

McKinsey Global Survey results:

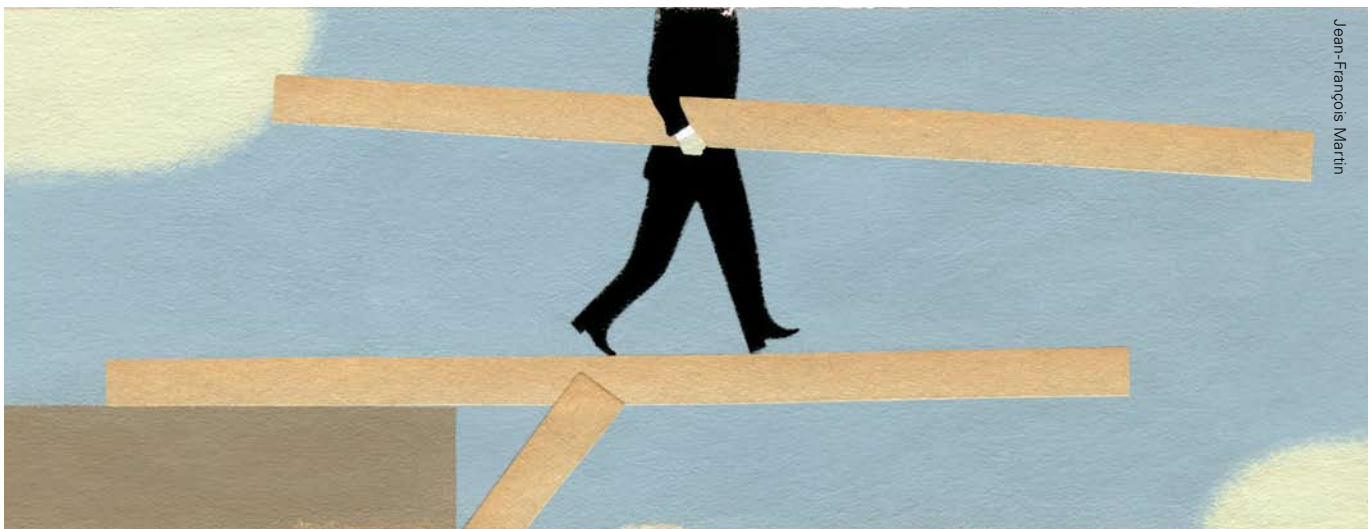
## What worked in cost cutting— and what's next

*Companies were able to cut costs effectively through the crisis, executives say, but they're less confident of their ability to contain or continue to cut them. Some companies are positioning themselves for longer-term success by planning the next round more strategically.*

Executives say their companies have made effective and significant cutbacks in overall costs since the onset of the economic downturn in September 2008, according to a recent McKinsey survey.<sup>1</sup> Even though cost containment remains a high priority, many respondents worry about the sustainability of the cost reductions and are only somewhat confident that their companies are adequately prepared for even bigger cost challenges, which they expect in the coming year. These are among the findings of a survey of 300 operations and other senior executives from around the world. We asked respondents about the size and scope of recent actions their organizations have taken to reduce costs, the strategic motivations underpinning the moves, and executives' views on the success and sustainability of cost cuts. We also asked respondents to identify the most significant risks facing their companies' cost structures in the coming year and assess their confidence in the level of preparedness of their organizations to manage those risks.

<sup>1</sup> The online survey was in the field in November 2009 and received responses from 301 executives from a full range of industries and regions; 72 are operations executives, and the remainder are senior executives with other functional specialties.

While the results reflect a lingering environment of uncertainty and risk in the short term, they also show that some companies are making important strategic moves in cost reduction—among them, a focus on organizational effectiveness and capability building—to position themselves advantageously for the long haul.



Jean-François Martin

A hard look at the bottom line

Even as moderate optimism about the global economy returns,<sup>2</sup> cost cutting remains a top priority for nearly three-quarters of all respondents to this survey. More than half say their companies have cut up to 10 percent of overall costs since September 2008, nearly one-third say their companies have reduced costs by 11 percent to 20 percent, and 9 percent of executives report cutbacks of 20 percent or more.

More than half of all respondents say the cost-cutting programs undertaken by their companies since September 2008 were targeted at labor, with overhead labor accounting for the lion's share of labor cost reductions. Forty percent of executives say they cut costs in all categories: frontline and overhead labor, nonlabor, and capital assets (Exhibit 1).

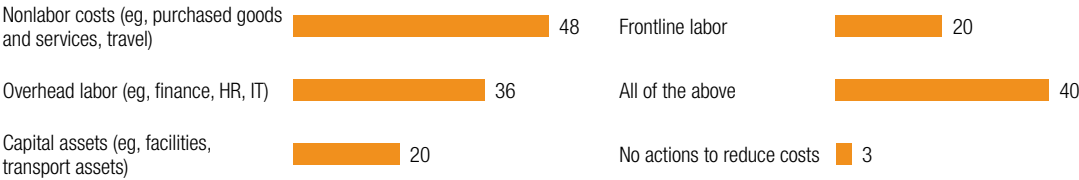
<sup>2</sup> See, for example, "Economic Conditions Snapshot, December 2009: McKinsey Global Survey results," mckinseyquarterly.com, December 2009.

Exhibit 1

Cuts everywhere

Actions taken to reduce costs since Sept 2008, % of respondents,<sup>1</sup> n = 301

Cost reduction focused on...



<sup>1</sup> Respondents who answered "other" are not shown.



The predominant motivation for cost reduction of any kind was to lower variable costs in response to lower demand (Exhibit 2). Nevertheless, a large proportion of respondents note that company-wide-improvement programs—such as lean or Six Sigma—were strong motivators as well. This finding suggests that many companies have an interest in making long-term, transformative changes to their cost structures.

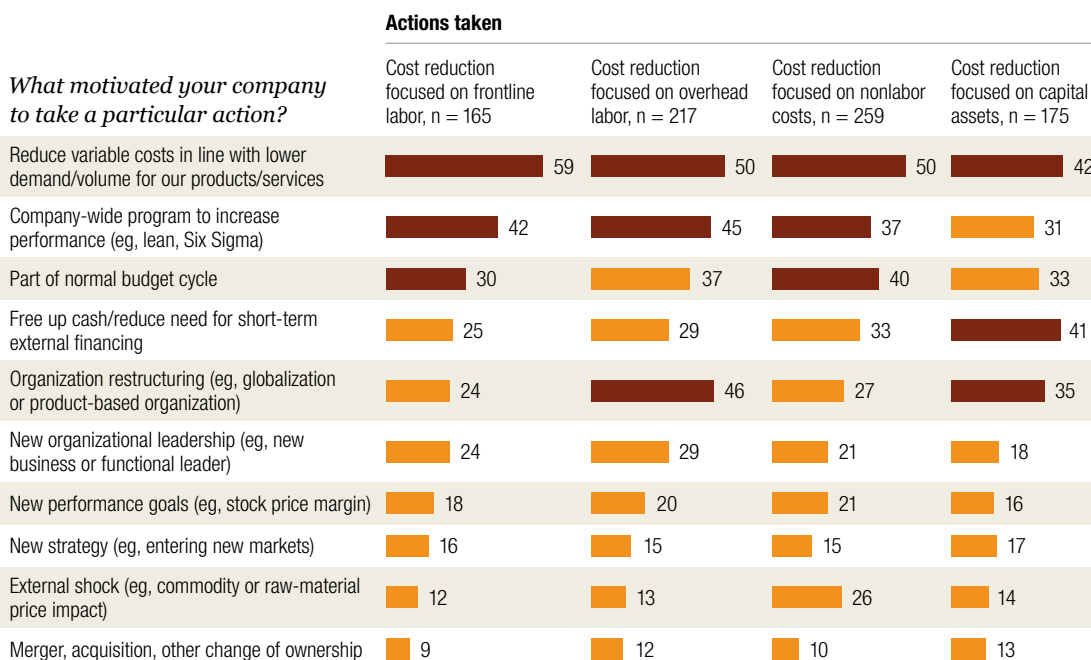
On strategy, just over half of all respondents say their companies took a targeted approach (focusing on a particular geography or function), whereas 44 percent say their companies' approach was an across-the-board cost reduction. Large companies—those with annual revenues of more than \$1 billion—and public companies were far more likely than their smaller or privately owned peers to take an across-the-board approach.

Exhibit 2

**Why cut?**

% of respondents whose companies have taken action to reduce costs since Sept 2008<sup>1</sup>

■ Top 3 reasons for action taken



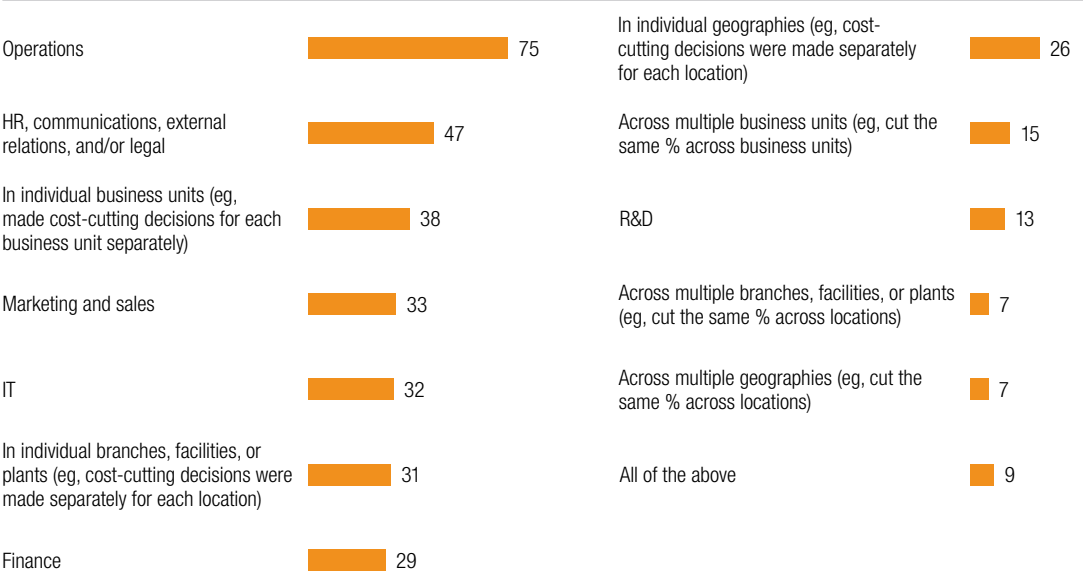
<sup>1</sup> Respondents who answered "other" or "don't know" are not shown.

Where did cutbacks occur? Among respondents whose companies took a targeted approach to cutbacks, a full 75 percent say their organizations trimmed costs in operations, and nearly half cite HR—the next most frequently chosen option (Exhibit 3). No area was spared, however: cuts were widely distributed across business units, geographies, and regions. Indeed, 9 percent of executives say their companies cut everywhere.

Exhibit 3  
**Where the cuts are**

% of respondents whose companies have taken a targeted approach to cost cutting,<sup>1</sup> n = 161

**Parts of the business where companies cut costs**



<sup>1</sup> Respondents who answered “don’t know” are not shown.

Making cuts stick?

Regardless of where or why companies trimmed costs, the majority of respondents say those moves were effective, and two-thirds say their companies met the cost reduction targets they'd set. Broadly, executives who say their companies were effective tend to credit those factors associated with basic tenets of good management. For instance, the top two factors cited by respondents as being responsible for successfully meeting their cost reduction goals are top-management support and clear targets (Exhibit 4). Among the minority of executives who say their companies' cost cuts were ineffective, the top barriers cited are a deteriorating economy, a lack of accountability, and an insufficient fact base to make decisions.

Exhibit 4

Top factors for meeting targets



<sup>1</sup> Respondents who answered “don’t know” are not shown.



While the majority of executives say the cuts will be sustainable over the next 12 to 18 months (particularly in North America, where nearly two-thirds agree), a sizable minority believe otherwise. Fully four in ten say that at least some proportion of the costs their companies cut since September 2008 will return.

Notably, executives who doubt that the cuts are sustainable are more likely to work for companies that took an across-the-board approach to cost cutting. By contrast, executives who predict that their companies' cuts are sustainable over the next 18 months are more likely to say their companies chose a targeted approach.

Further, respondents who think cutbacks will be sustainable are more likely to say their companies focused cuts on operations and less likely to have targeted marketing, IT, and R&D. This perhaps reflects a view among executives that is also seen in other surveys: that functions such as R&D, marketing, and IT are critical drivers of growth and, to some extent, must grow or shrink in line with demand.<sup>3</sup>

Finally, two-thirds of the respondents who expect some proportion of costs to return in the coming 12 to 18 months cite rising demand and volumes as the cause. (A full 20 percent say demand has already returned to pre-crisis levels, a response consistent with other surveys.<sup>4</sup>) Other causes of returning costs include the investments required because of a company's strategic direction (35 percent of executives) and changes in strategy (19 percent). By contrast, only 12 percent of respondents expect costs to return because their companies have no clear approach to limit them.

<sup>3</sup> See, for instance, "R&D in the downturn: McKinsey Global Survey Results," [mckinseyquarterly.com](http://mckinseyquarterly.com), April 2009; and "IT in the new normal: McKinsey Global Survey results," [mckinseyquarterly.com](http://mckinseyquarterly.com), December 2009.

<sup>4</sup> In a recent survey, we found that 49 percent of respondents expect demand to increase by the end of the first quarter of 2010, while 19 percent say an upturn has already begun and an additional 7 percent think the upturn will begin by the end of the year. For more, see "Economic Conditions Snapshot, December 2009: McKinsey Global Survey results," [mckinseyquarterly.com](http://mckinseyquarterly.com), December 2009.



### A risky future

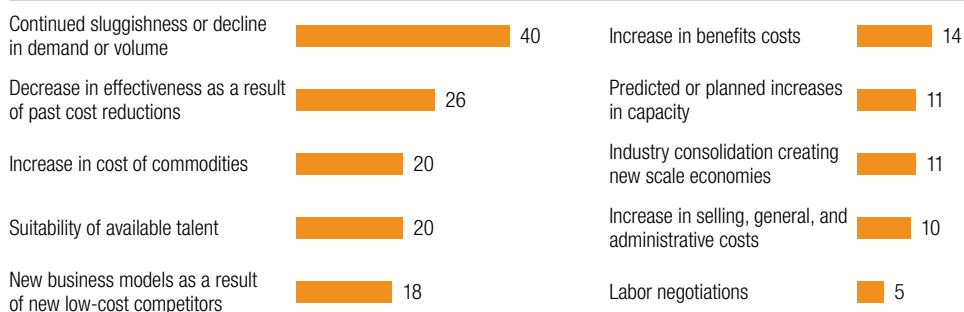
Executives express misgivings when it comes to the ability of their organizations to weather the risks they perceive as most relevant to their corporate cost structures in the coming months. Chief among these risks is continued sluggishness or decline in demand (Exhibit 5), for which only one-quarter of respondents say their companies are “extremely prepared” or “very prepared.” Meanwhile, 37 percent of respondents say their companies are “slightly prepared” or “not at all prepared” for decreased quality or service effectiveness resulting from past cost reductions.

Exhibit 5

### Concerns about demand levels

% of respondents,<sup>1</sup> n = 301

#### Biggest risks to company's cost structure in next 12–18 months



<sup>1</sup> Respondents who answered “other” or “don’t know” are not shown.

Executives in North America, compared with their counterparts in Europe, are four times likelier to cite increasing employee-benefits costs as a risk.



However, the importance of mastering cost-related risks will persist, as nearly three-quarters of survey respondents say cost containment or cost reduction will be among their companies' top three priorities over the next 12 to 18 months. Therefore, it is notable that some companies appear to be reacting to the pressures of the post-downturn economy by planning operational changes that could reduce their cost structures for years to come (Exhibit 6).

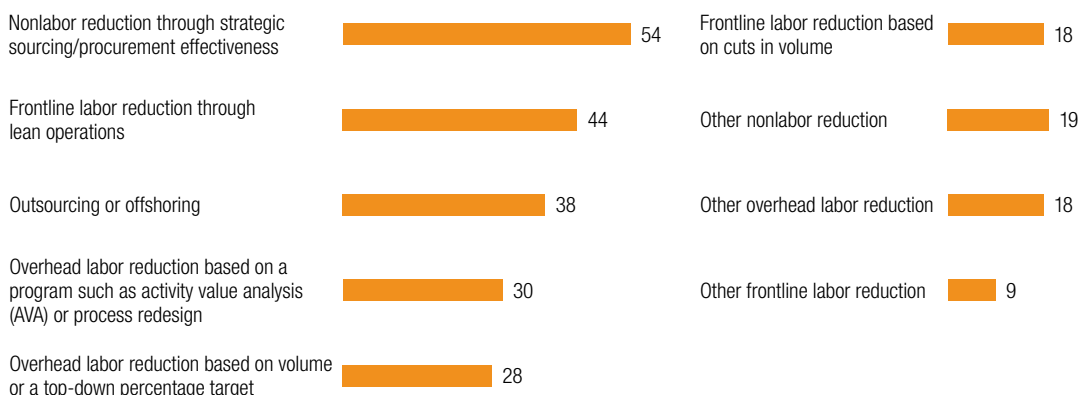
For example, more than half of all respondents say their organizations plan to lower nonlabor costs through the use of strategic sourcing or procurement effectiveness initiatives. Likewise, more than 40 percent of executives report that their organizations will reduce frontline labor costs by using lean-operating principles—a significant proportion, compared with the 20 percent of respondents in this survey who say their companies have focused on frontline cost reduction since September 2008.

Exhibit 6

### Reducing companies' cost structures

% of respondents,<sup>1</sup> n = 301

*Looking ahead at the next 12 to 18 months, which, if any, of the following actions is your company considering to reduce costs?*



<sup>1</sup> Respondents who answered "don't know" are not shown.


Executives in Europe are more likely than those elsewhere to say their companies are planning offshoring or outsourcing activities in the next 12 to 18 months.



In our experience, in order for strategic sourcing and lean to work, they require big cultural changes and long-term organizational commitment. Therefore, it's appropriate that 57 percent of all executives say their companies will focus on organizational effectiveness, including talent and capability building, as an operational priority in the coming months (39 percent of respondents say their companies will focus on productivity growth, the same proportion of executives who say their companies will focus on service improvement). Indeed, 21 percent of respondents cite “frontline talent and culture” as the single area where improvement would fundamentally lower their companies' cost structures—second only to “fixed-cost burden,” cited by 23 percent of respondents.

Notably, executives who describe their companies' past approach to cost cutting as both targeted and sustainable are even likelier to be focusing on organizational effectiveness than are other executives, suggesting they may be in position to further extend their cost advantages.

### Looking ahead

- Companies often employ an across-the-board approach to cost reduction because it is fast, relatively easy, and appears “fair” to business units and other stakeholders. Nonetheless, our experience and the results of this survey suggest that a differentiated approach is both more effective and more likely to be sustainable.
- In the coming months, a substantial number of companies plan to tackle perennially hard-to-reach cost areas, among them fixed-cost structures and product or service specifications. In our experience, securing large and sustainable improvements in such areas requires companies to be willing to make significant changes to how products and services are designed and delivered—and to develop a more sophisticated understanding of how customers perceive the value of product and service features.
- As companies seek to extend their cost reduction efforts further into the front line, they will likely find bigger rewards—and bigger challenges. Encouragingly, a majority of companies are focusing on organizational factors such as talent and capability in the coming months. In our experience, companies that fail to place a high priority on “softer,” organizational issues risk handcuffing their ability to make operational changes stick. 

Contributors to the development and analysis of this survey include **Kevin Dolan** and **Michael Murray**, an associate principal and principal, respectively, in McKinsey's Chicago office, and **Kelly Duffin**, a consultant in the Toronto office. Copyright © 2010 McKinsey & Company. All rights reserved.

