# Decreasing costs to accelerate growth

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Periods of economic downturn often highlight the obvious. Every company must regularly adapt and reallocate its resources. It must do so not only in its choice of activities, businesses, business models and geographies, but also in terms of costs. Only a significant decrease in costs allows investing for growth.

## 1. Growth costs and run-rate costs

Every activity is based on a mix of growth costs (additional transitory costs to grow and gain market share) and run-rate costs (structural costs to stay in the market).

Growth costs are the costs of innovation, marketing and sales investments needed to grow, transitory sub-optimizations during ramp-up, benefits of a more attractive business model for customers, necessary price reductions to gain market share…

They must be optimized: prioritization, reallocation of resources between businesses, countries and action levers, differentiation and adaptation of business models.

Run-rate costs must be competitive and as low as possible in order to generate room for maneuver and finance growth: competitive costs in terms of production, logistics, access to clients, as well as all general and administrative costs, operating processes and support functions.

This involves the relocation of production tools in low-cost geographies, the relocation of certain support functions (finance, IT) or development (R&D) in the same geographies, the clustering of certain support functions or their outsourcing, a reduction in complexity and its associated costs, the optimization of the brand portfolio, the optimization of prices, the digitalization of operations, the concentration of functions...

There is no growing sustainably if run-rate costs are not competitive and do not provide the necessary room for maneuver to finance growth. One must look at all sources of efficiency and saving which will generate the additional 1 to 3 points of EBIT necessary to finance the additional costs of growth.

## 2. The method for lowering costs and investing for growth

1. Define management principles

A movement of this magnitude must be based on sound management principles shared by the Management. These principles must define the foundations of the management approach: levers for value creation, delegation principles, centralization principles, autonomy principles and location, transversality modes, links between countries and activities…

They will make it possible to build the organizations, the business processes and consequently the required costs by having a guiding thread coherent with the strategy and consistent between entities. They will provide a framework and boundaries for the details for the implementation of approaches and the logic of centralization vs. local adaptations.

2. Set reduction ambitions in order to develop new approaches

Cost reallocation programs for growth must start with a global vision and an ambition from the management before being broken down by entity and worked out in detail.

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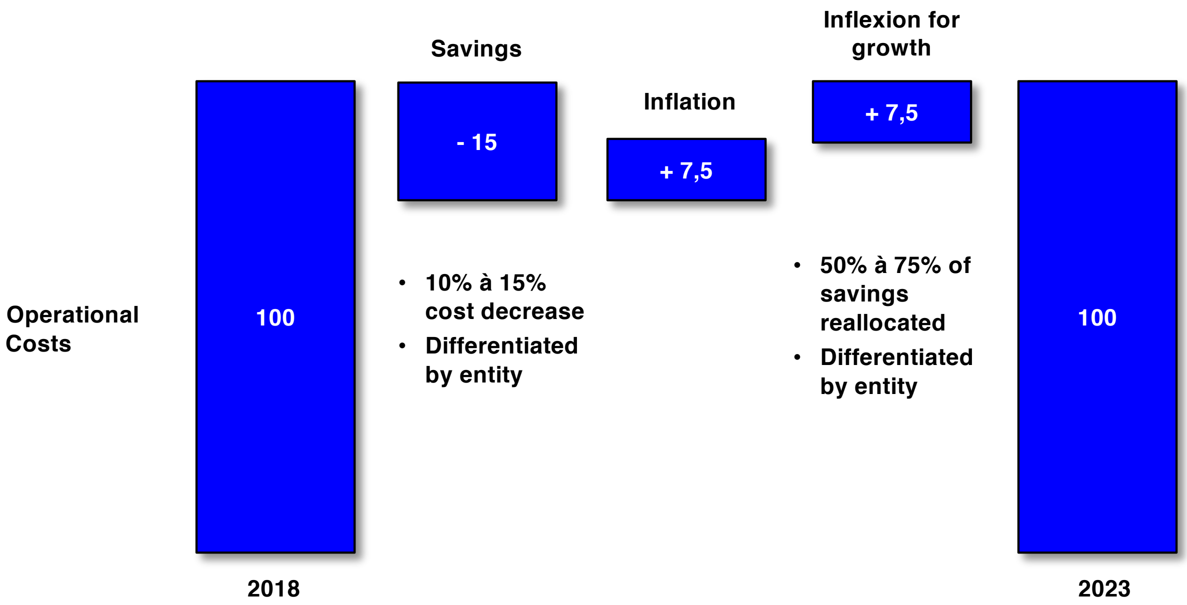


- Based on sound management principles
- With actions and disruptive approaches for savings
- With approaches to select growth projects in order to prioritize and monitor impact

Sources: Estin & Co analysis

For operating costs (OPEX), the right logic is generally to set an ambition to reduce them by 10% to 15% and to reinvest 50% to 75% of the savings for growth. Ultimately, the goal is to achieve stability or low growth in these costs. This approach must obviously be refined according to the growth ambitions and the nature of the activities and the scale effects.

3. Differentiate the reduction by entity and by issue

The breakdown by entity and by issue is necessary to focus on the main issues while including all the functions. It involves an analysis of the competitiveness of the various functions compared to competitors and other comparables for some support functions (finance, human resources, some IT functions...)

To reach the initial objective, it must differentiate between decreases of 5% to 35%.

4. Differentiate investments by entity and focus on growth

All businesses must invest to deal with market and technological developments and to improve productivity. Investing is also necessary to give a new impetus to the teams: for operational entities, to accelerate growth; for support functions, to serve the operational entities more effectively. Often these investments are not made at the right level due to a lack of resources. Managers do not dare carry out drastic reallocations within their scope which would allow them to do so. This movement must come from top management. At this level too, a differentiation of OPEX investments is necessary. Simple rules to prioritize invesmtents must be defined. For example, as a general rule, one euro of marketing and commercial investment must generate 5-7 euros of gross profit within three to five years.

5. Launch the program with the operational teams

With sound management principles, ambitious cost reduction objectives overall and by entity, investment objectives overall and by entity, the teams must define an action plan at three levels: disruptive actions with new approaches to lower costs, optimization actions and investment actions. This action plan, quantified and defined over time, will help prioritize and bring consistency from a financial standpoint by favoring cost reductions first, and then investments —not the other way around.

**What to conclude?**

Adapting a company to changes in its markets, technologies and expertise is necessary. It is about survival. This perspective is not enough. It must be complemented by investment in activities and approaches for growth. This is why it is necessary to cover two approaches in a combined way: lowering costs to restore room for maneuver in order to reinvest for growth in a differentiated way.

Without room for maneuver, there is no investing. Without investing, there is no growth.

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*Estin & Co is an international strategy consulting firm based in Paris, London, Zurich, New York and Shanghai. The firm assists the management of major European, North American and Asian groups in their growth strategies, as well as private equity funds in the analysis and valuation of their investment.*

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