

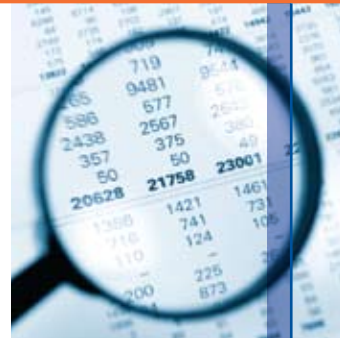
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Cutting costs – No shortcut to success

There is change in the air. Despite the resources boom and unprecedented growth in prosperity in this country, the emergence of new sources of competition and increased costs which cannot be passed on to customers are likely to put the squeeze on corporate profit margins.

With boards and shareholders clamouring for better returns, we are expecting to see companies turn their focus once again to cost management. But history suggests a slash-and-burn approach without changing inefficient processes is a recipe for disaster.

In this article we are going to examine some of the common approaches to cost management and the reasons why they fail. We will look at the difference between perceived saving and real bottom line improvement and also suggest areas that may be fertile sources of sustainable savings.



Fat or Muscle?

Around the country, CEOs and CFOs are scrutinising costs with a microscope. Some will announce cost cuts across the board – taking an axe to both staff and general expenses. Unfortunately, due to the arbitrary nature of the approach, it could cut both fat and muscle at the same time, potentially leaving the organisation crippled and incapable of meeting the challenges ahead.

Others will hire specialist consultants to review the business. This often results in hordes of management consultants – including freshly minted MBAs, some of whom have never worked in a corporate environment – distracting executives and disrupting business as they pull together their report.

Unfortunately, most of them don't hang around for the implementation, meaning few, if any, of the recommendations in the report are likely to be implemented. Of course, this allows the sceptical functional managers to go back to their old ways as soon as the consultants have departed.

Does this sound familiar? How do you ensure that your company becomes more efficient and not dysfunctional? Based on our experience, we have identified a few key lessons about what works and what doesn't when it comes to designing and implementing a cost-management program.

What doesn't work

While many companies have embarked on some form of cost-management initiative in the past, few are able to sustain the benefits successfully over the long term.

Our experience suggests that there could be several reasons for this:

Slash and burn

- At the basic level, falling profits trigger knee-jerk reactions that mandate across-the-board staff reductions
- At the crudest level, all departments are asked to make target cuts
- Both “lean” and “fat” functions are penalised equally, leading to unsustainable levels of capacity required to maintain service levels and/or growth

Best practice benchmarks

- Some consultant-led programs reduce headcount based on industry cost and productivity benchmarks
- Staff levels are reduced without actually changing work processes
- Inevitably, this results in unsustainable levels of increased workload and low employee morale

Big bang approach

- Company-wide programs with unrealistic “stretch” targets are often too hard to digest due to the demand for radical change
- Companies soon slip back to old habits when short-term pressure on profits is relieved

Squeeze the back office

- The first place that companies normally look is in support function areas like finance, HR and administration
- While there is nothing wrong with trimming excess fat, service levels could be diluted to unsustainable levels
- Also, front office functions like sales and marketing which may cause some of the back office processing complexity are left untouched, leading to poor processes being handled by fewer people

Cultural issues

- Resistance to change is often underestimated
- Managers who do not buy in to change in the first place will argue that the initiatives are too risky to undertake

No link to strategy

- Very often, cost reduction is seen as an isolated exercise to improve short-term profits
- Cost leadership as a strategy to compete is not made clear to middle management

Poor execution

- Good ideas and sound business cases are only valuable if they are followed through to execution
- If results are not measured or monitored, benefits often evaporate and cannot be linked to financial performance

Achieving a cost-leadership position is not easy – it requires sustained attention from executive management. Every aspect of the business should be looked at from end to end in order to improve efficiency and reduce costs.

In the table below are areas that should be explored for efficiency opportunities. These are equally applicable for companies making tangible products (such as manufacturing companies) or intangible products (such as financial services).

Area	Opportunity/Tactic
Supply Chain	<ul style="list-style-type: none"> ■ Choose suppliers based on value, not on first costs alone ■ Optimise touch points to reduce logistics costs ■ Improve the efficiency of warehouse processes ■ Optimise inventory levels through better forecasting, production planning, manufacturing and purchasing methods
Core Processes	<ul style="list-style-type: none"> ■ Enhance sales force productivity and effectiveness ■ Rationalise products and channels based on true profitability or optimise pricing ■ Search for cost-reducing linkages with suppliers and customers – such as packaging, order processing, etc. ■ Reduce complexity through standardisation, for example, product design ■ Search for scale economies across all processes
Support Processes	<ul style="list-style-type: none"> ■ Reduce or eliminate non-value-adding activities and associated resources ■ Outsource non-core activities that could be more efficiently performed due to scale economies or competitive cost structures

What does work

There is no magic formula to achieve success. However, some key lessons learned, based on our experiences, are:

Understand true costs

- Which processes or activities cause complexity and consequently increase costs?
- Are fixed costs really fixed or can some of them be made variable?

Develop improvements based on facts

- Avoid external benchmark-driven cost reduction
- A process view of costs needs to be developed first as a basis for reengineering, before reducing associated resources

- As accounting systems are transaction based and rarely lend themselves to analysis of processes, an accounting view of costs may need to be converted to a process or activity view first to determine which processes are inefficient

Develop a whole-of-business approach

- Look for cross-functional opportunities, as complexity in one functional area may be due to activities in another area. For example, a bloated back office (such as a contract management process in Finance Operations) may exist only to support front-end processes (such as a complex contract-creation process) that are not efficient. Hence, looking at the back office for opportunities in isolation may be sub-optimal or, in some cases, counter productive.

Use a staged approach

- Rather than a big bang initiative, savings generated from a smaller program can be used to fund a larger initiative. For example, some easy wins in procurement could be used to embark upon a larger efficiency program that could be costly if done in one go.

Use a change-management strategy aligned to the company culture

- Identify internal change agents quickly and encourage their participation in the program
- Develop a communication channel with all levels in the organisation that highlights objectives and success of the program

Link program objectives to corporate strategy

- Clearly articulate the link to management (for example: cost leadership is an imperative for maintaining competitive prices)
- Create efficiency objectives and reward management and staff based on performance.

Monitor benefits

- Build a robust benefits-tracking system that measures and monitors key performance indicators (KPIs) of individual initiatives and their relationship to financial results

Finally, it must be stressed that cost management is not just for bad times – the continuous drive to eliminate waste or to invest newly freed-up resources into value-adding activities such as customer services is for all times. The trimming of fat and the search for new and more efficient ways of doing things should become part of the corporate culture.



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