

Seven Steps for Achieving Sustainable Cost Reductions

Key Elements for Success



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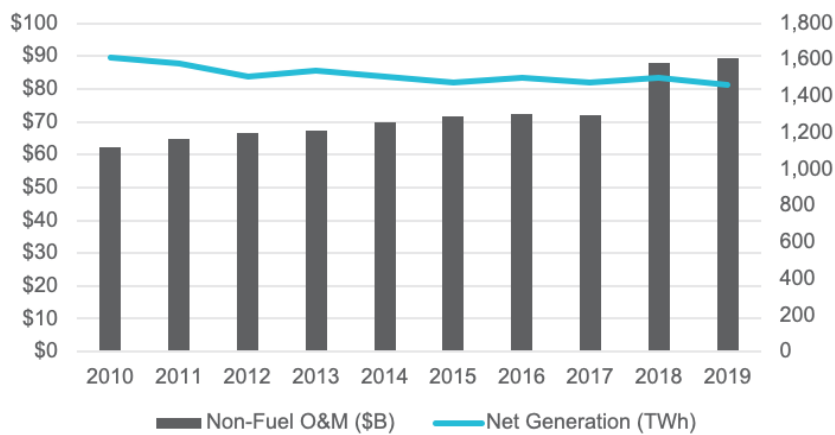

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Seven Steps for Achieving Sustainable Cost Reductions: Key Elements for Success



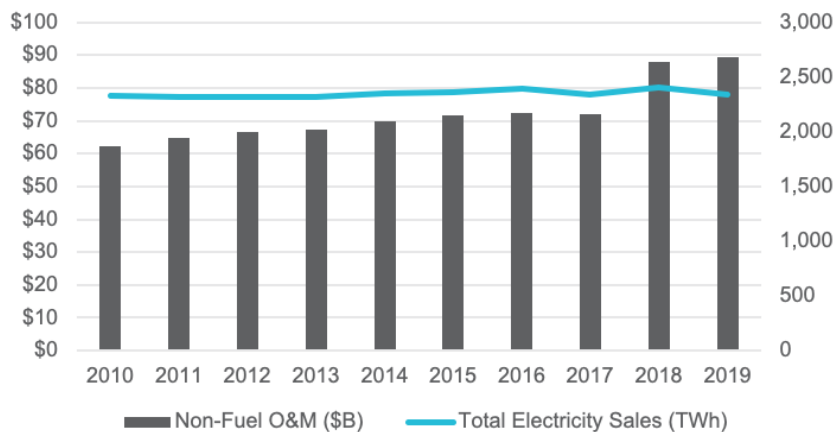
Slow economic and demand growth coupled with increased penetration of distributed energy resources (including energy efficiency) has resulted in declining energy industry sales and revenues. Many companies have witnessed their non-fuel O&M costs increase in the face of rapidly declining generation and sales, creating an unsustainable environment (see charts below). To avoid increasing energy rates and further eroding sales, companies are looking to reduce costs to meet shareholder expectations. This document provides an overview of the steps that you can take to achieve sustainable cost reductions.

Non-Fuel O&M vs. Net Generation

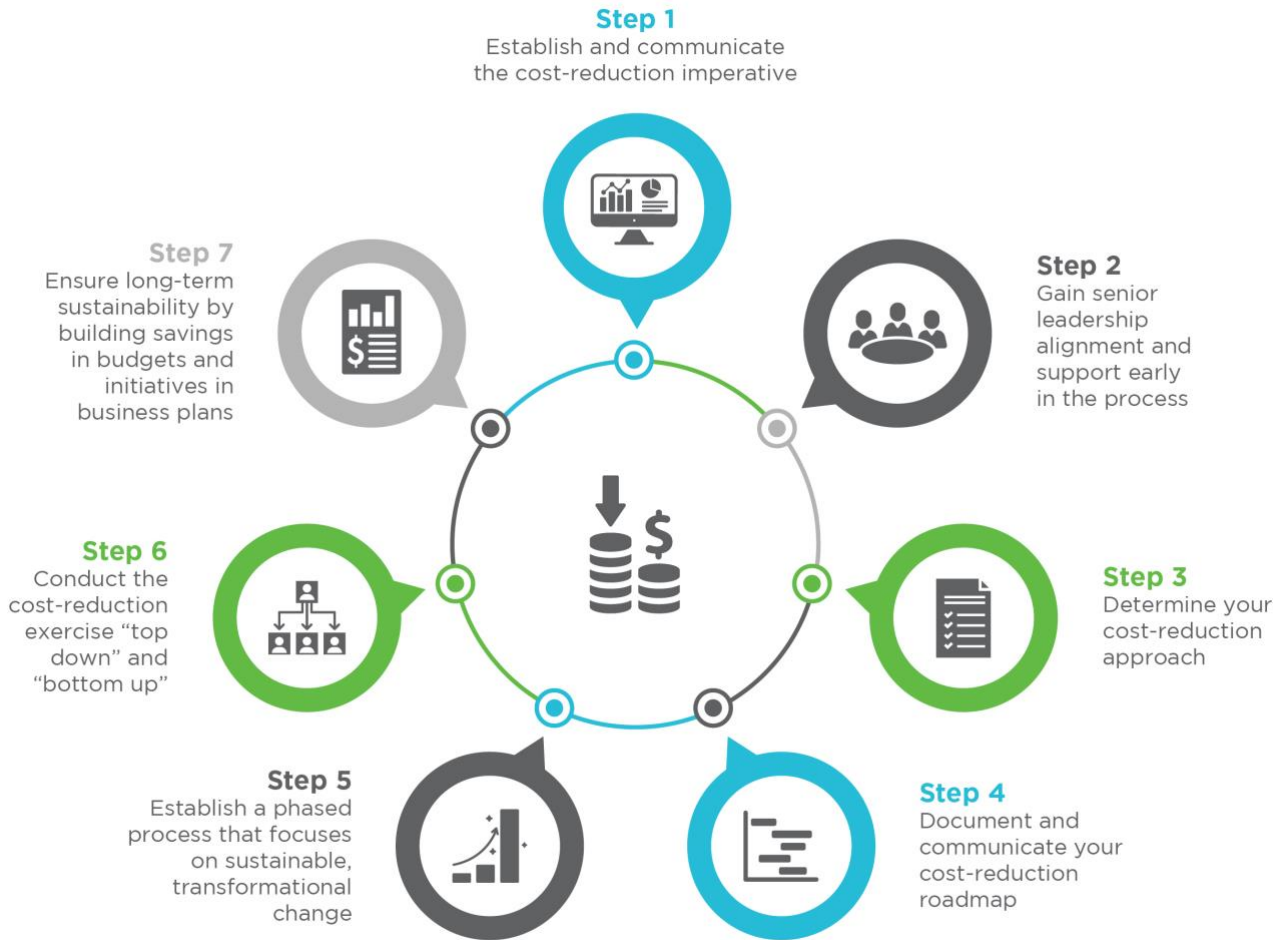


Note: Data is comprised of approximately 140 investor-owned utilities.
Source: SNL.com

Non-Fuel O&M vs. Total Sales of Electricity



To achieve significant, sustainable savings a methodical approach is important. The proven seven-step approach described below showcases the importance of the right steps in the right order to make the biggest impact.

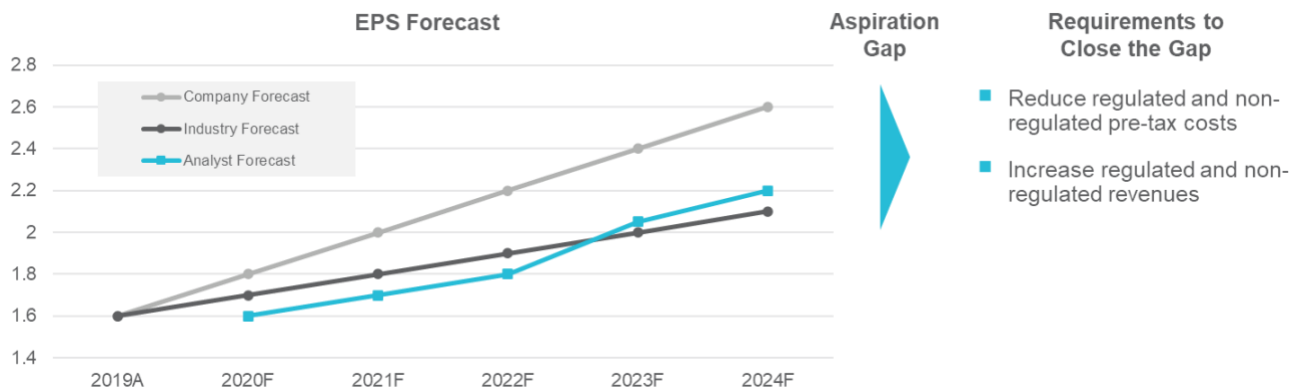


This approach helped one client save more than \$500 million in annual O&M costs.



Step 1: Establish and Communicate the Cost-Reduction Imperative

Establishing and communicating an easily understood imperative will help to ensure buy-in at all levels. One approach is simply illustrating the unsustainable environment of increasing costs relative to flat to declining revenues (see charts above). Another approach is using shareholder expectations to help to communicate the need for cutting costs (e.g., comparing management aspirations for earnings per share (EPS) to industry and/or analyst expectations—see example chart below). The gap between the analysts/industry forecasts and management’s EPS goals can be converted to cost-reduction and revenues requirements and highlight the need to further reduce costs.



Step 2: Gain Senior Leadership Alignment and Support Early in the Process

Conducting a cost-reduction planning workshop with senior leadership will ensure alignment and support for the cost-reduction process. When preparing for the workshop, you should consider the objectives as well as the outcomes and deliverables you want to achieve. Examples are shown below.

Workshop Objectives

- Gain senior leadership alignment and support for the cost-reduction imperative
- Establish a common philosophy and understanding of cost-reduction expectations/priorities, approach, process, critical success factors, and potential issues among the leadership team
- Develop preliminary components of the cost-reduction roadmap
- Establish company readiness to “jump start” the cost-reduction process

Workshop Outcomes and Deliverables

- Cost-reduction objectives, goals, and scope
- Cost-reduction critical success factors, design principles, approach, and potential issues
- High-level cost-reduction timeline
- Preliminary cost-reduction management structure and roles and responsibilities
- Preliminary areas for improvement (cost-reduction and organizational performance)



Step 3: Determine Your Cost-Reduction Approach

Four cost-reduction approaches are predominant. Each approach varies as to its ideal application and time to implement.

Benchmark Driven	Reductions set using functional or process benchmarks.
Organization Driven	New, leaner organizations are designed; headcount selected for all or new positions.
Target Driven	Top-down reduction targets are assigned to functions; functions individually determine how targets will be achieved.
Process Driven	Work elimination and streamlining through process redesign result in reductions.

Often, the best cost-reduction approach for an organization can be crafted using elements of each of the methods. Regardless of the cost-reduction method, an ideal approach should:

- Fit the organization's culture
- Achieve reductions with minimal impact on employee morale
- Retain high-potential and high-performing employees
- Ensure retention of organization knowledge that may not be well-documented
- Reduce work where necessary to ensure savings are sustainable
- Remove poor performers
- Once announced, stress frequent and meaningful communications



Step 4: Document and Communicate Your Cost-Reduction Roadmap

To achieve buy-in to the changes, it is important to clearly document and communicate the reasons, plans, and timing of the initiative. Consider these elements in your communications:

Imperative and Objectives

- Describes the needs for cost-reduction and the desired outcome
- Provides clear understanding of cost-reduction needs and objectives to employees, customers, and other stakeholders
- Clearly identifies organizational priorities

Decisions Already Made

- Communicates key organization, operations, and infrastructure decisions that have already been made
- Provides clarity for participants during detailed design and implementation plan development

Critical Success Factors and Principles

- Defines success and what principles are to be followed during the cost-reduction process
- Communicates an understanding of organizational values, beliefs, and philosophies

Approach, Process, and Timeline

- Defines the approach and process by which cost-reduction initiatives will be identified and documented
- Identifies and brings together key corporate planning and cost-reduction milestones
- Sets the pace and cadence for the cost-reduction process

Implementation Priorities and Critical Milestones

- Describes leadership's expectations for implementation priorities
- Identifies critical implementation milestones to achieve cost-reductions

Management Structure and Roles

- Clearly defines roles and responsibilities for all participants
- Establishes decision rights and the decision-making structure
- Defines the interfaces of various resources and efforts within the cost-reduction process



Step 5: Establish a Phased Process that Focuses on Sustainable, Transformation Change

Phase I: Establish the Cost-Reduction Imperative	Phase II: Develop the Blueprint	Phase III: Perform Detailed Design	Phase IV: Implement Designs
<ul style="list-style-type: none"> ■ Define strategic issues and the need for reducing costs (e.g., sales/revenue forecasts vs. costs, etc.) ■ Define what success looks like to address strategic issues (economic and non-economic) ■ Establish corporate-wide cost-reduction goals ■ Determine cost-reduction approach and scope ■ Identify preliminary areas for improvement (cost-reduction and organizational performance) 	<ul style="list-style-type: none"> ■ Establish the cost-reduction framework and communications plan ■ Perform current state assessment (cost and headcount trends) ■ Finalize improvement areas (cost-reduction and organizational performance) ■ Establish business unit cost and staff baselines and reduction targets ■ Develop functional guidance and design criteria 	<ul style="list-style-type: none"> ■ Identify and document cost-reduction initiatives ■ Define and document impacts to service levels (boundary issues and stop doing) and risks ■ Define organization design guidance (e.g., principles, spans/layers, job title alignment, etc.) ■ Finalize and recommend detailed organization design and staffing levels ■ Define performance metrics ■ Establish business plans and future year budgets 	<ul style="list-style-type: none"> ■ Implement business plans and cost-reduction initiatives ■ Implement staffing, change management, and facilities plans ■ Monitor implementation and track results
Key Questions to Answer			
<ul style="list-style-type: none"> ■ Why do we need to change? ■ What are we expected to achieve? ■ How fast and how far? 	<ul style="list-style-type: none"> ■ How will the cost-reduction effort be structured and managed? ■ What is the current state? ■ What are the targets and opportunities? 	<ul style="list-style-type: none"> ■ What will we look like? ■ What have we committed to do? ■ How will we achieve cost reductions? 	<ul style="list-style-type: none"> ■ What actions must be taken to get us there? ■ Have we considered all constraints and dependencies?



Step 6: Conduct the Cost-Reduction Exercise “Top Down” and “Bottom Up”

Using both a top-down and bottom-up approach allows you to create the most successful and sustainable plans by providing guidance and expectations while depending on your people to deliver on the details.



Senior leadership should set the top-down expectations by first selecting the expected approach to complete the exercise. Next, they should define the timelines required for the process and set targets/parameters on cost savings and organizational changes.



Functional teams should build the plans bottom-up by using top performers from multiple levels of the organization. The team should identify the future managers of a function and involve them in the process, as possible. It is important to provide the teams the resources and latitude they need to be successful and encourage new approaches and ways of thinking.



Final plans should be challenged by the leadership team prior to approval. Leaders from each functional area should present their approach and encourage peers from other functions to question and challenge everything, including plans, assumptions, targets, etc. During this challenge period, ensure everyone is maintaining an open mind, and adjust plans as needed.



Step 7: Ensure Long-Term Sustainability by Building Savings in Budgets and Initiatives in Business Plans

Budgets	Business Plans
<ul style="list-style-type: none">■ Ensure cost reductions are included in future multi-year budgets■ Avoid making cost savings one-time “management challenges” or solutions to plug one-time gaps■ Track and report on the key drivers for budget (e.g., labor), especially if labor reductions are integral to savings■ Maintain monthly budget discipline and be rigorous in variance reporting and review■ Take the time to build bottom-up budgets to justify all costs for future years	<ul style="list-style-type: none">■ Build all initiatives into multi-year business plans■ Align strategic goals and cost-savings goals to avoid conflict and support success■ Create the right metrics to track initiative progress and report regularly■ Provide progress updates on actions taken on a consistent basis; report out to senior leadership at least quarterly■ Reevaluate initiatives annually to make sure desired results are still on track

Do not lose the cost benefits of your teams’ plans by not maintaining momentum and discipline long-term.

KEY SUCCESS FACTORS

- Obtain CEO support (a platitude, but essential), then gain support of his/her directs.
- Establish a project structure with employee teams, one that is internally led. Consider the role of outside help—the project cannot be centered around consultants “chopping” costs, but consultants can help guide the process and help the teams achieve success.
- Establish a great core project team with recognized internal leaders (e.g., finance and HR, in partnership with consultants) to drive the process.
- Set reasonable targets informed by clear rationale (such as benchmarking).
- Focus on sustainability in cost reductions (i.e., translate cost-reduction targets into potential labor reductions).

- Make sure cost-reduction initiatives are “actionable” and clearly connect the path from current to future budgets.
- Track and monitor cost-reduction initiatives as they are being implemented to ensure they achieve cost savings.
- Utilize standard tools and templates to expedite the process and ensure deliverable consistency and quality.

CONTACT US

If planning and expertly executing cost-reduction initiatives is a priority for you, ScottMadden can help. Support for cost-reduction initiatives has been one of the core competencies of ScottMadden since our founding in 1983. Recently, we assisted a large electric utility client in saving more than \$500 million in annual O&M costs, and we have conducted myriad executive-level leadership team cost-reduction planning workshops. With significant experience assisting companies to successfully design and implement integrated operating models, our functional expertise in the energy industry is deep, and our consulting experience is broad—a combination we believe is unique in the consulting industry

[Contact us](#) to discuss any questions you may have or how to get started on a cost-reduction approach for your organization.

ABOUT SCOTTMADDEN, INC.

ScottMadden is the management consulting firm that does what it takes to get it done right. We consult in two main areas—Energy and Corporate & Shared Services. We deliver a broad array of consulting services ranging from strategic planning through implementation across many industries, business units, and functions. To learn more, visit www.scottmadden.com | [Twitter](#) | [Facebook](#) | [LinkedIn](#).

ABOUT SCOTTMADDEN’S ENERGY PRACTICE

We know energy from the ground up. Since 1983, we have served as energy consultants for hundreds of utilities, large and small, including all of the top 20. We focus on Transmission & Distribution, the Grid Edge, Generation, Energy Markets, Rates & Regulation, Enterprise Sustainability, and Corporate Services. Our broad, deep utility expertise is not theoretical—it is experience based. We have helped our clients develop and implement strategies, improve critical operations, reorganize departments and entire companies, and implement myriad initiatives.

ABOUT THE AUTHORS

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