

Cost Containment in the light of Geopolitical Bloc Building and Inflationary Pressure

Navigating between short-term firefighting and long-term steering

47th Congress of Controllers
Munich, May 16th, 2023

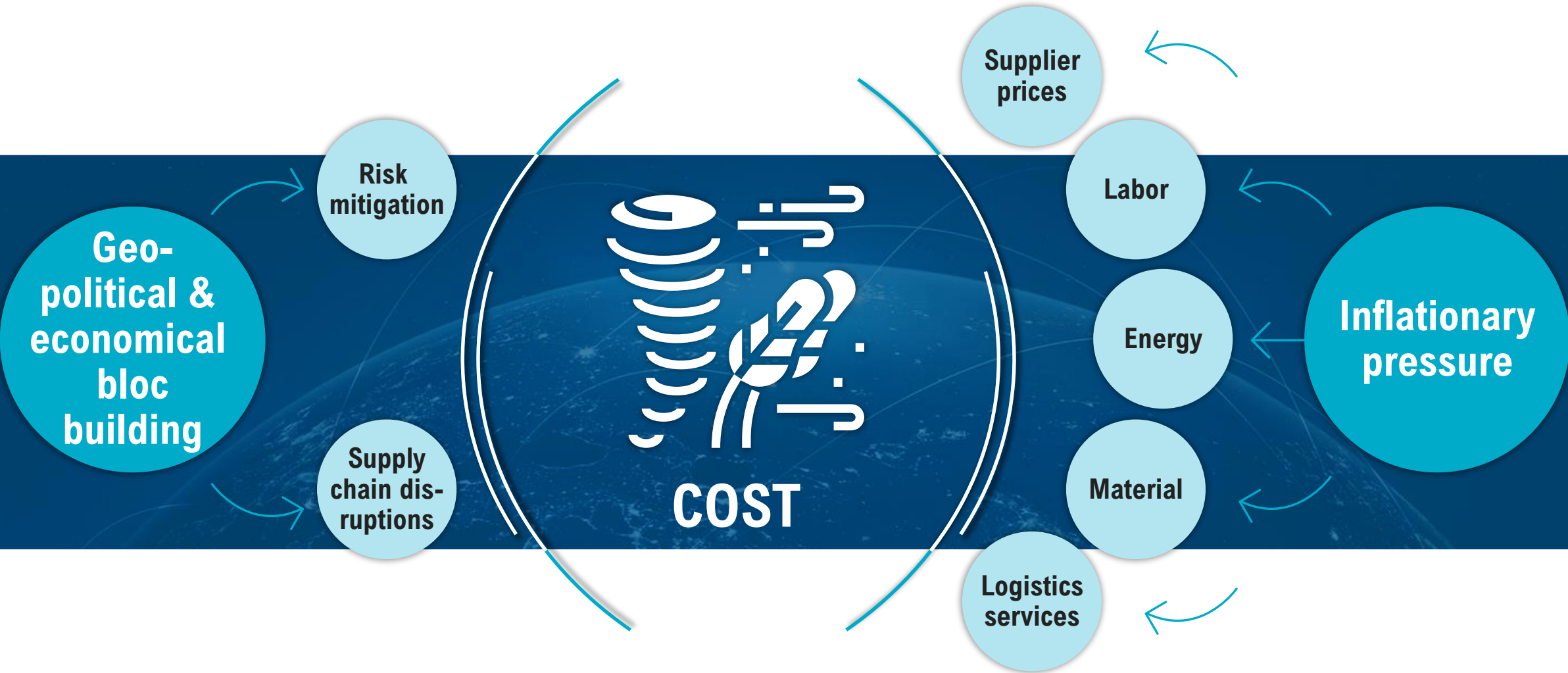
The VUCA world creates many challenges – Geopolitical & economical bloc building as well as inflation defense on top of the agenda for many CEOs

VUCA WORLD CHALLENGES



2023 →

Both challenges create additional cost pressure for companies



Challenge 1: Geopolitical & economical bloc building



Current initiatives are bottom-up and disconnected – Companies jeopardize their future

CORPORATE STRATEGY



Risky
Expensive
Inconsistent
Inefficient

Therefore, a top-down view is required to derive a holistic, consistent & economically feasible plan

What it takes to stay on course – Overview

Prioritization of challenges – Focus in this paper: Geopolitical and economical bloc building

Top-down alignment on geopolitical and economical scenarios & risk appetite



Bottom-up development of functional mitigation plans



Synchronization, financial evaluation and decision

Basis for holistic, consistent & economically feasible plan



Companies can follow six decision points to "connect the dots" and provide guidance to the organization

What it takes to stay on course – A decision framework



DECISION FRAMEWORK

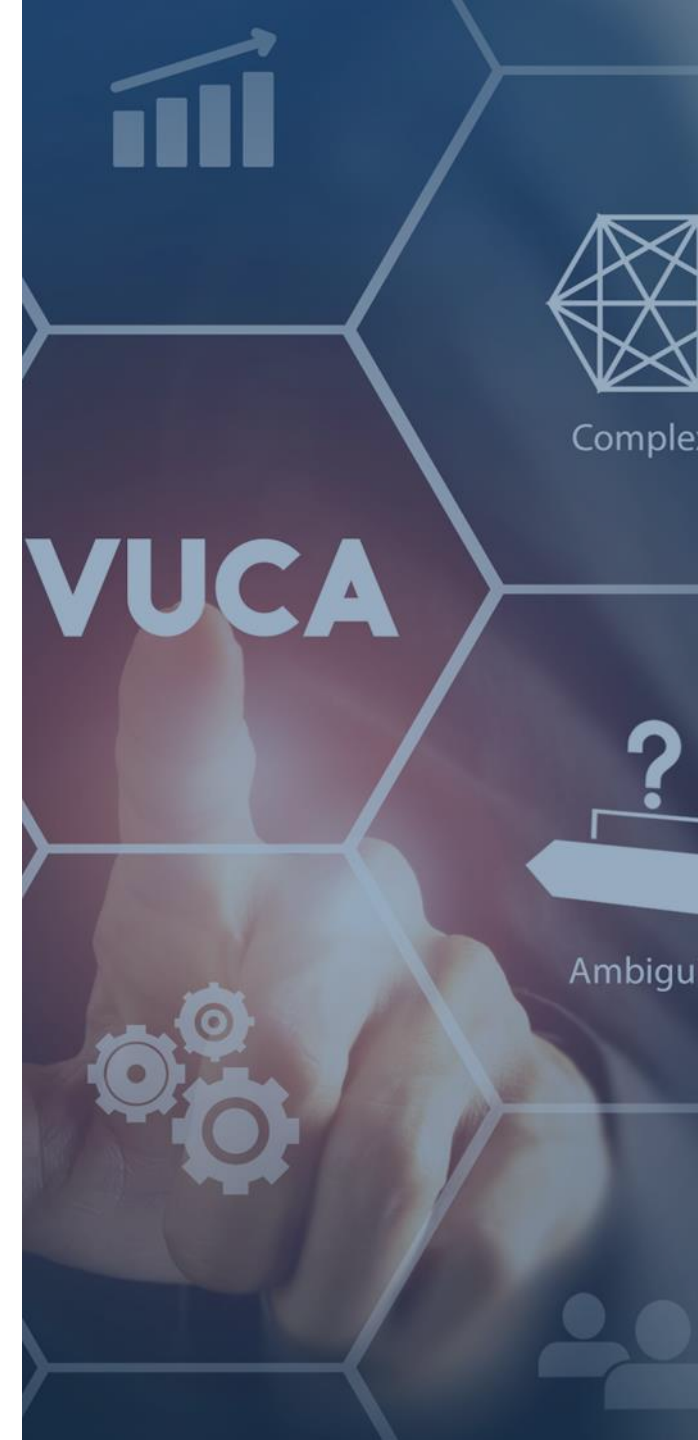


Top-down alignment

- 1 Geopolitical & economical scenarios** 
- 2 Trends & implications for the industry** 
- 3 Implications for the company, risk appetite & strategic guardrails** 
- 4 Business re-configuration & transformation requirements** 

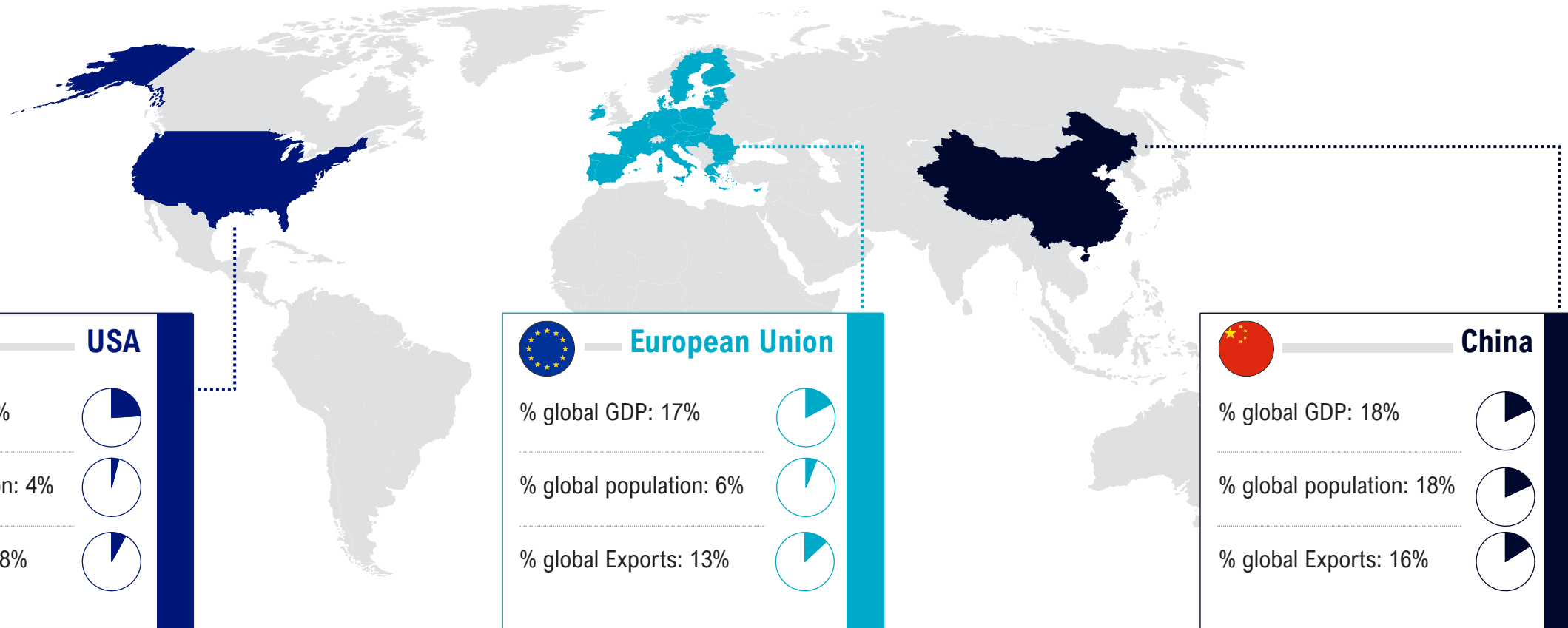
Bottom-up development

- 5 Functional mitigation** 
- 6 Synchronization across mitigation plans & business case** 



Today's economic world order is shaped and challenged by three major blocs that produce more than half of the global economic output

Socio-economic key indicators of the world's three major blocs

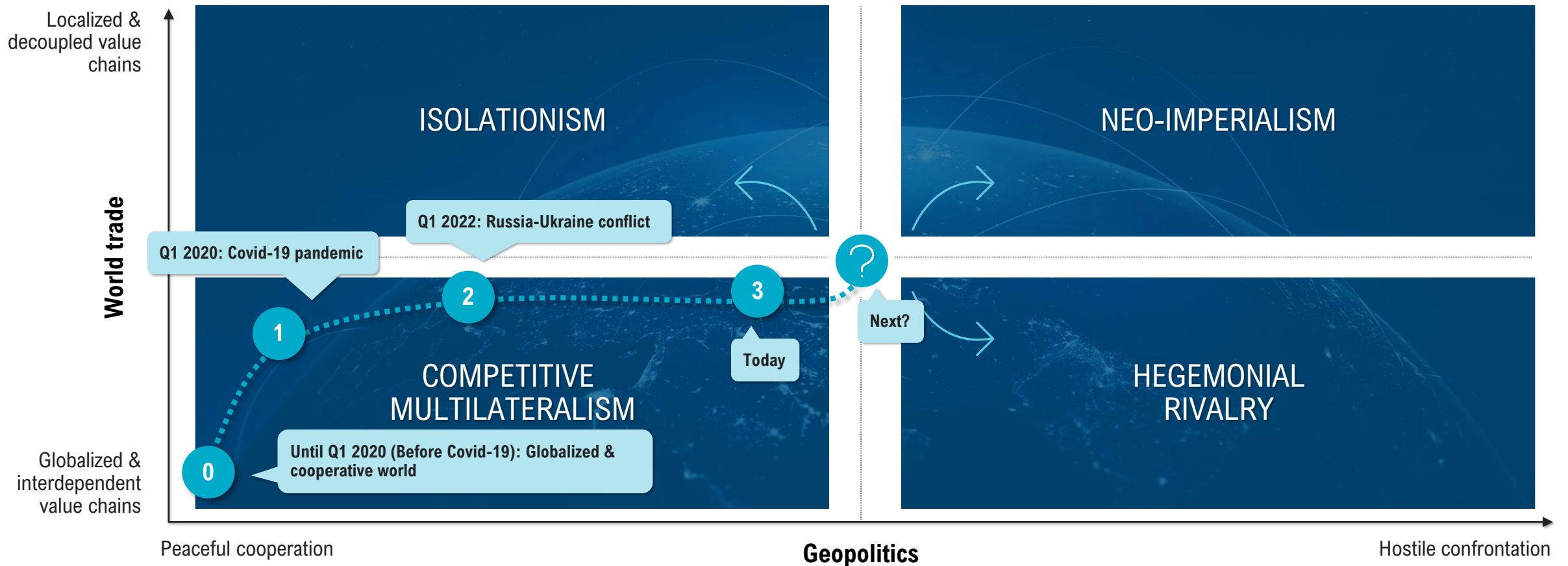


GDP numbers based on 2022 data (constant 2015 USD)
Population data as of 2022
Export numbers based on 2020 data

Source: Oxford Economics, World Bank, WITS, Eurostat

Recently, world trade has slowed down and geopolitical confrontation hiked in the wake of Russia's invasion of Ukraine – We see four scenarios for the world order





International order scenario matrix¹⁾



1) Scenarios as of July 2022

Except in the scenario competitive multilateralism, Europe is likely to be negatively impacted – Relationship between US and China as key impact driver

Impact of different scenarios on world regions

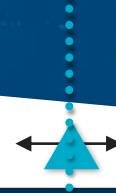
	COMPETITIVE MULTILATERALISM	HEGEMONIAL RIVALRY	ISOLATIONISM	NEO-IMPERIALISM
	Continues role as guardian of international rule of law through multilateral institutions +	Increases sanctions on China, continues trade with RoW +	Strengthens USMCA, benefit from big internal market, lower trade with EU and China 0	Higher military spending, internal market and stronger trade with EU only partly compensate losses -
	Continues trade with both China and the US, remains dependent on US as military and geopolitical partner +	Economically hurt by US sanctions on China, higher trade volume with US cannot compensate these losses -	Strengthened internal market cannot compensate losses from reduced trade -	Increased military spending, cuts ties to China to remain under NATO protection -
	Continues building its international soft power while strategically investing in EU and other emerging countries +	Compensates trade losses with US and EU through strengthened ties to selected BRI countries 0	Relies on ties to selected BRI countries and strong internal market, but problems with demography in the long run 0	Increases military presence in Pacific, trade with selected BRI countries & internal market partly compensate losses -
RoW (examples) 	Can trade with all three major blocs, new blocs around regional economic powers (e.g., India) will emerge +	Major blocs court these countries who might benefit from stronger military and economic cooperation with one or two of the major blocs +	Must align with one of the major blocs – less trade hurts their economies -	Forced to pick sides – trade with allies cannot compensate losses from lower global trade -

+ Positive impact **0** Neutral impact **-** Negative impact

USMCA: United States-Mexico-Canada Agreement
BRI: Belt and Road Initiative

Therefore, companies need to decide on their risk appetite to provide guidance to the organization – Five archetypes

RISK APPETITE



high

low

Risk mitigation archetypes

Full steam ahead

De-risking

Capsulation

De-coupling

Exit

Persona

"Global believer"

"Safety bufferer"

"Cautious risk taker"

"Risk minimizer"

"Risk avoider"

Description

No risk mitigation – 100% risk

Temporary risk mitigation – Risks mitigated for a pre-defined time duration

Hybrid risk mitigation – Some risks permanently mitigated, others can be mitigated in a pre-defined time

100% risk mitigation – Risks permanently mitigated in advance

100% risk avoidance

Implementation effort/cost

Very low

Low

High

Very high

Very high

Globalization benefits

Very high

High

High

Low

Very low

Dependent on the risk appetite, the impact on the company configuration must be derived

Configuration example: Capsulation



Market and product	Sales geography Sales steering Product portfolio scope Product technology
Engineering	R&D/Engineering
Procurement	Supplier base Sourcing strategy
Production	Production Plant scope Plant set-up
SCM	Warehouse & delivery Stock strategy
IT	IT system setup Data hosting
HR	Management rotation Employee profiles
Legal	Legal structure
Finance	Financial steering
Treasury	Cash pooling
IP	IP steering
...	...

DISCUSSION BY, E.G., ENTIRE COMPANY OR ECONOMIC BLOC



Schematic: Capsulation



		Global ¹ ² ³	Europe	USA	China	India	Other APAC	Other Americas	ROW
Market and product	Sales geography	Global ¹ ² ³							
	Sales steering	Global ¹ ² ³	By region		By product		By customer		...
	Product portfolio scope	Global ² ³	Regional		Local ¹		HCC vs. LCC		...
	Product technology	Global for global ² ³	Regional		Local for local ¹		HCC vs. LCC		...
Engineering	R&D/Engineering	Global for global ² ³	Region for region		Local for local ¹		LCC for region		...
Procurement	Supplier base	Global for global	Region for region		Region for region w. LCC ² ³		Local for local ¹		...
	Sourcing strategy	Multi source	Dual source ¹ ² ³		Single source		...		...
Production	Production	Global for global ² ³	Region for region		Local for local ¹		LCC for region		...
	Plant scope	Parts production & assembly ² ³	Parts production		Assembly		...		...
	Plant set-up	Global standard ² ³	Regional standard		HCC vs LCC standard		Local		...
SCM	Warehouse & delivery	Global for global	Region for region ¹ ² ³		Local for local		LCC for region		...
	Stock strategy	"Just in case"	e.g., 30-day ¹ ² ³		JIT		...		...

① ② ③ Country, region or geopolitical/economical bloc

■ Chosen configuration for specific country, region or geopolitical/economical bloc

Based on the re-configuration requirements, functions can develop mitigation plans

Risk mitigation levers (selection)

De-risking

Capsulation

De-coupling

Market and product	Global	Europe	USA	China	India	APAC other	Amer. other	ROW
Sales geography	Global	Regional	Local	By product	...	...	...	...
Sales steering	Global	Regional	Local	HCC vs LCC	...	...	...	...
Product portfolio scope	Global for global	Region for region	Local for local	LCC for region	...	...	...	...
Product technology	Global for global	Region for region	Local for local	LCC for region	...	...	...	...
R&D/Engineering	Global for global	Region for region	Local for local	LCC for region	...	...	...	...
Supplier base	Global for global	Region for region	Local for local	LCC for region	...	...	...	...
Sourcing strategy	Multi source	Dual source	Single source	...	...	...	...	...
Production	Global for global	Region for region	Local for local	LCC for region	...	...	...	...
Plant scope	Parts prod. & assy	Parts production	Assembly	...	...	...	...	...
Plant set-up	Global standard	Regional standard	HCC/LCC standard	Local	...	...	...	...
Warehouse & delivery	Global for global	Region for region	Local for local	LCC for region	...	...	...	...
Stock strategy	"Just in case"	e.g., 30-day	JIT	...	...	...	...	...
IT	Global	Regional	Local	...	...	...	...	...
Data hosting	Global	Western world	Regional	Local	...	...	...	...
HR	Global	Western world	Regional	Local	...	...	...	...
Employee profiles	Global	Regional	Local	...	...	...	...	...
Organizational setup	By BU	By function	By region	By country	...	...	...	...
Legal structure	Global/one	Joint venture	Cooperation	...	...	...	...	...
Finance and treasury	By BU	By function	By region	By country	...	...	...	...
Cash pooling	Global	Western world	Regional	Local	...	...	...	...
IP steering	Global	Western world	Regional	Local	...	...	...	...

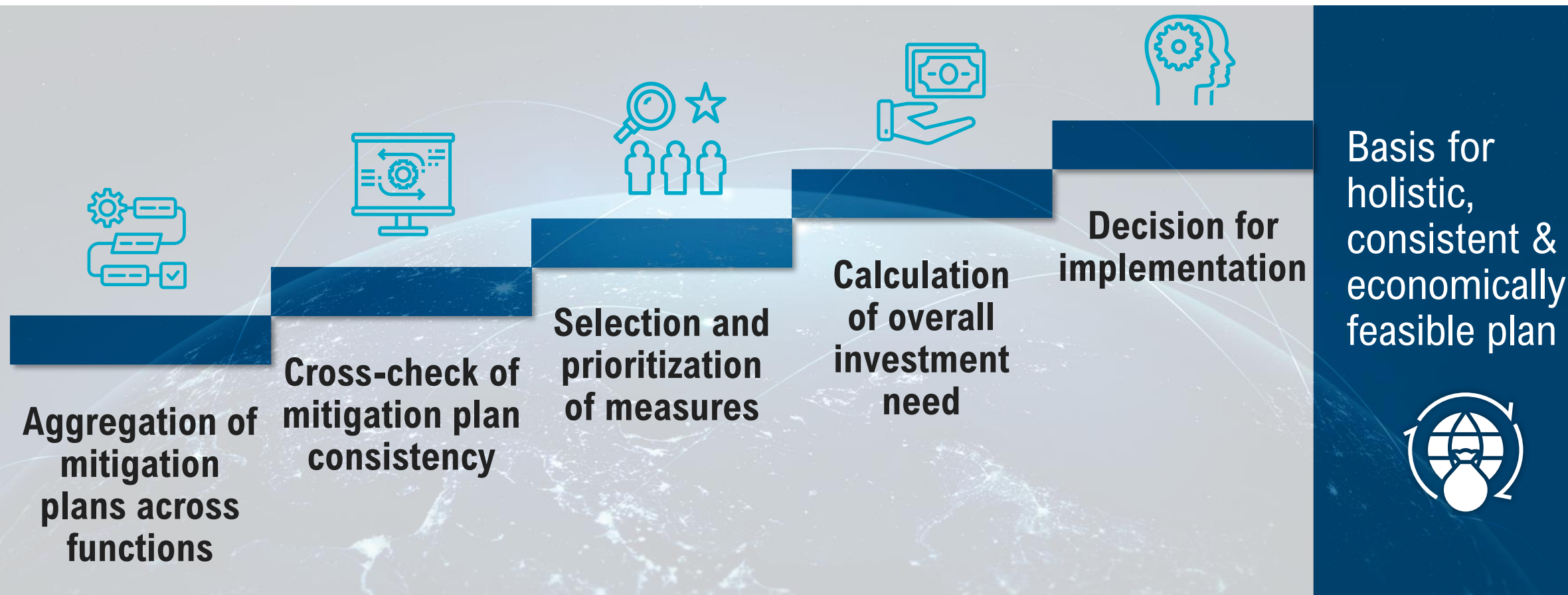
Market and product	Engineering	Procurement	Production	SCM & Log	Sales/ Aftersales	Service		
Product portfolio reduction (low runner)	Footprint adjustment engineering centers	Shift to regional/local supply base	More flexible pricing agreements	Plant footprint adjustment	Warehouse footprint adjustment	Reservation of special/air freight quota (in advance)	Outsourcing of sales	"Glocalized" service (central steering, local delivery)
Development of local product portfolio	New engineering partnership models	Dual, multiple sourcing	Data sharing & joint planning	Outsourcing of (non-core) production	Outsourcing of warehouses	Alternative transport capacity buffers	Sales/ aftersales via partnership models	Service partnering
Product complexity reduction, standardization	Outsourcing of (non-core) components to ESPs ¹⁾	Set-up of multi-year contracts	Insourcing/ outsourcing	Flexibilization of production network	Consignment, VMI ²⁾ , bonded warehouses	Resilient/ dyn. route modelling and freight planning	Consolidation/ localization of sales (physical) subsidiaries	Outsourcing of services
Product modularization	Flexibilization of engineering resources	Reservation of supplier capacities	First "right" to supplier stock	Scheduling flexibility (production sequences)	Increased safety stocks	First "right" to supplier stock	Increased online sales	Dedicated service supply chains & material availability
...

Comprehensive lever toolbox available

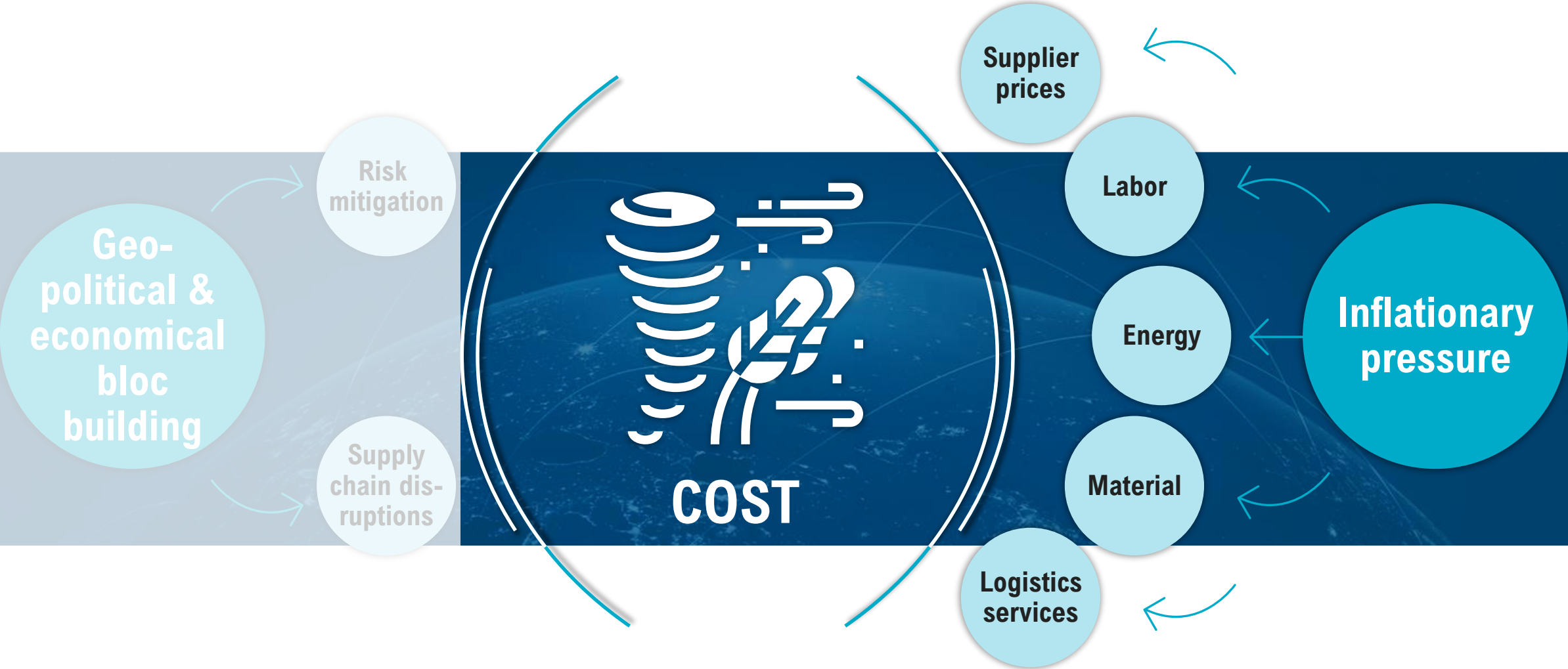
1) Engineering service provider; 2) Vendor managed inventory

Finally, Controlling can aggregate, synchronize and financially evaluate the defined mitigation measures

Aggregation and implementation preparation



Challenge 2: Inflationary pressure

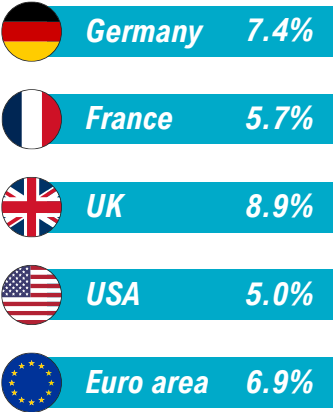


Prices of goods and services increased drastically since 2020 and remain on a high level across countries

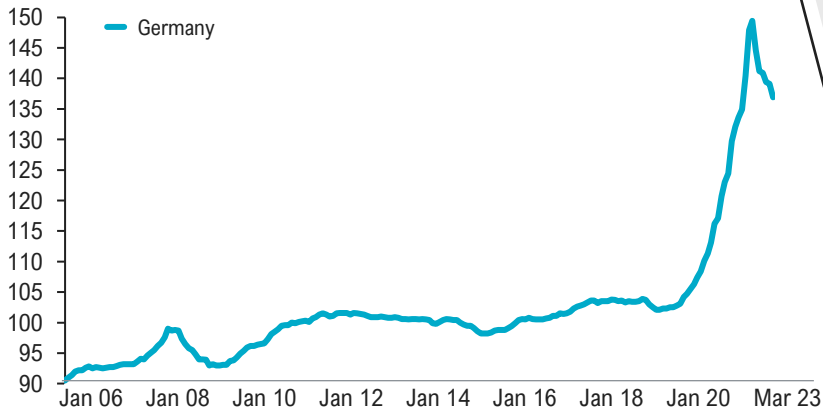
Market situation and implications for companies

INFLATION AND PRODUCER PRICE DEVELOPMENT

Inflation Mar 2023¹⁾

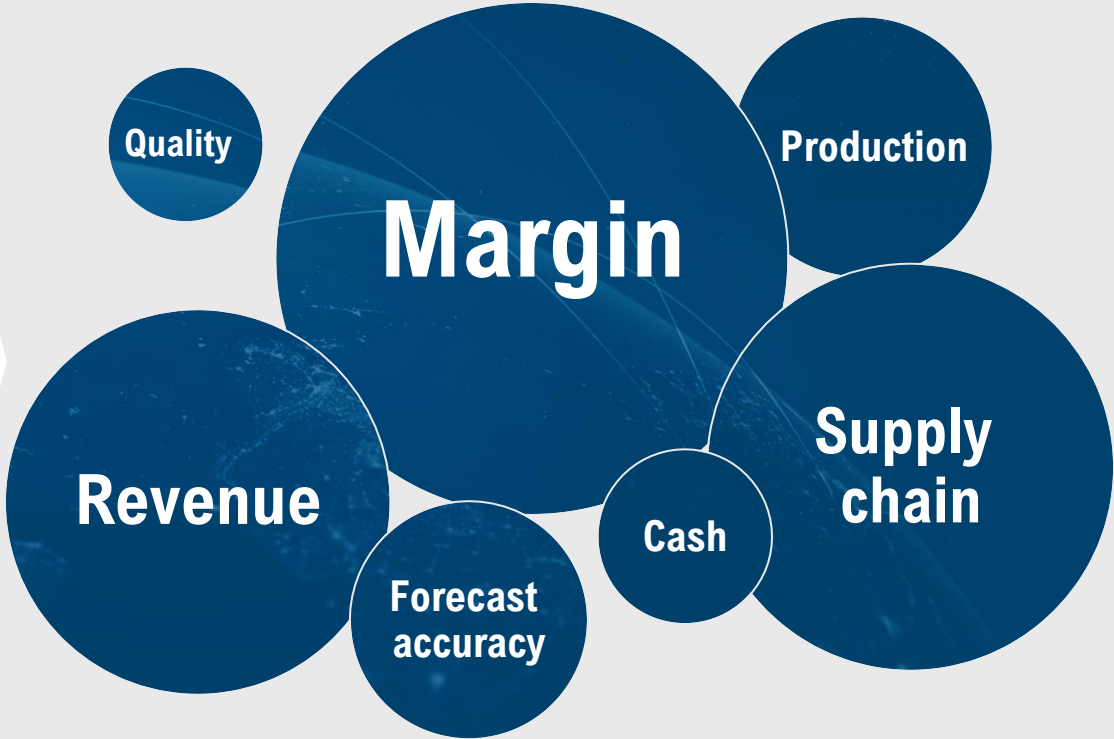


Producer price index Germany 2006-2022²⁾ [2015 = 100]



Oil
Construction
 Salary
Steel
 Alloy
Gas
 ...
 Food
Equipment
 Wood

WHAT'S AT STAKE



1) Monthly inflation rate - source: OECD 2) Manufacturing industry; source: Eurostat

In the light of inflation, companies are squeezed from four directions



The stable equilibrium is out of sync – Especially (tier-1) suppliers in manufacturing industries are squeezed

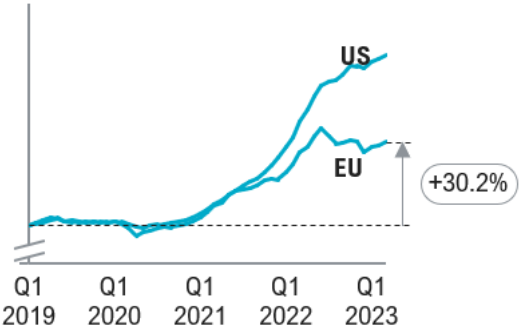


Price increases affect various areas including material cost, energy cost, logistics cost and labor cost



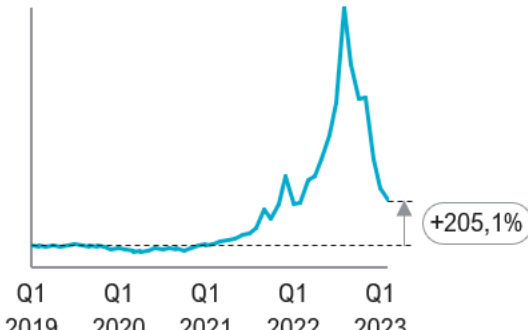
MATERIAL COST

Development of producer price indices in the USA and Europe [2019 = 100%]



ENERGY COST

Development of electricity price in Germany [Q1 2019 = 100%]



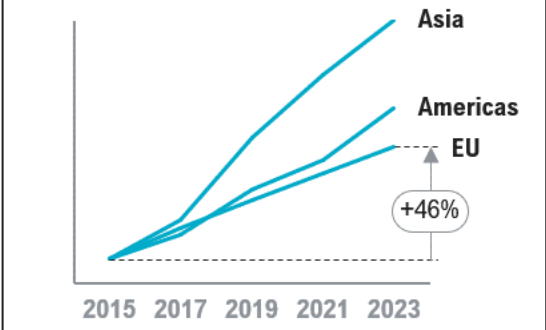
LOGISTICS COST

Development of logistics costs between China, Europe and the USA [2019 = 2000 USD]



LABOR COST

Development of average salary cost increase in Europe, Americas and Asia [2015 = 100%]



We expect cost to remain at a higher level compared to pre-crisis



Especially commodity prices increased drastically since 2020, which puts inflationary pressure especially on manufacturing companies

Price development of major commodities (2020 – 2023)

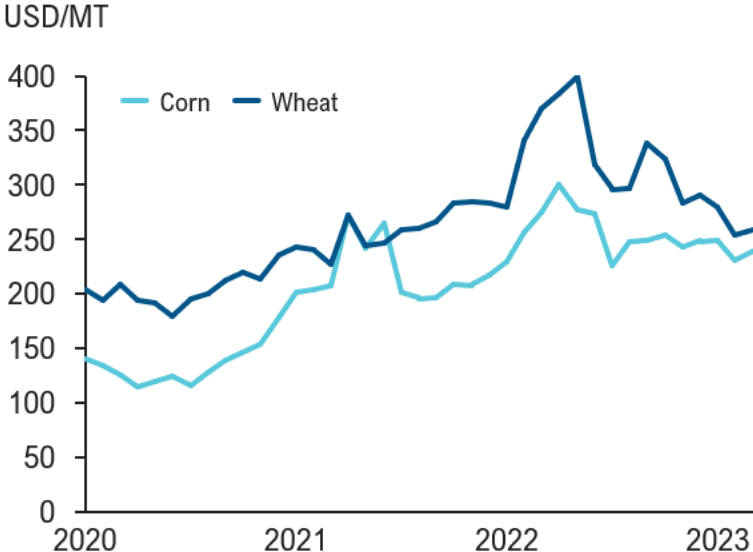
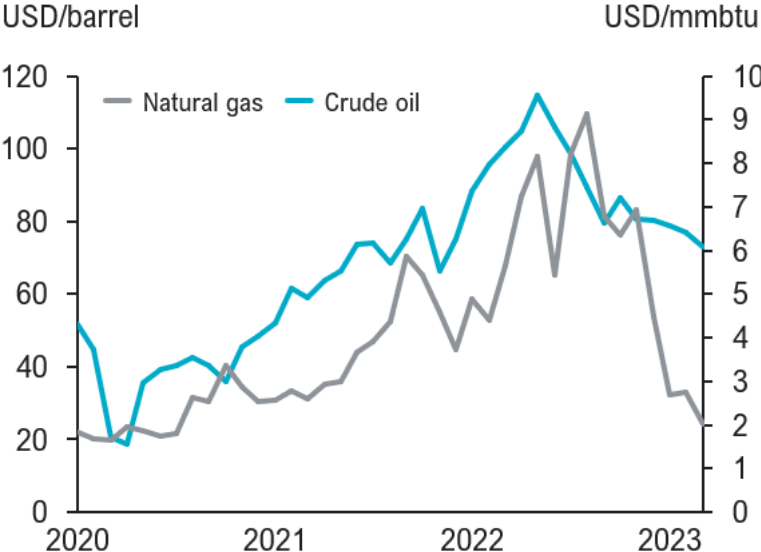
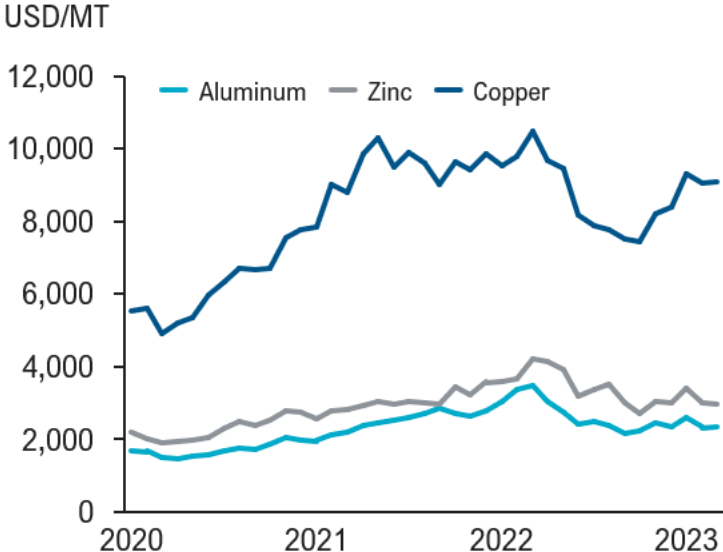
METALS



ENERGY



AGRICULTURAL



LME futures prices indicate that metal prices **remain on a high level**

NYMEX futures prices indicate that energy prices may even **slightly increase again**

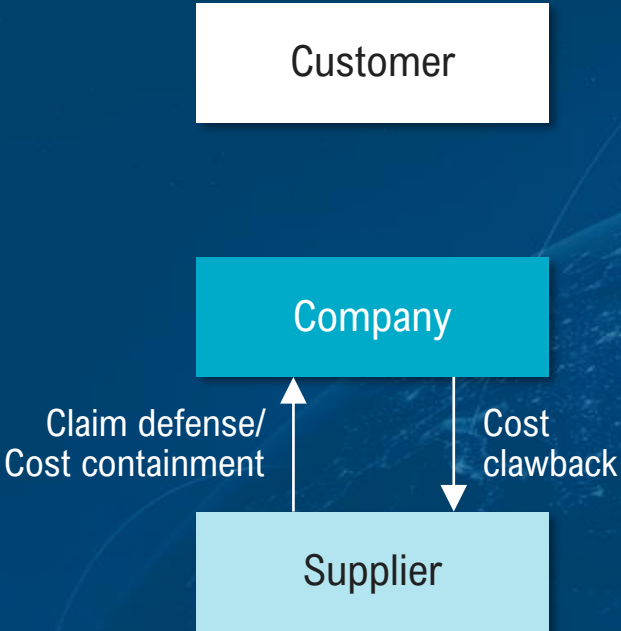
CME futures prices indicate that agricultural prices **remain on a high level**

Source: Eikon, London Metal Exchange (LME), New York Stock Exchange (NYMEX), Chicago Mercantile Exchange (CME)

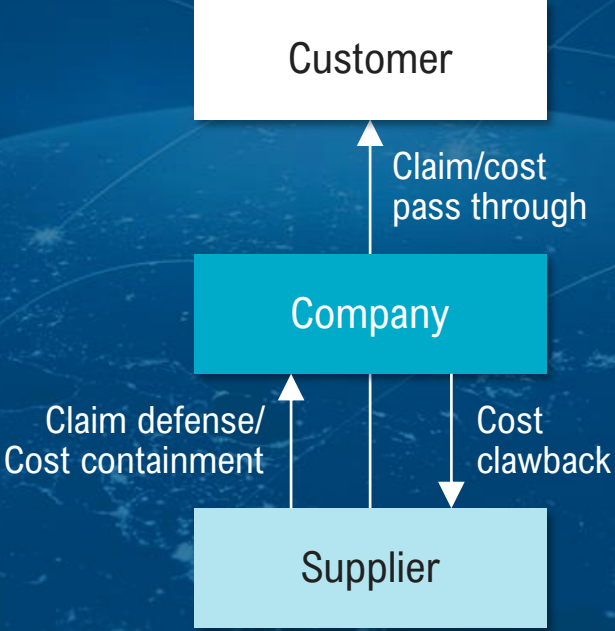
Companies can pursue different optimization trajectories

Inflation optimization trajectories – Overview

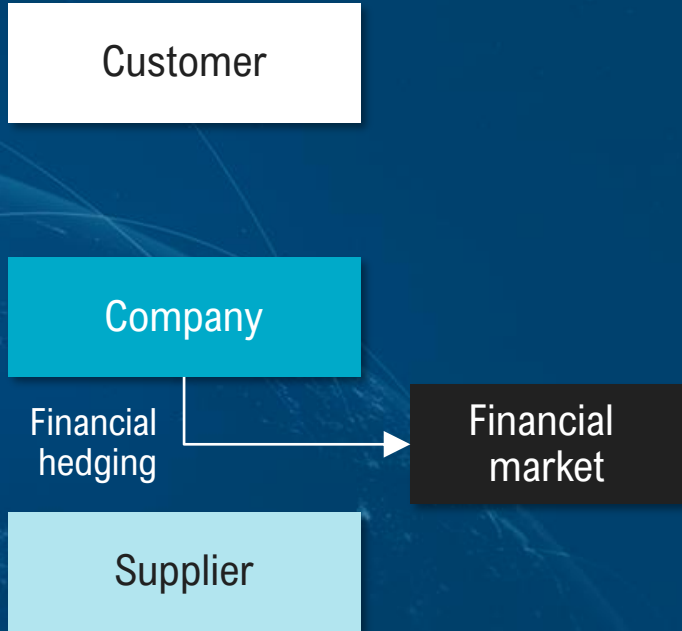
COST OPTIMIZATION



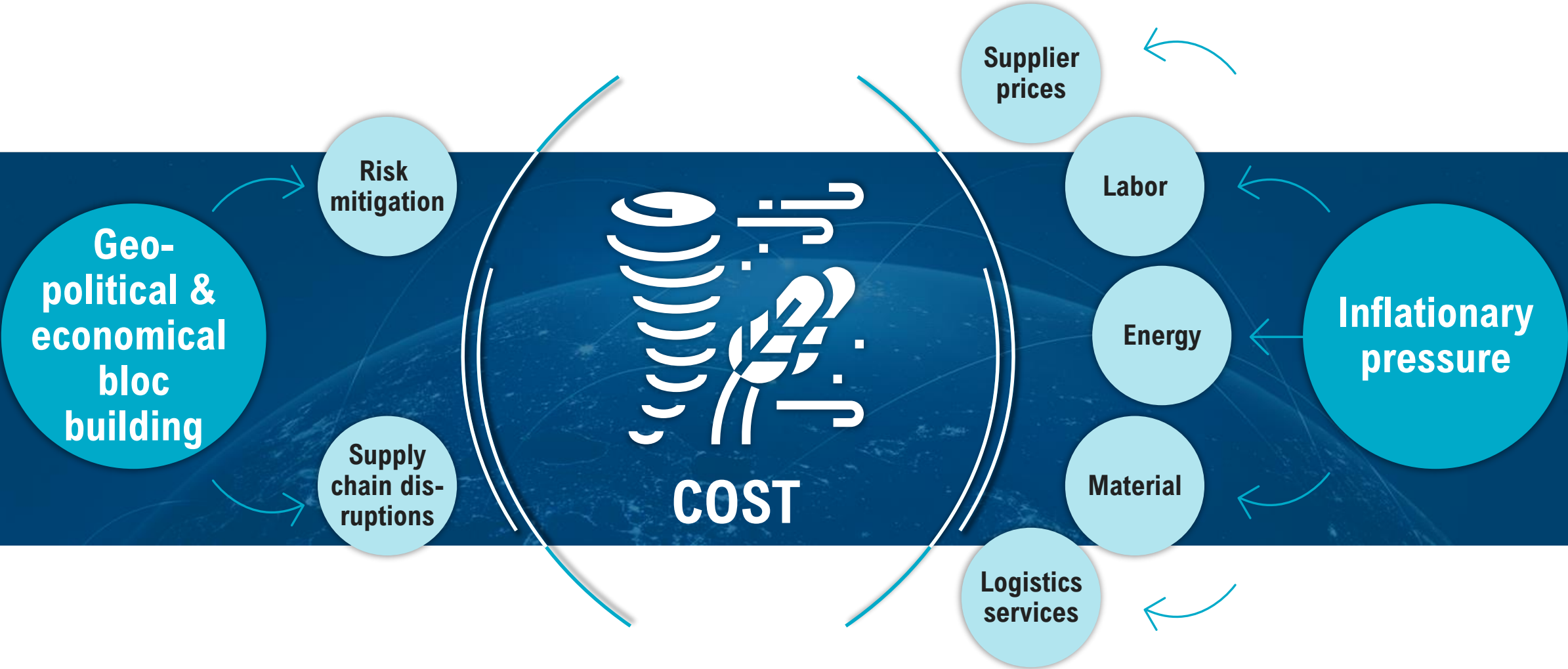
MARGIN OPTIMIZATION



RISK MINIMIZATION



What does that mean for Controlling?



Controlling has a central role to successfully navigate the VUCA world

Role of Controlling in a VUCA world

CONTROLLING IN A VUCA WORLD

Putting the finger in the wound – **Tougher**

Putting numbers to the "big picture" – **More forward looking**

Quantifying business at risk and P&L impact – **More entrepreneurial**

Triggering measures – **More aligned**

Synchronizing & evaluating measures – **More rigidly**

Driving decision making – **Faster**

Ensuring positive P&L impact – **More ownership**



Four actions are needed to increase the required impact of Controlling

Concrete actions for controlling



1. **SETUP PERFORMANCE INITIATIVE:** Cost claw back, cost containment, cost pass-through
2. **DRIVE BOARD ALIGNMENT FOR GEOPOLITICAL & ECONOMICAL BLOC BUILDING:** Scenarios, risk appetite, re-configuration requirements, financially viable mitigation plan
3. **ALIGN INITIATIVES:** Synchronization of all strategic initiatives, esp. with management & strategy team
4. **UPGRADE CONTROLLING OPERATING MODEL:** Mandate, processes, digital tools, etc.

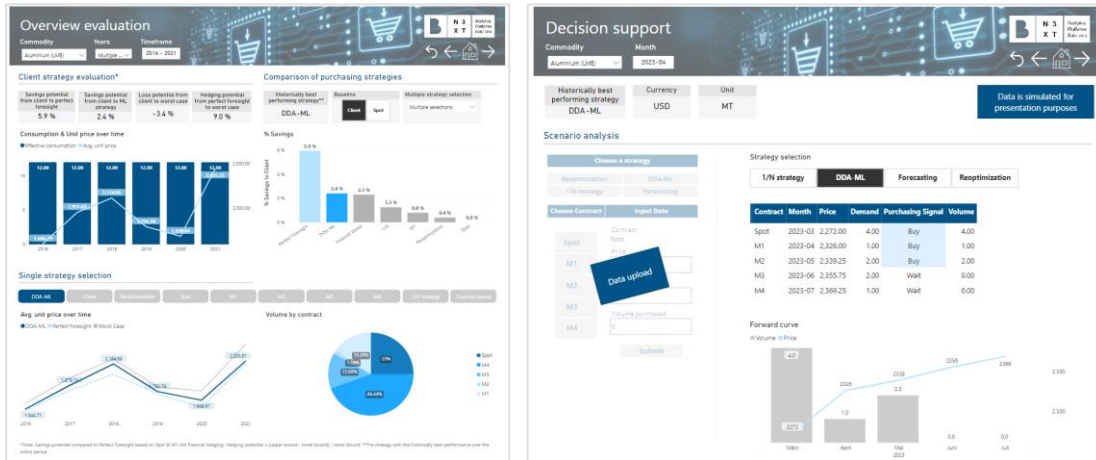
Example: Roland Berger's CostIQ is a digital tool to optimize raw material cost claw back and purchasing

Get your free power hour?

Digital raw material purchasing optimization

ADVANCED ANALYTICS FOR DATA-INFORMED DECISIONS

CostIQ is an innovative **decision-support tool based on machine learning** for optimized data-driven cost and risk management



VALUE OF COSTIQ FOR INFLATION DEFENSE



Natural gas

[EUR k per MWh]

Chemical industry

~5%

Aluminum

[USD k per ton]

Automotive industry

~6%

Copper

[USD k per ton]

Mechanical engineering


~8%


Cost savings [%]


Questions?


We offer you a free "Power hour" to introduce & discuss the details


"Power hour"

-  **Idea**
 - 45-60 min **content impulse** (pro bono)

-  **Content**
 - Introduction of the **RB view on navigating geopolitical & economical bloc building, inflation defense**
 - Introduction of **trends, examples and best-practices**

-  **Participants**
 - **You/Your team and RB experts**

-  **Format**
 - **Online/MS Teams – Minimal effort**

-  **Success factor**
 - **Discussion** – Get the most out of it for your specific situation

Geo-political & economical bloc building

Inflationary pressure

Companies can follow six decision points to "connect the dots" and provide guidance to the organization

What it takes to stay on course – A decision framework

DECISION FRAMEWORK

1. Geopolitical & economical scenarios
2. Trends & implications for the industry
3. Implications for the company, risk appetite & strategic guardrails
4. Business re-configuration & transformation requirements
5. Functional mitigation
6. Synchronization across mitigation plans & business case

Price increases affect various areas including material cost, energy cost, logistics cost and labor cost

Companies can pursue different optimization trajectories

Inflation optimization trajectories – Overview

COST OPTIMIZATION **MARGIN OPTIMIZATION** **RISK MINIMIZATION**

Your Roland Berger team

**Oliver
KNAPP**



Senior Partner,
Managing Director,
Global Co-Leader of the
Operations Platform

oliver.knapp@rolandberger.com
+49 160 7447213

RB Institute

**David
BORN**



Global Head of the
Roland Berger
Institute

david.born@rolandberger.com
+49 160 7446500

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OF THE SHIP!**



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