

iProCon Insight

White Paper: Measuring and Sustaining Cost Cutting Initiatives

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Change & Restructuring: Measuring performance and ensuring long-term improvement in organisational cost structures.

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The global economic downturn provides many organisations with an ideal opportunity to restructure their business to make it more efficient in the long-term.

Organisations undertaking restructuring programmes should be concerned with the sobering statistics that indicate the vast majority of cost cutting initiatives fail to achieve their expected savings targets. In addition, cost cuts, particularly those achieved through arbitrary methods, have a nasty habit of growing back.

This paper focuses on understanding and measuring the impact of cost saving programmes, as well as techniques to embed changes into the organisation's DNA so that the intent of the programme continues to deliver positive results long after the initial programme has been completed.

“Monthly job cuts hit worst rate in 34 years”

Financial Times, 6th December 2008



“The vast majority of cost cutting initiatives fail to achieve their savings targets”

Without doubt cost cutting is back on the agenda. Each morning we awake to new tales of job losses brought on by the need to restructure and drive cost from business. The most high profile cases are those where the ability to restructure is severely hampered by cashflow issues, making the organisation a case study in turnaround, if not insolvency.

Many organisations with cash are using the global economic downturn as justification for taking on significant cost cutting measures. Whilst some hope to weather the storm and simply conserve cash until the recovery starts, more enlightened organisations are using the downturn to improve the way they conduct business. They are creating new business models and are focussing on their customers' needs and their own organisational capabilities with a view to leaping ahead whilst their competitors hibernate through the dark winter.

Organisations that have decided to *do something* will be thinking about how implement the savings. Should they pursue arbitrary cuts or a take a more strategic view? Is it important to take the time to understand detailed cost drivers before acting, or simply start doing

something, based on the view that it is better than doing nothing?

All organisations should be concerned with the sobering statistics that indicate the vast majority of cost cutting initiatives fail to achieve their expected savings targets. In addition, cost cuts, particularly those achieved through arbitrary methods, have a nasty habit of growing back. These problems are of particular concern given that cost cutting programmes can be very expensive. There are financial considerations (such as redundancy costs, consultancy fees, legal fees, etc) as well as human capital considerations (including loss of key personnel and knowledge, reduced morale, reduction in capabilities, etc). Each of these can affect an organisation's ability to service its customers, and hence may ultimately affect the top line.

The question must be asked: How can organisations maximise their return on the investment on cost cutting programmes? How can organisations really be sure that the programme is not delivering unintended consequences that may do more harm than good? How can the organisation ensure that the investment continues to

Organisational Restructuring is a focus of the iProCon HCM Change Practice

“Efficiency is doing things right; effectiveness is doing the right things.”

Peter Drucker



pay dividends long after the initial programme is complete?

These questions form the basis for this paper. It focuses on understanding and measuring the impact of cost saving programmes, as well as techniques to embed changes into the organisation's DNA so that the intent of the programme continues to deliver positive results long after the initial programme has been completed.

Measuring Performance

Simply measuring the impact of an initiative implies that an organisation has a reference point – somewhere from which to base the measurement. Measuring against a target involves taking things a step further – having a baseline, and having agreed targets.

Whilst the purpose of this paper is not to discuss how organisations should go about setting cost baselines and targets, it is important to note these two important points:

- Many organisations agree cost baselines based on the previous year's results, without taking into account current sales performance and the effect of any cost cutting or revenue growth initiatives that might already be in progress. Changes in the underlying business can make it difficult to establish a credible and commonly agreed cost baseline, however this is exactly what is required for the business to effectively prioritise and monitor the different options available to deliver cost cuts. Thinking of cost reduction programmes in investment terms helps crystallise this point – if you are spending money in order to achieve a particular target, you need to know that the way that you measure the outcome is based upon solid data, so that you can prioritise effectively.
- In tandem with the above, organisations should clearly understand how they deliver value to their customers, so they can ensure that cost cutting does not unintentionally erode their

‘Any investment in cost cutting and restructuring should pay dividends long after the initiative itself is complete’

Choosing performance measures

When choosing measures it may be helpful to consider that there are five generic types of measures:

- Valuation – assess the worth of what's measured
- Navigation – ensure you are heading in the right direction
- Monitoring – assess progress against a standard
- Diagnosis – see where problems exist
- Accountability – to determine if commitments are met.

Measures should also be appropriate to your organisation's strategic style (see Porter, or Tracey & Wiersema). For example, an organisation focussing on being the lowest cost producer will place more importance on financial measures than one who differentiates through customer service.

capabilities in those areas. When deciding upon targets and setting measures, it is important to consider how you can gain early warning of unintended consequences – a classic example is poorly focussed cost cutting in 'non-core' functions, such as HR or IT, that then cascade into increased administration for line managers and hence decreased customer focus.

Once the cost reduction programme has commenced, it is common for organisations to measure progress in purely financial terms. Whilst this is understandable (the programme's purpose is to deliver cost savings after all), the urgency with which the programme is undertaken and the degree of top management team focus on it can mean that all other measures of organisational performance are subordinated to the pursuit of cost cuts. This scenario is only appropriate when an organisation is in severe financial distress, as at all other times it causes the organisation to lose focus on what should be its prime objective – creating long-term shareholder value.

There are a range of options (both financial and non-financial) used by different organisations to measure performance. Kaplan and Norton defined the Balanced Scorecard to measure performance in four dimensions: Financial, Customer, Operational and Innovation and Learning. A simplified version of the Balanced Scorecard considers value through three dimensions: Customer Value, Shareholder Value and Employee Value. When considering where to cut costs (a financial consideration), you should also consider if it is appropriate to adjust

your expectations in other dimensions, and be prepared to measure the results against an agreed baseline. Use of a balanced set of measures will guard against the unintended consequences discussed earlier, as well as help to ensure the organisation does not "drop the ball" by focussing on cost cutting targets alone.

There is a further reason why financial indicators used alone are not ideal - they tend to lag what is actually happening in the business. For example, you don't know you've lost customers until the quarterly report shows the impact on sales! Good measures will be both balanced (measuring a broad set of leading and lagging indicators to ensure the cost reduction is delivered without affecting value), as well as cascaded throughout the organisation (so that each business unit and function has a set of measures that contribute to overall strategic goals).

Embedding the Changes

So why do so many cost reduction programmes fail to deliver sustained benefits? The answer is typically because the initiative is viewed as a 'one off', that once delivered allows the organisation to return to normal.

Defining and working towards a balanced and cascaded set of measures will help continue to focus the organisation on what is important in your strategic context, however there are several other factors that will help to ensure that long-term benefits accrue from the cost reduction programme:

- Change the way organisations discuss cost. When cost is viewed as

something that is simply cut (and from then on no longer exists) people tend to relax when the cost cutting initiative is over, and costs start creeping back up. Leaders should talk about costs in terms of them being an investment required to deliver strategy. Rather than focus on how much to cut, ask how much should be spent to achieve the aim? This should become a regular discussion in which organisations constantly assess the return they are achieving from their cost investments, and hence seek to maximise the return.

- Strong leadership is essential. Long-term change is ultimately delivered through people, and this will only occur if ongoing cultural change is taking place. The entire organisation needs to understand the vision and how they can help realise it. They must be empowered to help deliver the vision, and they need to feel absolutely sure that the entire top team are committed to the new way of measuring both costs and organisational performance.
- When costs rise in future, focus not on the nature of the cost, but on its root cause. Use the opportunity to consider how the business model should be reshaped in order to ensure it does not happen again – appropriate responses may include revising business processes and investing in

technology). As discussed previously, financial measures lag what is actually happening in the business – a rise in cost is simply a symptom of inefficiency or a new way of working somewhere within the organisation.

Conclusion

The global economic downturn provides many organisations with an ideal opportunity to restructure their business to make it more efficient in the long-term. The majority of organisations continue to trade profitably, but recognise the need to trim excess fat in order to prepare for more difficult times ahead. When considering their restructuring and change programmes, organisations should view them as an investment intended to bring about long-term beneficial change. The adoption of a set of balanced and cascaded measures that encompass both financial and non-financial performance will help to ensure that the intended results are delivered, without bringing about unintended consequences that affect the ability of the organisation to deliver value to its customers.

As important as the chosen measures is the way that the top management team talk about cost. Strong leadership focussed on bringing about a new awareness

'Long-term change can only be delivered through people'

of cost is vital, as ultimately long-term change can only be delivered through people.

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