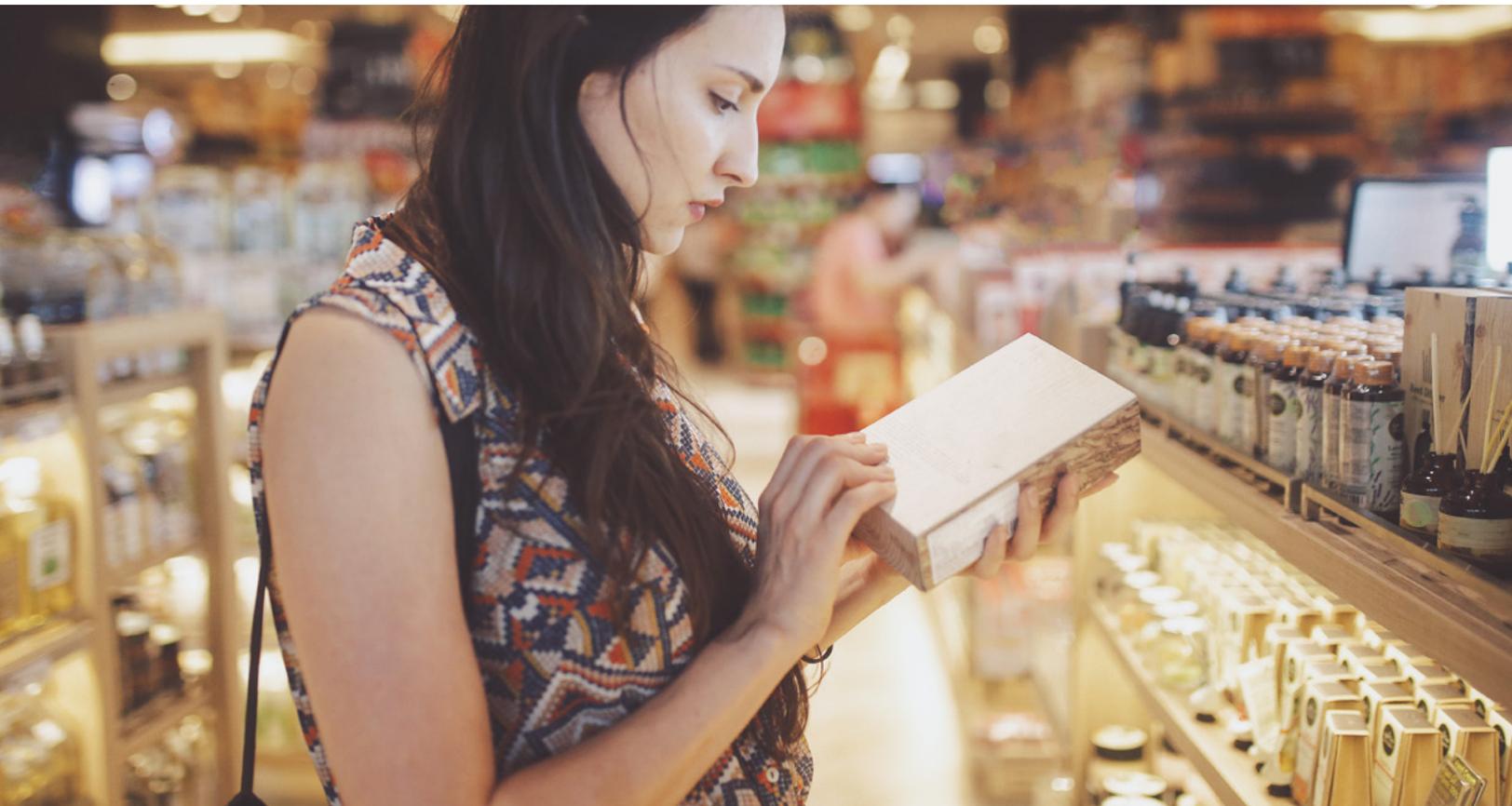


Operations Practice

# How to untap the full potential: An integrated—not isolated— view on cost

Consumer-goods corporations have already turned the screws on costs. To capture further potential, they need to adopt cross-functional approaches.

*by Philip Christiani, Sebastian Gatzer, Daniel Rexhausen, and Andreas Seyfert*



**Come on, you can do better:** for decades, producers of fast-moving consumer goods—from chocolate bars to toilet paper—have been working harder and harder to further reduce the cost of producing and distributing their brands. For a variety of good reasons, too. Many simply want to hit their return-on-investment targets. Others launch major transformations and need to free up cash for investment in new business models or in digitization. And some need flexibility in their pricing or promotion strategy to defend their market shares against retail brands aggressively competing on price.

Indeed, cost of goods sold (COGS) holds enormous potential for creating value. In times when there is little growth to be had in many consumer goods markets and categories, continuous optimization in the fields of procurement, manufacturing, logistics, and planning are among the most important sources of value creation. And it pays to turn the screws on costs. In recent years, leading companies in the industry have saved hundreds of millions, if not billions, of dollars with operational-improvement programs. More than one has increased their earnings per share (EPS) by over 50 percent through cost improvement despite low-single-digit growth in revenue.

It's not only industry leaders who are optimizing the costs. Those on their heels are also pulling the same levers, as is evident from McKinsey's Consumer Operations Benchmarking research. And there's another group who is squeezing costs: activist investors. For some years now, private-equity firms have been showing a growing interest in the consumer-goods sector. Particularly smaller companies in the sector are vulnerable to being taken over by investors looking to trim them for profit. From animal-food producers to bakery chains, private-equity companies have already generated substantial increases in value with cost-optimization initiatives.

### **The best approach: 1 + 1 = 3**

How can these value creation effects be generated? Cost-improvement programs are traditionally

anchored in individual functions: logistics pushes down its transport and warehousing costs, production increases its utilization of plant, machinery, and process capacity, procurement seeks savings in direct and indirect cost of materials. However, such isolated improvements are increasingly reaching their limits, and are by no means exhausting all sources of savings. Experience from numerous examples we have seen in the field shows that the sum of local optimizations is often less than the global optimum. In other words: it is only possible to capture the full potential with an approach that uncovers the opportunities for reducing costs across the entire value chain, especially at the interfaces of individual functions. It is at these intersections that a carefully conducted diagnostic can be most powerful (see sidebar, "Operations Full Potential Scan: Full-scope cost tuning").

Consumer-goods companies intent on achieving their ambitious performance objectives need to find alternatives to the traditional path of isolated optimization initiatives. From day one, high-performing companies pursue a combination of function-specific and overarching measures. Although this approach requires more preparation and management, the effort is worth it: integrative improvement programs capture up to 40 percent more savings potential than function-specific levers. And once the silos have been dismantled, the method unfolds its full potential as is illustrated by the following illustrative scenarios.

**Integrated planning.** A complex product portfolio is ideal terrain for the interaction between procurement, production, logistics, and sales. Viewed in isolation, every function pursues its own interests, partly in conflict with the interests of peer functions: sales favors having as many product variants as possible in order to meet customer demands and generate additional revenue. For logistics, greater variety primarily means increased inventory and, in turn, growing warehousing costs. In contrast, manufacturing chisels away at the design of their production networks in a bid to keep total costs within reason and to manage processes better. In good companies, each of these functions finds opportunities for improvements within their own

## Operations Full Potential Scan: Full-scope cost tuning

The links among the value chains of consumer-goods companies are so tightly interlocked that it is effectively impossible to analyze them in isolation. Companies seeking to capture the entire available savings potential must scan the complete value chain, from planning and procurement through to production and logistics.

It's an ambitious undertaking that many companies find overwhelming. But, supported by digital analytics tools, the Operations Full Potential Scan applies an integrative approach that enables the identification of more than 100 function-specific and cross-functional levers for cutting costs—in merely six to eight weeks. The spectrum spans autonomous planning and machine learning to data-driven pricing and revenue forecasting, through to automated throughput optimization in production and dynamic route planning in logistics. The approach draws on benchmarks from hundreds of operations and supply chain transformation projects. In a recent deployment in the food industry, the Operations Full Potential Scan was able to determine potential for widening the EBITDA margin by between 7 and 15 percentage points, with between 30 and 50 percent of the overall impact attributable to cross-functional levers.

Moreover, the approach creates opportunities to capture quick cost optimizations, particularly for companies that urgently need to take action but have insufficient resources and/or capabilities to tackle cross-functional initiatives.

remit. However, the full potential is only revealed after determining the true complexity costs across all functions. An integrative approach focuses on the total value of each stock-keeping unit (SKU) and strikes the right balance between customer benefits and operating cost.

**Network optimization.** The optimization of the network of facilities is another example of the added value of integrated cost management. Production and sales locations are structured in unison in order to weigh and optimize the costs incurred on both sides of the equation. For instance, the savings potential from centralized production in “mega factories” is counterbalanced by longer lead times, higher transportation costs, and more-demanding service levels. On the other hand, an overly fragmented production network risks underutilization of truck payloads and, in turn, higher logistics costs. Integrative management helps find the golden mean between both cost considerations.

**Digital technology and advanced data analytics accelerate cross-functional optimization.** Big data, advanced analytics, and machine learning model reality much more accurately—and in future it will be possible to predict customer needs much faster and with greater precision. In addition, these smart tools create greater transparency. For instance, the sales team can decide based on real-time capacity planning whether they should provide extra volume for a sales drive in the retail channels.

### Capturing the full potential—how it's done

But how do we reliably determine and realize hidden cost-saving potential? A standardized approach in four phases has proven successful in practice: collect all data of relevance for the analysis of potential, estimate the possible savings effects per function and then prioritize focus areas, determine cost targets, and finally elaborate an

implementation plan at functional and cross-functional level (Exhibit 1).

It is only in the application across all links of the value chain that the advantages of the four-phase model truly come to bear. That is because the Operations Full Potential Scan often examines more than 100 cost levers—function-specific and cross-functional, simple and highly complex levers. This is where the approach unfolds its full potential: from the early prioritization of the functions and focus areas that promise a particularly high impact on costs to rapid implementation of previously determined cost targets in weekly sprints. The cross-functional collaboration of agile teams further increases the effectiveness of the four-phase approach. This approach allows a faster unearthing of interdependencies between

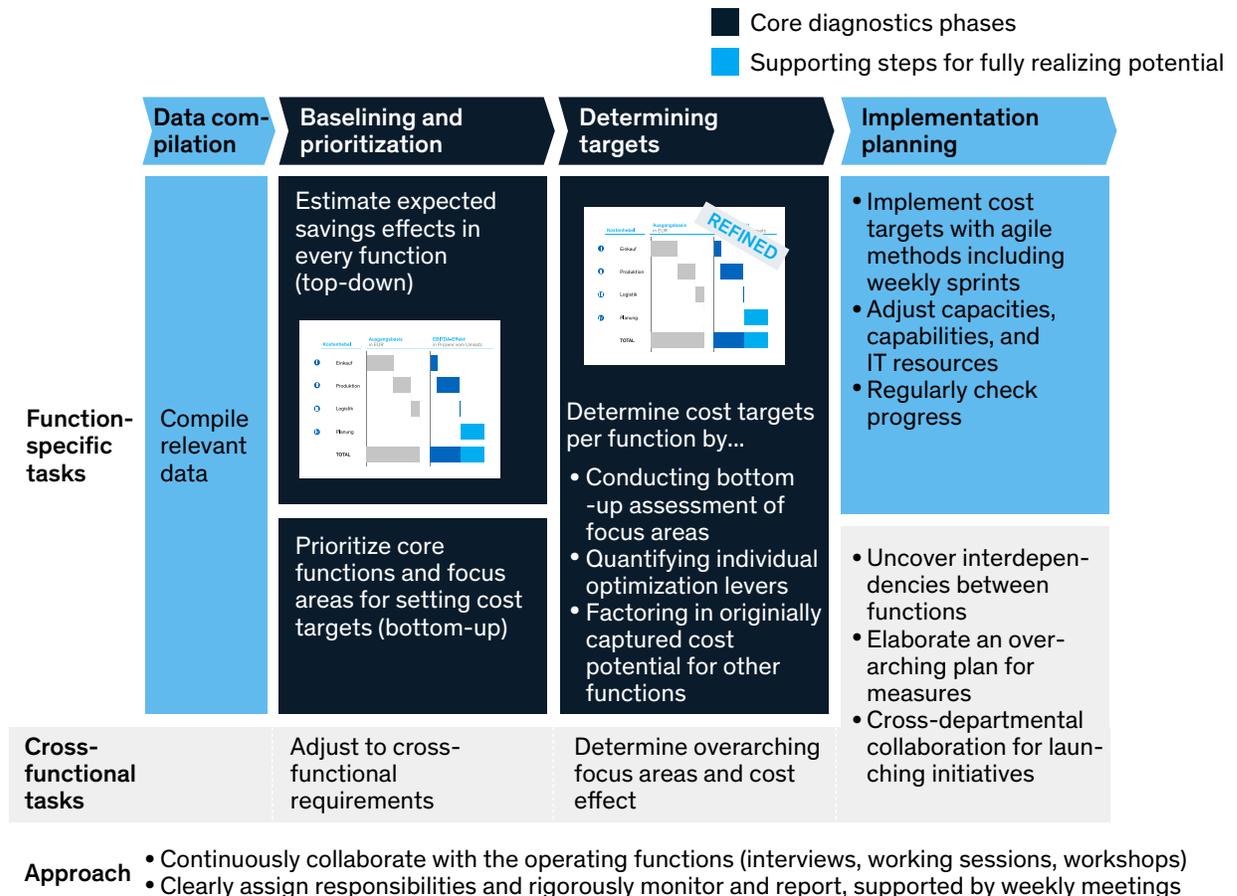
functions, while easing the task of pursuing cross-departmental measures for cutting costs. However, the success of cost optimization initiatives—particularly large, integrated efforts—hinges critically on having the right team: a balanced mix of content, business, and technology experts, along with data and analytics specialists, is essential to ensure that the entire array of cost levers can be pulled for maximum effect.

### Additional savings of up to 50 percent

Those who are seeking cost-saving potential merely in isolated sections of their value chains and who additionally resist the use of digital analytics tools are losing good money. That

Exhibit 1

## A four-phase approach can uncover, quantify, and realize all savings potential in operations.



is demonstrated by the surveys of potential that we have conducted on the basis of numerous industry studies: up to a 50 percent higher cost impact can be achieved through cross-functional improvements alone (Exhibit 2).

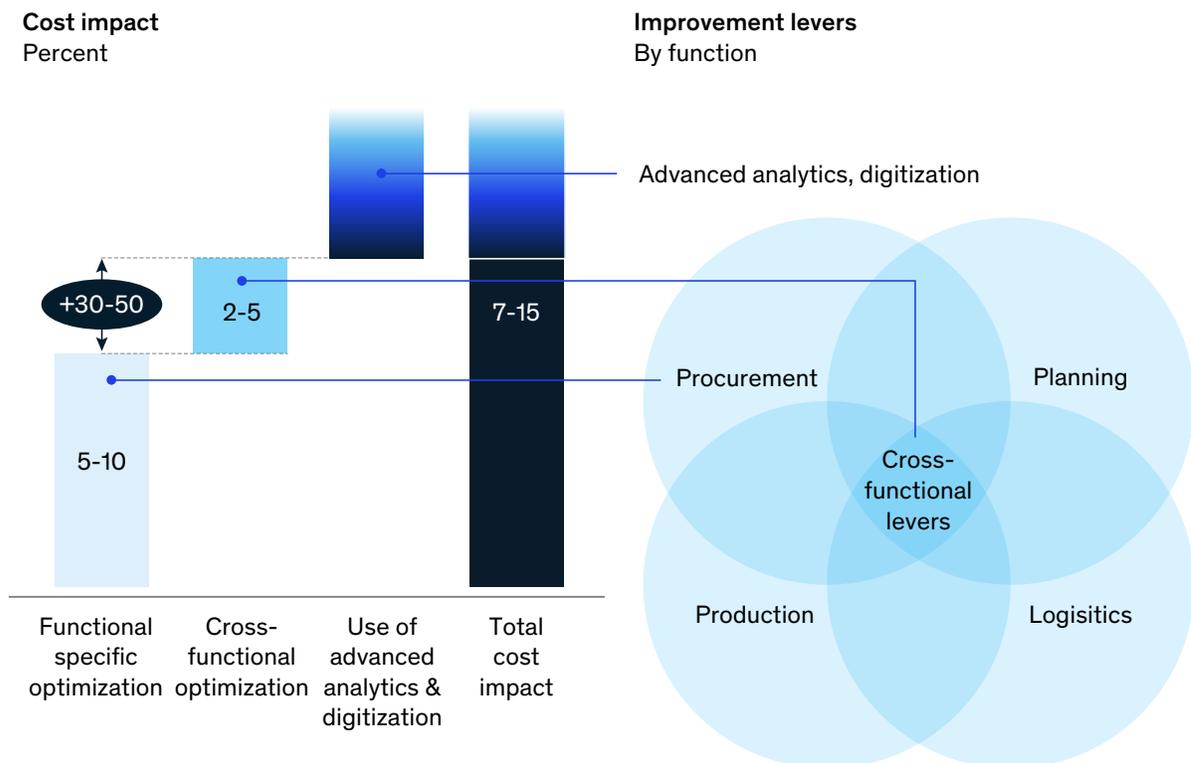
Two examples illustrate the specific benefits for companies: A producer of baked goods that primarily manufactured retail brands conducted an Operations Full Potential Scan in order to remove operational inefficiencies and to improve margins through increased volume growth. The optimization spanned procurement to planning to production through to logistics, and captured an improvement in EBITDA margin of 8 percentage points, roughly 30 percent of which was realized by pulling cross-functional levers. The most effective levers included optimizing the packaging design, simplifying indirect cost items, and redesigning the complete planning process.

A producer of frozen products improved its EBITDA margin by roughly 5 percentage points, generating 40 percent of the improvement with cross-functional levers. Decisive factors included simplifying the product portfolio, improving specifications for raw materials, and redesigning the sales network with new offer procedures in selected markets.

The success stories speak for themselves: companies seeking to take their operational excellence to the next level and to sustainably improve their profitability are well advised to examine their complete value chain and focus in particular on the interfaces between individual functions. A holistic approach like the Operations Full Potential Scan can serve as a basis for such initiatives.

Exhibit 2

**Cross-functional optimization and digital analytics tools can maximize impact of savings programs on costs.**



## Key messages

1. For years, consumer-goods companies have worked hard on lowering their product costs, yet isolated optimization efforts are insufficient to perceptibly add value.
2. Leading manufacturers pursue a combination of function-specific and cross-functional improvement levers—and generate up to 40 percent higher cost effects.
3. A diagnostic such as the Operations Full Potential Scan helps capture the full savings potential, from planning and procurement through to production and logistics.

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