### Rapid Cash Generation

**T**riage is used in an emergency room or a disaster site when medical resources must be carefully prioritized. To survive today's economic crisis, companies need to triage *cash*: the lifeblood of a business in these challenging times.

As the global downturn deepens, companies in almost all industries have seen a sharp decline in revenues. And as sales slump, costly inventory is piling up. At the same time, many customers are paying more slowly, so the cash crunch is worsening. And there's little relief to be found in the tight capital markets. With limited options at their disposal, companies must find new ways to quickly cut costs and generate much-needed cash without hurting future viability—a tough balancing act.

The good news is that many businesses can cut overall costs by 15 percent or more without undermining their core business strength—all within a matter of weeks instead of months. The key is to take a *rapid cash* approach, the most effective way to generate cash quickly. This is a direct, top-down approach, instead of a bottom-up effort, that engages all levels of the organization. Senior management must set the tone, assign people to cost-cutting teams, and make the hard decisions.

#### First Things First

Every company needs to balance its sources of cash—such as sales revenue and debt—with costs and expenses that consume cash. This is especially critical in the current financial crisis: an imbalance can truly jeopardize near-term viability. That's why it's important to know the level of cost savings your company will need before beginning any cost-cutting program. Given today's uncertainty, we advise companies to develop a series of downturn scenarios ranging from moderate to worst case—with projected revenue decreases of 20 percent, 30 percent, and 50 percent, for instance—considering such factors as declining sales volume, price reductions by competitors, and nonpayment by customers. These scenarios will affect cash inflows to varying degrees. Companies can then compare each scenario with their current

cost structure to define a cost reduction target for each scenario.

In this context, the cost baseline is the total of all costs and expenses from all departments and functions included in the cost reduction effort. The baseline will have a mix of fixed overhead costs (sales, general, and administrative expenses) and variable costs (labor and other direct inputs that will vary with production volume—and your downturn scenarios). This cost baseline is your starting point, a snapshot of all cash outflows at the present time, at your current level of production. Imbalances and excess fat are often readily apparent. By comparing this baseline with the most likely downturn scenario, you'll see how much of a cash shortfall you'll need to correct in order to become or remain profitable. The goal is an escalating series of plans—plan A, plan B, plan C—that will be activated if and when specific trigger points are reached.

This effort must be executed quickly—within two weeks. With a clear picture of the cost baseline and a well-defined target, companies can focus with laser-like clarity and speed on generating the cash they need.

### Triage for Cash

As the global economic crisis worsens, speed is of the essence. To meet the cost reduction target revealed by your chosen downturn scenario, your company must move quickly. To begin, top management should build SWAT teams of people to focus on specific functions (such as sourcing, manufacturing, and distribution) and cost centers (such as IT, real estate, and HR). Set an ambitious cost-cutting target for each team—more than is actually needed for each scenario. This “cushion” will provide a degree of flexibility when final decisions are made. One company established ten core teams, each of which conducted a series of cost-savings workshops with all divisions and cross-divisional functions. In just six weeks, the teams were able to identify savings of more than 20 percent. Among the new ideas was a revamped approach to internal logistics. In the past, divisions had owned their own trucks and forklifts. Under the new system, employees rent from a centralized pool of equipment, so fewer fixed assets are required and utilization rates are higher.

The key to generating cash quickly is to approach the problem from many different directions—leaving no stone unturned and taking fast action on a number of fronts at the same time.

**Rethink current activities.** Many things that consume cash can be cut back or eliminated to increase liquidity. Make sure that your people are focusing only on high-value activities. Stop, put on hold, or minimize anything else, including noncritical IT projects and any low-value tasks. Explore how to cut unnecessary administrative costs and services, temporary workers, and overtime expenses. Look at your customer accounts and product portfolio. Where is the cost of sales unacceptably high relative to the revenue generated? Which activities eat up the most cash but deliver the least return? Consider shelving these for now and focus on higher-margin activities. The key is to reduce cash consumption without hurting the areas of business that generate the most income.

In an effort to overhaul its internal reporting system, one auto supplier organized a report exposition. The company hung all its reports in a conference room and asked managers to mark the ones they really read. As it turned out, most of the reports were either redundant or simply “nice to have” rather than mission critical. After the expo, the company cut the number of reports it published from more than 40 to just 5 and saved \$1.5 million per year.

**Revisit strategic initiatives and sacred cows.** The basis for planned investments, business extensions, and other strategic initiatives may have disappeared with the downturn. This may not be the best time to move forward with that new product with high ramp-up costs or that costly push into an emerging market. Where appropriate, cut back—you may have better uses for your cash. One financial-services company halted a partnership agreement set up only three months earlier, forgoing future returns and long-term growth to release much-needed cash in the short term. Now is also a good time to question long-held assumptions and sacred cows. For instance, if a decision had been made to outsource parts manufacturing, bringing it back in-house may make more sense now in order to keep people and machines more productive.

**Pare back the R&D portfolio.** Most innovation portfolios are filled with projects that will never come to fruition, but they continue to consume valuable resources. In most portfolios, one-third of all ideas are clear winners—the sooner they get to market, the more value they'll create. Another third are question marks—projects that need a bit more time before a decision can be made whether or not to pull the plug. The final third are the “walking dead”—projects that everyone knows

are losers. Quickly kill the last third and sort through the question marks, keeping only those few projects with high potential.

**Go bargain hunting.** Having cash when credit is tight allows you to take advantage of the cost-savings opportunities that a downturn can present. Many things go on sale when times are tough—including your competitors' assets and even your competitors themselves. A downturn can be a cost-effective time to acquire new talent, customers, and intellectual property. Find these bargains.

The prices of many commodities and raw materials are down sharply, too. Review your supplier contracts and renegotiate more favorable terms where possible. Be careful not to jeopardize your supplier base, however, since putting valuable vendors out of business might be an unintended consequence. Instead, focus on your key suppliers and consider how much they're being hurt by the crisis as you review your options and push for cost savings. Also, keep in mind the tradeoffs that discounts often involve. If a 10 percent discount requires a two-year contract, the loss of flexibility may not be worth it.

**Optimize your assets.** Examine your manufacturing network. Are your production facilities efficient enough to be profitable with a lower utilization rate in the current downturn? Have you revisited product portfolios and volumes, capacity, and logistics at each site? How asset intensive are your operations, and how flexible? Mergers and acquisitions leave many companies with redundant assets, and outdated plants can be costly to operate. Which assets—and associated costs—could you do without?

Reviewing the current asset base often reveals opportunities to consolidate, make do, and repurpose, so that planned capital outlays can be deferred. One company asked every current and planned asset owner to cash-justify all facilities, rebalance tradeoffs between speed and cost, and work together to find ways to co-manufacture. As a result, the company was able to cut the year's cash outlays in half without sacrificing long-term viability.

**Purge waste and inefficiency from operations.** Flabby, inefficient operations are a major source of untapped cash. Where can you streamline operations, cut costs, release cash, and add value? How can you simplify work flows, products, projects, and assets? By fundamentally rethinking end-to-end processes across the value chain, companies can reduce buffer stock, decrease replenish-

ment times from suppliers, and optimize cash collection and payment cycles—all critical in a downturn. One company shortened the payment cycles of its second- and third-tier customers to speed up cash flow and give its troubled top-tier customers more lenient payment terms. Another began using a centralized, computerized virtual-inventory system that shows what parts are available where. The system improved the balance of supply and demand, and led to a 30 percent reduction of parts inventory.

You should use the downturn as an opportunity to shed nonstrategic assets and focus on strengthening your core business. Optimize processes that directly affect revenue generation and cost to serve, and find ways to get closer to customers and enhance their satisfaction.

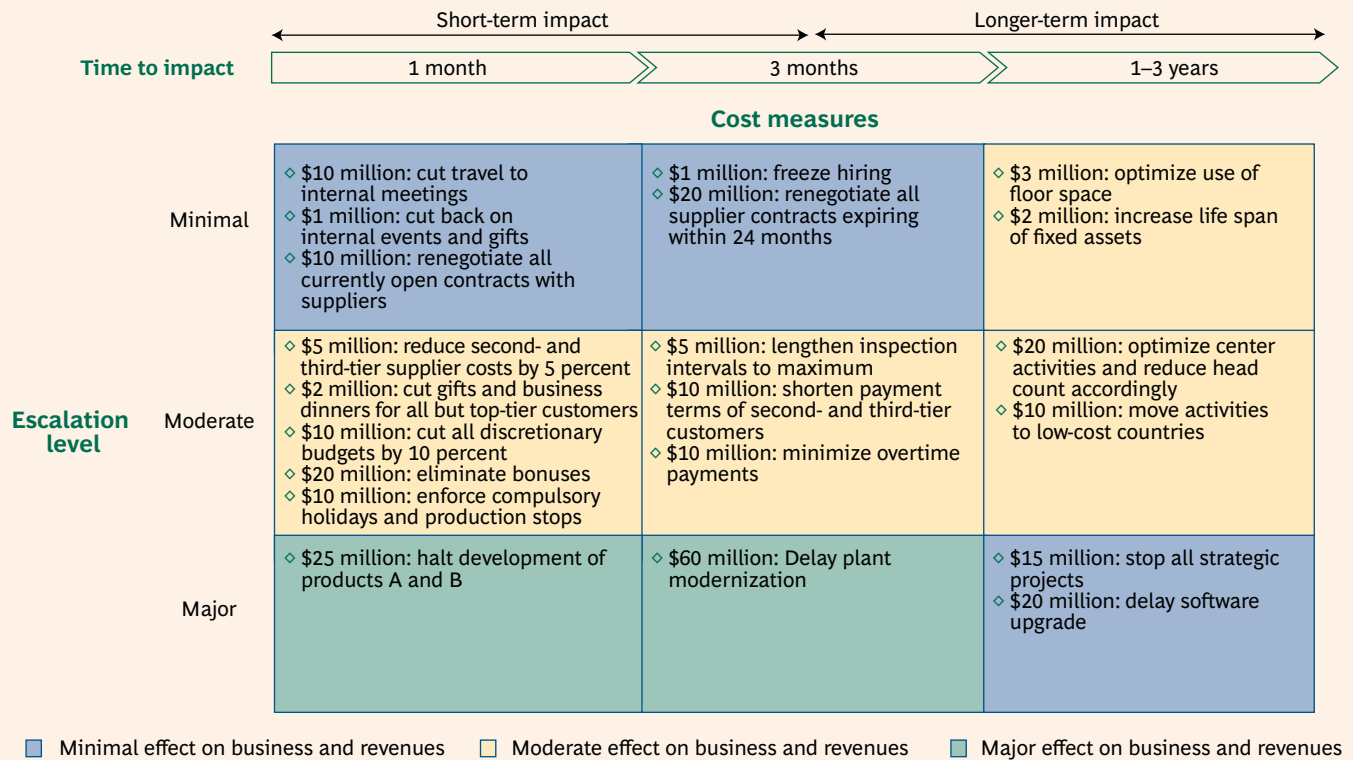
### Create a Prioritized Action Plan

After setting your cost-cutting targets and exploring money-saving ideas, the next step is to develop a prioritized triage plan—a mix of short- and long-term actions with varying degrees of risk and pain. Determine the time to impact for each option, ranging from less than a month to a year or longer. Plot each action on a triage matrix along an escalation continuum, depending on its severity. (See the exhibit “Plot Each Cost-Saving Measure on a Triage Matrix.”) For instance, actions might escalate from cutting discretionary budgets, which is a less painful effort, to cutting back on key strategic initiatives, which could have long-term implications for the business. Similarly, cash release actions might escalate from eliminating capital expenditures to sharply reducing supplier payments if conditions become more severe.

Create a set of trigger points—when sales volume drops to a certain level, for instance, or when customer defaults rise above a target percentage—for escalating to the next action level.

Actions that generate the most cash the most quickly should become top priorities since time to impact will be an important factor. Create priorities based on the time, effort, potential downside, and relative benefits of each action. With this approach, companies can often eliminate fat without cutting muscle. Then use a structured approach supported by a project management office (PMO) to ensure that the action plan becomes a disciplined cost-savings program. The PMO will initiate, push, and monitor all measures; provide support; track results; and give progress reports to the executive board.

Plot Each Cost-Saving Measure on a Triage Matrix



Source: BCG case experience.  
 Note: All figures are rounded.

Because cost cutting in one area of a company can add costs to another, having an enterprisewide view is critical. So that these tradeoffs can be evaluated—and errors related to double-counting of savings avoided—developing an action plan must be a cross-functional exercise with senior leadership. It’s critical that the leadership team is aligned on the plan. In times of crisis, there is little time for compromise and discussion. Leaders should act as role models, making tough decisions and cutting visible status symbols early on to show that they are serious about the effort and willing to make sacrifices. Their active participation signals the urgency of the situation.

cash they need to survive today’s crisis—and thrive in the future.

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In order to weather the current economic storm, companies must find new ways to reduce costs and rapidly generate much-needed cash. However, striking the right balance between cutting fat and preserving muscle is a significant challenge, especially as the cuts deepen. An intelligent, focused effort led by top management can deliver results in weeks instead of months, without damaging the core business. With this triage approach, companies can move quickly to generate the

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