RAPID COST REDUCTION

HOW TO DRIVE COST EFFICIENCY INTO BUSINESS OPERATIONS

SEPTEMBER 2022

8 | EIGHT INTERNATIONAL

EIGHT ADVISORY

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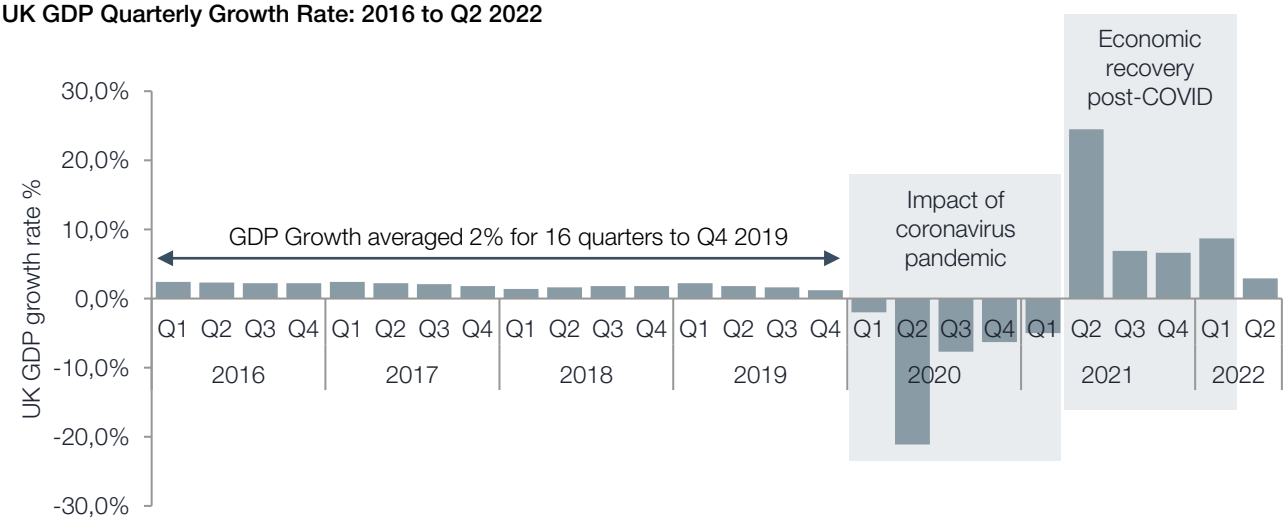
ECONOMIC BACKGROUND & OUTLOOK

The recent UK GDP growth rates are marked by the coronavirus pandemic. In Q2 2020, amidst nationwide lockdowns, the economy shrank by 21% in three months. As the country emerged from restrictions, pent up demand was the driver for a resurgence in GDP in 2021, and Q2 saw a growth rate of 25%, with Q3 and Q4 also offering 7% growth in both quarters.

UK GDP Quarterly Growth Rate: 2016 to Q2 2022

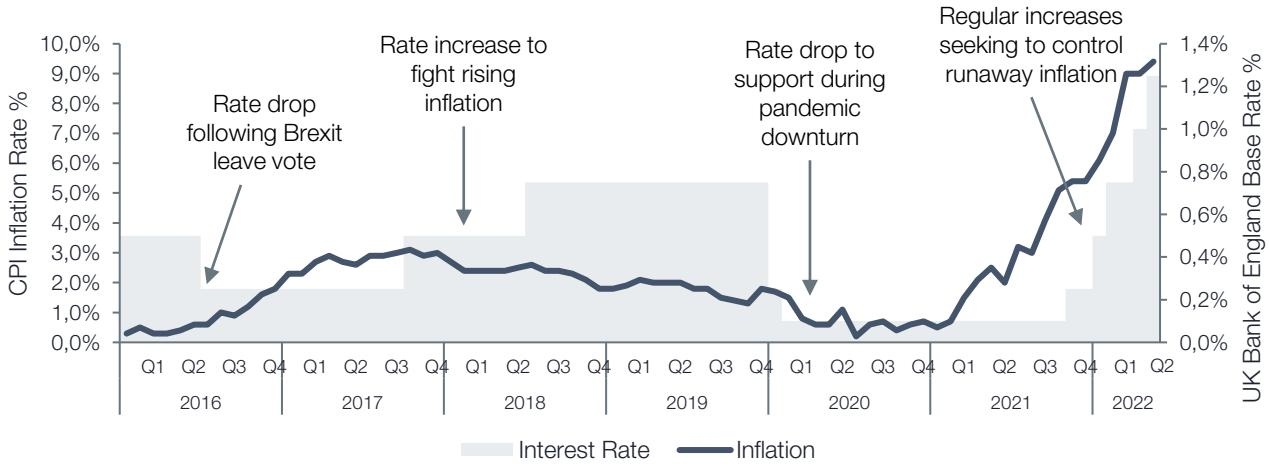


While Q1 2022 remained strong, with growth of 9% in the three month period, Q2 was already starting to look different. In the three months to 30 June 2022, growth had slowed to 3%. However, it should be noted that June 2022 was a month of decline, with GDP falling by 0.6%.

UK Inflation and Interest Rates: 2016 to Q2 2022

The post-pandemic economic reboot has been varied across the globe. Western countries have largely emerged from the pandemic, and their recovered demand is not being met by supply from Asia, particularly China where city-wide lockdowns are still enforced. This, combined with soaring energy prices following conflict in Ukraine, has driven inflation to new heights.

Central banks have responded by increasing interest rates from their historically record lows, and are commentating that rates will likely continue to rise as it seeks to control a runaway inflation rate.



Source: Data sources include the Office of National Statistics and Bank of England, extracted on 31 August 2022

RAPID COST REDUCTION: WHEN?

The economic climate places intense pressure on businesses, who will be facing forces from all fronts:

1. Rising interest rates increase the cost of capital while reducing the disposable income of indebted customers

2. Customers become price sensitive, placing revenue pressure both on volume and value

3. Cost pressure is felt across the business, as input costs, such as raw materials, utilities and wage inflation, all drive overheads increases

Businesses are therefore facing downward pressures on revenues and increasing costs, which will squeeze their margins. Longer term levers for firming up balance sheets (e.g. recapitalisation) or driving profitability (e.g. price increases) cannot deliver fast enough, so a rapid cost reduction programme becomes an effective and controllable way to provide profitability improvement quickly, strengthening the balance sheet and optimising the P&L.

We believe these three interlinking influences on the macro-economic stage will be reason enough for businesses to tackle costs, though we recognise that not all businesses suffer equally during downturns – for some there are opportunities as customer preferences shift.

While the rapid onset of adverse macroeconomic conditions are one obvious indicator, we outline below other catalysts for rapid cost reduction:

Loss of key customer
A large step-down in revenue may require the business to rapidly reduce operational and support costs

Product lifecycle acceleration
The accelerated obsolescence of products or services may require that overall cost structures are reconfigured to support profitability of remaining product groups and re-investment in R&D and growth

Raising new capital
Financing plans or investment plans often include requirements for cost optimisation to achieve required performance hurdles

Footprint or product rationalisation
A consolidation of sales outlets, geographies and product groups reduces complexity and requires that overhead costs to be reduced accordingly

Unrealised synergies
A recent integration may have not delivered the expected or required synergies, and a rapid cost programme is required to recapture lost deal value

Market disruption (e.g. new entrant)
Changes in the marketplace result in price pressures where costs must be reduced to combat price competition

RAPID COST REDUCTION: WHY?

For businesses seeking to overcome profitability challenges, there are a number of options available. For example, the cash injection of a divestment could simplify the business and improve the balance sheet. A longer term holistic transformation programme could unlock value through both top-line and continuous operational performance improvements. However, these options are medium to long-term in pay-off and the luxury of time is not available to a business in tough market conditions.

The key benefit to a rapid cost reduction programme is its tactical nature, and subsequent pace of implementation. Businesses are able to mobilise a programme within a matter of days, develop a comprehensive set of initiatives in weeks, and implement in a month or two – often with an initial phase of delivery complete within three to six months. Depending on the situation, we would expect to see at least 15-25% cost improvement on overheads and operating costs in this timeframe (at the end point, i.e. run rate).

The additional free cash flow released by a successful rapid cost reduction programme can be used to fund other value-creating initiatives, for example divestment or acquisition, digital transformation or supply chain optimisation.

In our experience there are four key benefits to a rapid cost reduction programme:

Pace

- The programme can be delivered very quickly, with benefits being realised within weeks
- Mobilising the programme can be done in a matter of days with limited up front costs
- Once identified, the phasing of delivery of initiatives is controllable (serial vs parallel)

Control

- The programme is not reliant on customer behaviours or market conditions
- The scope is clearly defined – the business can ring-fence areas not subject to the programme
- The timing of the programme can be determined to fit around seasonal and peak trading
- The narrative of the programme is controllable and can be defined from the start

Predictability

- The linkage between inputs and outputs is clear – it is possible to model with certainty how proposed changes in operations will impact costs
- With the right tools, financial benefits can be tracked through the P&L
- There are well-established toolsets and methodologies to ensure successful delivery

Longevity

- Removed costs have an immediate and lasting profitability impact on the business financials
- Well managed-programmes embed a mindset change which drives a cost / value focus throughout the organisation
- The cash release from the programme can be used to drive investment and growth

DELIVERING A RAPID APPROACH: DO'S

Cost reductions demand urgency. Leaders who act with a sense of urgency throughout the programme will embed a productivity and cost focus within their organisation which endures long after the programme has ended

The event which provides the catalyst for a cost reduction programme is the "burning platform" which drives urgency within the business. The programme also offers the opportunity for the business to redefine its ways of working, its focus on profitability and how its teams interact with each other. The platform also offers an opportunity for the business to challenge the norms of the business – fostering a "no sacred-cows" mind-set ensures that the business leaves no stone unturned.

In order to mobilise any change programme, leaders must be willing and able to follow the following four steps:

The challenge
Shared understanding and appreciation of the "burning platform"

The cost
A desire to change, and an acceptance of the personal sacrifice

The objective
A clear articulation and clarity over the vision of the future beyond the programme

The plan
Practical steps which provide comfort and assurances on how to get from A to B

Leaders cannot deliver cost reduction programmes alone, so must ensure that their teams are personally committed to its delivery and success. As this is understood and appreciated, teams work in a networked way to identify and quantify cost saving initiatives, and then detail the practical steps to implement savings. Teams must work across networks as different skillsets are crucial to success.

As we have detailed in this document, one of the key benefits of cost reduction programmes is pace. Rapid cost reduction programmes can be mobilised quickly, and can drive financial benefits within weeks. Below we outline an extract of an indicative timeline for mobilising and delivering a rapid cost reduction programme. Phase 1 could be a targeted 4-6 week programme, with implementation duration being informed during this phase (though typically lasts 2-3 months).

Phase 1: Design | **Phase 2:** Implement

	Mobilise	High Level Design	Detailed Design	Plan & Finalise	Implement
Key activities	• Collate & build financial baseline • Review org. structures • Benchmarking comparisons • Agree scope • Align timescales and targets • Mobilise teams	• Financial reviews with department leads and Finance Business Partners • Identify "quick wins" • Identify opportunity areas • Refine scope and objectives	• Detailed analysis of cost structure • Quantify and validate opportunities • Develop future model and org. structures • Engage 3rd parties re outsourcing, automation etc.	• Develop practical delivery plan • Agree linkages between teams • Confirm one-off costs • Confirm savings & reforecast budget • Deliver "quick wins"	• Mobilise delivery • Commence meeting cadence and governance • Initiative capture and tracking of benefits • Change management and Comms

DELIVERING A RAPID APPROACH: DON'TS

Cost reduction programmes are emotive and require personal sacrifice throughout the business – if poorly implemented, key employees may opt to leave or disengage

A cost reduction programme often has negative connotations – for example, a business conducting the programme in response to adverse market conditions doesn't have the same PR capital as a growing business during boom times. However, when framed as an entrepreneurial enterprise seeking to reinvent itself and continue to thrive in a changing world, reducing cost is seen as an opportunity, not a problem.

However, personal sacrifice is a material part of a cost reduction programme and should never be underestimated. All people, both leaders and employees, may have become comfortable with things as they are. They may like the suppliers they work with, the teams they interact with and the "perks of the job", which may not longer be affordable.

When tackling cost, we frame initiatives as being captured in priority as:

1

Legacy
The programme has highlighted that there are costs which simply do not add value, and can be removed

2

Prioritise
There are costs which add value, but the business can no longer accommodate them, and they can be removed

3

Optimise
There are costs which add value, but in their current form are too expensive – they must be done differently if they are to remain

These three steps ensure that the business avoids some of the key pitfalls to cost reduction programmes. Costs are not retained for emotive reasons, and each cost is justified as adding value to the business. People must qualify with honesty, in three stages, why any given cost should remain in the business – and if they can there is good reason for it to remain.

Below we outline some of the key areas where cost reduction programmes do not realise value in the short or long term:

Leaders do not live the changes implemented
People lose trust in the programme if leaders actions are not aligned to their words

Cost levers are not understood in detail
The business is unable to connect changes made to financial and service impact

Savings identified are eroded in delivery
Teams remove cost savings during implementation when reality sinks in

Programme is seen as a one-off exercise
Changes are not embedded into behaviours and costs creep back into the P&L

Teams operate in siloes
Unchecked inter-dependencies between functions create implementation and operational risks

Lack of visibility of financial impact
Cost savings which are not seen flowing through the P&Ls result in a lack of accountability

OUR KEY TAKEAWAYS

The economic climate is creating a challenging environment for businesses. Those which focus on cost control now will build headroom into their P&L, and will be in better shape to navigate the months and years ahead

The economic climate is likely to worsen before it improves. A winter which will likely be marked by the cost of living crisis will place pressures on businesses – especially those which rely on seasonal peak trading at Christmas.

While the benefit of rapid cost reduction programmes is their tactical nature and speed of delivery, delivering these programmes in the midst of a downturn is more challenging. Those businesses which get ahead of the curve and implement a cost-focused culture now will be better prepared for future volatility in their markets. Indeed, those who capture cost savings earlier will also having the benefit of the reduced spend for longer, helping to create a rainy day fund on the balance sheet.

For those businesses seeking to undertake a cost reduction programme, or wishing to strengthen their financial position for the future, we have the following key takeaways:

Leaders' actions speak louder than words

Personal sacrifice must be witnessed and real; symbolic wins are highly impactful at reinforcing the case for change and demonstrating that nothing is off the table clarifies the reality of the situation

Build momentum quickly and maintain focus and pace

The initial urgency of the programme, often arising from a particular event, helps to mobilise quickly – this pace must endure through to implementation

Be aggressive and add-back if necessary

Be hard on all and every cost, and take out more than you think you need – it is easier to add back items than it is to remove costs without a "burning platform"

Communicate clearly about the objectives

Take your people with you, be honest about the need for change and be as open as you can be. Build and maintain trust throughout

HOW WE CAN HELP

Our teams have deep experience in transformation programmes, including cost reduction, performance improvement and turnaround. We also have experience in M&A activity within a distressed environment which often complements traditional cost reduction activity.

When supporting clients on cost reduction programmes, we leverage the following to identify initiatives and mitigate spend:

- Activity Reduction
- Service Level Change
- Supplier Renegotiation
- Organisational Design
- Digital Transformation & Automation
- Insource, Outsource or Offshore

Should you have any challenges regarding cost reduction, turnaround or performance improvement. Our teams would be keen to work with you on your desired solution. This can also include CFO advisory which would encompass finance function effectiveness and working capital optimisation.

EIGHT INTERNATIONAL

Within Eight International, a global advisory organisation Eight Advisory is a co-founder of, we have a pool of professionals who can support on a host of restructuring activity. Within the UK, Eight International has two member firms: Eight Advisory and FRP. These two firms work side-by-side on broader cost reduction and restructuring programmes to ensure clients receive a full complement of services for their situation.

EIGHT ADVISORY

Eight Advisory is an international transactions advisory firm, specialising in Transactions (FDD, ODD, ITDD, Integration & Carve-out) Restructuring, Transformation and Financial Engineering.

The business is home to 650 professionals across six European countries.

FRP

FPR is a UK based business advisory firm, specialising in Corporate Restructuring (inc. Insolvency), Corporate Finance, Forensic Accounting, Pensions Advisory and Debt Advisory

The business is home to 540 professionals across 26 offices within the UK.

Our Eight Advisory and FRP professionals have experience of working as one combined team under the Eight International brand to fulfil the requirements of our clients seamlessly.

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