



Driving Sustainable
Cost Reduction

Kurt Salmon 

INTRODUCTION

Retailers, including the major grocery chains, have dominated recent business headlines as they try to respond to the dramatic shift in the market place caused by intense competition and changing shopping habits. One after another, retailers have announced a series of cost cutting measures that include discounting prices, making staff redundancies, closing unprofitable stores, and reducing levels of investment.

In an apparent contradiction, there appears to be a general sentiment of 'cautious optimism' in the wider retail sector, as illustrated in the recent Retail 2015 report, the definitive report on the state of the industry, produced by Retail Week in association with Kurt Salmon. Indeed, from the first of our follow-up quarterly sentiment analyses (March 2015), it would appear that the majority of senior retail executives believe that the future continues to look brighter than it has done for some considerable time.

This returning customer confidence is likely to be reflected in retailers' strategies, investment plans and operational decisions in 2015. Retailers must make appropriate investments in both strategic and operational capabilities to increase their chances of longer term success.

The Retail 2015 report indicates that omni-channel and digital capabilities form the main focus of this investment.

In our view, retailers are refocusing their activities to be best placed to take advantage of this market improvement, and the recent cost-cutting announcements reflect these attempts to refocus.

CHANGING MARKET LANDSCAPE

Over the last couple of years, consumers have focused increasingly on value and convenience, and retailers have been making continual adjustments to their business models, notably with the development of e-commerce capability. Consequently, it is critical for retailers to understand their cost base and identify opportunities for savings that enable investment ambitions to be funded.

We believe that the Finance function needs to play a key role in driving this focus, leading the analysis and supporting the decision-making that will enable cost reduction opportunities to be identified and implemented.

COST REDUCTION MUST BE SUSTAINABLE

Although retailers are generally very cost-conscious by nature, we have seen many examples in which knee-jerk cost reductions have proved unsustainable, often leading to higher future costs or unacceptable performance.

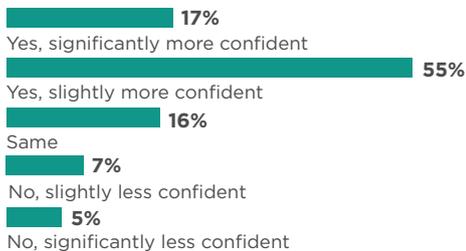
At Kurt Salmon, we believe the key to delivering sustainable cost reduction is not just to focus on the cost base and what can be cut, but also to identify what drives value in the business and look to invest there. By looking to invest in selective areas of the business while simultaneously addressing levels of cost in other areas, it is far more likely that the business will be better placed to exploit market conditions over the longer term.

Recent announcements from grocery retailers indicate a trend to invest in convenience stores whilst looking for opportunities to reduce the cost of operating larger formats.

Economic Sentiment



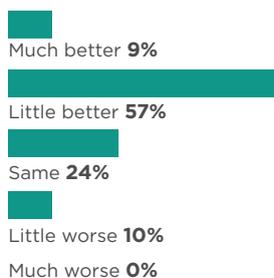
Do you feel more confident in the state of the economy than this time last year?



Consumer Sentiment



What's the mood like amongst your customers compared to this time last year?



Source:
Retail Week / Kurt Salmon Sentiment Analysis, March 2015

Retailers are clearly deciding which activities are core and there is growing evidence that non-core activities are being divested.

COST REDUCTION AND STRATEGIC PLANNING

Any initiative to identify and implement sustainable cost reduction should be clearly aligned to the Strategic Planning Cycle, with cost reduction and its subsequent monitoring being critical parts of the Actions and Outcome phases.

As part of setting and communicating strategic goals, an initial diagnostic review allows a business to assess the suitability and cost of its business operating model for delivering strategic objectives.

This review should also identify necessary actions at two levels, strategic and operational.

With appropriate actions now identified, budgets and other financial targets can be adjusted to reflect the expected outcomes. Ongoing management reporting and information should clearly identify variances with target performance and support subsequent decisions.

Examples of potential actions include:

STRATEGIC ACTIONS
<ul style="list-style-type: none"> Review and rationalise, where appropriate, channel, category, product and customer mix Review relevance of sourcing, supply chain and distribution operations – are they capable of meeting customers' needs?
OPERATIONAL ACTIONS
<ul style="list-style-type: none"> Identify inefficient or unnecessary processes for simplification or elimination Establish appropriate target inventory levels and develop plans to achieve these Review organisational structures and headcount by area for opportunity Ensure indirect spend is managed in a disciplined manner Review terms of trade with suppliers for opportunity to reduce spend



KURT SALMON'S APPROACH TO COST REDUCTION

Kurt Salmon has been supporting retailers exploit their growth opportunities, improve their operations and optimise their cost base for nearly 80 years. Our industry knowledge and focus means we are uniquely positioned to help navigate through these difficult choices.

Our proven and pragmatic approach to delivering smarter and sustainable cost reduction comprises a number of key steps:

- » **Step 1:** Identify which areas of the business drive value, assessing the financial position in the light of strategic and market opportunities and threats.
- » **Step 2:** Identify areas of the business where activities are under-performing and costs are out of alignment, using benchmark analysis; look for opportunities to simplify, standardise or eliminate tasks. Where practical, reorganise structures and processes – if cost effective then centralise or outsource tasks.

» **Step 3:**

Develop capabilities and create a culture of continuous improvement by involving and engaging all employees.

» **Step 4:**

Monitor performance by developing suitable metrics and reporting to measure and track progress.

THE DIAGNOSTIC PHASE

The first phase of our approach is to conduct an initial diagnostic. This involves:

- » Understanding the strategic context and the key value drivers in the business
- » Conducting a detailed assessment of the cost base, services and operational performance, and comparing against benchmarks and leading practices
- » Consolidating the findings from the activities above to determine opportunities and develop initiatives to deliver cost savings
- » Quantifying the potential benefits to be gained
- » Setting out the roadmap for delivery

The processes and business areas in scope depend on the particular circumstances of the organisation but we would expect to include both core retail processes – store operations, merchandising, product development and sourcing, marketing, supply chain and logistics – and support areas such as IT, Finance, HR, and Customer Services. Although timescales vary significantly, a thorough diagnostic of a medium-sized retailer can typically be completed in 5-8 weeks.

THE IMPLEMENTATION PHASE

The Diagnostic Phase highlights potential opportunities to realign a retailer's cost base to match its strategic objectives. Detailed planning for each initiative is then necessary before moving into implementation. Successful implementation requires active involvement of employees at all levels of the organisation. Appropriate communication, project management and governance are key activities, as are management reporting, benefits tracking and continual monitoring of progress.

Such projects can only succeed with sponsorship from management at the very top of the organisation, supported by input from a wide cross-section of stakeholders. While the Finance department will not be the overall sponsor, Finance should take a leading role in driving the process, supporting the required analysis and providing focused management reporting.

CASE STUDY

Kurt Salmon have supported a number of retailers and organisations in other sectors with their cost reduction initiatives, tailoring our approach to the specific circumstances and requirements of each client. We recently worked with a sporting goods retailer to review its structure and operations, and identified a series of initiatives across all key functions which could deliver an improvement in operating margin of 2-5% and help position the business for future growth. Fundamental to this work was our in-depth knowledge of retail processes and best practices, and our database of comparative benchmarks. We continue to work with this client on the implementation of high priority cost reduction initiatives.

SUMMARY

Retailers are continually being challenged to look for ways to meet the ever changing needs of consumers, and the need and pressure for investment in specific areas is growing. It is imperative that companies continually look to manage their cost base and ensure that funds can be reallocated where they are most needed. Cost reduction efforts must always be viewed in the context of their impact on future growth.

Kurt Salmon has been supporting retailers exploit their growth opportunities, improve their operations and optimise their cost base for nearly 80 years. Our approach to cost reduction reflects this industry knowledge and focus, and seeks to build sustainable benefits through changes in operating processes and structural models and through developing capabilities.

Kurt Salmon



Success for what's next

Kurt Salmon is a global management consulting firm dedicated to building the market leaders of tomorrow. More than just partnering with our clients, we ally with them, integrating ourselves seamlessly into their organisations in order to develop innovative, customised solutions for their business issues.

Succeeding in today's increasingly complex, consumer-driven environment is an enormous challenge.

But companies need to look beyond today; they need to position themselves for continued success in the even more uncertain future. That's where Kurt Salmon comes in.

We call it delivering "success for what's next." The results are transformative.

AUTHORS

For further information or to explore these steps in more detail, please contact:



Ankush Mattu

Partner, CFO Advisory Services, Kurt Salmon UK
ankush.mattu@kurtsalmon.com



Simon Bennett

Director, CFO Advisory Services, Kurt Salmon UK
simon.bennett@kurtsalmon.com

Kurt Salmon
10 Fleet Place
London, EC4M 7RB
T +44 (0)207 710 5200
F +44 (0)207 710 5201

www.kurtsalmon.com

Hong Kong · Shanghai · Tokyo

Brussels · Casablanca · Düsseldorf · Geneva · London
Luxembourg · Lyon · Manchester · Nantes · Paris

Atlanta · Minneapolis · New York · San Francisco