THOUGHT PIECE

Implementing Intelligent Cost Reduction (ICR)

Stratevolve

In challenging economic times such as these all organisations are under pressure to cut costs, but it is important to avoid the common pitfalls of easy cost reduction that destroy long term organisational value.

When the pressure is on to cut costs most managers quite naturally resort to the easier cost cutting options. These include:

- Cutting travel
- Delaying Research & Development spend
- Trimming marketing budgets
- Postponing planned maintenance or refurbishments

If these measures fail to miss cost reduction targets we then look to more difficult options, and given that wages and salaries form the bulk of on-going costs, this means reducing head-count. But again, the easier options are naturally selected first:

- Don't replace staff that leave
- Stop all recruitment
- Offer voluntary redundancy
- Encourage early retirement

So far, so good (relatively painless). However, if the painless measures aren't delivering the scale of reductions required, the likely next stage is to make people redundant. But in order to be seen to be 'fair' and 'even handed' we opt to make 'across the board' head count reductions, of, say, 20%.

So we all share in the pain equally.

However, such approaches can be unworkable in practice and undesirable from a strategic standpoint. They lack practicality, for example, there will always be 'ring fenced' departments and teams within your organisation that cannot be touched, e.g. because of statutory obligations. All of a sudden 20% cuts across the board may actually mean 50-70% to those who fall outside ring-fenced areas.

Long term, these measures are little better than knee-jerk responses. They will no doubt have an impact on your cost base, but they can deal unforeseen damage to the sustainability of your organisation.

Random Damage? The majority of these cost reductions are literally mindless in the sense that they are not aligned to the business strategy.

The operation of a 'rule' imposed from the top that is determined by a) the need to cut costs, b) the need for speed, and c) the need for relatively pain-free surgery leads to a set of actions that lack rigour and intelligence. It will be fortuitous if they benefit the organisation longer term but will more likely lead to substantial unanticipated consequences.

If we scrutinise any one of these measures they are likely to damage the continued viability of the organisation. But perhaps the most critical are the effects of broad headcount reduction measures. 'Salami slicing' your resource pool in this way will mean losing critical staff who are fundamental to delivering your strategy.

Intelligent Cost Reduction (ICR) So what's the alternative? The alternative is *Intelligent Cost Reduction*. This approach avoids the most severe effects of random cost cutting. To engage in intelligent cost reduction requires an insight into the value creation processes within the business.

This takes a resource-based view of the organisation, helping us to approach cost reduction in an intelligent and rigorous manner. It means following the golden thread of the organisation, from the top level strategy down to the individual contribution. Techniques like cause mapping and asset auditing can help us uncover subtle sources of competitive advantage and differential value-creation in the business.

Working with our clients reveals that enduring competitive advantage often derives from complex processes and assets e.g. tacit knowledge, collective routines, relationships with key clients and complex interactions between different types of know-how. These enduring sources of advantage need to be fully recognised as they form the *strategic asset base* of the firm.

We can distinguish critical value activities from those that are less critical. If we also understand the value creation processes in detail then we should be able to identify activities that are either tightly connected to other value processes, or loosely coupled. Armed with these insights we can identify areas of the organisation where cost reductions would be highly damaging to value creation and those areas where cost reduction would only have peripheral impact.

Putting it into practice Having established the intelligent cost reduction options and selected the most appropriate one for your organisation, a business case will record benefits realisation expectations over life of the cost reduction programme.

Critically, to stay intelligent the cost reduction initiative must be mindful of other programmes and changes occurring in the business. Portfolio analysis ensures that the cost reduction programme and all other programmes fit together and underpin successful strategy execution.

Conclusion There are intelligent ways to reduce costs that will increase long term prospects as well as meet short-term needs. Executives can choose the seemingly less painful options, those listed at the beginning. But this is an abdication of their strategic responsibilities. What is required is a thorough assessment of the value creation processes, and then tough decisions to eliminate costs in non-core activities. This will not be 'across the board' cost cutting; this will be focused, and will be informed by strategic insight. It certainly isn't a soft option, but Intelligent Cost Reduction will enable greater organisational capability to be retained with firmer long term prospects than broad measures left to chance.

How much are you looking to save?

Stratevolve has Intelligent Cost Reduction (ICR) tools to help you effectively lower costs without harming your organisation's long term capability. This includes detailed practical guidance for targeting:

- **5-15% savings**
- **5-25% savings**
- **25+% savings**

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