CORPORATE PERFORMANCE IMPROVEMENT

HOW TO CUT 20% OF HR, IT AND FINANCE BUDGETS WITH HAPPIER STAKEHOLDERS

"Internal customers walk away with a greater understanding of HR, IT and Finance costs they drive and feel more in control of these charges."

EXECUTIVE SUMMARY

Extraordinary cost cutting (20–30 percent) is a challenging but necessary action when a business needs to severely course-correct (fix large strategy or execution errors) or during a downturn when costs rise faster than revenues and P&Ls quickly stop scaling. Leadership often chooses to execute one large cost cut verses a more gradual trimming over several quarters. Morale is the biggest reason cited to take cost out in one motion, so the organization can heal and move on. More gradual trimming can also lose steam versus the one fell swoop approach.

For 20-plus percent cost cuts, Zero Based Budgeting (ZBB) is the weapon of choice. ZBB, as the name suggests, is when budgets are built up from zero as opposed to making incremental percentage reductions over the previous year's actuals. The goal is to strip out all costs where the ROI cannot be cleanly justified, including some that might otherwise bypass scrutiny, such as existing multi-year vendor contracts. Internally facing service departments, namely HR, IT, and Finance, usually bear the lion's share of cost cutting. Sales is usually spared, and Marketing, tied at the hip with sales, usually receives a much lighter sentence.

Most ZBB exercises fail for one of two reasons. First, ZBB requires a different set of data compared to what's readily available in the financial systems and general ledger (GL). Second, ZBB requires cross-departmental executive conversations and execution discipline, a process often lacking within corporations. It is impossible to achieve a 20-plus percent sustainable cost reduction unless departments are jointly working to reduce costs and make those cuts with precision.

Given our operational heritage, Alvarez & Marsal (A&M) has developed a 20-plus percent cost take-out tool and methodology to help HR, IT and Finance reduce costs with minimal impact to the internal customers they primarily service. In fact, internal customers can walk away from the process with a greater understanding of HR, IT and Finance costs they themselves drive and feel more directly in control of these charges.

In simple terms, our A&M tool and methodology converts the standard GL output (Exhibit A) into a new set of consumption-based metrics (Exhibit B) and then manages the joint 20-plus percent cost reduction within departments. In addition to our tools and methodologies, this requires a cultural change that our Change Management Office (CMO) teams are trained to implement. Happier internal stakeholders now own their own cross-functional budget and are able to make their own choices from a menu of options.

WHAT HR, IT AND FINANCE CAN LEARN FROM SALES

Have you noticed that Sales is usually the last department to be impacted by budget cuts? Sales is a customer facing organization and, by definition, Sales is continually measuring and optimizing for returns on its customers. Working with Product Management, Sales will package and display products in ways customers can easily understand them. Products that do not sell are quickly replaced by other products that drive customer demand. To show growth, Product Management is always under pressure to create products that have increased customer appeal — or that product's P&L will witness a decline in sales. If customer budgets shrink by 20 percent, Sales will work with the customer to figure out how they could jointly maximize the budget.

As the Sales Controller, Sally's job is to know which product lines sell and which do not. She's constantly talking to salespeople and monitoring sales data. Sally is also ultimately responsible for the product forecast (both current and new pipeline products), which tells the supply chain which products to build and which to scale back on. Customers are at the center of everything Sally does, and this is something HR, IT and Finance must learn for this 20-plus percent cost takeout to be successful.

TAKING THE SALES MINDSET AND USING ZBB

Gary is the financial controller over the IT department and approaches his job differently than Sally — and herein lies the problem! Gary breaks up IT costs into hardware, software and labor per GL guidelines. At the end of each quarter, Gary loads all IT costs into the appropriate box in the Enterprise Resource Planning (ERP) financial system. These rolled up products costs then get allocated out to the firm's internal divisions: Sales, Marketing, HR, Finance, Operations, Manufacturing and Logistics. Since IT supports employees, Gary allocates these costs to various departments by number of employees, a tried and true, simple to understand approach in "normal" times, yet inadequate to enable extraordinary cost reduction. Exhibit A shows the GL rollup of $20.0 million in 2018 IT costs allocated across the firm using Gary's methodology.

Putting it frankly, IT needs to think and operate more like Sales. IT "Product Management" should be under constant pressure to create easily understandable IT products that can be billed in arrears per employee per month (or some other logical per unit consumption metric like square feet consumed). Examples of IT products include a monthly email access charge, monthly costs per Android phone and iPhone, monthly costs to maintain Windows and Mac laptops, monthly costs to maintain 1,000 square feet of Wi-Fi and monthly costs to maintain one license of Salesforce or Oracle. Like Sally, Gary's role should be to know which IT products sell internally and which do not. Gary should be constantly talking to internal stakeholders and monitoring IT sales for what's selling and what's not. Gary's IT forecast tells the entire IT supply chain which products to focus on and identify those that have limited internal customer appeal. Internal department heads should receive a monthly cross charge based on IT products consumed by their employees. The CIO would be responsible for reducing "product cost," which includes bringing down the monthly cost for email access or the monthly cost to support a Mac — also known as scaling. Department heads then "own" more of their IT budget and vote with their dollars.

EXHIBIT A

	Sales	Marketing	HR	IT	Finance	Operations	Manufacturing	Logistics	Total
Hardware	$1,600,000	$160,000	$160,000	$106,667	$80,000	$400,000	$1,333,333	$160,000	$4,000,000
Software	$2,400,000	$240,000	$240,000	$160,000	$120,000	$600,000	$2,000,000	$240,000	$6,000,000
Labor	$4,000,000	$400,000	$400,000	$266,667	$200,000	$1,000,000	$3,333,333	$400,000	$10,000,000
Total	$8,000,000[1]	$800,000	$800,000	$533,333	$400,000	$2,000,000	$6,666,667	$800,000	$20,000,000
Employees	1,200	120	120	80	60	300	1,000	120	3,000
Allocation By Employee	40%	4%	4%	3%	2%	10%	33%	4%	100%

This is the 2018 GL breakdown of $20.0 million in IT costs. Gary, the IT controller, allocates this to the various internal divisions using headcount as a proxy. Sales has 1,200 of 3,000 employees and, therefore, is allocated 40 percent of IT costs, or $8.0 million[1], for 2018.

With help from A&M and using this approach, Gary is now able to reallocate 2018 IT cross charges very differently. Looking at Exhibit B, costs are now reallocated by usage per employee by department — with very different outcomes. Using GL allocation, Sales got hit with $8 million of the 2018 IT bill as it had 1,200, or 40 percent, of the 3,000 employees (see Exhibit A). A revised, bottoms up, consumption-based 2018 reallocation assigns $10.83 million to Sales (see Exhibit B). On the one hand, that's likely an unwanted surprise to Sales, but now the Sales lead and her direct reports can see the charges they drive and make informed choices, e.g., who needs a full access software license or the most expensive smartphone.

The A&M tool breaks down high level GL costs into consumption-based line items by department. Sales, Finance, HR and every department get a bottoms-up bill based on actual employee consumption. The Sales lead and CIO are jointly asked to reduce this $10.83 million 2018 expense by 20 percent going into 2019; $2,185,000 needs to come out of the 2019 joint IT / Sales budget. With employee-level consumption data, both leaders jointly make the following decisions summarized in Exhibit B.

First, the upcoming laptop refresh will save $520,000 or 5 percent in 2019. Field Sales gets Macs and everyone else gets the cheaper Windows-based PCs. Second, Sales opts for a cheaper Salesforce Force.com license for most users who can live without full Salesforce Enterprise Edition access. This saves another $1,250,000 or 12 percent. Third, the upcoming phone refresh saves another $190,000 or 2 percent, as only field employees would be permitted to use the more expensive Apple iPhones. Last, Sales manager offices would now be replaced with open cubes, reducing real estate and savings $225,000, or 2 percent in Wi-Fi costs alone. Working together, both leaders now have a bottoms-up plan to save $2,185,000 million, or 20 percent, in 2019 with no loss in Sales performance! The A&M Cost Management Office (CMO) ensures that decisions reached are real, buy-in is high and the jointly-owned cost reductions will happen.

EXHIBIT B

	2018 Restatement: IT Costs Related To Sales			2019 Revised IT Target For Sales - 20% Cost Savings				
	Cost Per Unit	# Of Employees	Total Cost	Cost Per Unit	# Of Employees	Total Cost	2019 Savings $	2019 Savings %
Laptop: Mac	$2,500	900	$2,250,000	$2,500	500[3]	$1,250,000	$(1,000,000)[4]	-9%
Laptop: Windows	$1,200	300	$360,000	$1,200	700	$840,000	$480,000[4]	4%
License: Oracle	$3,500	120	$420,000	$3,500	120	$420,000		
License: Other	$2,000	250	$500,000	$2,000	250	$500,000		
License: Salesforce	$2,500	1,250	$3,125,000	$1,500[5]	1,250	$1,875,000	$(1,250,000)[6]	-12%
License: Coupa Procurement								
License: IQMS Manufacturing								
Phone: Apple	$1,200	750	$900,000	$1,200	500[7]	$600,000	$(300,000)[8]	-3%
Phone: Android	$550	500	$275,000	$550	700	$385,000	$110,000[8]	1%
Sales Tech Support	$425	1,250	$531,250	$425	1,250	$531,250		
Email	$1,150	1,250	$1,437,500	$1,150	1,250	$1,437,500		
Partner Support			$406,250			$406,250		
Wifi Charges			$625,000			$400,000	$(225,000)[9]	-2%
Manufacturing: 24/7 Support								
Finance: Additional Data Security								
			$10,830,000[2]			$8,645,000	$(2,185,000)	-20%

The A&M tool breaks costs down based on actual consumption by employee by division. All IT costs consumed by Sales including Salesforce license fees or the premium for Mac laptops are charged to Sales. Sales is not charged for IT costs related to Procurement or Manufacturing. The first step using the A&M tool is to restate 2018 cost allocations with this level of granularity. Based on employee consumption, it turns out that Sales-related 2018 IT costs are $10.83 million[2] versus a GL-based approach of $8.0 million[1] (see Exhibit A). The second step is to now reduce Sales-related IT costs by 20 percent, or $2.185 million ($10.83 million minus 20 percent). With the additional granularity, this becomes much easier as sales leadership, the owner of the $10.83 million[2] IT budget, takes the lead in figuring out where to cut costs. With GL-based approach (Exhibit A), Sales would have no clue on where to find the savings. With this breakdown of IT costs, 20 percent savings is easy to find with accuracy.

First, Sales management decides that only 500[3] employees (down from 900 of 1,200 Sales employees who currently have Macs) would get a Mac with the upcoming laptop refresh. The rest get a cheaper Windows laptop. This saves Sales $520,000[4]. Second, Sales opts for a cheaper Salesforce license, reducing the blended cost to $1,500[5]. This saves $1.25 million[6]. Third, Sales employees allowed Apple phones with the upcoming refresh would be reduced from 750 to 500[7] employees, saving another $190,000[8]. Now, 700 employees would get the cheaper Android-based phones, up from 500. Last, by moving from lavish offices to open cubes for managers, Sales saves another $225,000[9] in IT Wi-Fi cross charges. Working jointly, IT and Sales found $2.185 million[10], or 20 percent, in savings.

Similarly, HR could do a cross charge monthly for existing employees, new employee onboarding, employee termination services, executive support, classroom training, online training, general insurance, executive insurance, the HR hotline and more. HR cross charges could be reduced by shifting all employee training online, getting rid of executive support and asking employees to pay 20 percent of their total insurance bill.

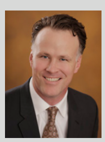
Finance could cross-charge for every account receivable and accounts payable invoice, forecast submissions, running the deals desk, monthly closes and more. To consolidate and reduce the number of invoices, Finance and Sales might jointly come up with a program whereby customers are now billed via two consolidated monthly invoices.

HOW DOES A&M DRIVE 20–30-PLUS PERCENT COST REDUCTIONS?

A&M has created a cost reduction capability that has transformed the cost structures of IT, Finance, HR and other functions for our clients. High-level steps in A&M's approach include:

1. Start by analyzing how the GL, cost centers and accounts are set up today. Then identify significant cost factors such as licensing renewal information, which may not be readily apparent in the GL but can be extracted from other systems, reports or other sources.
2. Convert the GL data into HR, IT and Finance products consumed by internal groups. Working with appropriate client stakeholders, examine each department's costs from multiple angles to determine the proper allocation treatment for each product.
3. Facilitate internal joint 20-plus percent cost reduction conversations using the consumption-based metrics by employee and department. This rigorous approach ensures cost reductions are identified that meet targets and have buy-in for execution.
4. Transfer knowledge about the tool and methodology to our clients so they can repeat the process. Clients ask A&M to return from time to time to refresh new participants on the approach and to ensure cost reductions are sustained and do not creep back up over time.

FOR MORE INFORMATION:



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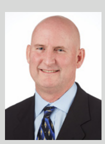

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Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) when conventional approaches are not enough to make change and achieve results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services.

With over 3000 people across four continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, help organizations transform operations, catapult growth and accelerate results through decisive action. Comprised of experienced operators, world-class consultants, former regulators and industry authorities, A&M leverages its restructuring heritage to turn change into a strategic business asset, manage risk and unlock value at every stage of growth.

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