Gartner for Finance Leaders

The 3 Habits of Elite Cost Cutters
Since 2013, costs have been outpacing revenue at S&P 1200 companies. As companies sprint to come first — however they define it — they’re taking risks to catch up with their competitors. And if the race is a long one, like this growth period, the costs add up.

**Why Companies Trip Up During a Downturn**

This is particularly a problem late in the economic cycle because, during a recession, the average time before organizations require a material overhead cost cut is three quarters — a very small window compared to the average of seven quarters after the financial crisis.

In short, when companies try to slash costs in a hurry — a temptation even if the enterprise has positioned itself carefully — they tend to do so frantically rather than thoughtfully.

Consider a spectrum with cost cutting at one end and cost optimization at the other. On one end are actions that can help shore up liquidity and meet market profitability expectations in a downturn. On the other end are long-term tactics companies pursue to boost efficiency during growth (see Figure 1).

**Figure 1: Spectrum of Cost Cutting to Cost Optimization**

*Illustrative Example From an IT Budget*

- **Cost Cutting**
  - 0 to 6 Months: Head Count Reduction, Postponing Projects
  - 7 to 12 Months: Outsourcing IT Support Services
  - 13 to 18 Months: IT Operational Process Standardization
  - 19 to 24 Months: Data Center Consolidation, Migrating Existing Services to SaaS

*Source: Gartner*
Executives tend to make three major missteps when they’re under pressure to cut costs:

1. **Making across-the-board cuts**
2. **Losing the business’s commitment**
3. **Stifling growth investment**

Here’s what your company can do differently to avoid each mistake.

### 1. Use a Value Framework to Prioritize Cuts

When urgency pushes finance leaders toward a posture of “just cut something — or anything,” impose discipline on your decisions with a value framework — a model of your financial strategy positioning your business areas according to their performance in each dimension (see Figure 2).

You’ll also need to track the trajectory of these businesses within the model over time to provide a perspective on direction (see Figure 3).

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**Figure 2: Business-Line Assessment Matrix**

*Illustrative*

- **Size of Bubble**: Invested Capital
  - (Other Options: Size of Business, Total Addressable Market)

- **Revenue Growth**
  - (Other Options: Market Attractiveness, Strategic Fit)

- **ROIC**
  - (Other Options: Ability to Compete, Stacked Gross Margin)

Source: Gartner

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Here, Business Unit A is sliding in terms of profitability, but its revenue is growing as investment increases. However, the critical question is, how is it faring compared to the other businesses? A framework will enable you to answer this question.

Figure 4 shows the same portfolio but with specific actions for businesses in each quadrant. This view can save a management team months when cost cuts are pressing, and it helps the team avoid harming businesses that are top growth prospects.

The next step is to reallocate capital from businesses in the upper-left quadrant to those in the lower-right quadrant.

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**Figure 3: Business-Line Assessment Matrix — Change Over Time**

Illustrative

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**Figure 4: Business-Line Assessment Matrix — Segmentation**

Illustrative

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2. Get Management’s Buy-In on Competitive Urgency

In a period of pressurized cost cutting, companies tend to underinvest in business leader engagement, but it’s important. It can be especially difficult if all business leaders feel their businesses will deliver the most growth or have seen more than their share of cost cuts over the years.

Whether business leaders are actively fighting cuts or their mental models simply stay rooted in another economic scenario, you need to address this risk. There are two ways to do so.

The first approach is to name and quantify the threats to business performance. Finance at Stanley Black & Decker did this by requiring business management and line finance to put hard numbers on the things hindering and helping the company’s profitability for the year (see Figure 5). Finance leaders go over the scorecard with the CEO and the CFO in quarterly operating reviews before releasing the results to Wall Street.

Stanley Black & Decker’s review features headwinds (the risks) and tailwinds (forces pushing the company closer to its goals). The company uses this method consistently, but it’s most helpful during economic turns because it builds managers’ commitment by asking them to quantify and define the problem.

Figure 5: Stanley Black & Decker’s Headwinds and Tailwinds Forecast Review

<table>
<thead>
<tr>
<th></th>
<th>First Quarter</th>
<th>Second Quarter</th>
<th>Third Quarter</th>
<th>Fourth Quarter</th>
<th>Year</th>
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</thead>
<tbody>
<tr>
<td>Operating Profit</td>
<td>$150M</td>
<td>$280M</td>
<td>$290M</td>
<td>$980M</td>
<td></td>
</tr>
<tr>
<td><strong>Headwinds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Volume, EMEA</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Price</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>-$15M</td>
<td>-$13M</td>
<td>-$15M</td>
<td>-$4M</td>
<td>-$47M</td>
</tr>
<tr>
<td><strong>Tailwinds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Volume, APAC</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SG&amp;A Actions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$5M</td>
<td>$17M</td>
<td>$6M</td>
<td>$7M</td>
<td>$35M</td>
</tr>
</tbody>
</table>

Source: Adapted from Stanley Black & Decker
The second way to address the risk is to build urgency by bringing the business closer to the voice of the investor. Making a public cost-cutting commitment to the market is the ultimate means of holding everyone accountable for the outcome.

P&G did this when it faced pressure to cut costs during the Great Recession. The company used three cost strategies with all the brands in its portfolio (see Figure 6):

- **Half-overhead growth** — Costs will grow at half their usual rate compared to sales.
- **Zero-overhead growth** — Costs will remain steady.
- **Negative-overhead growth** — Cuts will take place. The company announced this model at an investor roadshow.

Managers get on board when a company is transparent about the rationale and declares its plans to the world — putting its leadership’s reputation on the line.

### 3. Close Information Gaps With Proof-of-Concept Testing

After a recession, executives often regret investments that were stalled or never made because of worries about financial performance. During good times, strong investment management is based on discovery — learning about the company and its capabilities, customers and markets. In an economic turn, it’s no different from the good times, but it’s harder to get the necessary information because the conditions for investment success often change.

The solution is to attack these gaps more directly and go after the details you need with proof-of-concept testing — a pilot project designed to collect information that reduces uncertainty about a critical variable in an investment.

Finance executives at one biotechnology company told us they categorized investment project types as:

- **Transformational growth investments**, such as new products in entirely new fields
- **Investments with a mix of revenue and efficiency benefits**, such as making current products available in more geographies
- **Efficiency investments**, such as implementing shared data systems

Initiatives in the first category were ideal candidates for proof-of-concept testing because they were typically riskier, with a broader range of outcomes, and the company didn’t have significant experience to draw on.

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**Figure 6: P&G’s Downturn Cost Reduction Model**

<table>
<thead>
<tr>
<th>Half-Overhead Growth</th>
<th>Zero-Overhead Growth</th>
<th>Negative-Overhead Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fast-Growing Businesses</td>
<td>Slow-Growth Businesses</td>
<td>Business With a Structural Cost Disadvantage</td>
</tr>
<tr>
<td>Investments Largely Protected</td>
<td>Self-Fund Efficiency Projects</td>
<td>Revisit Divestment Triggers</td>
</tr>
</tbody>
</table>

Source: “P&G Commits to ZOG, HOG and NOG but ‘No Layoffs,’” WARC
This approach helped the company capture its most uncertain assumptions about why a project should succeed or fail (see Figure 7).

The second example in Figure 7 is a good candidate for proof-of-concept testing because it has significant risk from uncertainty.

The company used the likelihood of success at any point — before and during discovery investments like the market leader survey — to ascertain the size of the proof-of-concept budget.

If the company could not reduce the largest uncertainties for a given project, it shut that project down. If, on the other hand, it could increase the probability of success through additional information, it funded the project.

The result: Executives avoided missing out on promising investments while minimizing the risk involved in funding new transformational projects.

This white paper is adapted from an article in the Q3 2019 issue of Fi.r.st. Quarterly Journal. Download the latest journal at [gartner.com/en/publications/first-journal](http://gartner.com/en/publications/first-journal).

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**Figure 7: Differing Credibility Levels**

*Illustrative*

<table>
<thead>
<tr>
<th>Variable</th>
<th>Assumption</th>
<th>Credibility Level</th>
<th>Risk From Uncertainty</th>
<th>New Information</th>
<th>Cost of New Information</th>
<th>Needs Proof of Concept?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Expansion</td>
<td>$10B</td>
<td>High</td>
<td>Low</td>
<td>N/A</td>
<td>N/A</td>
<td>X</td>
</tr>
<tr>
<td>Return on Marketing</td>
<td>$2.5B</td>
<td>Low: $500,000 to $2B</td>
<td>About $2B</td>
<td>Market leader survey</td>
<td>$75,000</td>
<td>✓</td>
</tr>
</tbody>
</table>

Source: Adapted from Logic Co.*

* Pseudonym
About Gartner

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Contact Us

Phone: 1 866 913 8102
Email: financeleaders@gartner.com
Web: gartner.com/go/finance

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