There is a right way and a wrong way to take costs out of a business. **The wrong way is to ‘salami slice’ identical cuts across the organisation.** This risks destroying the company’s long term ability to compete, by cutting out value as well as waste. Companies which can avoid this now will steal a march on their competitors – for them, the crisis will be an opportunity not a threat.

Unfortunately, salami slicing is tempting: it is relatively easy to placate demanding shareholders with dramatic statements about x thousand cuts. When under pressure for action, leaders may have no choice but to make these symbolic announcements. But where do the savings come from?

The right way to cut costs involves three choices: **Effectiveness** – are we doing the right thing? **Efficiency** – are we doing the right thing well? **Protection** – are we making changes in a way that safeguards the future?

Some companies can make these choices better than others: so we finish this paper with some thoughts about why that is.

**Effectiveness**
The biggest potential savings come from understanding **how the business creates value** for customers and shareholders:
- The features of products, services and sales experience which customers value most.
- How we keep building advantage in these features, and how we do so with increasing returns for shareholders.

Effectiveness is an outside-in journey. What makes customers come back for more (or stay away)? What makes them willing to pay a higher price? What has changed for them since the last time we asked these questions?

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When we identify activities that create value, we protect them at all costs. We can certainly try to do them more efficiently, but we need to do them. Savings here that don’t come from efficiency are simply negligent. We may even identify features and profit drivers that we need to add to our repertoire. If we are brave, this may be a time to make acquisitions and investments.

There is immense pressure on almost every business to cut costs. For some, the demands amount to major surgery, with a high mortality rate. In this paper we discuss how businesses can make savings without damaging their organisation.
Thinking about effectiveness shows up the limitations of unsophisticated benchmarking as a guide to cost cutting – we may need to be more expensive in some activities if they are a source of competitive advantage.

When we identify activities that don’t create such value, we have an immediate opportunity to cut costs from our business without damaging our position. In fact, we will probably improve it.

These opportunities may appear at any level, in both head office and operations. They might include product features, product range, logistics and supply chain, support functions, retail environments, product development, R&D, improvement initiatives, training programmes, management information systems, specific jobs, management layers etc. The list is long, so we suggest using the following criteria: does each item significantly add value or protect profitability? Would something else do more good?

As well as impact on value, there may be other considerations required: the magnitude of the cost involved (is the saving worth it?), the time taken to realise the benefits, the risk and side effects.

Activities assessed for effectiveness can be increased, sustained, reduced, outsourced, sold off or eliminated altogether. For those that we keep, it is important to be as efficient as possible. For those that we eliminate, it is important to protect the business in the way we eliminate them.

**Efficiency**

Once we have mapped value, for customers now and shareholders into the future, we can then improve efficiency. This is about doing the right things well.

It is not about striving to be a low cost competitor; this is an impossible goal for businesses which are not already engineered for this game. But, even for businesses competing on differentiation and quality, now is not a time to be carrying unnecessary cost.

We assume, as a result of step one, that the business is focused on highly valued outputs – we therefore do not want to reduce those outputs, we want to sustain them for lower cost. (We also assume a people intensive business). In these organisations cutting costs without damaging outputs means increasing output per employee. This creates the opportunity for redundancies or redeployment.

Thinking this in terms of headcount can be helpful, but a better target for our attention is output per ‘cost of employee’ (i.e. the salary bill for the outputs generated). This creates more options. We could, for example, swap from more expensive to cheaper roles. And, if we manage the salary bill differently, we may be able to avoid job losses altogether.

There are five main strategies to increase output per employee or employee cost:

- **Investment** – one way of increasing output per employee is to invest in resources, equipment or skills which increase their capability to deliver. This is a tough call in today’s climate. A variation on this tactic is to remove under-performers from the workforce, and replace them with fewer high performers.
- **Innovation** – we can also seek new ways of doing things more cheaply and quickly: new processes or improvement of existing processes, new structures, different procurement models, job redesign, waste reduction and continuous improvement.
- **Inspiration** – we can increase outputs by engaging and motivating the workforce, and aligning their efforts with the vision. Difficult to do in a time of job cuts but not impossible.
- **Sacrifice** – we can ask for sacrifice from the workers – in terms of more hours or reduced salaries. Again, a tough but not impossible proposition. We can do it in a spirit of partnership or through more coercive tactics.
- **Salaries** – it is also possible that immediate savings could be obtained without reductions in perceived rewards by looking at the clarity of incentive design, total rewards and the competitiveness of base salaries.

It is likely that a combination of the above will be required. We can also divide them up into short and long term pay offs:

<table>
<thead>
<tr>
<th>Short term</th>
<th>Long term</th>
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<tbody>
<tr>
<td>Investment</td>
<td>Training</td>
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<tr>
<td>Performance</td>
<td>Forced ranking</td>
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<tr>
<td>Innovation</td>
<td>Cut waste</td>
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<tr>
<td>Inspiration</td>
<td>Leadership (clarity)</td>
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<tr>
<td>Sacrifice</td>
<td>Voluntary cuts</td>
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<td>Salaries</td>
<td>Incentive design</td>
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In a people intensive business, productivity depends on more than just efficiency and capital investment. It is driven by engagement, effective role design, strong collaboration, accelerated career progression and purposeful talent management. Capturing the benefits of productivity gains is also a challenge in these environments, requiring strong programme management and determined leadership.
Protection
It is easy to work on effectiveness and efficiency in ways which damage the long term health of the business. This is not just the danger of weakening the competitive position by neglecting investment, but also the risk of destroying the psychological contract with the workforce. We need to consider how we implement savings, particularly if we want to use inspiration or sacrifice as a means of increasing efficiency.

There are three common traps: silence, unilateral action and tolerance of waste.

In times of uncertainty, it is natural for leaders to keep quiet until they can be sure of their direction. This is poison, as people will fill in the blanks with their own (invariably sinister) speculations. Leaders need to over-communicate, even if they don’t have all the answers.

Unilateral action – imposing decisions and sacrifices upon a workforce is equally damaging. People want to see leaders take a share of the sacrifice and role model the new ways. They want partnership.

Nothing irritates people being asked to work harder or smarter than obvious waste being left unaddressed. Regardless of its impact on costs, leaders need to eliminate red tape, bureaucracy and dysfunction. They must also remove under-performers first.

Finally, when thinking about where to make cuts, a business needs to consider the talent and skills it will need in three to five years time, as well as today. The debate about effectiveness should provide the insights to underpin these decisions.

It is easy to be complacent about talent during a time of rising unemployment. Three facts might challenge this position:

- The most talented people are the most mobile. They can still find jobs; they may even see this as an opportunity to take risks and make some life changing decisions e.g. start their own business, go travelling etc. The average and under-performers will sit tight. The net effect: a slow degradation of the workforce, reducing efficiency.
- Trust is easily destroyed. It has a hard cash value; it is also a form of efficiency. Think of all the costs that arise because of low trust: controls, audits, sign-offs, protocols, security etc. Do you really want to be adding costs back in at a time like this?
- One in three senior leaders we have spoken to recently* are actively seeking talented staff who may be disenchanted with their current employer.

* See Hay Group’s report, Fight or flight

“There are three common traps: silence, unilateral action and tolerance of waste.”
Adaptable and determined
Some businesses are going to find these actions easier than others. It is probably too late now to do much about it, but when the economy improves, it will be worth developing the agility and resilience of the business to make future economic cycles easier to bear.

In our experience, the companies that navigate these challenges well tend to:
- invest heavily in leadership
- possess a unified, effectively functioning senior team
- support collaboration across boundaries
- understand the perceptions and engagement of their workforces
- hold a clearly and openly articulated business model and operating principles
- have a questioning and open culture.

Further information
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