

MFB News – December 2009

Cost – A Strategic Issue!

There are encouraging signs that the economy entered a new phase of recovery. Most industrialized economies showed a better than expected growth in the third quarter, for some countries the best showing in two years, fuelled by government spending and restocking. The much-awaited turnaround ended the streak of four straight quarters of contracting economic activity, the first time that's happened in the post-World War II era.

Although things are getting better, the recovery will be fragile and painstakingly slow. We are far away from pre-crisis growth rates. Factories are not working to their full capacity. In fact, capacity utilization is running at about 70 percent -- well below the 82 percent long-term average. The unemployment rate is likely to go up; growth simply won't be fast enough to create new jobs. Despite aggressive downsizing by many industries, the enormous excess capacity will put increased pressure on product prices for years to come.

Avoid opportunistic savings: Defend your pricing power

The slump in total demand will remain for years causing facility closures, layoffs and increases in banks' bad assets. This is a trying time for businesses. Revenues drop, costs seem to be unmanageable and product prices are under constant pressure. The new environment forces companies to focus not only on cost reduction — the norm during any recession — but also on cash release. In fact, costs need to be managed (not necessarily reduced) all the time – both prosperous and troubled times – and not with a stop-start approach. Cost management is a strategic task. It allows companies to ask whether there is unrealized value in the business and focuses on critical areas where specific costs can be reduced.

As pricing power deteriorates and sales begin to dip, the temptation for many bosses is to cut costs and slim down what they wrongly perceive as 'non-essential' spending. Short-term choices amounting to false economy often take precedence over long-term investment which can pay dividends. To create a competitive advantage, cost management systems must be tailored to brand and price sensitivity enabling companies to become masters of their external cost drivers as much as of their internal ones.

Cost management demands leadership qualities

To survive these challenging times, companies need to make an accurate assessment of medium- and long-term demand and adjust capacity accordingly. Any restructuring

and cost management should focus on actions that will bring about sustainable improvements in profits and liquidity.

Intelligent cost management demands leadership qualities. Your management has to take appropriate action on costs and sales in order to strengthen your core competences and competitive position. The execution of any chosen strategy has to be carefully managed to ensure the appropriate balance between revenue growth and cost. Independent experts can assist your company in creating a best-practice optimized process that is based on your expertise.

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Contact:

MFB Resultants GmbH
Luisenplatz 1
65185 Wiesbaden

Phone 0611 / 34 11 70

Fax 06 11/ 34 117 22

kontakt@mfresultants.com

www.mfresultants.com