



Expert Insights

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# Cost and value transformation in the era of COVID-19

IBM Institute for  
Business Value



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## Key takeaways

### Remember the big picture

Cutting cost in a crisis is crucial—but so, too, are strategic investments that harden an organization’s resilience and increase growth potential once the crisis abates.

### The exponential solution

To optimize value, organizations should systematically embed AI and other exponential technologies in processes, workflows, and operating models.

### Foundations for resilience

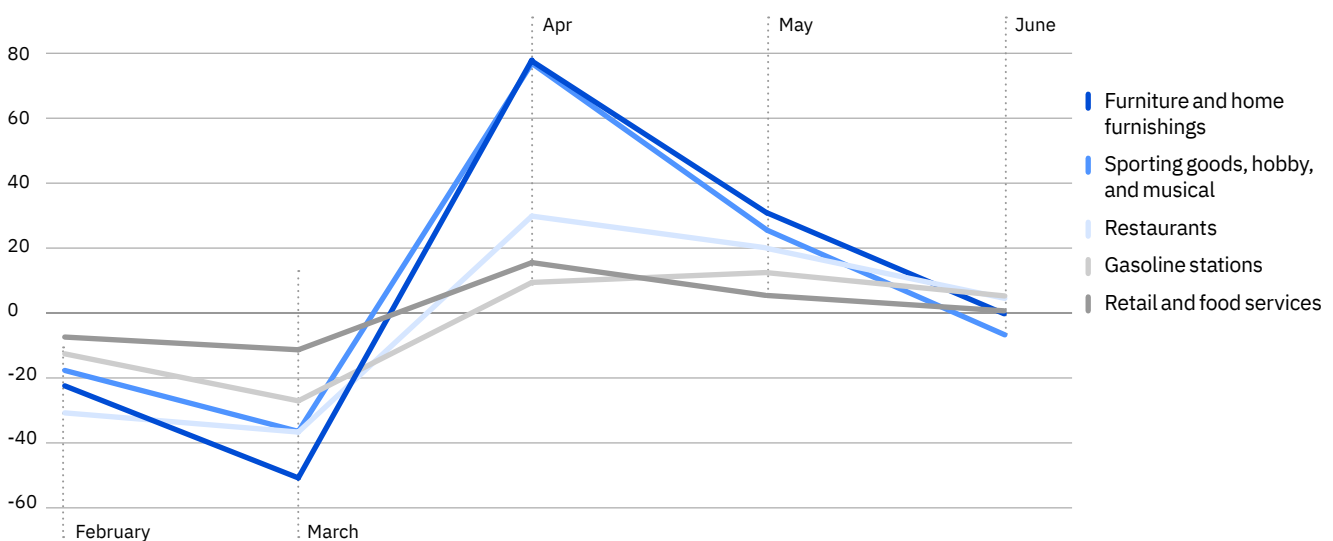
Organizations should also make costs more variable, expand the potential of cloud, and move non-core functions to shared services models.

As organizations around the world continue to navigate COVID-19, uncertainty remains about how businesses will finally reemerge, and what markets will look like. One thing is clear. In the different normal that ensues, resiliency, agility, and speed will separate those organizations that succeed from those that don’t.

In a disruption-ready reality, organizations need to anticipate and respond more frequently to sudden and significant change. They will not know in advance when or how often shocks will take place, or their precise nature and how they will affect individuals, regions, industries, or businesses. With COVID-19, for example, some industries are experiencing radical swings in areas of demand (see Figure 1). To better prepare for a more volatile future, organizations should be taking steps now to develop the core business capability of responding quickly to challenges.

**Figure 1**

COVID-19 impact varies across retail (month-to-month sales change)



Source: U.S. Census Bureau, Advance Monthly Retail Trade Survey, July 16, 2020

## Companies that cut the deepest do not usually rebound well from recessions.

Beyond immediate health and safety concerns, cost control ranks high in business executives' minds (see Figure 2). Sudden revenue decline, supply chain disruption, and rapid workforce adjustment—regarding how and from where employees work—all create substantial liquidity challenges. As Jerome Powell, Chairman of the US Federal Reserve, noted, “the passage of time can turn liquidity problems into solvency problems.”<sup>1</sup>

Just weeks into the COVID-19 crisis, reports emerged that nearly a quarter of global public companies would run out of cash within six months without some form of intervention.<sup>2</sup> Several high-profile bankruptcy filings have been reported.<sup>3</sup> Uncertainty remains about the timing of eventual recovery. An extended period of stagnant innovation, productivity, and growth seems inevitable.

**Figure 2**

Cost control is still a top priority



Source: IBM Executive pulse survey Q1C; n=3450, fielded April 27 – June 9, 2020. Question: To what extent is your organization prioritizing the following business competencies?

## Value transformation versus cost cutting

Cash preservation is critical. Without a strategy that balances value transformation with cash preservation, organizations face the temptation to cut costs in blunt, linear, traditional ways that preserve cash but rob them of the capacity to flourish in the future. Among these cuts, the impulse is often to lay off people and ask the organization to do more with less.

But companies that cut the deepest do not usually rebound well from recessions. One study found, for instance, that among organizations that faced past crises, 37 percent of those who deployed a balanced, “reduction plus offensive investment” approach went on to outperform their rivals in subsequent years, in contrast with those that focused on defensive, reduction-focused approaches.<sup>4</sup>

The answer, then, isn't merely cost cutting—it's a focus on cost and value transformation: Finding better ways to organize and run a business that lower cost and make it more variable, while enabling investments so the company is positioned for growth.

Unavailable just a few years ago, exponential technologies—including artificial intelligence (AI) with natural language processing, robotics and automation, IoT, and a variety of hybrid cloud-based analytical tools—give organizations powerful new ways to pinpoint cost and value drivers, diagnose and prioritize business areas, and create new approaches to value transformation. Furthermore, “as a service” business models enable more flexible cost structures.

## Value analysis

Highly strategic organizations use the opportunity of challenging times to reposition themselves for an unknown future. Value analysis will address near- and longer-term opportunities through coordinated activities across three broad categories: capability and process cost optimization; operating model transformation; and digital and cognitive reinvention (see Figure 3).

During crises, an organization must recognize what can and should be done immediately, and where to target its efforts as it emerges into a different normal. An emphasis on stabilization and rapid cost transformation opportunities will give way over time to adaptation and value transformation. As such, for each of these categories, we have identified areas of focus for both the near-term and the longer-term.

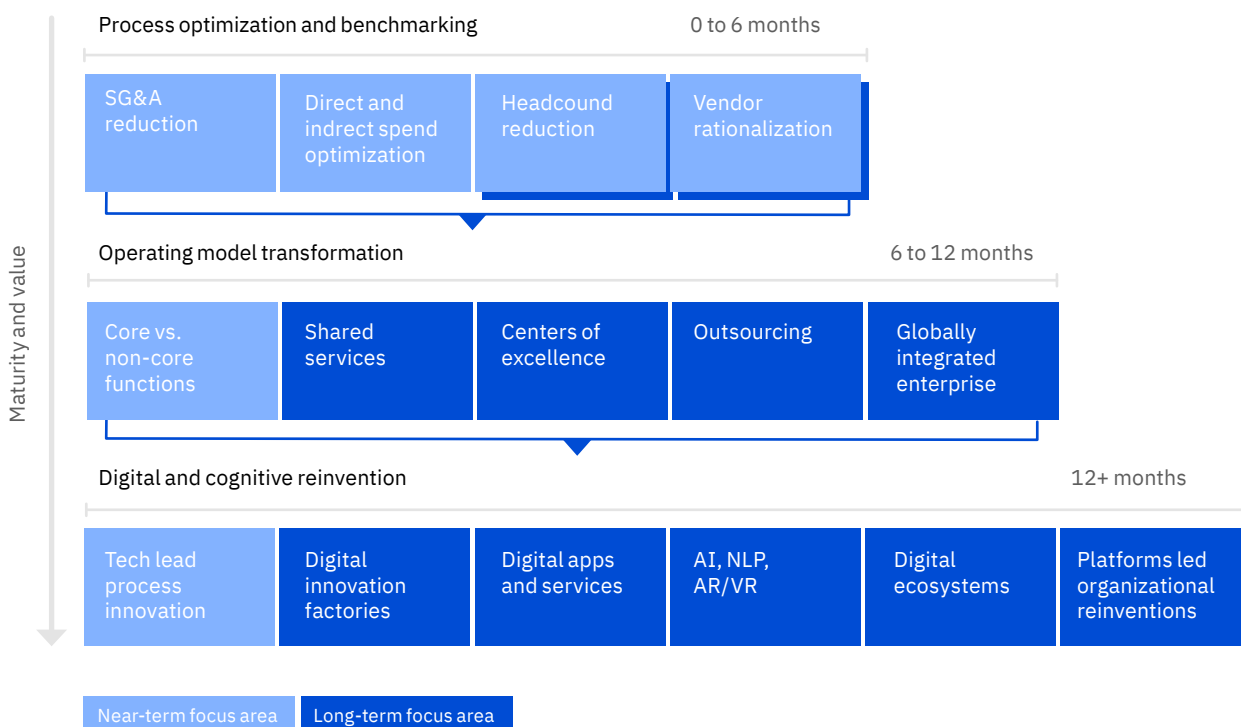
Based on our work with clients through many challenging times, including the ongoing COVID-19 crisis, we see value transformation comprising three major phases:

- Survive
- Transition
- Thrive

The fundamental purpose of value transformation, though, is to lessen as much as possible the impact of the first two. By taking the right steps now, a company confronted with an unexpected disruption will be better equipped to shorten its survive phase and transition quickly to growth.

**Figure 3**

Scope of Digital Reinvention impact



## Survive: Process optimization and benchmarking

### Short-term

The foundation of cost and value transformation is gaining an accurate picture of an organization's costs and value drivers, including the relative cost of various capabilities and processes, the balance of which may have shifted during the crisis. Job one, therefore, is finding the right cost and value levers to adjust, keeping in mind what portion of the total cost base they will influence. Cutting a cost, even substantially, that makes up a miniscule part of the company's overall cost base will have little long-term effect.

To help them identify high value transformation functions or processes, organizations can employ a methodology like component business modeling (CBM) to identify 3-5 priority areas for cost transformation (see "Insight: Component business modeling"). Functions, processes and tools that enable business continuity and improve work flexibility should jump to the top of the list. So should customer-facing experiences that are the lifeblood of a company's business. Technology, work policies and culture that support remote work also tend to increase resiliency and may reduce cost.

Benchmarking against peer organizations, industry leaders, and even the "art of the possible" can help identify and map the biggest pockets of spending for cost optimization to stabilize cashflow and reduce risk. As an example, many organizations have been forced to evaluate their supply chains and reexamine risks on transportation, logistics and other factors that affect the flow of critical materials.

## Insight: Component business modeling (CBM)

CBM is an approach to modeling and analyzing an enterprise that seeks to define an organization's "business components"—entities within the organization that comprise activities, resources, applications and infrastructure, and a governance model, as well as provide value in goods or services. CBM can operate at several levels, taking higher level entities that qualify as "businesses" and then breaking them down further into finer-grained components. A sophisticated pre-built model may have more than 400 components that can be used as a starting point for any CBM project.

The CBM approach helps a company evaluate the criticality, business readiness, and value of various processes and functions, and helps it balance its cash flow and operational expenses.

Free up workers for more complex, variable tasks—the kind of work humans excel at and find far more rewarding.

An IBV study conducted in May 2020 suggests that executives at organizations producing physical products were planning for a different future even before COVID, with the percentage favoring a just-in-time supply chain strategy dropping from 39 percent two years ago to just 15 percent. Taking a more balanced approach will enable them to procure assets or raw materials at a reasonable price, while building greater capacity to weather future uncertainties.

### **Longer-term**

As they optimize processes and look at benchmarks for guidance, organizations should not forget to fully support their existing employee base. While at times benchmarking may point to headcount reduction as a viable area for cost reduction, it's important to weigh the impact of headcount reduction against organizational capacity and employee morale.

To build a resilient workforce, companies need to examine how they communicate transparently with employees and how they enable them to work productively. They must assess if their current policies, data security and privacy protocols are aligned with new work realities, including the capacity to shift quickly to remote work. (See also “The CHRO’s guide to workforce re-entry—Rethinking the workplace,” IBM Institute for Business Value, June 2020.)<sup>5</sup>

In determining the right level of organizational capacity for the long term, organizations should recognize that vendor negotiations, direct and indirect spend reduction, and IT spend optimization can often create more desirable long-term impact.

## **Transition: Operating model transformation**

### **Short-term**

The immediacy and seriousness of the COVID-19 crisis provided an undeniable impetus for change. Companies may find it easier now to break up calcified operating models, re-examine supply chains, and reconfigure their workforce’s capabilities using modern technologies. Once the organization has identified areas for immediate cost reduction and taken initial steps to stabilize cash flow, it can shift its attention toward defining a digital operating model for the future.

The journey to revamp a company’s operating model begins by identifying core versus non-core functions based on the company’s strategy and recognized core competencies. In the near term, organizations should prioritize business continuity and leverage virtual ways of working for both core and non-core functions. Evaluate functions identified as non-core—possibly personnel administration, payment processing, and accounts payable and receivable—for centralization, automation, or a move to a shared services model.

Organizations should consider three areas for investment. First, identify opportunities to accelerate the migration of applications and workload—especially legacy mainframe work—to the cloud. Second, consider transitioning applications, where possible, to open source software. Third, invest in the advanced automation of repetitive tasks, using approaches like robotic process automation (RPA), to increase cost efficiency and free up workers for more complex, variable tasks—the kind of work humans excel at and find far more rewarding.

# Intelligent workflows use exponential technologies to get work done more efficiently and with greater responsiveness.

## Longer-term

As an organization considers longer-term actions and looks to transform operations across the enterprise, it should consider establishing Centers of Excellence (CoEs) around core technologies, critical processes, or applications. CoEs bring together cross-disciplinary teams that sit outside of established governance silos, promote consistency and governance, and help to define scalable and repeatable solutions. This cross-disciplinary collaboration not only contributes to operational efficiency, but can improve customer experience.

As a resilient organization evolves its operating model, it will match staffing with areas ripe for rapid growth and embed agile principles in the way its employees work. Agile principles encourage focusing on more cost-effective outcomes aligned with changing market conditions. Applying agile principles also supports a better employee experience. If a company is alert to the possibility, new virtual ways of working may reveal unanticipated opportunities to decrease cost and improve productivity and morale. Where appropriate, consider the opportunity to gain flexibility and variable cost through business process outsourcing and/or developing a contingent workforce.

## Thrive: Digital and cognitive reinvention

### Short-term

As an immediate, short term step toward digital and cognitive reinvention, organizations should look to leverage ready-made platforms and established capabilities that support stabilization and value transformation opportunities.

A simple but powerful application is seen in cognitive call centers. When companies were faced with having to adapt quickly to a COVID-19 environment, cognitive call centers helped compensate for personnel restrictions and answered customer requests while maintaining a viable level of service and—crucially—the company’s image. For example, as the pandemic began to spread in North America, requests for help or information to the airline WestJet increased more than 1,600 percent on Facebook Messenger and WhatsApp. The airline’s virtual agent completely handled 87 percent of the issues, helping lower response time.<sup>6</sup>

Similarly, AI-enabled chatbots for simple requests related to HR, procurement and employee IT needs can manage transaction volume and reduce pressure on the workforce. This flexibility is proving invaluable to many companies. At IBM, for example, we reported saving almost USD 1 billion since 2011 by embedding AI in human resources processes.<sup>7</sup>



## Longer-term

As the organization shifts focus toward longer-term adaptation and sustained value transformation, the integration of cognitive technologies enables an organization to build new business platforms on which it can compete. Control towers can coordinate work, data flows and analysis in real time across the company (see “Insight: Control towers help manage disruption”). Intelligent workflows supersede outdated, siloed business processes that resist optimization and change.

Intelligent workflows use exponential technologies, such as sensors and IoT devices, to get work done more efficiently and with greater responsiveness. Applying intelligent workflows can make possible cost savings in the 50-70 percent range, compared to conventional belt tightening approaches that yield cost savings in the 10-20 percent range. But more importantly, intelligent workflows can at the same time improve quality, effectiveness, and worker safety. Typically, belt-tightening degrades quality.<sup>8</sup>

Adding AI with natural language processing also empowers employees and helps shift their focus to higher value work. AI-enabled content curation tools, when used for professional development or training, for example, enhance employees’ skill sets and their ability to continue growing professionally. Advanced and customized chatbots can extend employee capability by capturing the collective expertise of the entire organization.

Together with ecosystem partners, an organization can establish digital platforms that use its talent, workflows and data to compete in new ways, convene coordination across its value chain, or expand into new markets. New partnerships can help mitigate gaps, or even lead to new offerings identified in the midst of a crisis.

## Insight: Control towers help manage disruption

A control tower is a connected, personalized dashboard of data, intelligence and analyses. It enables organizations to more fully understand, prioritize and resolve critical issues in real time. Control towers are especially useful in times of unpredictable, yet inevitable, vulnerabilities and disruptions, such as a pandemic.

A control tower provides end-to-end visibility across a discreet set of workflows and applies AI to bridge data silos, reduce manual processes, and derive real-time actionable insights from data. It also enables collaboration across teams and partners and preserves organizational knowledge to accelerate better decision-making. Ultimately, it can help an organization better predict disruptions, improve resiliency, manage exceptions and respond to unplanned events.

## Action guide

### *A progressive path to value transformation*

#### **Survive—Focus on liquidity**

Preserve cash to support ongoing operations and pave the way for longer term progress.

- Conduct a rapid diagnostic for business continuity and cost reduction opportunities, including benchmarking and advanced analytics, to decide on options for expense reduction and temporary shutdown.
- Assess supplier and vendor relationships, as well as product assortment and performance, as part of your cost reduction analysis.
- Review your capital project portfolio and use intelligent supplier lifecycle management to optimize spending cuts.
- Benchmark shared services and back-office expenses to identify areas for cost optimization.
- Develop a resiliency strategy and implementation plan.
- Establish a roadmap to shift select workloads to the cloud for operational agility and scaling.

#### **Transition—Build flexibility and seek opportunities**

Develop scenarios and plan responses for potential contraction of the business or sudden increases in demand.

- Use AI and advanced analytics to pinpoint and prioritize production issues, reducing the amount of time needed to resolve issues.
- Scale up your procurement function to renegotiate key contracts quickly.
- Implement robotic process automation (RPA) for back-office activities to reduce manual work and cycle time.
- Use AI-driven technologies to optimize logistics and distribution for sudden decreases or increases in demand.

Build crisis management tools and conduct robust financial stress testing.

- Develop a suite of applications for issue routing and resolution, automated reporting, and predictive maintenance.
- Build a knowledge and decision platform with AI intelligence for faster decision making.

Drive renewed demand and prepare for success by creating a ramp-up strategy.

- Establish an agile, market-responsive innovation program, such as an IBM Garage, to prototype and pilot a first wave of cost reduction minimum viable products (MVPs).<sup>9</sup>
- Re-design and re-imagine workflow processes with the goal of embedding exponential technologies like AI to make them into intelligent workflows.

#### **Thrive—Invest and scale value**

Reduce your effective fixed-cost base—Modernize IT infrastructure and build new cloud-based microservices to increase agility and scalability.

Create more quickly scalable solutions that support growth.

- Develop MVP pilots into a first production-ready release.
- Continuously monitor, test, and improve releases, and scale them rapidly.
- Deploy agile innovation projects in growth areas, as well as candidate areas for continued cost improvement.
- Personalize and contextualize customer outreach based on localization and/or time-sensitive triggers.

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