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A Hard Look in the Mirror:

What an Independent Assessment Can Reveal About Bloated Costs

A frustrated Chief Executive Officer (CEO) wants to know why their company is running at full throttle but not moving forward. Shareholders are unhappy. The board is aware that activist investors are looking for companies in just this type of predicament. What can a CEO do to end stagnation and kick-start profitable growth?

A critical first component of any transformation should be an independent, fact-based assessment of a company's performance. Often, costs become entrenched, and budgets grow in girth because managers instinctively protect their fiefdoms. They spend every dollar, whether they need to or not. When this pattern is repeated throughout an organization, the overall picture that a CEO sees can be significantly distorted. Inefficiencies are compounded if budget planning is based on the preceding year's results.

"The important part of our job as transformation agents is to use a zero-based budgeting approach - a clean sheet of paper - to look at what the business is capable of achieving," says [Joe Berardino](#), Managing Director of Alvarez & Marsal's Corporate Transformation Services practice.

Zero-based budgeting is used by global companies including Kraft Heinz, Diageo and Unilever. They plan from scratch every year, rather than basing budgets on the previous year's spending. This requires managers to justify costs afresh each year.

"Managers will not openly admit to where they can achieve cost savings because it is an admission of poor management," says [Pamit Surana](#), Managing Director at Alvarez & Marsal in New York. "Instead, they will build a case, and/or a wall, in their fiefdom to prevent an independent view of deficiencies and missed opportunities. CEOs need an independent view that gives them transparency on figures, rather than the filtered guidance and data they are receiving."

Activist investors focused on streamlining operations are often "making a bet on the magnitude of the filtered numbers," adds Surana. Board members, he says, are sometimes put in the unenviable position of having to "defend the management without an independent set of facts to validate their defense."

A&M recently worked with a client with \$400 million in revenue and \$405 million in costs. The CEO told the Board that his senior executives had identified only \$2-\$3 million in cost savings. An activist investor believed the company could cut costs by \$7-\$8 million. An independent assessment by A&M uncovered and delivered \$40 million in cost savings within months.

"The disparity was huge, however the \$40 million was accomplished with the buy-in and acceptance of the same management team that originally provided the \$2-\$3 million guidance," says Surana. "Most often, the issues include broken processes and inconsistent data, as well as a lack of alignment with the customer base and overall business strategy," he explains. "We reveal the irrefutable facts by walking in with a mirror."

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