



Implementing Cost Control – Challenges & Advice

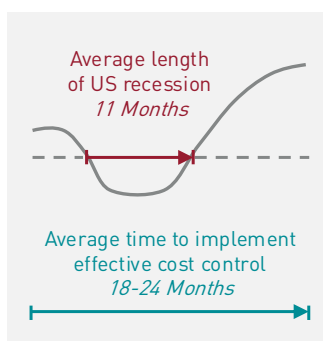
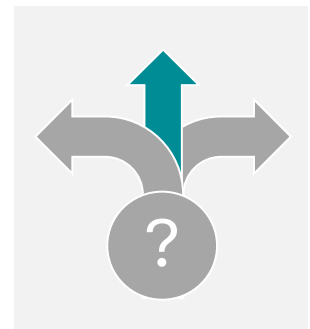
“COST CONTROL IS JUST LIKE LEARNING A LANGUAGE. LIKE LEARNING ANY LANGUAGE, MASTERING COST CONTROL TAKES TIME AND EFFORT TO PERFECT”

WHY SHOULD I CARE ABOUT COST CONTROL NOW? INDEED, THE GCC ECONOMIC OUTLOOK IS GOOD, HOWEVER THE OUTLOOK IS ALSO IS VERY UNPREDICTABLE AND WHEN MARKETS TURN IT WILL BE TOO LATE TO START REDUCING COSTS.

WE ARE CERTAINLY LIVING IN UNCERTAIN TIMES. THE ECONOMY WILL TURN, BUT WHEN IS NOT CERTAIN. THEREFORE, ORGANIZATIONS NEED TO BE READY FOR A TIGHT COST ENVIRONMENT.

Why talk about Cost Control?

As 2023 began, economists were predicting a global recession¹. However, moderation of low unemployment, and a faster than expected easing of post-pandemic inflation has brought the global economy into 2024 on a somewhat more solid footing, albeit with localized weakness particularly in Europe². Conversely, in the GCC, markets remained strong due to strong non-oil GDP growth in KSA & UAE³. According to the IMF, non-oil GDP growth in the GCC will moderate in 2024 & 2025³. In the US, there is still predicted to be a 63% chance of recession by the end of 2024⁴ although interest rates are still not coming down as quickly as predicted during the pandemic period. US Inflation is back down to just over 3%⁵, for now, but wage growth remains above 5%⁵. There have been layoffs in the tech sector although share prices continue to rise.



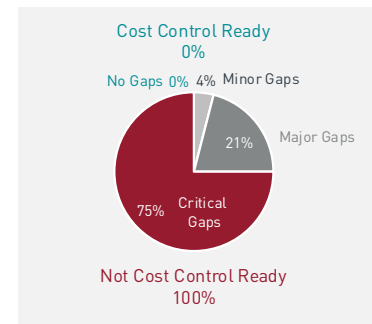
The many contradictions between market predictions and reality are evidence of the unpredictability of the current economic situation. The only certainty that we have is that the economy will turn at some point.

The paradox is that, if the market does turn and your organization suddenly needs to reduce cost, it is too late to start cost control in a sustainable way. Cost-cutting will provide short-term relief but will damage the organization's ability to recover in the medium term.

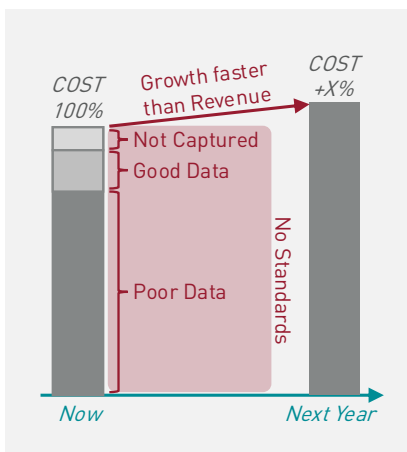
Our team conducted a study on the capabilities of companies in cost control and also the performance of a bundle of companies who are practiced. What surprised us was how poorly companies were prepared and how well those who were practiced performed. 0% of the companies in our study were cost control ready while those who were practiced in cost control outperformed their market indices by ca. 200 percentage points on average⁷.

Cost Control, how ready is everyone else?

The short answer is – not very. A Four Principles study of over 50 cases in the GCC in the past 10 years showed that in 100% of cases, companies' master data was either not complete and/or accurate. To be clear, not one company in our study had master data that could be just analyzed directly without either, major clean-up, filling gaps with manual studies or just measuring through sampling as their master data proved too unreliable. This had the knock-on effect that any digitization initiative or application relying on this data was ineffective.



From the same study, our team also examined the breakdowns in terms of unit cost across a range of industries from Converters (with up to 80% of cost contribution from commodity raw materials) to Service Providers (with up to 50% Personnel costs) to Retailers with (with up to 60% of cost between Rent and Sales & Marketing Costs). What were the common issues that our team saw?



- By ratio, the biggest cost contributors tended to have the lowest amount of detail data available. i.e. companies had the worst visibility on their main cost drivers.
- 2% to 5% of direct costs were not captured as COGS but in overheads and could not be attributed to individual materials or orders.
- In most cases, the company had no Per Unit Cost or equivalent with which the effects of any potential cost increases or savings could be correctly determined. They also had no available guidelines for converting operational KPIs into cost.
- Also interesting was the observation that in the cases where revenue had been growing, cost growth was even faster.

So, what can be concluded from our team's study: few if any of the companies studied were ready and able to control their cost in detail. The detailed data basis was not there to provide the necessary input for analysis. The methods were also not in place to make unit cost transparent and used to control cost within the organization.

If companies know that markets are unpredictable and the economy may turn at any time, why do companies only really attend to cost control when they are forced to by a downturn?

Because it is hard.

Why is Cost Control so hard? It is more than just data



Every activity within an organization contributes to the effort required and therefore the cost. As such, to control the cost of all these activities, we need to have the means to understand each activity in terms of cost. This then implies that we must understand not only every activity or process but also how it is to be measured and who is responsible.

What does 'all activities' mean? It means all the activities end-to-end in the value stream from product/service design right the way through to customer delivery and those of the supporting organization. This is a lot of activities, upwards of 1,500⁶ individual processes in an organization. Even when using an 80/20 rule and focusing only on the operational activities that contribute the most cost and tend to be repeated often, this still leaves 300 processes that require detailing.

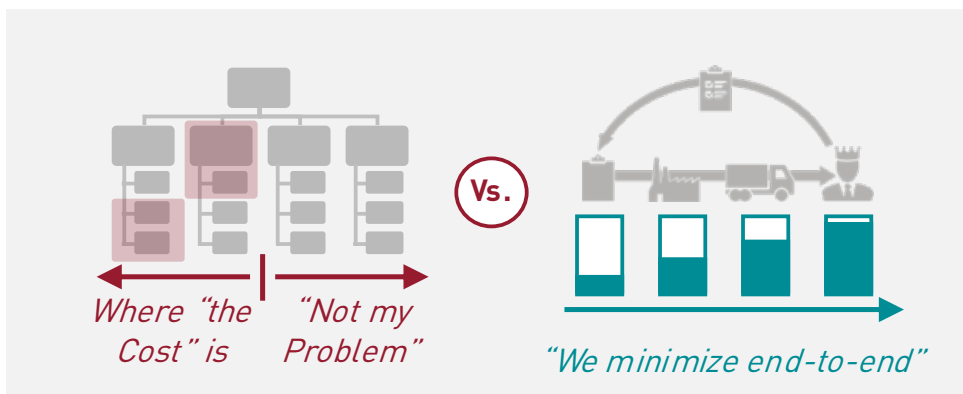
Won't digitalisation solve this?

No, because in most cases the data is simply not there to make applications work effectively.

The SAP R/3 ERP system was launched in 1992. ERP system workflows are based on processes and log data as when transactions are made in the system. Since then, countless applications have been created to visualize data and create insights. Why then, after 30 years, are organizations still struggling so badly to use their systems to control their costs? The conclusion based on our teams' study is simple; the data contained in those systems is not accurate or comprehensive enough to cover all activities and to therefore give an accurate picture of total cost.

Assuming we fix the data problem, wouldn't that solve it?

The data is half the battle, the other half is culture - it is always some else's problem.



If every activity within an organization must be considered, as they all contribute to cost, then those responsible for each activity should also be responsible for the associated cost. Everyone must take responsibility for their cost full stop. Not Finance, not Supply Chain and not the PMO office - even though they may report on the cost. This is an integral part of company culture like Quality or Continuous Improvement.

How you enable them to manage their cost is through the rules and methods that the organization establishes. Our study showed that few organizations had an established Per Unit Cost or standards to define expressing operational KPIs in terms of Cost. Using the language analogy, without these standards, those who are responsible for the activities and cost and those that are responsible for governance are simply not able to speak the same language.

The definition of a Per Unit Cost would be the basis of a cyclical process to review and manage changes to cost. Therefore, the absence of the Per Unit Cost as indicated by our study, is a clear indicator that such standard cyclical reviews of cost involving all those responsible are not part of these companies' culture.

Cost control is an expansive topic that has more similarities with other governance and culture topics such as Quality or Continuous Improvement, as opposed to being simply a reporting or Finance topic. Establishing culture and governance in an organization takes a high amount of effort to establish and then maintain. Due to this high level of effort required, few organizations have implemented good cost control.

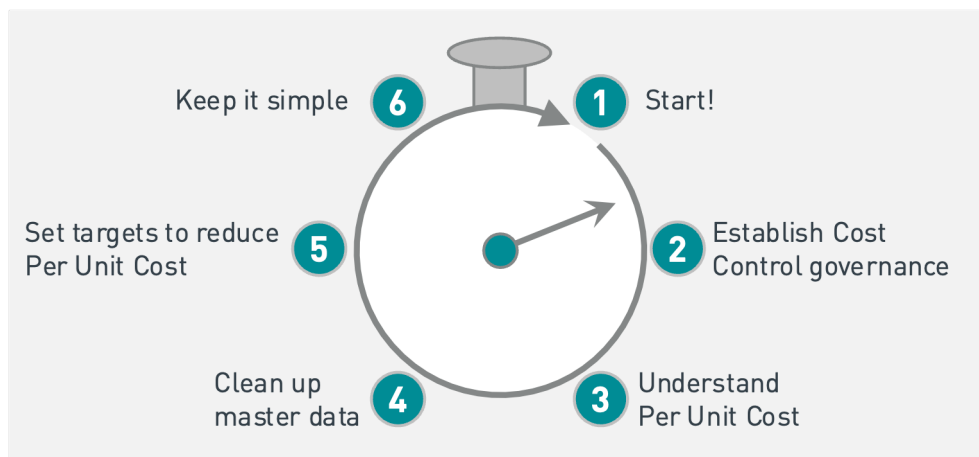
But if implementing Cost Control fully is so much effort, is it really worth it?
Short answer, you cannot afford not to.

What do the Big 4 say about managing cost?

They list focus areas such as; Cost Transformation, Digital Transformation, Operational Excellence, Strategic Cost Management, Risk Management, Supply Chain Optimization, Data-Driven Insights, Sustainable Cost Reduction. They also state that this varies by industry and an individual approach is advisable.

What advice do Four Principles give?

The Big 4's advice is not wrong, but it is rather generic and not that actionable. So, we asked James Ryan, our Partner and Subject Matter Expert on operational excellence for his top tips for implementing effective cost control:



1. Start.
 - a. Set-up the topic as you mean to go on: thoroughly, and in a planned manner.
 - b. Act and get some “wins on the board” early. Without this, your initiative will run out of momentum, cash, or your tenure as CEO will end prematurely.

2. Establish Cost Control like a governance topic, because it is one.
 - a. Make it everyone’s problem. If they have activities, they generate cost and are responsible for it.
 - b. Establishing the processes, methods and standards topic will be significant, so you will need a comprehensive plan through which you can monitor progress.
 - c. Someone will need to lead this topic, so chose carefully. They do not need to be a finance person, more a “do-er” who understands the organization.

3. Understand your Per Unit Cost.
 - a. This will generate the necessary transparency for you to make good decisions.
 - b. The by-product of defining the Per Unit Cost are the standards required by your organization, so the set-up invest is worth it.
 - c. You will also then understand where you have holes in your data and reporting.

4. Clean up and plug any holes in your master data.
 - a. This will require an up-front effort, but it is worth it. Your team will find that some of the technology you have will “magically” start to work.
 - b. Where you have holes in visibility, it is worth the investment in new technology. In other areas it is not.
5. Set clear and quantifiable targets to reduce Per Unit Cost.
 - a. Establish a regular Per Unit Cost Review Cycle with your senior team. Monthly is a good rhythm and it can be tied to quarterly financial forecast reviews or S&OP (Sales & Operations Planning) to avoid duplicating efforts.
 - b. With the reporting and review basis in place, you can then set Per Unit Cost reduction targets for leaders in the organization motivating them, in turn, to lead their teams.
6. Keep it simple.
 - a. Get on with the basics, process definition, cost control standards and regular reviews.
 - b. Keep the communications regular, simple, and direct about what Cost Control is and why it is needed.
 - c. The topic is complex enough, add technology, methods, and sub-initiatives set-by-step.

What you argue here about the uncertain economy and rising costs is not all new. So why all the effort, and why now?

That’s exactly the point that we show. Very few organizations are capable of cost control in any meaningful way, but yours could have that advantage. We are also not claiming it is easy, quite the contrary, but you can start.

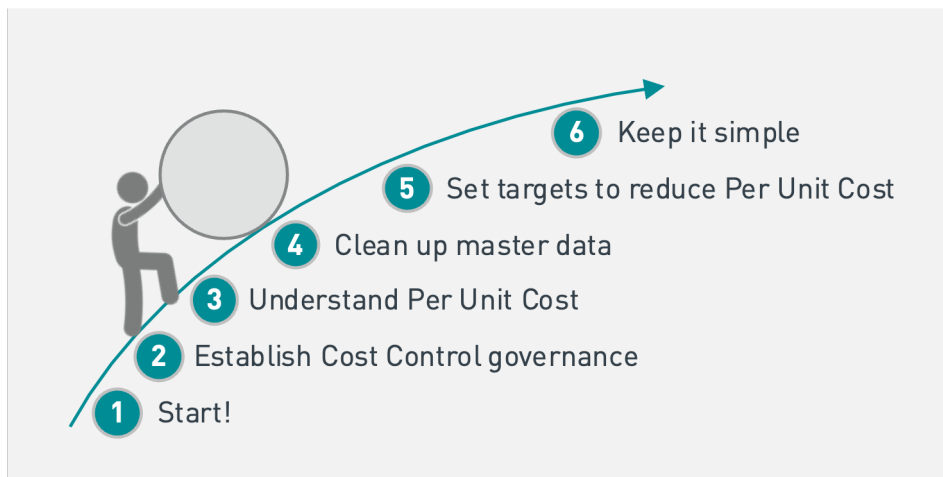
The economic outlook is very unpredictable. Recession is happening or predicted in much of the world. Regionally in the GCC, the effects have not been felt as yet. The only certainty that we have is that the economy will turn at some point.

Our team at FP conducted a study of past cases to see how capable or prepared organizations really were to implement effective cost control. They concluded that in the vast majority of companies, the detailed data basis was not there to provide the necessary input for analysis. In these companies, the methods were also not in place to make unit cost transparent and used to control cost.

Cost control is an expansive topic that has aspects and is not just reporting for Finance's problem. This makes cost control more like culture and governance which take a high amount of effort to establish and then maintain. Due to this high level of effort required, few organizations have implemented good cost control.

The paradox is that, if the market does turn and your organization suddenly needs to reduce cost, it is too late to start cost control in a sustainable way. Cost-cutting will provide short-term relief but will damage the organization's ability to recover in the medium term.

The benefits of investing the time and effort in cost control are obvious. The organization is better able to adapt to market changes, be more competitive and will recover faster when markets recover. Our studies have also shown that companies with a strong culture around cost and operational excellence, perform better over time. Our bundle of companies⁷ outperformed their market indices by ca. 200 percentage points on average.



So, what is FP's advice:

1. Start.
2. Establish Cost Control like a governance topic because it is one.
3. Understand your Per Unit Cost.
4. Clean up and plug any holes in your master data.
5. Set clear and quantifiable targets to reduce Per Unit Cost.
6. Keep it simple.

To use an analogy, Cost is just like a language. It is a way of expressing what we do operationally in terms of money. But like learning to speak any language, it takes time and effort to understand the rules, practice and become competent.

GET IN TOUCH

Should you be interested to know more about our services regarding this topic, then please contact:

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