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Cost Transformation: A Journey, Not a Destination

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White Paper



Table of Contents

Cost Transformation	3
Introduction	3
Why Focus on Transforming Cost?	3
Cost Transformation is Not a Traditional Approach to Cost Reductions	4
Understanding Cost Drivers	5
With Building Blocks in Place, Look to the Future	5
Time to Prioritize, Set Targets and Measure	6
In Conclusion	7
In Practice.....	8
Fortune 50 Enterprise Embarks on Cost Transformation Journey	8
Business Process Initiative Creates Forecasting Models and Integrates Data Sources for \$1B OpEx Cost Stream	8

Cost Transformation

Introduction

Few, if any, enterprises can escape the challenges created by marketplace disruptions, increasing client expectations, burdens of legacy platforms or more stringent regulatory compliance requirements. In today's environment, a business as usual response to these challenges is not a recipe for success. Business transformation is an absolute call to action for those who want to be leaders in their industry. Specifically, financial success requires continuous evaluation of all the levers that impact financial performance – including the way costs are managed.

Traditional methods of cost management assign cost reduction targets by department, forcing each to manage within their silos by targeting low hanging fruit. While straightforward to implement, these are short-term, narrowly-focused approaches to cost management that are not sustainable over time.

Alternatively, Cost Transformation enables a firm to recognize the factors that drive its end-to-end costs and aims to understand how changes in business processes can create a new, optimized cost profile.

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Why Focus on Transforming Cost?

Some specific triggers create a priority for Cost Transformation:

- The current budget process is reminiscent of Groundhog Day, where every cycle surfaces budget shortfalls and cost reduction plans can never quite close the gap.
- A disruptor has changed the way the industry provides the organization's service or product, and so business as usual cost management will not enable a competitive superiority.

Consider how Netflix disrupted the video rental industry or how taxi services are being disrupted by companies like Uber and Lyft. Unburdened with legacy systems and processes, the disruptors start with a clean slate, so their cost structure is already transformed. An established organization that needs to make the necessary investments in innovation requires a detailed examination of the existing cost structure to identify what is and isn't beneficial to the firm's future success.

Cost Transformation is Not a Traditional Approach to Cost Reductions

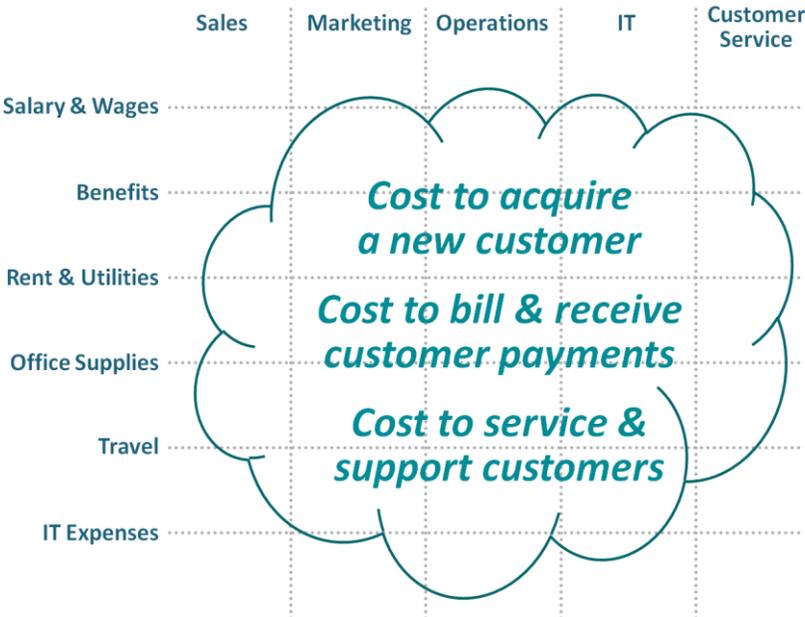
Traditional cost management limits its approach to a functional view. Each department independently reviews its costs, looking for reduction opportunities within its own silo. This traditional cost management derives its analysis using the P&L, examining departments (e.g., Sales, Marketing, Operations, IT, Customer Care) and general ledger line items (e.g., workforce costs, benefits, supplies, travel, training).

Cost Transformation, however, takes an end-to-end look at costs from a process point of view. For example, the Sales organization must no longer look only at costs within its own department. Instead, the enterprise must examine cost drivers by core process, asking such questions as:

- What does it cost to acquire a new customer?
- What does it cost to bill a customer?
- What does it cost to service or support a customer?

The Cost Transformation methodology examines cost drivers, associated volumes and unit costs. While this stratification of costs must foot to the P&L totals, it is a substantially different thought process than a general ledger focus. It creates an end-to-end view of core business processes.

Linking Traditional P&L Cost Categorization to an End-to-End Process View of Costs



A cost transformation approach uses P&L data as the basis for its analysis, but describes costs from an end-to-end process perspective.

Understanding Cost Drivers

Successful organizations understand at a detailed, operational level the correlation between the work done and the resulting costs incurred. Cost drivers can be represented in a number of ways, for example:

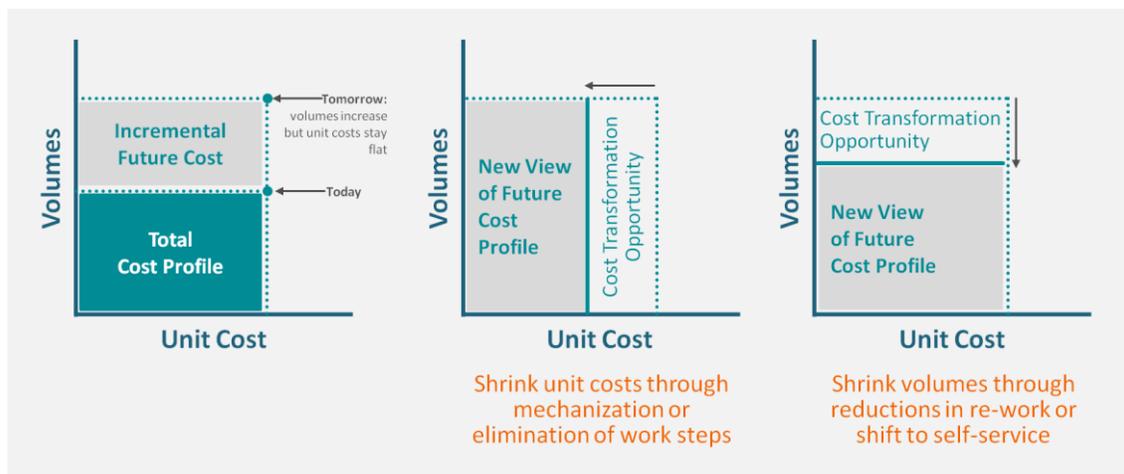
- Number and types of customers served (e.g., new, churn and renewals, or needs and demographic-based customer differences)
- Number of transactions performed (e.g., orders taken, inquiries answered, invoices produced, or requests for support)
- Method of handling those customers and transactions (e.g., manual or digital)
- Degree of process breakdown which occurs (e.g., errors, manual intervention, rework)
- Upstream and downstream interdependencies (e.g., cross-functional, end-to-end impacts)

Understanding a firm's underlying cost drivers enables a more disciplined approach to planning, prioritizing and transforming.

With Building Blocks in Place, Look to the Future

At this point, an organization has identified the end-to-end processes and work drivers that create costs. Now, there is an established baseline for work driver volumes and work driver unit costs. With these building blocks in place, organizations should ask themselves:

- What happens to overall costs if volumes change?
- What happens to overall costs if unit costs stay flat?
- What's the range of potential variances in volumes?
- How much do unit costs need to change to meet future cost profile requirements?



This exercise helps envision how extensive the cost transformation challenge is. Once complete, executives can identify the business change required to improve those future cost trends. Improvements can take the form of better use of technology to strengthen digital capabilities such as customer self-serve options, or enhanced business processes that simplify or eliminate work steps, or mechanize traditionally manual work.

Time to Prioritize, Set Targets and Measure

Business improvements to transform operations will require investments. Having a solid prioritization methodology, coupled with an implementation roadmap and a means for keeping track of progress are keys to successful realization of cost goals.

These changes won't happen overnight. In fact, implementation timelines often span months and sometimes years to reach full transformation impact. Occasionally, the changes require investments up-front, offering little cost relief in the short-term.

Each cost reduction initiative and investment priority should be sized and timed for impact both in-year and for future years. The supporting analysis and rationale that substantiates the improvement opportunity must outline the assumptions for success and be agreed to by the initiative sponsor and stakeholders. Appropriate metrics must be defined, so that a clear and concise executive dashboard creates visibility to progress and insights to risks or jeopardies. Additionally, a governance process must be in place to ensure ongoing communications and decision-making among the leadership team.

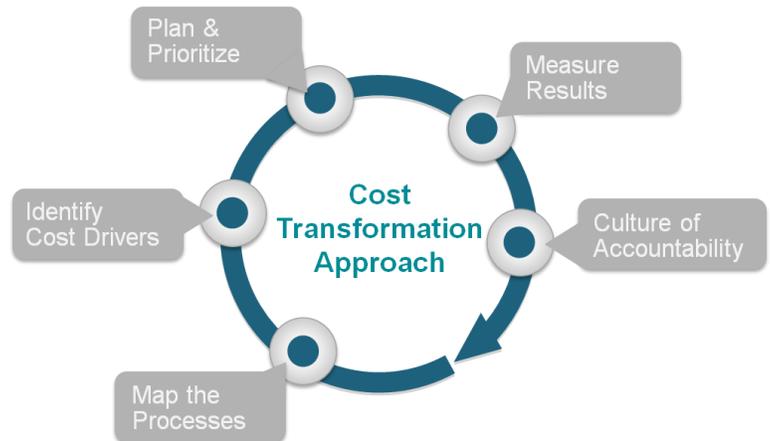
Cost Transformation Initiative Roadmap



Initiatives that encompass a cost transformation are typically implemented over a multi-year time horizon and will increase cost savings over and above business as usual plans.

In Conclusion

The success of an organization-wide cost transformation initiative requires a mutual understanding of the future goals for the organization, a clearly defined and prioritized path to achieving the goals and metrics that drive accountability for results achievement. Consistent communication and alignment of the future vision for the enterprise will achieve a common perspective on the strengths to capitalize on and the weaknesses to overcome in order to succeed in the marketplace.



Cost transformation breaks the paradigm on how to manage costs. It's a disciplined mindset and a continuous journey.



In Practice

Fortune 50 Enterprise Embarks on Cost Transformation Journey

Scope

Current business performance was strong. Yet a Fortune 50 enterprise understood the financial downside of pervasive market disruption in their industry, the looming negative pressures of ever-increasing complexities across their products, services and platforms, and the overall need to influence unit cost trends in the face of business growth.

Past attempts to reduce costs focused on low hanging fruit within departmental silos. This approach provided short-term results that were not sustainable over time and did not create a path towards long-term cost management. Cost transformation became a business imperative.

Results

Using a highly collaborative approach, Northridge created the structure and led the process for this firm's cost transformation.

- Through interviews and data mining, established a baseline of the current cost structure
- Using data-driven analytics, identified and sized opportunities for transformation
- Created executive-level discipline for governance and communication, building the management infrastructure for an on-going cost transformation culture

Business Process Initiative Creates Forecasting Models and Integrates Data Sources for \$1B OpEx Cost Stream

Scope

The client's operating expense budget was driven extensively by headcount, yet current forecasting methodology provided insufficient insight to future headcount requirements. Multiple data sources existed without the capabilities to connect information in a meaningful manner. The client required greater insight into their true cost drivers in order to drive meaningful cost out of the business.

Results

- Northridge collaborated with the client to define work drivers by organization, work center and function; creating forecasting models for future headcount requirements
- Data sources for work volumes, current headcount and current costs were integrated to create fact-based work time factors.
- The resulting data transparency also created visibility to additional opportunities for cost take out, which will enable hundreds of millions in OpEx savings.

Marriann Cole

Chief Strategy Officer



A member of the firm from its early years, Marriann has served Northridge in a variety of roles including Senior Vice President of Service Delivery, Chief Operating Officer, Chief Financial Officer and currently as Chief Strategy Officer. Whether working on internal Northridge matters or leading an engagement for a premier client, Marriann applies her hallmark style of a disciplined, steady approach focused at solving the right problem, to ensure that exceptional results with long-lasting impacts are delivered time and again. Marriann has guided the firm through years of successive growth and profitability, and continues to focus on the future development of Northridge.

A proponent of servant leadership, her philosophy is that successful, sustainable organizations are built on the foundation of team members who are coached and guided to grow and be their best. Marriann graduated from Clarke University with a BA in Math and Computer Science. She holds an MBA from the Executive Telecommunications Program at the Illinois Institute of Technology.

The Northridge Group

The Northridge Group is a leading management consulting firm specializing in business transformation initiatives and customer experience solutions. Founded in 1999, the 100% woman-owned-and-operated firm serves Fortune 200 clients in the healthcare, telecom, financial services, travel, transportation, retail, and distribution and manufacturing industries, as well as government agencies at the federal, state and local level.