The Path to Prosperity

CFOs at small and midsize companies on post-downturn cost control

A report prepared by CFO Research Services in collaboration with Expense Reduction Analysts

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CFO research services

Expense Reduction Analysts

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ABOUT THIS REPORT

In March 2011, CFO Research Services (a unit of CFO Publishing LLC) conducted a survey among senior finance executives at small and midsize companies in the United States to examine their views on cost management in the emerging recovery.

We gathered a total of 325 complete survey responses from senior finance executives. Respondents work for companies in a broad range of company segments:

ANNUAL REVENUE

<$10M	5%
$10M–$25M	30%
$25M–$50M	23%
$50M–$100M	19%
$100M–$250M	13%
$250M–$500M	6%
$500M+	3%

TITLES

Chief financial officer	48%
Controller	25%
VP of finance	10%
Director of finance	8%
EVP or SVP of finance	4%
Treasurer	2%
Other	3%

Respondents work for companies in nearly every industry. The manufacturing, wholesale/retail trade, and financial services sectors are particularly well represented.

Note: Percentages may not total 100%, due to rounding.

Cost discipline in the recovery

In 2009, as the recent recession entered its deepest and most critical phase, CFO Research Services conducted a study exploring G&A cost management[1] at midsize companies. Nimble, responsive, and entrepreneurial, midsize companies often enjoy robust growth in strong economies. But when the economic cycle turns, midsize companies often face painful choices as they strive to maintain profitability—without compromising their competitive edge.

Through a survey of 218 senior finance executives at midsize U.S. companies, we confirmed that companies were eager to ease the pain of those choices through more disciplined management of G&A costs. The finance executives who participated in the 2009 study recognized the connection between better G&A cost management and better-funded, more-secure businesses, and they looked forward to moving into the next period of growth with organizations that are leaner, less wasteful, and more competitive.[2] In March 2011, CFO Research conducted another study among 325 senior finance executives at small and midsize companies to learn more about their cost-management achievements in the course of the downturn—and to explore the role that continued cost discipline will play in midsize companies' growth efforts in the months and years to come.

This study examines senior finance executives' cost-management achievements in the course of the downturn and explores the role that continued cost discipline will play in midsize companies' growth efforts in the months and years to come.

[1] We explored G&A costs in particular in our 2009 study—even though they make up a relatively small portion of a company's overall cost structure—because direct costs tend to go down when the flow of incoming orders slows and revenue growth starts to level off (excluding certain economies of scale). While companies' efforts to reduce direct costs through benchmarking, supplier consolidation, and vendor negotiation are undoubtedly valuable, the need for many G&A items and other indirect expenditures tends to remain stable, even when companies are taking fewer orders and revenue is declining steeply. To gain more complete control over their profitability, midsize companies in the downturn found they had to turn to slashing G&A costs.

We found, however, that companies were often much better equipped to manage direct costs than they are to manage G&A costs; in general, midsize companies had not applied the expertise, information, and resources to G&A costs that they routinely directed toward direct-cost management.

[2] For more information on our 2009 study of G&A cost management at midsize companies, see *Bringing the Discipline of Direct Cost Management to G&A Costs*, available for download at www.cfo.com/research.

Growing confidence in business prospects

Since our 2009 study on cost management, the contours of economic recovery have gradually emerged. Progress so far has been somewhat fragile and uncertain, but there has been good news: key economic indicators are slowly but consistently trending upward. The National Bureau of Economic Research decided in September 2010 that it had sufficient evidence of consistent economic growth to declare June 2009 the official end date of the recession.

Nearly two years later, the results of this survey confirm that the economic recovery is at last gaining some traction among small and midsize companies, although survey results suggest that finance executives expect modest—not vigorous—improvement in business prospects over the next year. Most respondents (72%) report that their companies are experiencing at least some recovery in business performance. Few respondents (13%), however, say they're enjoying *robust* recovery in business performance. (See Figure 1.)

The results of this survey confirm that the economic recovery is at last gaining some traction among small and midsize companies, although survey results suggest that finance executives expect modest—not vigorous—improvement in business prospects over the next year.

Figure 1. Small and midsize companies are experiencing at least some degree of recovery in their business performance.

Compared with the lowest point of the recent downturn, my company is currently experiencing…

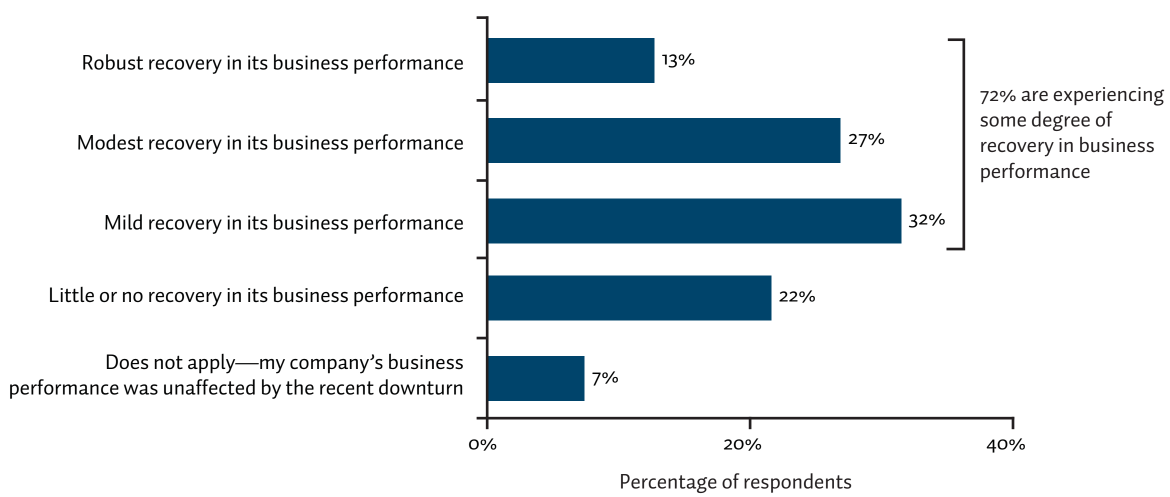
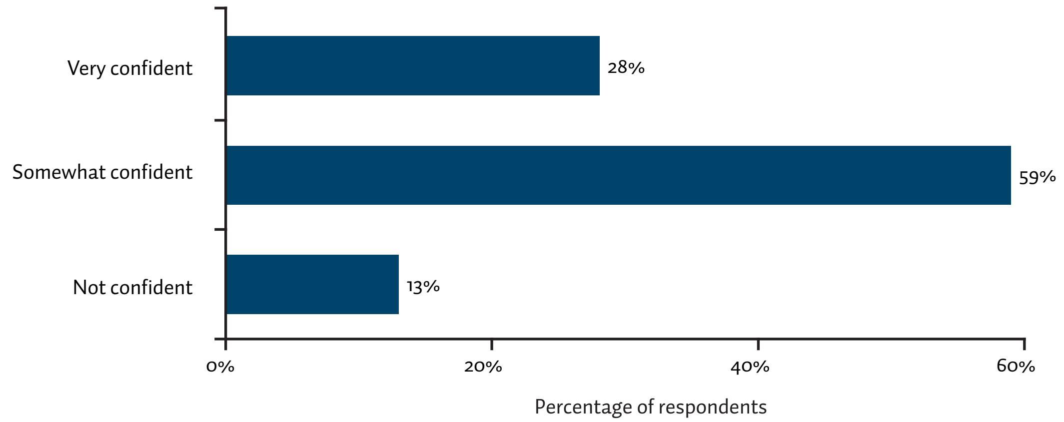


Figure 2. Finance executives are at least "somewhat confident" in their ability to meet performance targets—but relatively few say they are "very confident."

How confident are you that your company will achieve its business performance targets in the next 12 months?



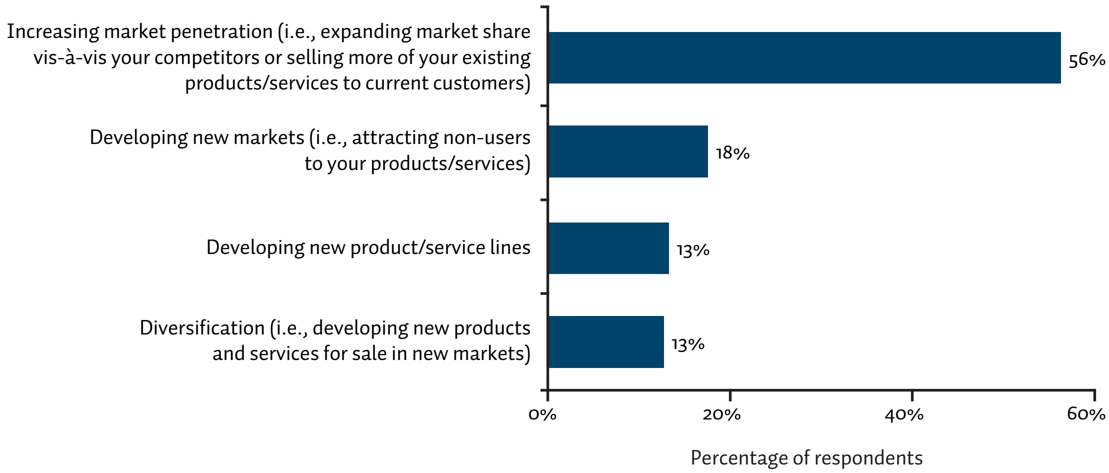
Looking forward, 87% of all respondents say they are at least *somewhat* confident that their companies will achieve their business performance targets in the next year—although only 28% of respondents say they are *very* confident that their companies will achieve their targets over the course of the year. (See Figure 2.)

Low-risk growth strategies dominate. Lingering uncertainty and persistent volatility in commodities and energy prices help to explain why increasing market penetration—a comparatively conservative path—is the dominant growth strategy among small and midsize companies. More than half of all respondents (56%) say that increasing market penetration for existing product lines represents their companies' greatest opportunity to grow over the next year.

By contrast, only 13% of respondents, respectively, say that developing new products and service lines (a capital-intensive and therefore riskier path) or diversification (an even riskier strategy that involves developing new products and services for sale in new markets) represents their companies' greatest opportunity to grow. (See Figure 3.)

Figure 3. Companies see increasing market penetration—a relatively low-risk strategy—as their most promising opportunity to grow over the course of the year.

In your opinion, which of the following items represent your company's greatest opportunity to grow over the next year?



Taken together, survey results confirm that many small and midsize companies are focused on gaining a strong footing in relatively familiar territory by selling more of their existing products and services to the customers they understand best. At the same time, the gradual shift in economic and business prospects is increasing pressure on companies to make a convincing return to growth. After two years or more of slashing costs, companies are reaching the point where they must expand their top lines in order to increase margins. The results of this survey show, however, that finance executives aspire to maintain the cost discipline that served their companies well throughout the downturn—even as the pressure to increase spending and investment for growth builds.

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Focus on sustained, profitable growth

Survey results confirm that many small and midsize companies are relaxing their attention on the bottom line. One-third of all respondents say their companies primarily focused on bottom-line profitability over the past two years. But looking forward to the next two years, only 12% of respondents say their companies will focus primarily on bottom-line profitability (a difference of 21 percentage points).

While survey results confirm that laserlike attention on the bottom line is making way for growth at even the most profitability-focused companies, they also show that finance executives are not willing to sacrifice bottom-line profitability as they seek growth. More than half of all respondents (53%) say their companies primarily focused on sustained, profitable growth (encompassing both the top line and the bottom line) over the past two years. But many more respondents—nearly three-quarters (74%)—say they plan to focus on sustained, profitable growth over the next two years (again, a difference of 21 percentage points). At the same time, comparatively few respondents (15%) say their companies focused on the top line over the past two years, and nearly the same number (14%) say their companies will focus primarily on the top line over the next two years. (See Figure 4.) Taken together, these results provide ample evidence that both cost control and efficiency improvement—which protect the bottom line—will continue to play a critical role in small and midsize companies' broad strategies in the years ahead.

Figure 4. Survey results show that small and midsize companies are turning their attention from managing the bottom line to pursuing sustained, profitable growth.

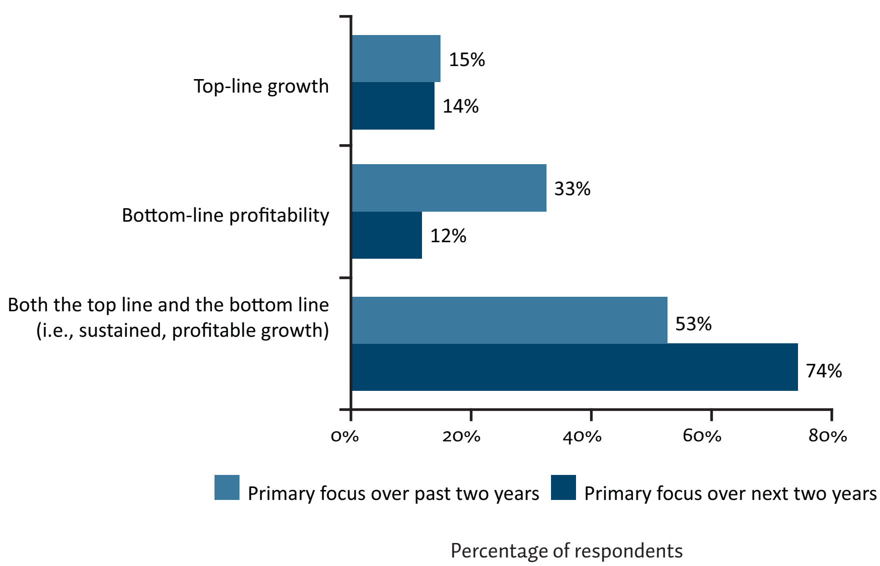
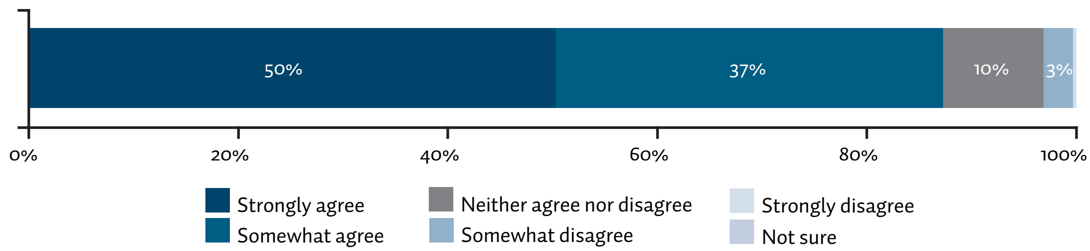


Figure 5. Continued cost discipline will be a source of competitive advantage as the recovery unfolds, say finance executives.

To what extent do you agree or disagree with the following statement?

"Over the next two years, my company's ability to maintain a lean cost structure will be an important source of competitive advantage."

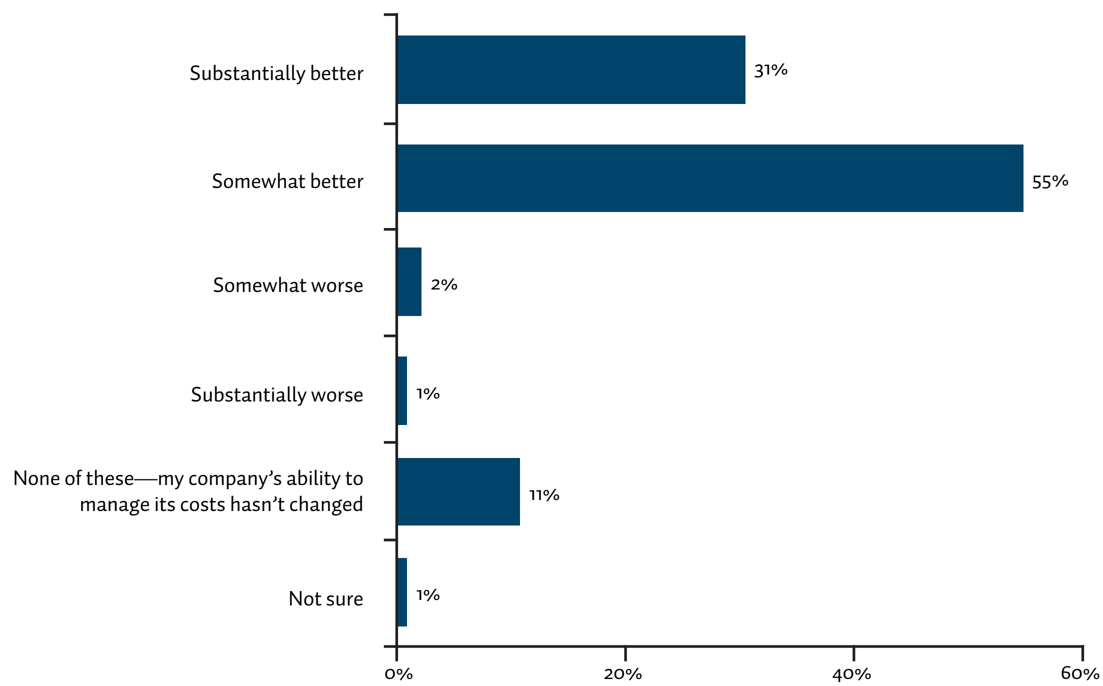


In response to another survey question, half of all respondents *strongly* agree that their companies' ability to maintain a lean cost structure will be an important source of competitive advantage over the next two years (another 37% of respondents agree *somewhat* with that statement). (See Figure 5.) What do small and midsize companies hope to gain by maintaining cost discipline while pursuing growth? According to these results, they hope to gain nothing less than a critical edge in a fiercely competitive business environment.

Continuous improvement approach to cost management. Considering the stakes, it's not surprising that small and midsize companies have applied time, attention, and resources to cost management in recent years. Certainly companies have improved their ability to manage costs over the course of the downturn. A solid majority of survey respondents (86%) report that their companies are better at managing costs today than they were two years ago. Indeed, 31% of respondents are willing to say that they're "substantially better" at managing costs today, compared with two years ago. (See Figure 6.)

Figure 6. Finance executives say their companies got better at managing their costs over the course of the downturn.

In general, my company is__________ at managing its costs today than it was two years ago.

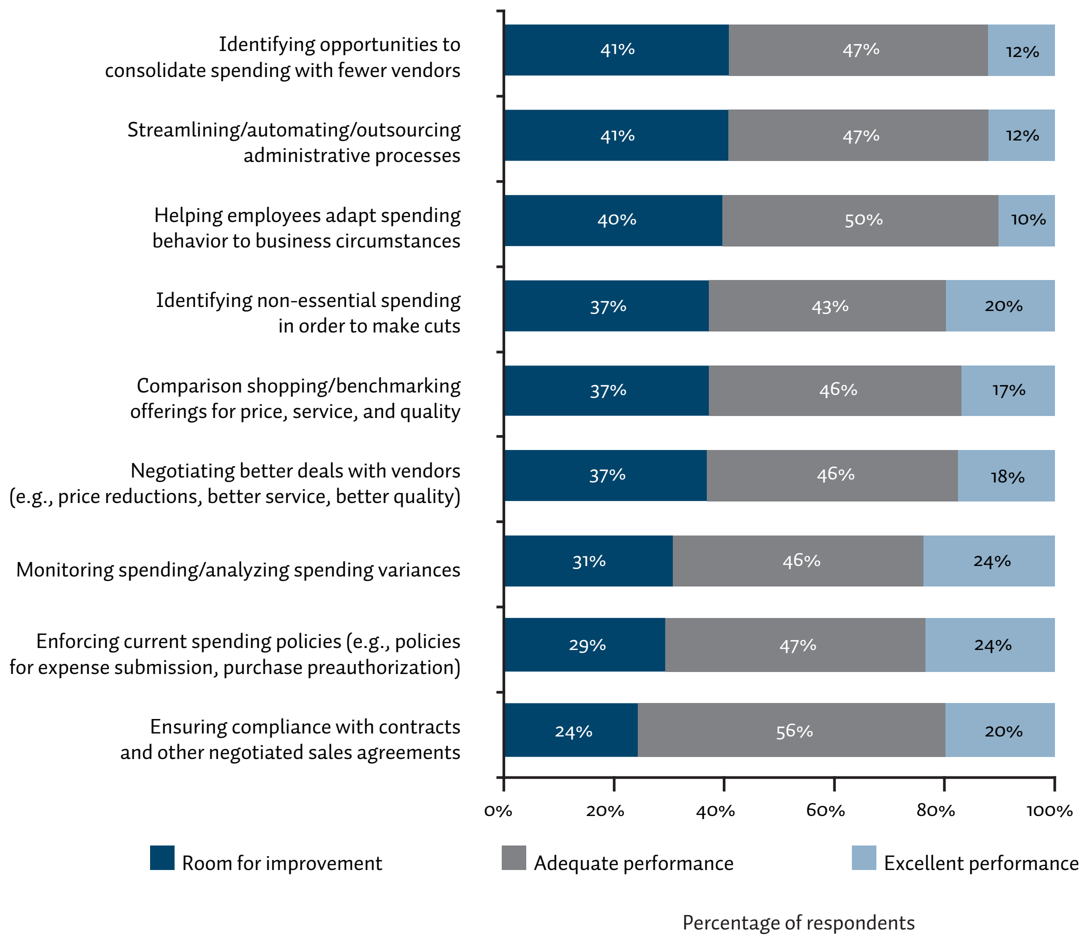


At the same time, however, a substantial number of respondents see room for improvement in a wide range of cost-management activities—most notably, in identifying opportunities to consolidate spending with fewer vendors (41%) and helping employees adapt spending behavior to changing circumstances (40%). (See Figure 7.) Taken together, these results—indicating, on the one hand, that small and midsize companies have improved their ability to manage costs in the past two years, and, on the other hand, that they still see room to improve further—confirm that small and midsize companies are adopting a "continuous improvement" approach to managing their costs.

What do small and midsize companies hope to gain by maintaining cost discipline while pursuing growth? According to these results, they hope to gain nothing less than a critical edge in a fiercely competitive business environment.

Figure 7. Despite recent improvements, a substantial number of finance executives see room to improve performance on a wide range of cost-management activities—in particular, vendor consolidation, administrative process improvement, and employee adaptability.

In your opinion, how well is your company currently performing at the following cost-management activities?



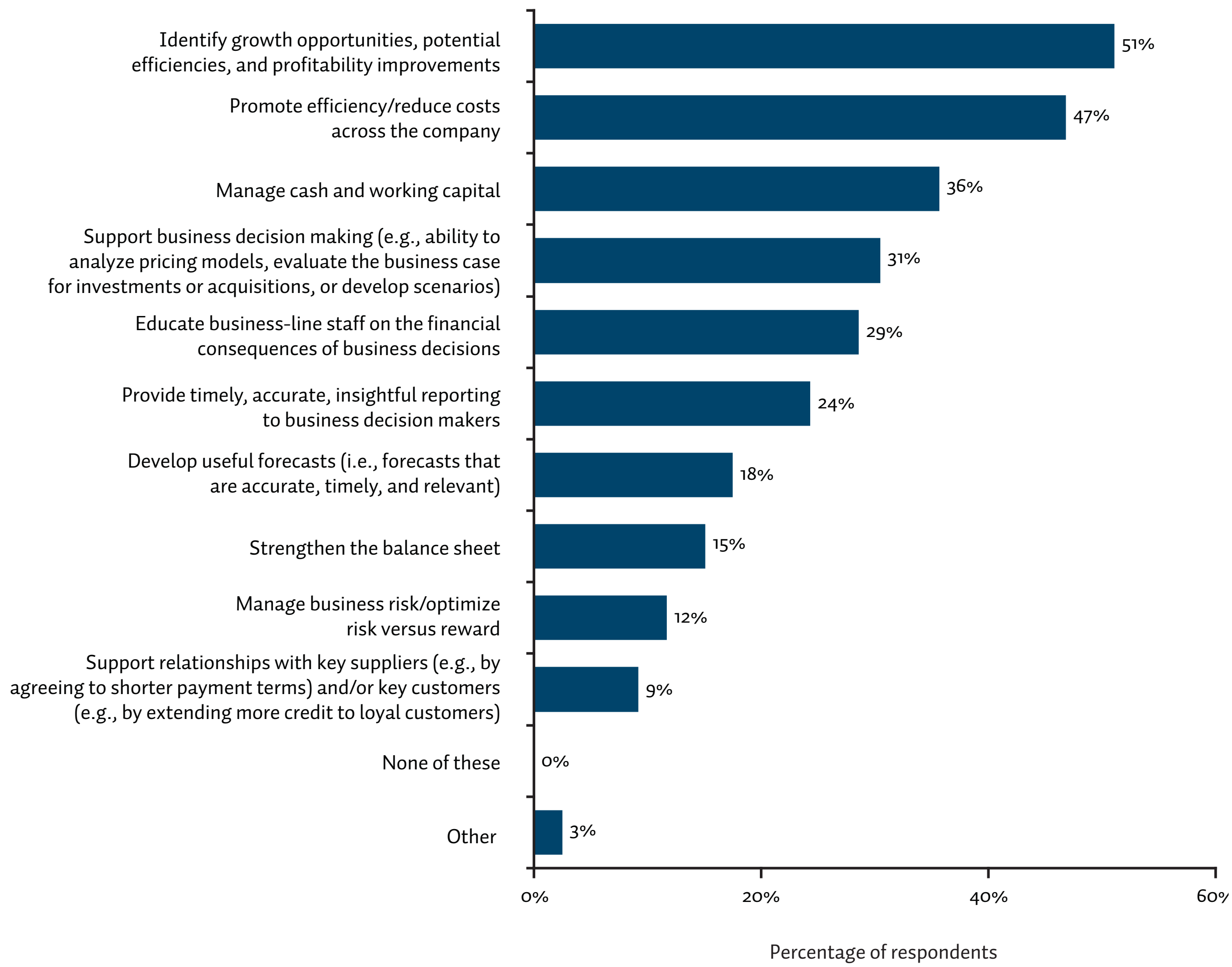
A more influential finance function

The results of our survey show that finance executives aspire to help guide their companies to sustained, profitable growth by improving their ability to identify growth opportunities as well as potential efficiencies, and by improving their companies' ability to control costs. More than half of all respondents (51%) say that improving finance's ability to identify growth opportunities, potential efficiencies, and profitability improvements ranks among the improvements that would contribute most to their companies' ability to succeed over the next two years. Nearly as many respondents (47%) say that improving finance's ability to promote efficiencies and reduce costs would contribute to their companies' ability to succeed in the next two years. (See Figure 8.)

Figure 8. Improving the finance function's ability to identify growth opportunities, potential efficiencies, and profitability improvements in a complex and uncertain environment would contribute most to their companies' overall success, say finance executives.

In your opinion, which of the following finance-related improvements, if any, would contribute most to your company's ability to succeed in the next two years?

Improvement in finance's ability to…



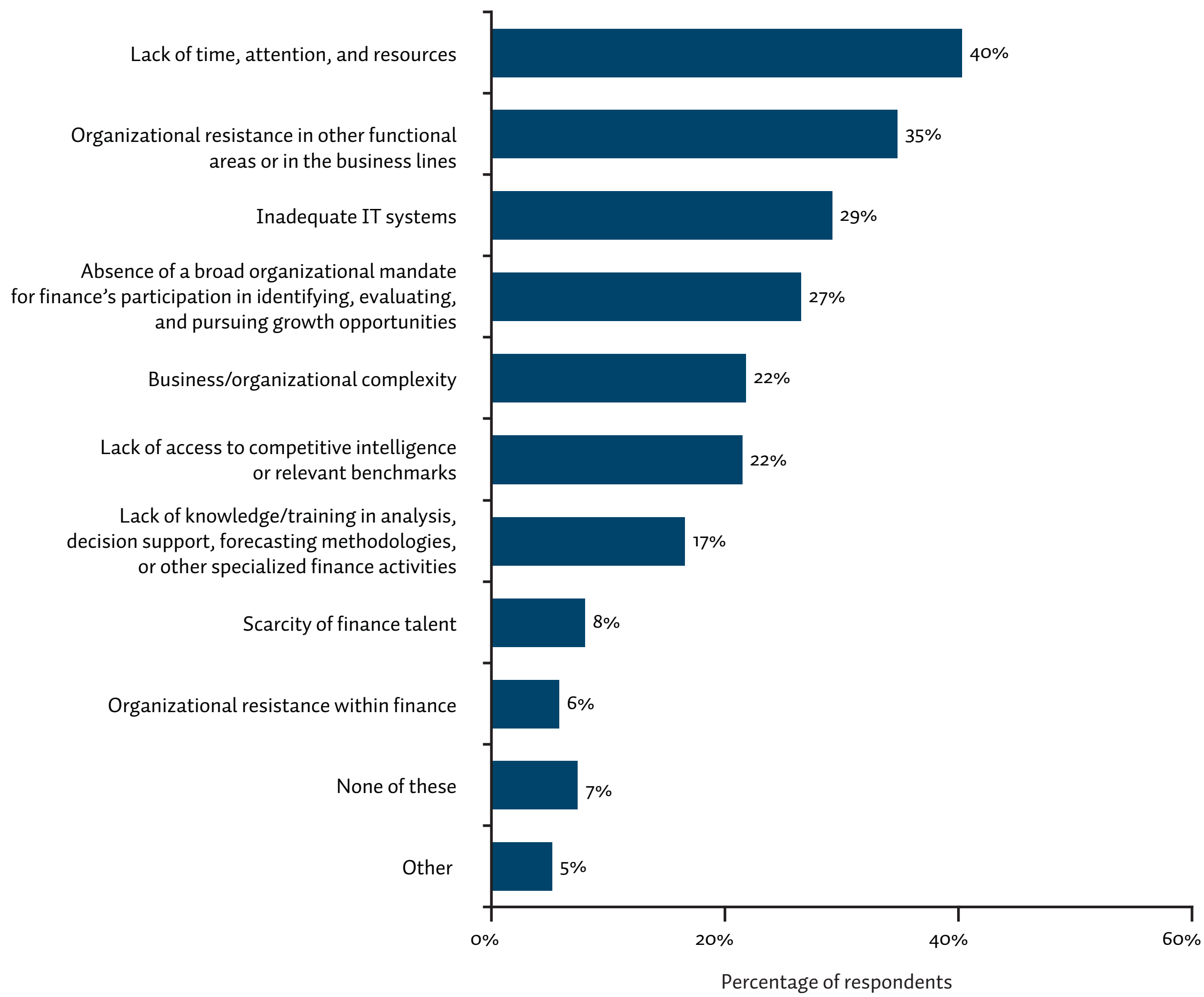
Respondents were asked to choose up to three answers.

What gets in the way of finance's efforts to improve its contribution to growth? Respondents see a lack of cross-functional collaboration (particularly between finance and the operating business lines) as a major obstacle. Aside from the universally problematic "lack of time, attention, and resources," survey respondents most often choose "organizational resistance in other functional areas or in the business lines" as a barrier to finance's ability to contribute to growth (35%). (In addition, more than one-quarter of respondents see the "absence of a broad organizational mandate for finance's participation in identifying, evaluating, and pursuing growth opportunities" as a substantial barrier.) (See Figure 9.)

The results of our survey show that finance executives aspire to help guide their companies to sustained, profitable growth by improving their ability to identify growth opportunities as well as potential efficiencies, and by improving their companies' ability to control costs.

Figure 9. Aside from the perennial lack of time, attention, and resources, organizational resistance from outside of finance is the most-often cited barrier to finance's ability to contribute to growth.

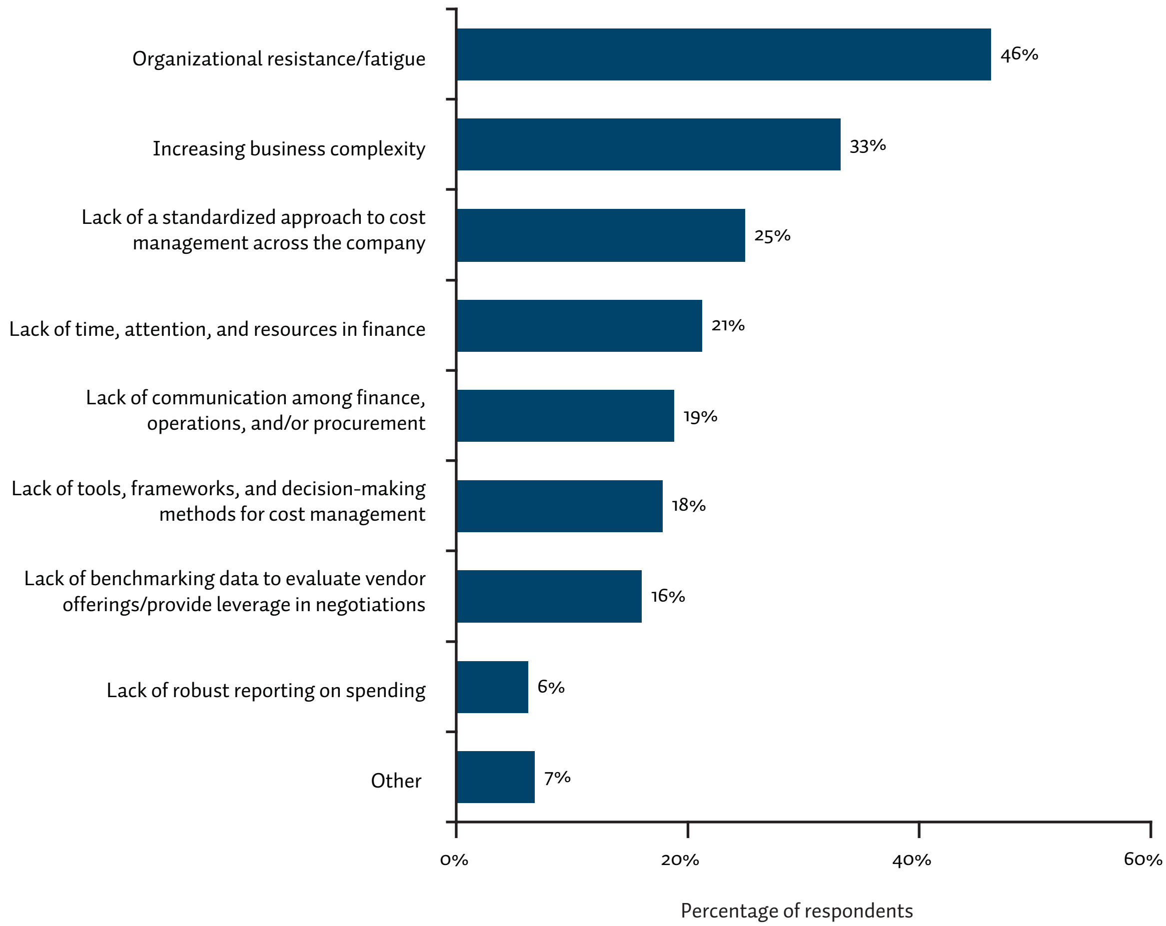
In your opinion, what are the greatest barriers to making the finance-related improvements that would contribute most to your company's overall growth efforts?



Respondents were asked to choose up to three answers.

Figure 10. Organizational fatigue will likely be a serious barrier to maintaining cost discipline over the next two years, respondents say.

In your opinion, what will be the greatest obstacles to maintaining cost discipline at your company over the next two years?



Respondents were asked to choose up to three answers.

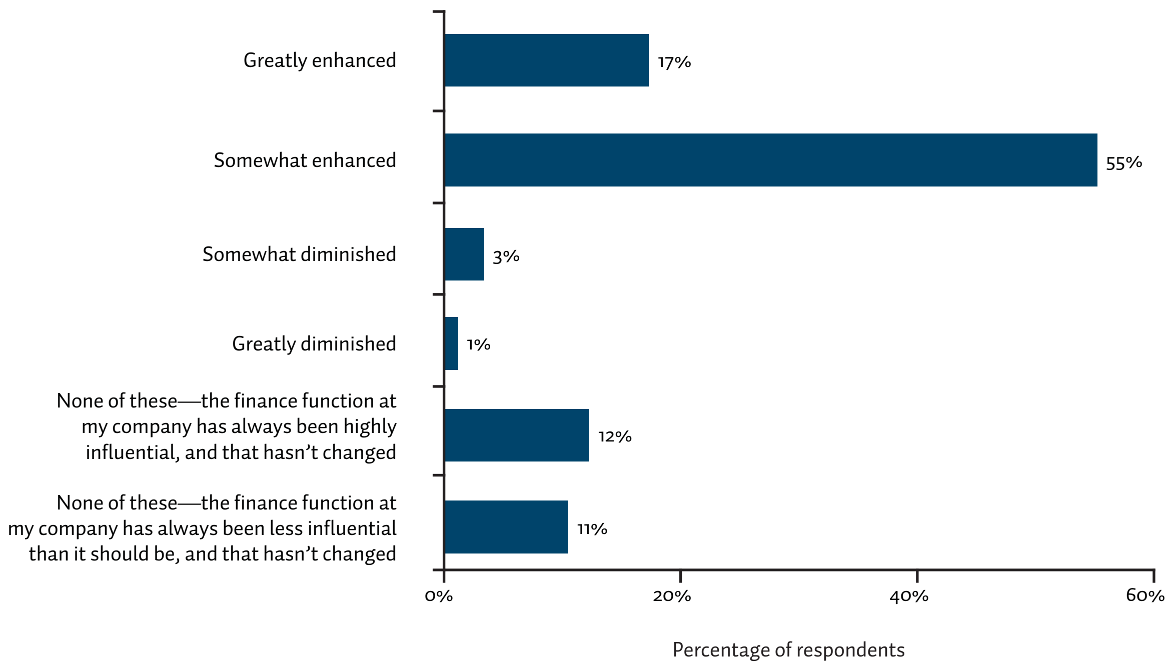
When it comes to hanging on to hard-won cost-management gains, finance executives are most concerned with fatigue—an understandable concern, given the persistent atmosphere of scarcity and the amount of time and attention that cost-control efforts can absorb. Forty-six percent of all respondents say that "organizational resistance/fatigue" will rank among the greatest obstacles to maintaining cost discipline at their companies over the next two years, followed somewhat distantly by "increasing business complexity" (33%). (See Figure 10.)

But circumstances at small and midsize companies have rarely been more favorable to senior finance executives eager to make improvements. As the financial system teetered on the brink of collapse in the fall of 2008, freezing credit markets and chilling economic activity around the world, finance executives took the lead in securing funding, managing cash and working capital, paying down debt, and implementing the financial disciplines—including cost discipline—that often proved essential to their companies' survival.

Circumstances at small and midsize companies have rarely been more favorable to senior finance executives eager to make improvements.

Figure 11. Finance has gained organizational influence in the wake of the recent downturn.

The experience of the recent downturn has ____________________ the finance function's standing and influence at my company.



Survey results confirm that the finance function—already highly influential at most small and midsize companies—has gained in organizational stature in the wake of the recent downturn. Seventy-two percent of respondents confirm that the experience of the recent downturn has enhanced the finance function's standing and influence at their companies. (See Figure 11.) These results suggest that many finance executives are well positioned to gain organizational buy-in and support for the initiatives they deem important in the post-downturn environment—including the maintenance (and even improvement) of cost discipline.

Survey results confirm that the finance function has gained in organizational stature in the wake of the recent downturn.

More expansive plans for cost savings

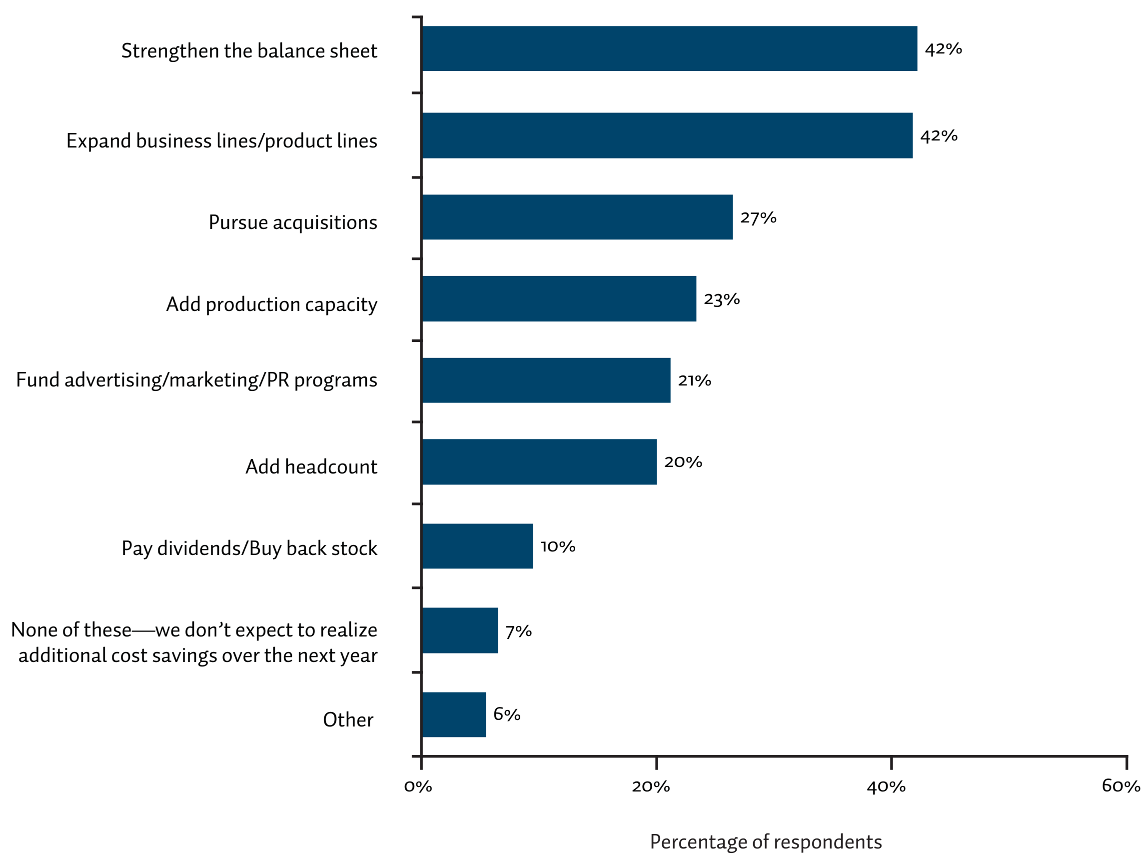
In our 2009 cost-management study, survey respondents told us that their companies were most likely to apply savings gained through cost-reduction efforts to strengthen their balance sheets (56% of respondents to the 2009 survey) and to maintain headcount (41% of respondents to the survey).

This year, strengthening the balance sheet again registers as an important destination for cost savings, but survey results suggest that small and midsize companies are just as likely to apply savings to expanding business or product lines. (See Figure 12.) These results suggest that finance executives at small and midsize companies expect close attention to finance fundamentals—including cash and working capital management, balance-sheet management, and cost control—will help their companies take advantage of growth opportunities without taking on untenable risks in the course of the recovery.

As small and midsize companies make their way from the depths of the downturn into a fragile and uncertain recovery, finance executives recognize the advantages of a more cost-conscious, more efficient, more disciplined company culture.

Figure 12. Small and midsize companies are just as likely to use savings gained through cost-control efforts to boost business or product lines in the coming year as they are to strengthen their balance sheets.

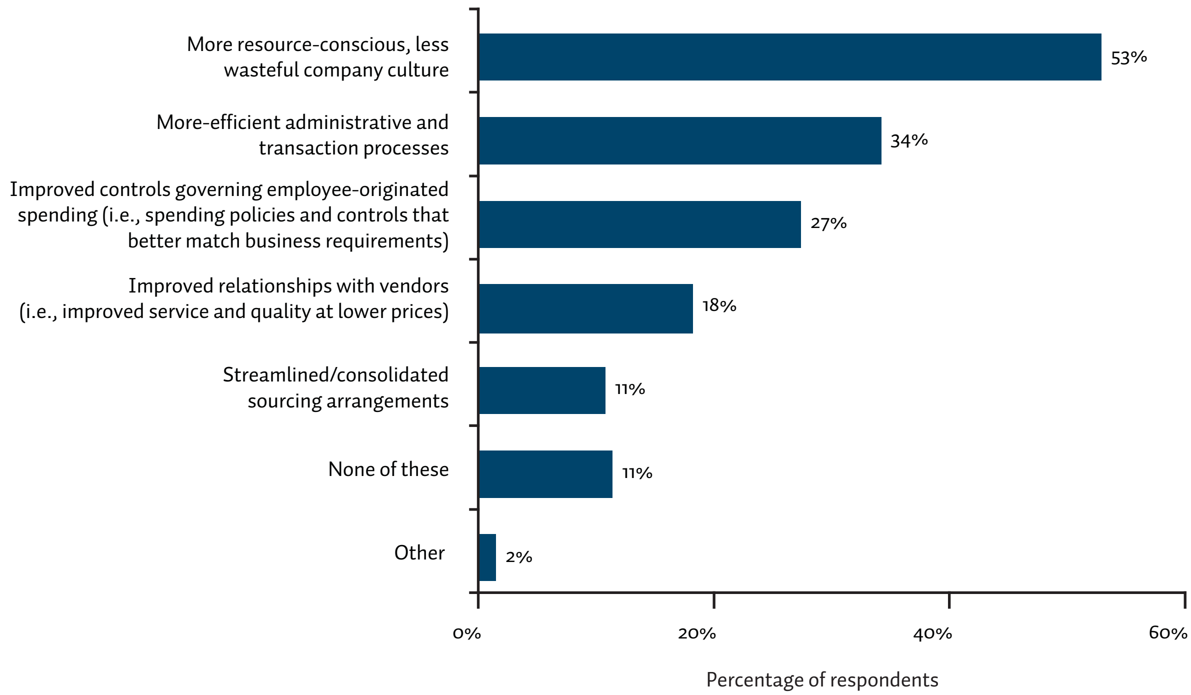
Over the next year, my company is most likely to use savings realized through cost-reduction efforts to help…



Respondents were asked to choose up to three answers.

Figure 13. Cost-management discipline through the downturn has yielded more resource-conscious, less wasteful companies.

In your opinion, which of the following business benefits (in addition to monetary savings), if any, did your company realize as the result of its cost-reduction efforts over the past two years?



Respondents were asked to choose up to two answers.

* * * * *

While senior finance executives undoubtedly welcome the savings that result from cost-control efforts, the results of our recent studies on cost management show that many small and midsize companies have experienced a broader cultural shift as a result of the recent downturn. In the 2009 study, we learned that finance executives were looking forward to a "more resource-conscious, less wasteful company culture" as a result of cost-reduction efforts. (Seventy-two percent of respondents to the 2009 study said they expected a more resource-conscious, less wasteful company culture to stem from cost-reduction efforts, followed distantly by "improved controls governing employee-originated spending" [40%].)

In this year's study, we learned that small and midsize companies seem to have realized the business benefits they predicted they would gain from cost-management efforts—in particular, a more resource-conscious culture (53%). (See Figure 13.)

As small and midsize companies make their way from the depths of the downturn into a fragile and uncertain recovery, finance executives recognize the advantages of a more cost-conscious, more efficient, more disciplined company culture. They also recognize that they have a role in instilling and maintaining the cost discipline that will protect their companies from undue risk as they shift from guarding the bottom line to investing wisely to promote growth. The finance function's ability to help their companies strike the right balance between moving forward into increasingly unfamiliar territory in pursuit of growth and maintaining a solid financial foundation for those efforts may well distinguish winning companies from their competitors in this emerging recovery. With renewed organizational stature and influence in the aftermath of the downturn, finance executives are in an excellent position to guide their companies to achieve that balance.

Use Savings to Fuel Growth

It comes as no surprise that cost reduction has played a significant role in helping businesses with their bottom line during the economic downturn. In fact, this current survey supports findings from our 2009 survey, when 79% of finance executives indicated that their businesses would increasingly rely on cost reduction to meet profitability targets. Now, businesses can use those savings to help fuel growth.

Whenever sales dip, reductions in many expenditures logically follow. But during the recession, many businesses were forced to go beyond cost reductions to the more severe step of reducing their workforce. With limited opportunity for top-line growth, reducing and containing costs became a top priority.

As businesses begin to emerge from the recession, we are encouraged to see that the finance executives who participated in this survey do anticipate growth, modest though it may be. We are equally encouraged to learn that as their top-line sales grow, these same finance executives are committed to maintaining the cost discipline that they helped instill during the recession.

In our experience, as businesses grow, their attention to expense management tends to wane.

That's when companies turn to Expense Reduction Analysts (ERA).

Our professionals apply years of experience and highly specialized skills to lowering clients' costs, while assuaging the typical barriers that such efforts tend to raise.

Cost containment fatigue. While the finance executives who responded to this survey don't want to lose ground on savings achieved during the economic downturn, they also indicated that there is a sense of fatigue around expense reduction efforts. Their organizations made significant cuts during the recession and tend to feel that they have trimmed all possible excess. Time and again, ERA experts have been able to go into companies where expense management projects have been undertaken and still find significant savings over and above the results the companies achieved on their own.

Organizational resistance. Consistent with the 2009 study, organizational resistance emerged as a significant barrier to improving cost management. As outside consultants, we find that collaborating with internal staff and supplying missing resources enables us to earn staff buy-in, cooperation, and commitment to ongoing cost reduction efforts.

Lack of time, attention, and resources. As businesses shift back into growth mode, we can expect this challenge to become even more pronounced. Businesses are now operating with fewer employees than in 2009, and if remaining staff members are now turning their efforts back to top-line growth, then maintaining cost discipline could prove more challenging than ever. Plus, ERA does all of the heavy lifting, so from a time management perspective, the impact of an ERA project on our clients' team is minimal.

Let ERA mind the bottom line while you grow the top.

Because each of the dozens of cost categories has a unique universe of suppliers, delivery processes, pricing models and lingo, the application of specialized knowledge and expertise greatly improves cost-cutting results. ERA's proprietary procurement tools and extensive benchmark data from more than 14,000 successful projects are just two of the many reasons we are well-positioned to maximize savings.

You and your in-house staff have likely done a very good job of cutting costs. But as the economy continues to improve and your business grows, wouldn't it be more prudent to focus on areas of your core business that will support increased top-line sales?

One of the most gratifying results of this survey is that U.S. finance executives are experiencing a new-found level of influence within their organizations. This dedicated group of professionals was largely responsible for helping their organizations maintain operations during this difficult economic period. ERA is committed to providing support to finance executives in their efforts to maintain cost discipline within their organizations. As a total expense management solution, ERA can help you reduce and contain spending across your organization. You've likely seen the value those saved dollars had on your business during the recession. Imagine the boost saved dollars would provide to help fuel your company's growth.

For more information, visit
www.expensereduction.com

Expense Reduction
Analysts

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At CFO Research Services, Celina Rogers directed the research and wrote the report.

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