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by Josh Peters

Given the competitive pressures that companies face today, many are seeking to cut costs and improve margins. Unfortunately, cost-cutting without organizational change won't create a lasting cost advantage. Standard, across-the-board efforts—the kind typically applied when a recession or some other external force threatens profits—affect only the amount you spend, not what you spend it on. Costs almost always creep up again after the threat passes, because resource-allocation policies haven't changed.

Instead, the right approach should reinforce a capabilities-driven strategy, which entails shifting resources toward activities that support your differentiating capabilities and away from others that don't. This type of strategic cost management can't be accomplished with a single top-down austerity program. It's a continuous process of steering finite resources toward high-return activities. To channel resources to these differentiating capabilities, you'll need to adjust every aspect of your organization, from formal structures and processes to informal work habits and mind-sets.

There are eight elements of a company's organization—what Booz & Company refers to as its organizational DNA—yet four stand out as critical to capabilities-based cost management:

1. Information. Implementing a capabilities-driven strategy requires clear choices about which capabilities should get more resources and which should get less, an idea that builds on organizational concepts introduced in earlier articles.

Once those decisions are made, leaders must make them clear to everyone at the company. A few pronouncements from on high won't do the trick. Managers from the CEO on down must reinforce the message consistently and continuously, clarifying corporate objectives and the behavior changes needed to reach them. As word spreads, employees' resource choices will begin to reflect strategic priorities.

Jack Welch demonstrated the power of information three decades ago when he set out to make General Electric "the most competitive company on earth" by focusing exclusively on markets where it could be number one or two. After outlining the strategy to 500 top executives, he fleshed out the related priorities in a series of monthly meetings with company leaders. He broadcast the message in numerous speeches, and brought it to the rank-and-file in weekly visits to GE plants and offices. Eventually, Welch's resource priorities became common knowledge throughout GE. As a result, tens of thousands of GE employees internalized and carried out those priorities in their daily work.

2. Structure. Traditional organizational structures can thwart the cross-functional collaboration needed to focus resources on differentiating capabilities. Depart-

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mental silos breed redundancy, duplicated efforts, and low-value activities. Each group pursues its own agenda, often to the detriment of broader corporate goals.

Only when people across the organization work together can a company eliminate overlapping effort, reap the productivity benefits of specialization, and ensure that resources flow to top strategic priorities. This won't happen without an organizational structure designed to foster collaboration.

For many companies, one answer is to centralize support functions under a shared-services model. This structure facilitates the sharing of functional resources across the company in a way that prioritizes strategic capabilities. In fact, the most effective shared-services organizations drive process improvements by allocating resources based on demand, like a competitive market.

Procter & Gamble embraced a market-based shared-services model more than a decade ago. Its global business services unit provides accounting, IT, procurement, and other corporate support services across the company's various product lines and geographic markets. Unlike shared services units that rely primarily on "service level agreements," P&G's model achieves continuous improvement with such methods as variable pricing and annual performance targets. The result has been steady quality gains and lower costs.

3. Mind-sets. Throughout your organization, employees make thousands of decisions every day about how to spend time, attention, and money. Collectively, these decisions will determine whether your key capabilities get enough resources to become real competitive differentiators. Longstanding assumptions, biases, habits, and unwritten expectations have at least as much influence as C-suite edicts on these choices. If you don't align mind-sets with strategic priorities, people will keep making resource choices that don't prioritize differentiating capabilities.

Techniques such as zero-based budgeting and targeted investment policies can help, by forcing managers to think hard about how every spending choice strengthens unique competitive advantages. More powerful is the personal example of senior executives who model the new approach to resource allocation. Employees who see leaders prioritizing differentiating capabilities will follow suit, embedding your new investment strategy in day-to-day operations.

Few companies have been as successful as Toyota in instilling a continuous improvement mind-set across the workforce. Employees from the executive suite to the factory floor are charged with carrying out the "Toyota Way." This isn't an empty slogan but a codified set of principles every Toyota worker is expected to implement every day. As part of that responsibility, every worker has the power to slow down or even stop a production process when he or she spots a quality issue. In addition, employees are encouraged to suggest regular improvements in cost, quality, culture, productivity, and every other aspect of the company. Together, these continuously reinforced mind-sets have made Toyota's lean production system a model of efficiency emulated by manufacturers around the world.

4. Decision rights. A capabilities-driven strategy depends on timely, well-informed decision making. The right choices will strengthen your capabilities and advance your strategy. The wrong ones can undermine the strengths you're trying to build. The odds of making good choices will improve if the right people have authority to allocate resources. In general, decision rights should reside as close as possible to your differentiating capabilities. This gives you the agility and flexibility to make smart decisions and act on them before opportunities disappear.

For example, companies such as Nordstrom and Ritz-Carlton, which differentiate themselves on the basis of customer service, typically give more decision-making power to workers who interact directly with customers and can meet their needs in real time. Coca-Cola, McDonald's, and others that emphasize branding are more likely to empower regional marketing units with the localized expertise to make the brand relevant in each market. Industrial companies like Caterpillar or DuPont, which differentiate themselves through advanced manufacturing capabilities, extend decision rights deep into the supply chain, where resource choices directly affect production efficiency.

In sum, a company's organization is the most powerful tool you have for advancing a capabilities-driven strategy through sustainable cost management. By harnessing these four key elements of organizational DNA, you can ensure that resource decisions made every day at all levels of your organization will enhance the company's differentiating capabilities and create a true competitive advantage. +

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