Executive
Perspectives

The CEO’s Dilemma

Building Resilience Through Competitive Cost Position

November 2022

Introduction to this document

COVID-19, followed by the war in Ukraine, has brought general changes in customer demand (from services to products, for example), commodity price growth, inconsistent supply due to supply chain distress, and the highest inflation since the 1970s crisis.

It is therefore imperative for businesses to optimize their cost position to stay afloat or create competitive advantage.

The best organizations know how to turn uncertainty into opportunity. This document focuses on how organizations can build a playbook that drives cost reduction through operational and organizational lenses.

In this BCG Executive Perspectives edition, we address how to respond to uncertainty and build resilience through competitive cost advantage

Executive Summary | Building resilience through competitive cost position

The time to act is now

Recent global disruptions have brought **general uncertainty**, testing companies' ability to handle labor shortages, high inflation, eroding demand, broken supply chains, and surging commodity prices.

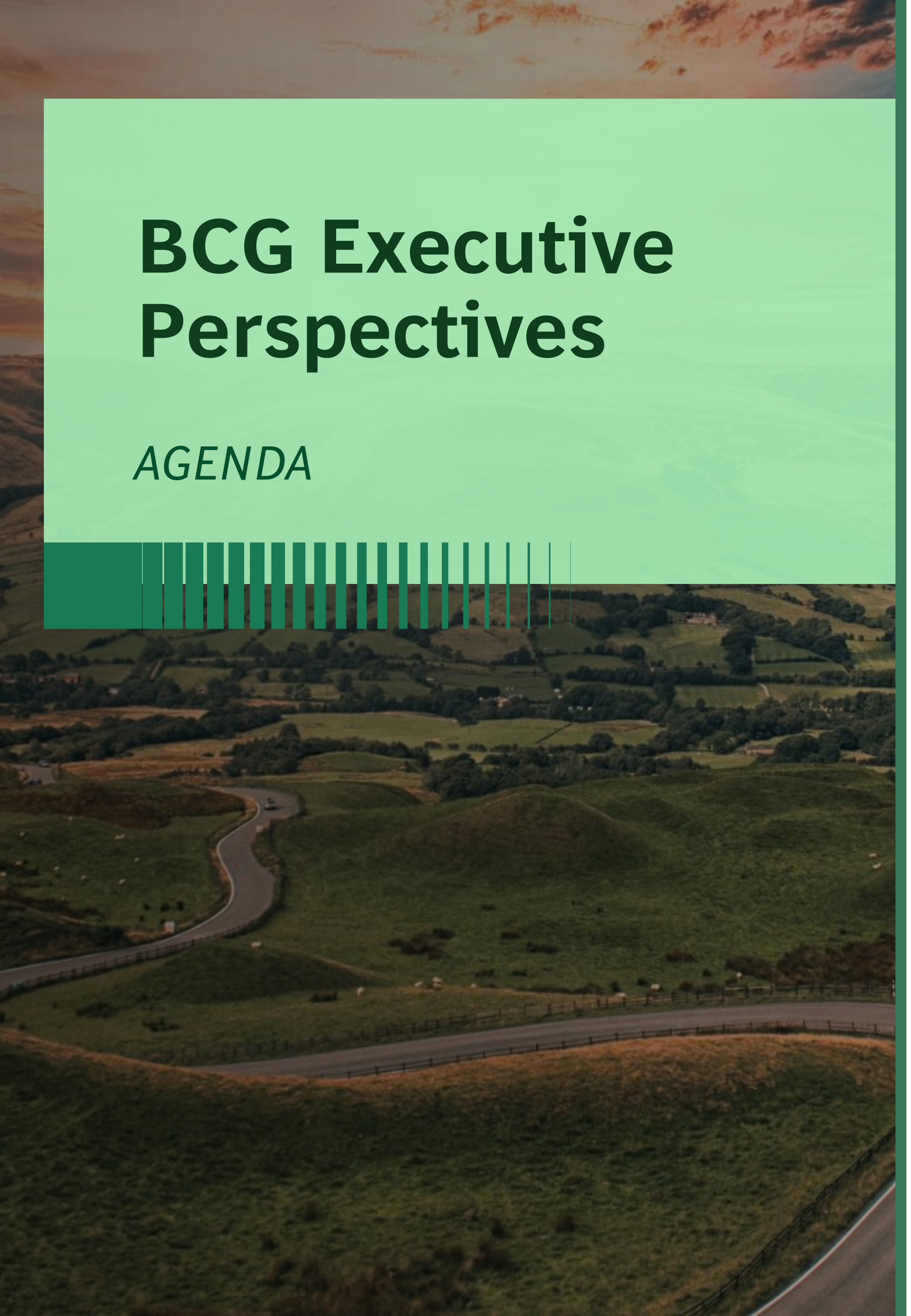
Our global economy makes **instability contagious across borders**, so adaptability is vital for any company, regardless of financial position and industry condition.

Our research shows "winners" must **programmatically reduce cost to preserve margin/flexibility** while investing freed funds to transform, build capabilities, and develop more agile teams. **Reducing costs now frees resources and reorients companies** for any uncertain future, creating opportunities from instability.

Options to achieve and sustain value

By understanding their strategic starting point and objectives through **rapid assessments**, organizations can diagnose inefficiencies and gauge savings potential. These evaluations guide organizations to levers for achieving a competitively advantaged cost position. While companies may employ different sets of levers, our research suggests they are **typically combined in one of four common pathways:**

1. **Organizational streamlining**: Simplifying structure and reducing overhead cost.
2. **Direct/indirect materials optimization**: Reducing costs and cost variance through improved procurement.
3. **Operating model and process redesign**: Holistically optimizing work, processes, and organization.
4. **Full strategic operations transformation**: Processing end-to-end value chain looking at inefficiencies in each step of the process.



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AGENDA

- **A view of the world**
- The time to act is now
- Options to achieve and sustain value

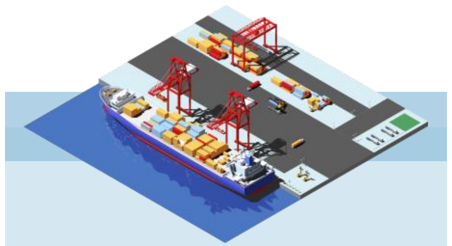
Inflation and volatility are becoming the "new reality" across the globe

Drop in demand and general uncertainty

-25 pp. (from 83% to 58%) drop in consumer sentiment index[1]

+8.6% estimated to be global inflation in 2022[2]

Layoffs and hiring freezes are being announced[3]



Supply chain distress

111 days (+34% y/y) new freight time to US from China

+25% rise in ocean freight price index

Volatility in global markets

~2 times higher S&P 500 volatility than in 2021

~15-35% drop in major global stock market indexes including US, Germany, and China

Up to 40% commodity price growth (mostly energy, metals, and agrifoods)

Central banks fight with consequences

Investors expect central banks to raise global monetary-policy rates to almost **4% through 2023**[4]

Nearly 4 dozen countries (e.g., US, UK, Saudi Arabia, India) have **raised rates ranging from 0.5% to 4%** in the last 6 months[5]

Varying government support for COVID-19

Removal of foreclosure and eviction moratoriums, rental assistance, and stimulus payments in the US

New **wave of government lockdowns** imposed in China affecting millions, including labor markets

Despite **increasing infections** in Europe, major central banks withdrawing stimulus packages

1. From 05/2021 to 06/2022 2. Euromonitor International; 3. Tesla, Netflix, Redfin, Meta, Twitter, Apple; 4. World Bank press release; 5. *New York Times*
Source: Federal Reserve Economic Data, US Bureau of Labor Statistics, World Bank, press search, BCG analysis

Global macro update | Economic snapshot for October

1 Global growth outlook

GDP forecasts[1] (Real GDP YoY)

	2021A	2022E	2023E	2024E
US	5.9%	1.7%	0.4%	1.4%
Eurozone	5.3%	3.0%	-0.1%	1.5%
Global	6.0%	2.9%	2.3%	2.9%

2 Commodity prices and inflation

Commodity prices[2]

	Jul '22	Aug '22	Sep '22	Change[10]
Brent oil	98.6	89.6	79.5	-11.2%
Natural gas				
US	8.2	9.1	6.8	-25.9%
Eurozone	194.7	228.9	165.0	–27.9%

Consumer price inflation (YoY) [3]

	Jul '22	Aug '22	Sep '22	Change[10]
US	8.5%	8.3%	8.2%	-0.1ppts
Eurozone	8.9%	9.1%	9.9%	+0.8ppts

3 Financial markets

Equity market performance (YTD change)[7]

	Jul '22	Aug '22	Sep '22
S&P 500	-13.3%	-17.0%	-24.8%
Eurostoxx 50	-13.7%	-18.2%	-22.8%

Corporate spreads (High Yield)[8]

	Jul '22	Aug '22	Sep '22	Change[10]
US	4.69%	4.84%	5.52%	+68bps
Eurozone	5.90%	5.60%	6.31%	+71bps

4 Monetary policy

Monetary policy rates[6]

	Jul '22	Aug '22	Sep '22	Change[10]
US	2.5%	2.5%	3.25%	+75bps
Eurozone	0.5%	0.5%	1.25%	+75bps

5 Labor market

Job openings rate[4]

	Q1 '22	Q2 '22	Q3 '22	Change[10]
US	7.3%	6.8%	6.5%	-0.3ppts
Eurozone	3.1%	3.2%	-	+0.1ppts

Unemployment rate[5]

	Jul '22	Aug '22	Sep '22	Change[10]
US	3.5%	3.7%	3.5%	-0.2ppts
Germany	3.0%	3.0%	-	0ppts
France	7.4%	7.3%	-	-0.1ppts

6 Manufacturing

PMI manufacturing (<50 = contraction)[9]

	Jul '22	Aug '22	Sep '22	Change[10]
US	52.8	52.8	50.9	-3.6%
Eurozone	49.8	49.6	48.4	-2.4%

1. Bloomberg, data as of 11/01/2022. 2. Data presented as end of month figures. Brent oil in $/bbl; US Natural gas (Henry Hub) in $/MMbtu; Dutch Natural gas (TTF front month future) in EUR/MWh. 3. CPI monthly seasonally adjusted data from Bureau of Labor Statistics; HICP monthly data for Eurozone from Eurostat. 4. Seasonally adjusted rates; Bureau of Labor Statistics for US; Job vacancy rate from Eurostat for Eurozone. 5. Bureau of Labor Statistics for US; Eurostat for Eurozone. 6. Federal Reserve for US; ECB for Eurozone (main refinancing rate). 7. Bloomberg. 8. Bloomberg US Corporate High Yield Average OAS; Bloomberg Pan-European High Yield Average OAS 9. ISM manufacturing PMI for US; S&P Global Eurozone Manufacturing PMI from Markit for Eurozone. 10. Change Sep vs Aug 11. Change Q1 '22 vs Q2 '22. Note: All displayed numbers are based on end of month figures, and changes represent incremental changes vs. previous months.

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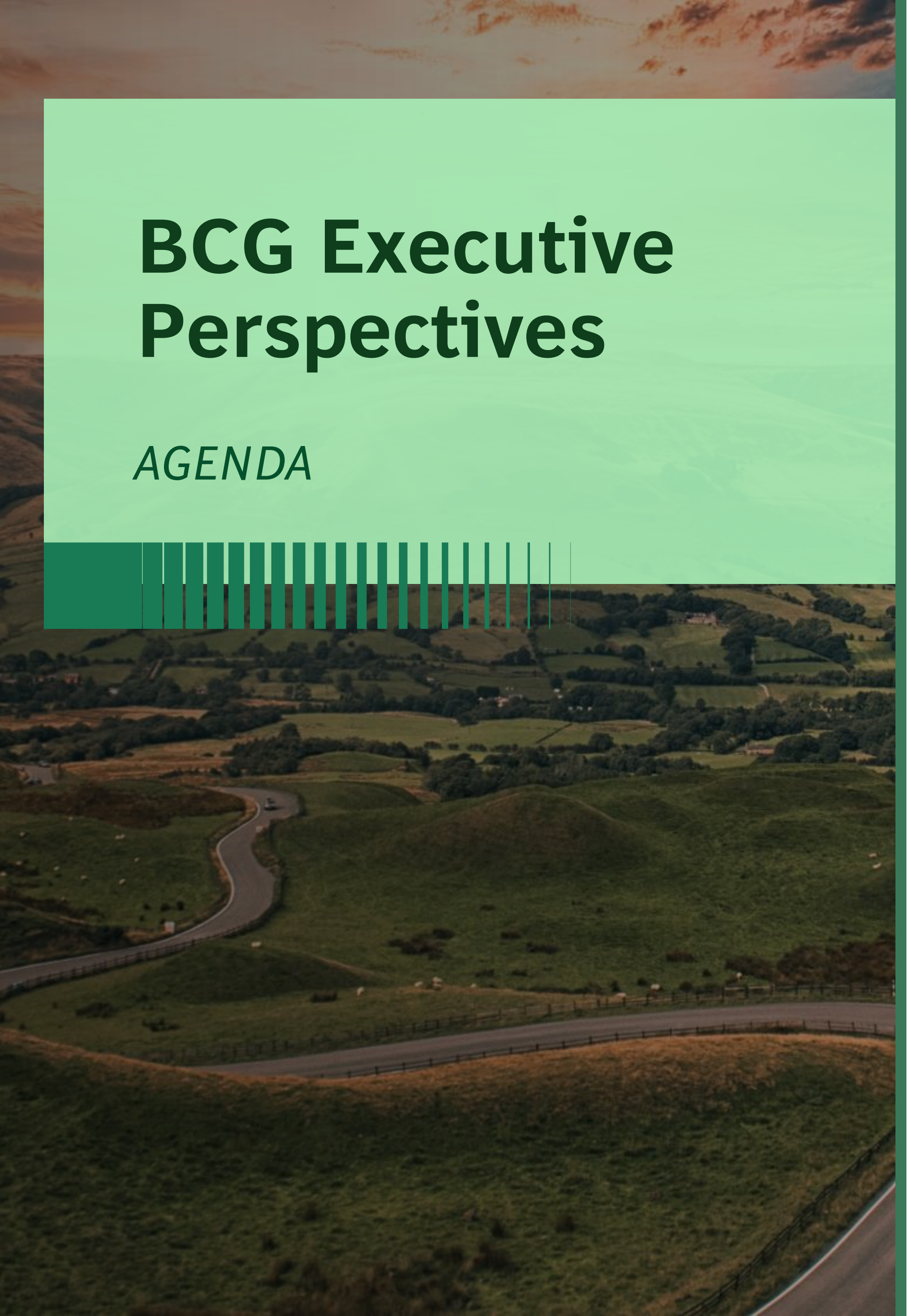

- A view of the world
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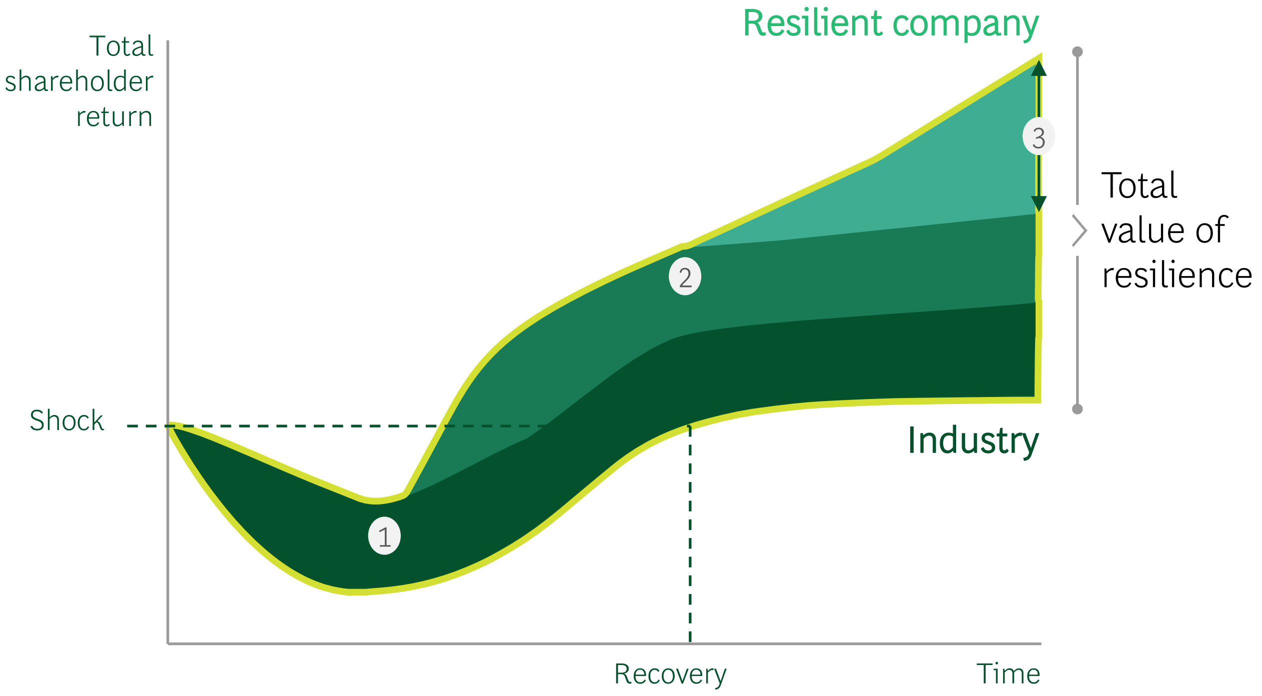
The time to act is now | Companies that build resilience rapidly in changing environments have a much higher chance of success

Developing resilience is a key way for companies to create significant long-term value by increasing preparedness to hedge against external shocks and disruptions



Building resilience creates competitive advantages and allows companies to rise above their peers:

1. Rapid execution of no-regret actions to absorb the shock
2. Adapt to new circumstances and ensure a high-speed recovery
3. Reimagine their business to the new circumstances in the 12 months following the shock

Transformations improved performance[1] by…

+25pp	-20pp
For top quartile of resilience built	*For bottom quartile of resilience built*

1. Performance relative to industry in response to future crises, i.e., successful resilient transformations enhance company performance by 25%; Source: Press; BCG Henderson analysis

Cost pressure is increasing globally, exacerbated by an unprecedented labor market disruption

Evolving skill needs leave talent shortages in key areas

1B Jobs reconfigured in the next 10 years

<5y Half-life of skills

90% Orgs expected to be affected by digital skill shortages by 2025

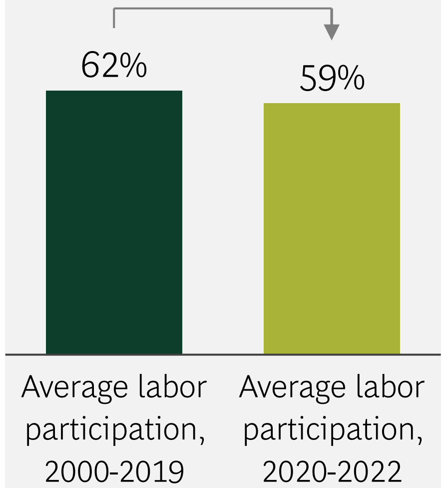
Existing employees are looking for new opportunities…

55%

Of knowledge workers open to considering other positions in the next year with 20% actively looking for a new role next year

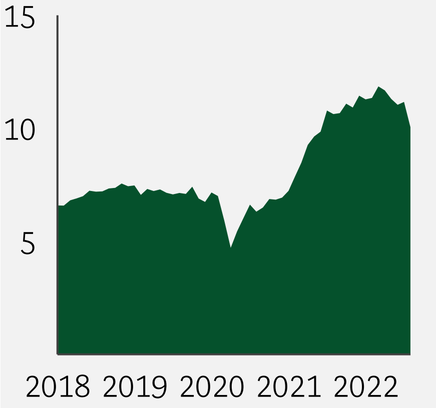
…and some have left the workforce altogether

Global workforce participation is 3pp below the pre-pandemic average



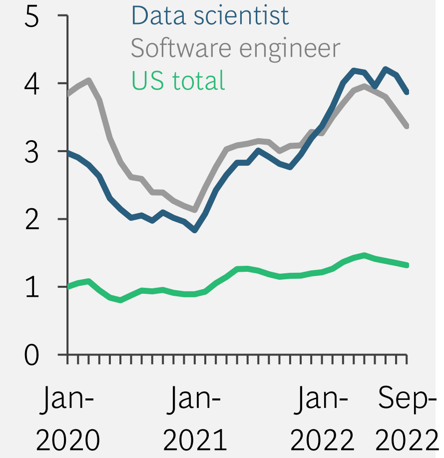
… culminating in labor bottlenecks as demand outpaces supply, recruiting struggles

Monthly US job openings (millions) as of August 2022



Talent shortage is especially pronounced in digital roles

Demand intensity index (# of job postings/talent supply)

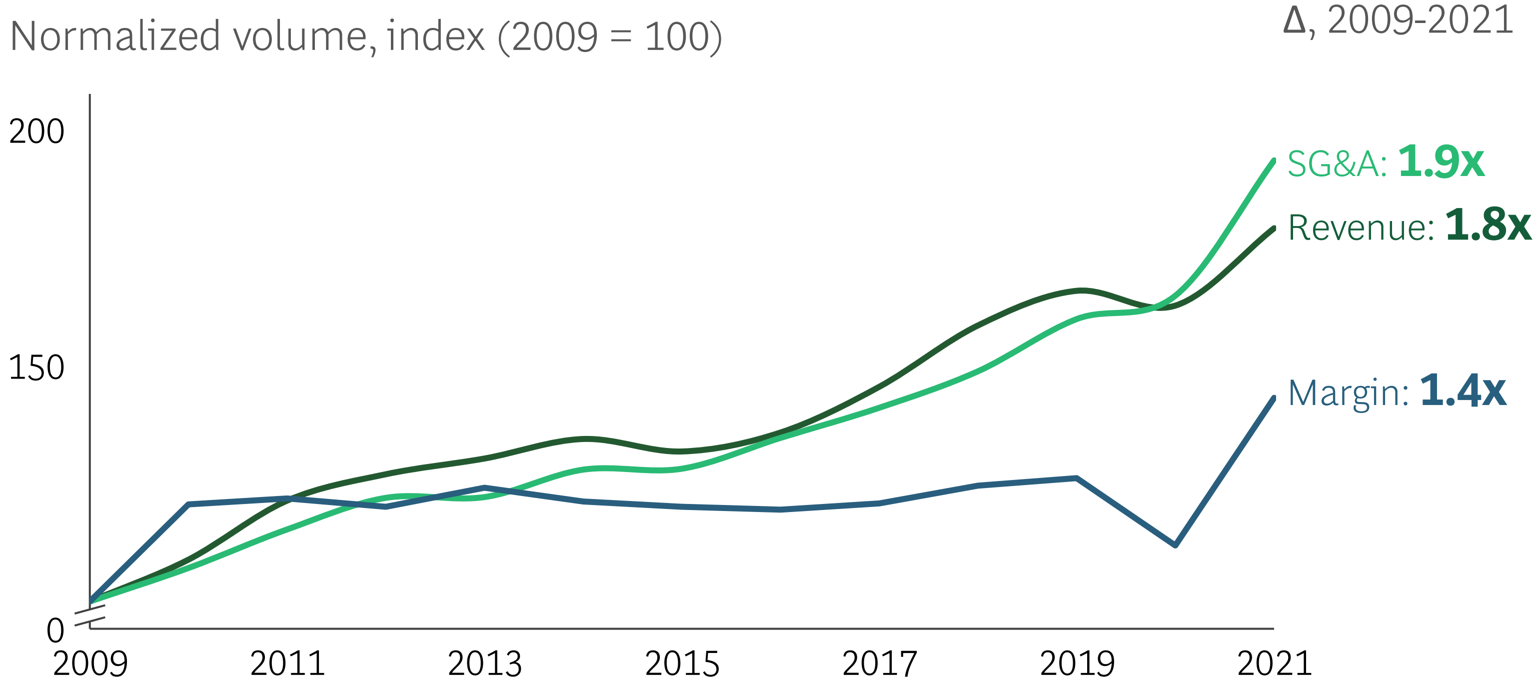


Sources: Job switch data from Future Forum Pulse Survey, conducted January 27-February 12, 2022. Number of respondents = 10,818 knowledge workers across US, Australia, Germany, Japan, France, and the UK; For labor force quits, participation and job openings: International Labour Organization, BLS, BHI Center for Macroeconomic, Federal Reserve, press search; Quit rates are computed by dividing number of quits by employment and multiplying that quotient by 100; includes non-farm industries

Companies have ~doubled their SG&A costs since last crisis and successfully passed it to consumers; that will no longer be possible in a recession

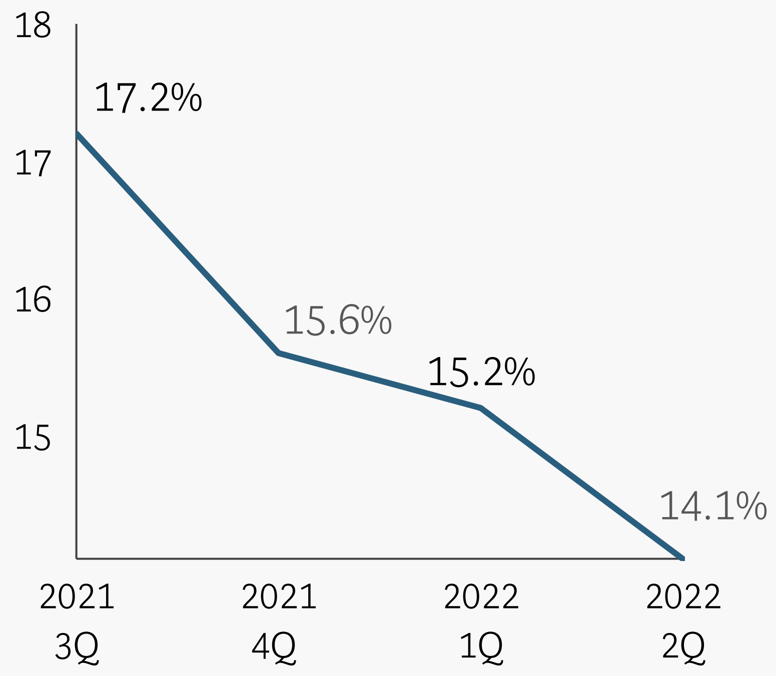
SG&A[1] costs have grown 1.9x since 2009; that didn't affect margin due to price increases

Normalized volume, index (2009 = 100)

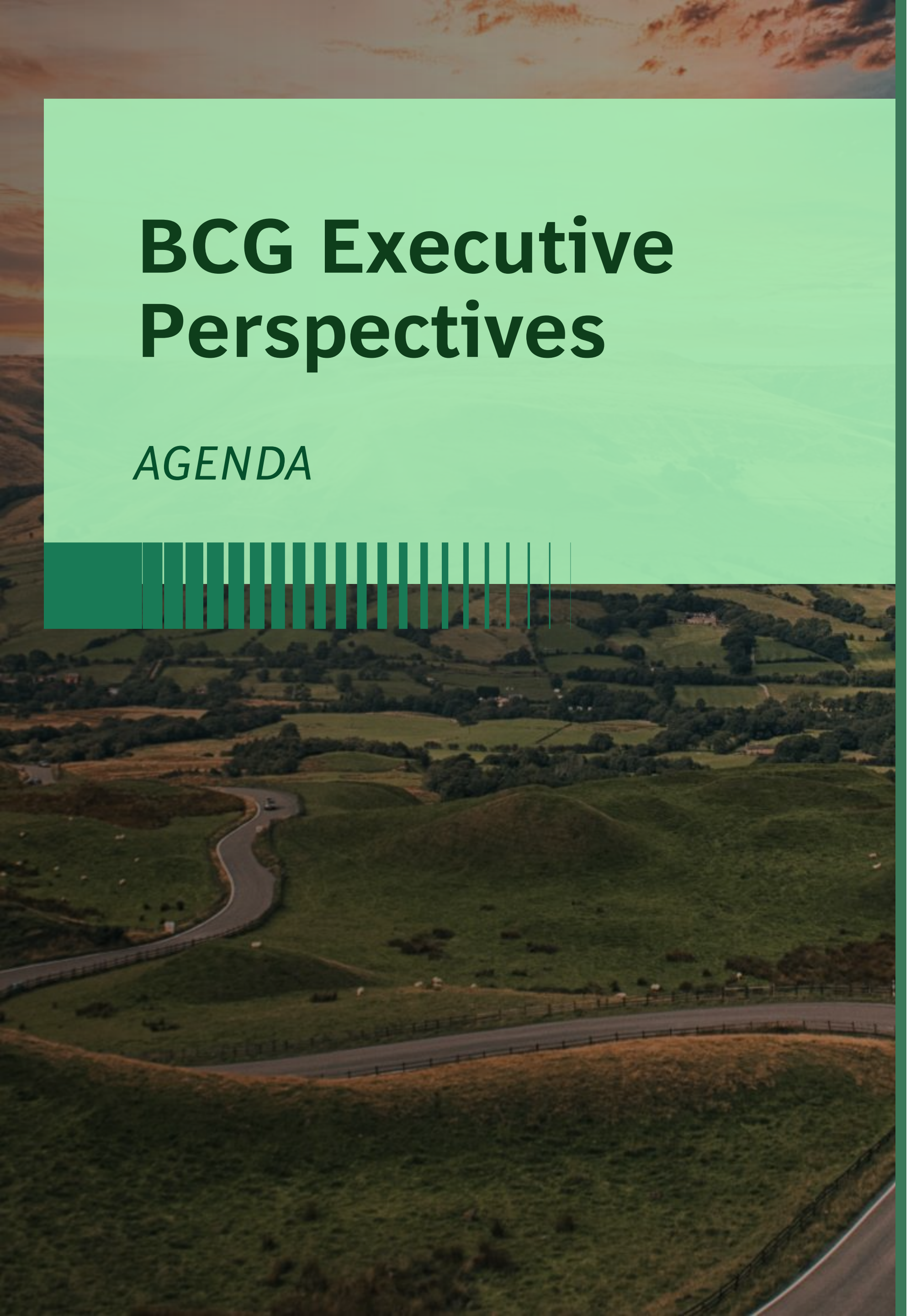


But over the past 4 quarters, we see much higher margin pressure

EBIT margin[1]



1. S&P 500 companies. Note: SG&A and revenue values were turned into indexes; 2009 value equals 100%
Source: S&P Capital IQ; Federal Reserve Bank of Minneapolis; Social Security Administration



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Contributors to cost are numerous and complex – companies must pull various levers to achieve a competitively advantaged cost position

Time to run rate

- x 3-6 months
- x 6-18 months

Functional impact levers/sources of efficiency[1]

% savings potential on relevant baseline[2]

Non-exhaustive list

R&D & engineering	Procurement		Manufacturing		Sales, (bid) project mgmt.	SCM logistics	After sales and services
	Direct spending	Indirect spending	Network optimization	Plant optimization			
Design for value	Syst. supplier review	Bundle frame contracts	Plant consolidation	Material utilization	Field force optimiz.	Warehouse optimiz.	Smart dispatching
Tool development	Demand management	Renegotiate terms.	Utilization increase	Lean manufact.	Sales force effect.	Digital supply chain	Field network optimiz.
Product quality increase	Make or buy optimiz.	Lock-in budgets	Network cost reduction	Equip. asset optimiz.		Service level adjust.	Parts availability
Time-to-mkt. optimiz.	Supplier development	Services reduction	Delivery times optimiz.	Plant layout & flow		Transport optimiz.	
	Best country sourcing	Activities cut	Strategic sourcing	Logistics optimization		Inventory mgmt.	
				Industry 4.0 leverage		Complexity optimiz.	
~5-15%	~5-10%	~10-15%	~20-25%	~5-15%	~15-20%	~5-8%	~10-15%

G&A and organization and process redesign

Spans and layers	Resource control & accountability optimization	Automation and AI in selected workflows
Reducing low-value work/'Products'	Technology landscape simplification	Detailed process optimization
Leveraging cloud services	Rationalizing geo location/sourcing model	GBS Implementation

~15-30%

1.Leverage advanced analytics and software tools to rapidly size opportunity; 2. Savings potential based on BCG experience
Note: Percentages refer to savings on relevant baseline. Savings levers are not additive yet interlinked

Organizations should consider their strategic and immediate needs and pull a set of levers that fit one of four common cost transformation pathways

In deciding which cost transformation pathway to pursue…

1	**Organizational streamlining**	Company needs to secure significant labor savings and **enhance organizational effectiveness, fast**
2	**Direct/indirect materials optimization**	Company intends to **quickly reduce outside spending and improve procurement processes**, without meaningful organization changes
3	**Operating model and process redesign**	Company with very ambitious savings goals **enhances operating model and optimizes processes** to significantly improve capabilities and cost posture
4	**Full strategic cost transformation**	Company is prioritizing **longer-term impacts across all strategic dimensions** (labor, direct and indirect procurement)

… organizations should consider their needs across these strategic dimensions

Magnitude of savings required

1 — 2 — 3 — 4

Relatively moderate → Ambitious savings targets

Urgency to bottom line

1 — 2 — 3 — 4

3-6 mos. → 6-24 mos.

Readiness to address direct (e.g., blue-collar) labor costs

2 — 1 — 3 — 4

Low → High

Viability of short-term procurement levers

1* — 3 — 4 — 2

Relatively low dependence → High dependence

Willingness to invest to break cost/capability tradeoff

1 — 2 — 3 — 4

Relatively low → High ambition

*Procurement levers not relevant

These four common pathways employ levers designed to address different cost buckets and savings potentials

Pathways can go together: in parallel or sequentially

	1	2	3	4
	ORGANIZATIONAL STREAMLINING	**DIRECT/INDIRECT MATERIALS OPTIMIZATION**	**OPERATING MODEL AND PROCESS REDESIGN**	**FULL STRATEGIC COST TRANSFORMATION**
Sample levers	• Spans and layers • Simplification • Consolidation/scaling • Redundancy elimination	• Demand management • Make or repair or buy • Variance reduction • Contract mgmt. (incl. tech suppliers)	• Activity optimization • Tech landscape simplification • Lean manufacturing process • Digitization, automation	• Strategic sourcing • Digital supply chain • Production efficiency • Design to value
Relevant cost buckets	Value discovery sprint **Support labor** costs reduction *(e.g., indirect labor incl. SG&A labor)* **Direct labor** costs reduction *(e.g., production labor; assembly, mfg.)* Direct nonlabor costs reduction	Value discovery sprint **Support nonlabor** costs red. *(e.g., nonlabor overhead incl. IT, mkting)* Direct labor costs reduction **Direct nonlabor** costs red. *(e.g., direct material inputs)*	Value discovery sprint **Support labor** costs reduction **Support nonlabor** costs reduction **Direct labor** costs reduction Direct nonlabor costs reduction	Value discovery sprint **Support labor** costs reduction **Support nonlabor** costs reduction **Direct labor** costs reduction **Direct nonlabor** costs reduction
Savings potential	$ 10-25% of addressable costs (e.g., direct, indirect labor expenses)[1]	$ 5-15% of addressable[2] procurement spending, incl. IT and tech spending	$$ 20-30% of labor costs	$$$ 10-20% of all operating costs

Increasing magnitude of total savings potential

3-6 months to full impact (pathways 1–2)

6-24 months to full impact (pathways 3–4)

1. G&A, sales, all managers across enterprise; 2. 25-55% of operating costs, procurement spending includes IT and tech costs

Pathway 1 | Organizational streamlining helps US-based airline reduce costs while improving effectiveness

Example of network airline streamlining white-collar employees

An airline committed to a major restructuring, **redesigning the organization** for improved accountability and customer service while significantly reducing costs and creating a talent-selection process that improved overall talent levels

Top-level realignment

Designed of "top of house" operating model, including degree of function centralization/decentralization

Improve talent selection

Built target organizations based on positions, influencing negotiation with employees and final staffing plan

Optimize spans and layers

Decreased layers within organization, speeding up planning, decision making, and execution

Leading to significant impact

15-20% reduced costs from white-collar jobs

2 layers removed, improved median span of control by 1

Improved overall talent profile

>5% of team members promoted or staffed in new functions

Source: BCG analysis

Pathway 2 | Direct cost optimization for a global automotive original equipment manufacturer

Example of auto equipment manufacturer improving procurement

After a successful launch of a new project portfolio, the international auto equipment manufacturer set ambitious goals for material cost optimization, hoping to cut spending through procurement optimization without sacrificing input quality.

Systematic supplier review

Implemented regular analysis of the market and collection of statistical data on suppliers, materials, and equipment

Procurement digitization

Utilized AI-coach-provided tips on power balance, relevant market data, and useful procurement tools before negotiation

Renegotiation/ management of contracts

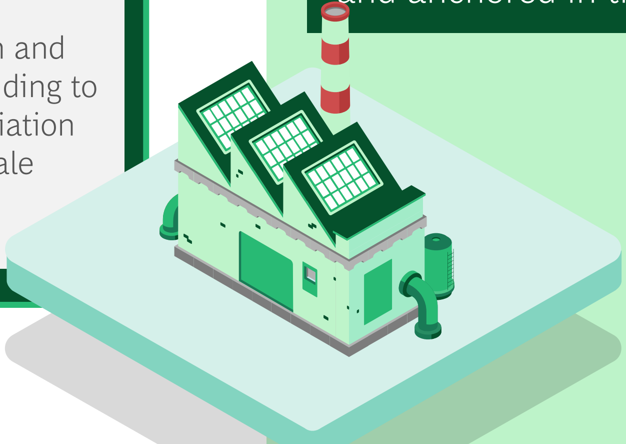
Leveraged value-chain and pricing power understanding to allow contract renegotiation with win-win rationale

Leading to significant impact

~12% direct product cost improvement, boosting margins

~2000 measures successfully implemented and safeguarded

Cross-functional team enabled and anchored in the organization



Source: BCG analysis

Pathway 3 | Reorganization of a leading health care company facing slow growth and rapidly rising coverage costs

Note: Pathway 3 builds on Pathway 1

Example of health care company rewiring operating model and processes

After struggling to hit growth targets and earnings goals, a leading health care company required a major cost restructuring focused on increasing efficiency while cutting costs to free up resources for investments in products, marketing, and sales.

Reorganize org model (e.g., spans of control)

Increased spans of control and reduced duplicative work across the organization by consolidating locations

Manage third-party spending

Rationalized IT portfolio and reconsidered travel and expense policies to decrease low-value spending

Automate/implement AI in selected workflows

Eliminated low-value work and optimized, outsourced, and automated processes for employees to focus on key tasks

Leading to significant impact

~$1.25B in total costs cut within 9 months

~$350M reduction in spending with third-party vendors

Exited low-value businesses, using savings to invest in better projects

Source: BCG analysis

Pathway 4 | Complete strategic operations transformation at a European beverage company

Example of European beverage company transforming value chain

The beverage industry faced challenges due to a highly volatile market, increasing commodity prices, and evolving consumer tastes. A major beverage company that struggled to match its competitors in overall equipment effectiveness committed to a **transformation of its strategic operations.**

Digitize/promote supply chain excellence

Introduced AI-based tools and implemented rapid digitization to improve demand forecasting, optimize footprint, and manage logistics

Implement design to value

Made use of expertise by fostering cross-functional and collaborative processes when refining projects

Simplify value chain

Reduced fragmentation of procurement purchases to scale advantages and lower transaction costs using digital tools

Leading to significant impact

~$500M of estimated impact from cost transformation program

~10% reduction in total supply chain costs from deep dives

Aligned site plans with financial targets and incentives to reduce conflicts

Source: BCG analysis

Prior to pursuing a cost transformation, companies can use a rapid assessment to shape their approach

Organization setup, benchmarks, first hypothesis

Identification of largest opportunities

Quick wins and opportunity charters

Recommendations on cost transformation pathway and roadmap forward

	Organization setup, benchmarks, first hypothesis	Identification of largest opportunities	Quick wins and opportunity charters	Recommendations on cost transformation pathway and roadmap forward
Organization	**Groundwork for success established:** Resources committed for the change mgmt. program	**Largest opportunities related to functional structure pinpointed:** Org baseline (e.g., volume, locations, FTE, performance) identified, analyzed	**High-level design principles drafted:** Support functions / shared services externally benchmarked with long-term strategic focus	**Roadmap built to achieve savings:** Includes cascade-cycles, timeline, and finalized org design criteria with maximum savings based on high-level estimate of full potential
Operations	**Analysis-based change in progress:** Internal data collected, including industry benchmarks for talent and material spending	**Resources focused on biggest priorities:** Cost value drivers analysis complete & bottlenecks in planning, sourcing, mfg., warehousing, etc., evaluated	**Size, root causes, and feasibility of opportunities identified:** Loss levers analyzed (e.g., procurement, contract services, labor productivity) and bottlenecks identified	**Findings validated; senior leaders aligned on path forward**

Learnings reveal imperatives for how to come out on top of today's supply and demand mismatches despite the challenges

Anticipate evolving geopolitical and macro-economic uncertainty by creating resilience within organization

Support growth by engaging your supplier ecosystem and by "owning" value chains and product life cycles

Act now while flexibility to maneuver exists, and there is still freedom to invest

Prioritize sustainable cost reduction where capabilities are built – cut for short-term survival and build capabilities for the longer term

Don't take a business-as-usual approach because the macroeconomic context requires transformation deep within the org

Be transparent with employees to build trust, generate respect, strengthen cohesion, and create a sense of ownership

Emphasize getting the right people in roles to make best use of capable and respected employees regardless of original position in organization

Address employee value proposition and actively brand the program to reduce worry and effectively compete for prospective talent

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