



# Why Retooling Requires a Zero-Based Cost Management System

More than ever, companies need a cost management capability designed to sustain results.

**By Jason Heinrich and Andrew Mintz**

## About the authors

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### At a Glance

- ▶ About 20% of companies play offense during downturns and launch strategic cost transformations—they are able to accelerate their growth trajectory, outgrowing their peers by nearly four times, with the biggest advances in performance achieved during downturns.
  - ▶ Most companies approach cost management as just a target-setting and benchmarking exercise—they fail to fundamentally redesign the work or embed a cost management capability to sustain savings.
  - ▶ By combining all three aspects of cost transformation (Bain’s Zero-Based Cost Management System), companies can rapidly reduce or redeploy as much as 25% of their cost base to drive growth and expand operating margins, while they redesign processes and ensure efficiencies can be sustained.
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In the early months of the Covid-19 pandemic, companies made quick and bold moves to survive. They aggressively reduced discretionary spending, and put investments behind new initiatives on hold, while protecting their employees and assets.

Now, as they enter the recovery phase, they must also prepare for an uncertain future. Companies are trying to maintain these lower spending levels—and have a new appreciation for how lean they can be in certain areas—while shifting spending to invest behind strategic priorities to drive growth. Developing a true zero-based cost management system will allow them to create greater flexibility in their cost base and shift funds for new growth investments.

This is a time to act fast. About 20% of companies play offense during downturns and launch strategic cost transformations—they are able to accelerate their growth trajectory, outgrowing their peers by nearly four times, with the biggest advances in performance achieved during downturns (*see Figure 1*).

To understand where leaders see the big, high-value opportunities for retooling costs, we surveyed 150 companies and found that executives are planning for the post-Covid world by addressing five major themes: simplicity; automation and digitalization; new ways of working; visibility and accountability; and operational resilience (see the Bain Brief “Retooling for the New Cost Imperative”).

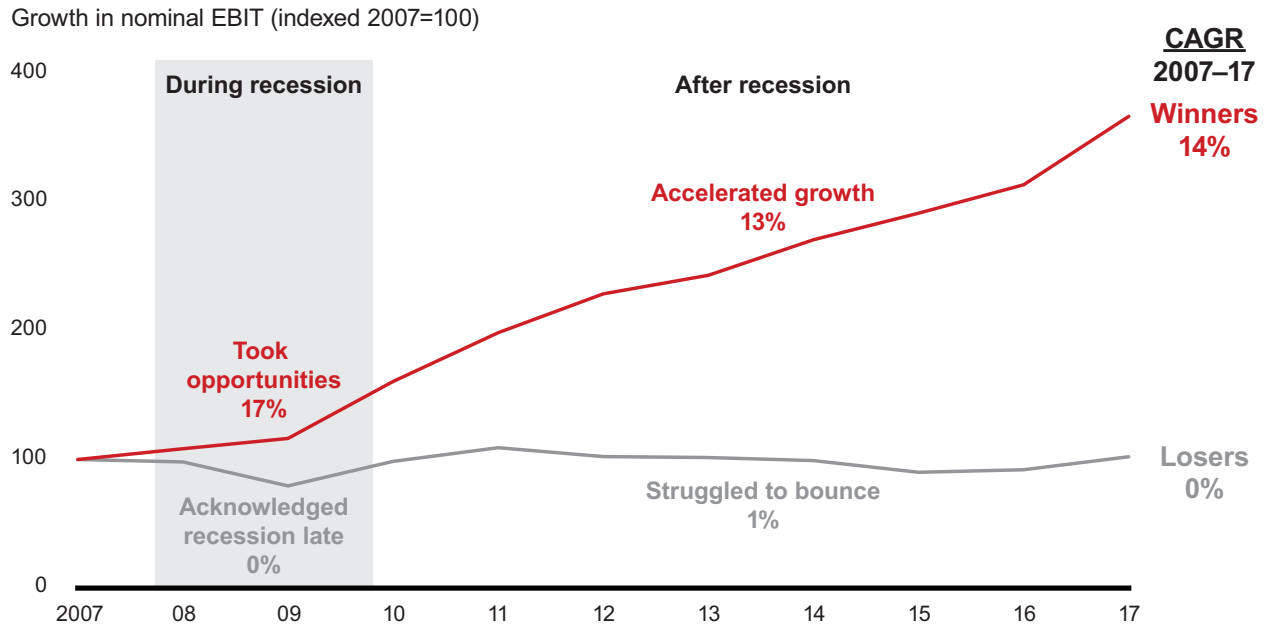
But as executives look to these five themes, many are haunted by the reality that when they have simplified and cut costs in the past, those costs and complexities always seem to come back. They are looking for a methodology that will allow them to allocate resources with more agility and sustain the results, particularly in a more turbulent environment.

In our experience, companies can go after costs at three levels (*see Figure 2*).

**Level 1: Benchmarking and setting targets.** This is what *most* companies do. They figure out where they can compress costs, set top-down targets and require the business and functional leaders to fall in line. It’s a brute-force approach to cutting costs, but the underlying work and activities don’t go away. As a result, any cost reduction through this approach typically lasts only one or two years before costs creep back in.

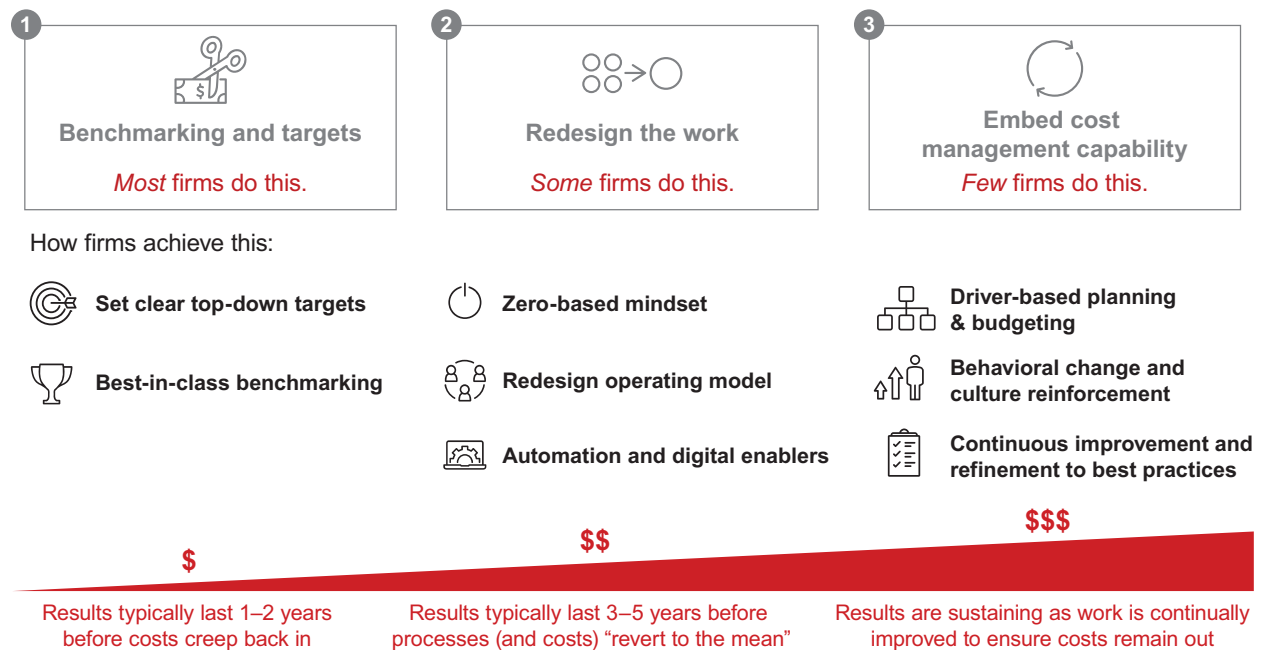
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**Figure 1:** Companies achieve their biggest advances in performance during downturns



Notes: Global analysis of 3,865 companies (winners n=416, losers n=3,449); winners defined as companies whose revenue, EBIT and TSR growth exceeded 2x industry/country average growth over the 10-year period; CAGRs calculated for 2007–10 and 2010–17  
Sources: S&P Capital IQ; Bain Sustained Value Creators analysis

**Figure 2:** Companies can go after costs at three levels



Note: Key lessons informed by a study of 20 companies across industries, a survey with more than 100 company C-level executives, and collective Bain experience  
Source: Bain & Company

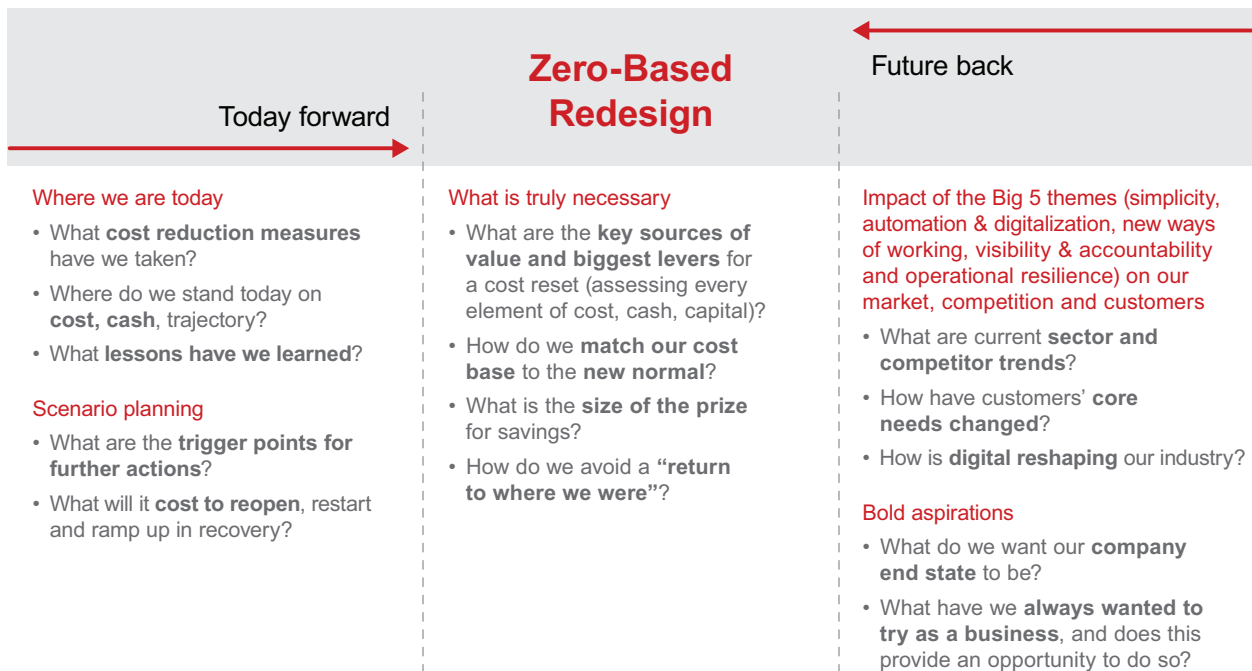
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**Level 2: Redesigning the work.** This is what *some* firms do. They take complexity and work out of the system, redesigning their operating model and relying on automation and digital enablers. Companies that do this well use a clean-sheet mindset, or Zero-Based Redesign (ZBR), an approach that resets the way work is done. They strengthen capabilities that provide true competitive differentiation, while intentionally downgrading other activities and functions that are noncritical. Zero-Based Redesign should start by taking a “future back, today forward” view (see Figure 3). Future back means envisioning customer needs, required capabilities and cost structure three to five years from now to define a clear point of arrival. Today forward involves defining the pathway to move from where the company is today to that future state point of arrival. The shortcoming is, most companies fail to put new ways of working and performance processes in place to track and sustain the value creation. The results typically last three to five years before the costs return.

There is a third level of cost takeout that ensures long-term savings and flexibility—**Level 3: Embedding a cost management capability.** It’s a combination of the right skillset (people, processes and technology) and mindset (the culture as manifested in values, behaviors and ways of working). This is what *few* firms do. Zero-Based Budgeting (ZBB) is one methodology that can create both the skillset and the ownership mindset while sustainably taking costs out and reallocating scarce resources to their most productive uses. ZBB is more than just a new budgeting process; it is a set of tools that enables a fundamental shift in a company’s overall approach to cost management.

These companies set top-down targets and redesign the work. But what separates them is that they also set up rigorous performance management routines to continuously identify and start new productivity initiatives, track the progress of those initiatives and ensure that they are visibly delivered

**Figure 3:** Zero-Based Redesign helps companies think strategically about the Big 5 themes



Source: Bain & Company

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to the P&L. If they are not, leaders are held accountable; and if they are, those leaders are rewarded. The results stick because cost savings can be identified, tracked and continuously improved. Even companies that choose not to go the full ZBB route can still build cost discipline by investing to increase spending visibility, understand the demand drivers behind spending and embed behavioral change and culture reinforcement into the organization.

By combining all three levels of cost management (what we at Bain call our Zero-Based Cost Management System)—setting targets to take out low-hanging costs, redesigning processes and activities to operate at a lower cost level, and instilling new cost management capabilities—companies can rapidly reduce or redeploy as much as 25% of their cost base to spur growth and expand operating margins. Companies with consistent cost productivity gains realized higher growth in total shareholder return (TSR). The top 5% of performers—those companies with five years of cost productivity gains between 2012 and 2017—achieved a TSR of 25% on average, double that of the rest of the pack. (TSR is defined as stock price changes assuming the reinvestment of cash dividends.) Moreover, cost productivity remains relevant at any point in the economic cycle. Top TSR performers far outpace bottom TSR performers in both revenue growth and productivity, in good times and bad.

Implementing all three levels of cost management—the full Zero-Based Cost Management System—will enable companies to most effectively drive and deliver against the five retooling themes for the post-Covid recovery.

For example, launching a level 2 effort will help companies *simplify*, embed *automation and digitalization* and deploy *new ways of working*. Redesigning the work means identifying areas of complexity or waste where spending can be reduced and low-value work can be eliminated. Companies using a clean-sheet approach to process redesign identify opportunities to run more efficiently through automation, using digital tools to simplify and increase the effectiveness of certain activities.

Going to level 3 and embedding the full cost management capability helps to build *visibility and accountability*, and ultimately increases *operational resilience*. For the first time, companies can truly understand how much of the cost base is fixed vs. variable. There's high-resolution visibility into who is spending and what they are spending. This enables companies to tie cost results—savings delivered, budgets met—to incentives and establish accountability across the leadership team. It is not a matter of using one approach for analyzing efficiency opportunities and another approach for designing processes to sustain those efficiencies. It is an integration of both.

And by maintaining this focus on cost and building the capability to understand demand drivers, companies are better able to shift spending and make their cost structures more variable as market conditions change. They become more nimble and competitive.

At all three levels of the cost management capability, companies that are the most effective share a distinguishing feature: CEO/CFO leadership and a full change management effort to support the change. These leaders acknowledge at the outset that cost management is an equal marriage of skill set and mindset. They commit to playing a major role in shaping the goal and ambition. They design programs that address the potential barriers to change. They also invest to build the strategic case for change, instead of just focusing on the change itself. In doing so, they bring the organization with them, as opposed to letting the organization fight against the change.

All business leaders are now looking ahead to a future in which anything can happen. Those who embrace all three levels of zero-based cost management and design a sustainable system will be able to navigate unpredictable near-term market shifts even as they gain a competitive differentiation for the long term.

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