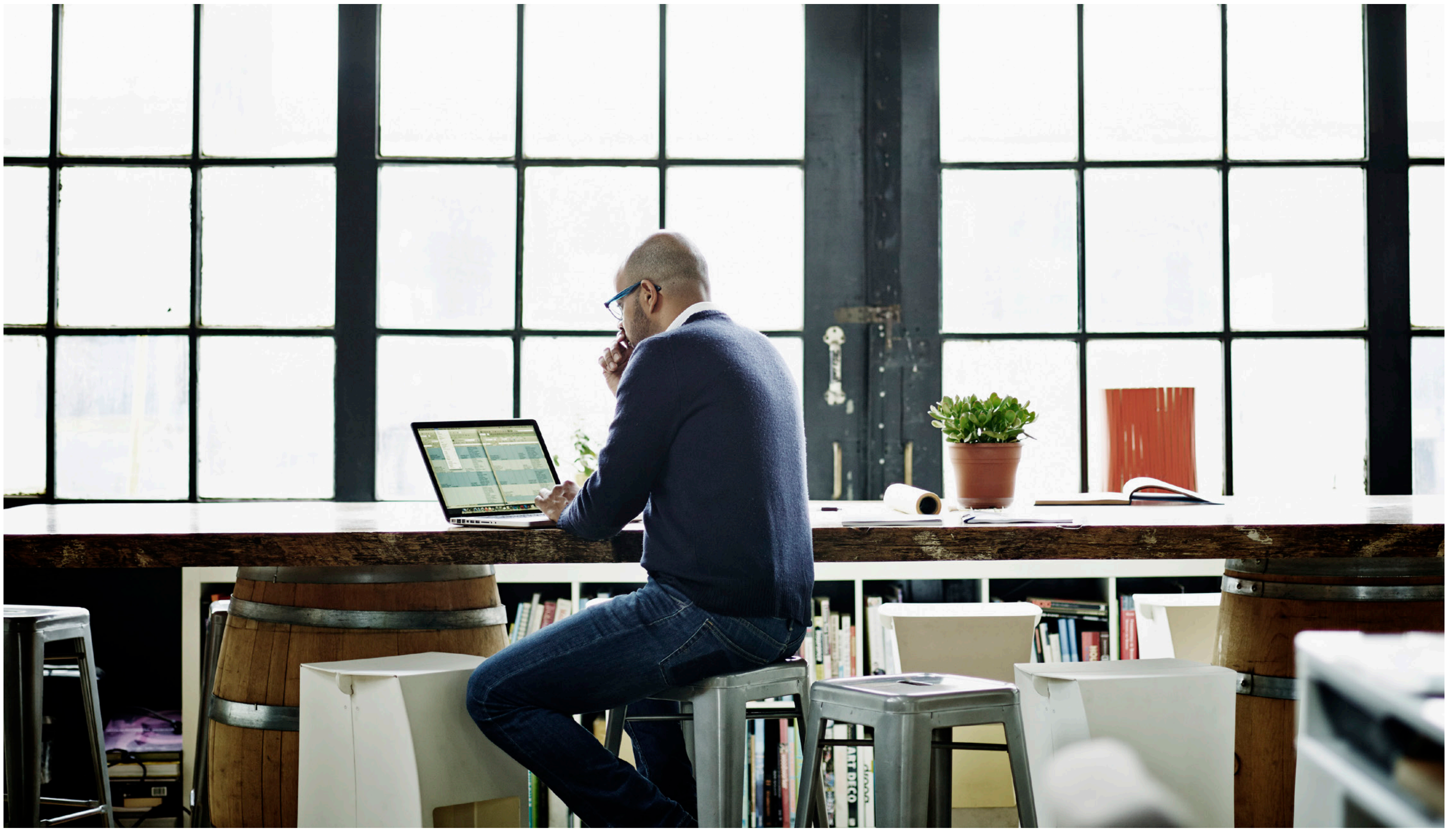


Cost Leadership at Fast-Growing Tech Companies: The Sector's Unsung Hero

Productivity champions show it's not just revenue growth that drives shareholder returns.

By Tom Holland and Dan Levy

BAIN & COMPANY

At a Glance

- Fast-growing tech companies that also relentlessly attack their costs generate an outsize reward for shareholders, Bain analysis shows.
- Tech cost leaders thrive by reinvesting efficiency savings in fresh top-line growth opportunities.
- They also do five things extremely well: get high-resolution spending visibility, prioritize strategic spending, inject clean-sheet rigor into budgeting, eliminate unnecessary work, and move on to game-changing innovations.

Equity investors are drawn to the technology sector because of its strong, sustained revenue growth. But that doesn't mean fast-growing tech companies can afford to neglect cost management and focus solely on growth.

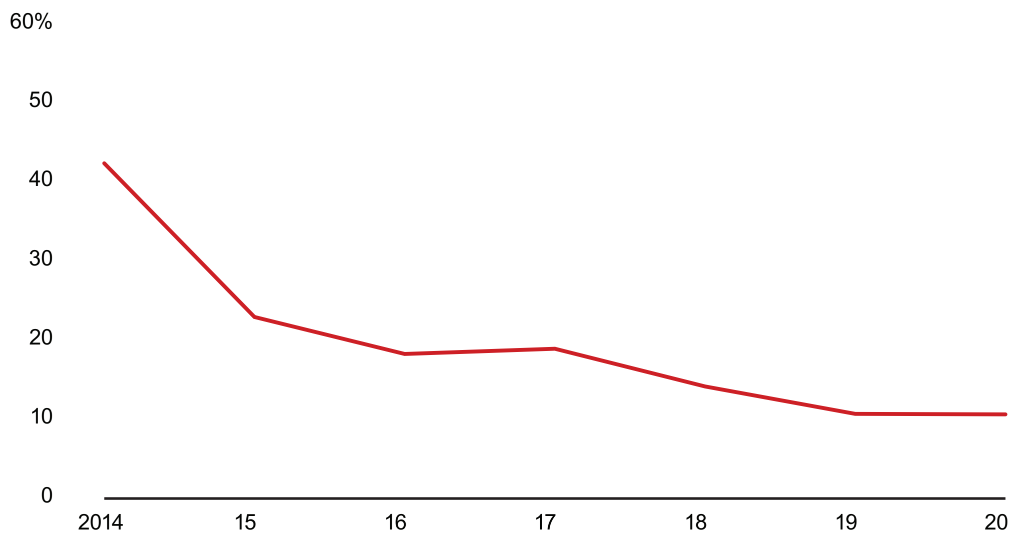
For a start, growth rates tend to slow over time. Markets and businesses mature. The law of large numbers says it's hard to keep posting triple- or high double-digit revenue gains when businesses have already achieved impressive scale. Those limiting factors were evident when we analyzed the performance of more than 200 high-growth publicly listed tech companies in the US from 2014 through 2020. Average growth for the cohort was more than 40% in 2014 but dwindled to 11% in 2019 and 2020 *(see Figure 1)*.

Crucially, equity markets also place more value on cost productivity gains in the technology sector than some might think, as shown by Bain & Company analysis of the stock market performance of all US-listed tech groups during the 2014–2019 period that preceded Covid-19's turbulence. We found the strongest investor returns at companies that most consistently demonstrated cost productivity gains by increasing earnings before interest, taxes, depreciation, and amortization (EBITDA) faster than revenues, year after year *(see Figure 2)*.

This is not simply a case of margins expanding as the business gains scale. Across all growth cohorts, companies that sustained productivity improvements for several years ("cost leaders") outperformed all other companies in their growth peer group on total shareholder return *(see Figure 3)*. Cost leaders follow a clear path to accomplish this feat. They invest in process and technology to achieve cost leadership vs. competitors, then reinvest that cash "fuel" internally to drive the next wave of growth.

Figure 1: Most tech growth stories slow eventually as the business gains scale and its opportunities mature

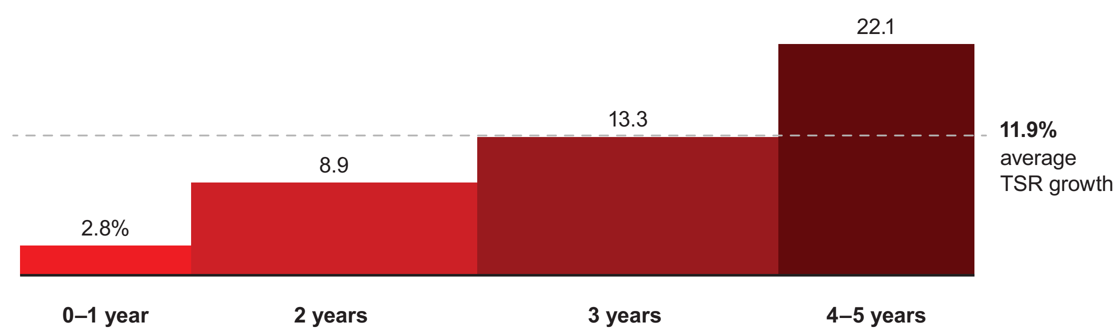
Average annual revenue growth for US tech companies that each posted more than 10% growth in 2014



Note: Includes US tech companies that were publicly listed as of 2019, with starting year (2014) and ending year (2020) revenue greater than $100 million (n=201)
Sources: S&P Capital IQ; Bain analysis

Figure 2: In tech, there's a significant link between superior shareholder returns and sustained cost productivity improvement

Average compound annual growth of total shareholder return for US tech companies vs. years of productivity improvement achieved, 2014–19



Proportion of tech companies at this productivity level*	18%	30%	32%	21%

* Percentages do not total 100% due to rounding
Notes: Productivity improvement defined as growth in EBITDA outstripping revenue growth; includes all US technology companies publicly listed as of 2014 that remained public through 2019, with 2014–19 annual revenue greater than $100 million (n=307)
Source: S&P Capital IQ

Figure 3: The link between productivity gains and strong equity performance holds across fast-, medium-, and slow-growing tech companies

Average compound annual growth of total shareholder return for US tech companies, 2014–19		Years of productivity improvement achieved, 2014–19: 0–1	2	3	4–5
Revenue growth, 2014–19	<5%	–5.6%	–1.4%	4.2%	**15.8%**
	5%–10%	6.0%	10.0%	14.7%	**22.5%**
	10%–15%	–0.2%	14.6%	11.6%	**22.3%**
	15%+	15.4%	18.4%	21.1%	**25.8%**

Top performers

Notes: Productivity improvement defined as growth in EBITDA outstripping revenue growth; includes all US technology companies publicly listed as of 2014 that remained public through 2019, with 2014–19 annual revenue greater than $100 million (n=307)
Source: S&P Capital IQ

Fast-growing cost leaders in tech get a handful of things right

In our work with tech companies globally, we've identified patterns in how cost leaders repeat this cycle of saving and reinvestment. They tend to do a handful things well. For tech executive teams aspiring to cost leadership on top of growth, these five imperatives can help to shape a broad cost management strategy.

1. **Get high-resolution spending visibility.** Management teams at cost leaders build up a more granular picture of spending than traditional management reporting allows. That high-resolution clarity enables executives and managers at all levels to fully and quickly understand where money is spent, who spends it, and whether it is being actively managed. In a growth business, where unit or revenue growth can become the excuse for runaway cost increases, this visibility is essential to avoid unchecked cost inflation.

2. **Differentiate between strategic and nonstrategic spending.** Not all costs are created equal. Cost leaders don't cut spending across the board by a set percentage. They distinguish between non-

strategic costs and spending that underpins critical customer experiences, effective R&D, high-return sales and marketing, and other strategic priorities where they need to outinvest competitors.

Salesforce is one example. While posting annual revenue increases topping 20%, the cloud software company prioritized strategic spending even as it expanded margins through tight cost control. For instance, it increased the proportion of its spending going into research and development. It was a similar story in sales and marketing: Strategic spending directed at driving market gains was unaffected by initiatives that cut the proportion of revenue spent on sales and marketing by almost 8 percentage points over five years, through measures such as centralizing work, encouraging self-service, and streamlining sales management.

Cost leaders also manage down nonstrategic costs through a rigorous annual and ongoing process, to drive investment in the growth of the business. This "investment posture" sets the stage for reshaping the company's profit and loss statement, cost structure, and operating model, while signaling that productivity (absolute and unit cost) improvements will be expected in most areas of the company.

The "investment posture" sets the stage for reshaping the company's profit and loss statement, cost structure, and operating model, while signaling that productivity (absolute and unit cost) improvements will be expected in most areas of the company.

3. **Inject clean-sheet rigor into budgeting.** At many companies, there's a tendency in the budgeting process to let costs drift upward in line with rising sales, inflation, and investment requests. Cost leaders break free of this default setting. Instead of indexing costs to growth, or allowing them to run ahead of sales increases, they invest in annual clean-sheet budgeting processes that consistently deliver quarterly unit cost improvements, while flattening or even managing down fixed costs.

4. **Embrace zero-basing and automation to eliminate unnecessary work.** Tech cost leaders excel at cutting unnecessary

work. They constantly reinvent customer-facing and internal processes to take out complexity and manual work, often guided by a zero-based redesign approach that scrutinizes *what* work is done and then how it is done.

Simplifying work and then streamlining it further with automation tools can yield sustained results. Take ServiceNow, the California-based provider of enterprise cloud computing solutions. It has thrived by overtly balancing sales growth and profitability, and part of that success has come from internally deploying the workflow platform it sells to other companies. It recently told investors that the platform had created $300 million in internal savings from increased employee productivity over three years—cash it reinvested in growth-generating areas such as IT innovation.

5. **Move from efficiency basics to game changers.** Cost leaders first get all the basic efficiency measures in place, such as trimming waste, managing third-party spending and staff expansions through budgeting, etc. They then move to more advanced or cross-functional game changers, such as truly zero-basing functions and costs, reducing product line and operating model complexity, and introducing large-scale automation *(see Figure 4)*.

   Bold moves are possible at the enterprise level and in most functions. In procurement, nailing the basics might mean consolidating all contingent labor needs to negotiate better rates. The most ambitious executive teams might then progress to game-changing moves such as embedding a company-wide vendor management system (VMS) into policies and practice. For instance, one software maker made VMS implementation and contingent labor consolidation a key plank of a broader company-wide efficiency drive that within a year freed up about $200 million in spending, for reinvestment in high-priority areas such as artificial intelligence.

Bold moves are possible at the enterprise level and in most functions.

Figure 4: Relentless cost management often means getting the productivity basics right and adding one or two game changers

	Quick wins and efficiency levers	Game changers
Overall	• Scale down or stop projects • Impose spending hand brakes	• Embrace zero-based redesign: a bold, clean-sheet rethink of the operating model and processes • Reduce complexity through a portfolio review of the optimal mix of businesses, products, SKUs, projects, and locations
General and administrative expenses	• Reduce or stop low-value work • Manage demand by dialing down service levels • Defer or stop discretionary projects • Deploy lightweight automation tools (e.g., robotic process automation for low-complexity tasks)	• Zero-base processes end to end to simplify, standardize, and digitize/automate (e.g., for enterprise technology spending) • Reset functional operating models: role of business vs. functions, level of centralization and use of shared services, role of outsourcing • Reduce complexity of technology and data; accelerate shift to the cloud
Procurement	• Consolidate spending on third parties to fewer vendors to negotiate rates • Implement guidelines for usage and demand	• Establish preferred-vendor programs leveraging user rating platforms, to channel spending to fewer vendors and increase buying power • Reevaluate the right "make vs. buy" mix for core functions such as software development • Deploy AI-driven sourcing tools to automate insights from spending data, flagging savings and compliance opportunities in real time
Research and development	• Reallocate work across lower-cost sites • Optimize team structure, size, and processes	• Reevaluate or take a clean-sheet approach to the pipeline of products, R&D priorities, and in-house vs. external work • Reinvent site and talent strategy • Redesign products for low technical debt and efficient cloud delivery
Sales	• Retool sales quotas and incentives to align with the most critical demand drivers (region, product, SKU, etc.) • Standardize sales enablement processes	• Reinvent field sales to reflect customers' use of digital channels • Expand digital self-service options • Move more repetitive or transactional work to an inside selling model
Marketing	• Shift low-impact spending to high-impact areas • Consolidate and reduce third-party media spending	• Reevaluate or take a clean-sheet approach to all spending (on brand, etc.) • Explore efficiencies by increasing use of digital marketing
Cost of goods sold	• Reduce slow-moving items for improved efficiency and margin improvement • Optimize freight rates and limit expedited shipping costs through customer segmentation	• Conduct a clean-sheet review of SKUs to prioritize higher-velocity and higher-margin SKUs • Optimize use of low-cost countries as business scales • Reconfigure manufacturing model to leverage scale across network • Redesign production and distribution center network • Automate and redesign distribution center operations • Use predictive analytics/machine learning to improve planning and forecasting

Source: Bain & Company

Getting started: Monday morning questions

As management teams weigh where and how to attack the challenge of sustained cost productivity, we suggest a few fundamental discussions around the following questions.

- Do we have full visibility into **what we spend and who spends it**?
- For each major cost area, how many years in a row have we achieved **reductions in absolute cost or unit cost**?
- Do all our leadership roles include a focus on **annual improvements in efficiency or unit cost**?
- Do we ever **zero-base** our approach to department or process costs, what work gets done, and how it gets done?
- Are we **automating most repetitive, rules-based tasks**?
- Does our procurement team find a **3%–5% reduction in external costs (adjusted for volume and inflation) each year**?
- Are all our investments in R&D and marketing **generating a positive return on investment**?

The answers to these questions may well identify opportunities to be bolder on cost—and strengthen shareholder returns.

Bold ideas. Bold teams. Extraordinary results.

Bain & Company is a global consultancy that helps the world's most ambitious change makers define the future.

Across 63 offices in 38 countries, we work alongside our clients as one team with a shared ambition to achieve extraordinary results, outperform the competition, and redefine industries. We complement our tailored, integrated expertise with a vibrant ecosystem of digital innovators to deliver better, faster, and more enduring outcomes. Our 10-year commitment to invest more than $1 billion in pro bono services brings our talent, expertise, and insight to organizations tackling today's urgent challenges in education, racial equity, social justice, economic development, and the environment. We earned a gold rating from EcoVadis, the leading platform for environmental, social, and ethical performance ratings for global supply chains, putting us in the top 2% among other consulting firms. Since our founding in 1973, we have measured our success by the success of our clients, and we proudly maintain the highest level of client advocacy in the industry.

For more information, visit **www.bain.com**