

Sustainable Cost Cutting

July 16, 2009

Michelle Morgan, Pelorus Advisors - At constant odds with each other: the age old “We have to reduce our expenses” versus “We can’t compromise our ability to build, sell and deliver products and services.” My personal favorite is the e-mail from Finance (usually during budget time or just after 3Q results and always across the board):

- “Cut travel by 10%” (*Great, that really helps me to get out and sell to my clients*)
- “Eliminate supplies” (*Did you really mean to tell me I can’t order toner or paper for a year?*)
- “No outside printing, do it yourself” (*Hmmm, but you just eliminated my toner and paper budget*)
- “Freeze Open Requisitions” (*Makes sense since I can’t send anyone to meet with clients anyway*)

Insanity – the action of repeating your efforts with expectations of different outcomes.

You would think by now lessons would be learned, but these draconian actions continue to occur because they are viewed by management as easy ways to accomplish immediate results. Having helped large and mid-cap companies to achieve significant cost efficiencies for over 25 years, I can tell you that they may be easy steps to initiate, but I’ll argue they are neither sustainable nor results-oriented. Furthermore, I’ll assure you from first-hand feedback, they are not popular.

Effective expense reduction requires a thoughtful and creative approach. Working with the right supplier on a given spend category can generally yield savings from 5% to 10%. And that merely requires replacing like for like (or at least just freshening up the gene pool of suppliers). Consolidation, rationalization and quick fixes are almost always there for the taking, but you still have to be willing to perform necessary supplier due diligence and determine who is best-in-class. Achieving a great level of cost saving typically requires implementing less traditional definitions of categories - by combining typical spend categories and finding suppliers who want to partner with you, both horizontally and vertically, will provide different and more attractive pricing models.

The Importance of Risk Models

So your organization has commenced a cost cutting initiative and now you have a list before you of expense savings opportunities. How do you go about deciding which ones are worthwhile and which ones carry inherent risks? By coupling the expense savings with a proven operational risk model you can accomplish three things:

1. You are able to prioritize with a risk weighting, such that the greatest expense save may carry an unacceptable risk score, leading you to look at less riskier options earlier.
2. You have uncovered the risks to making a change. This gives you the opportunity to prepare a mitigation strategy prior to implementation.

3. By doing a self-assessment, you have the people who are responsible for the implementation identifying their objections up front versus stewing and perhaps dragging their proverbial feet because of their unheard objections. And like the risk, you know have an opportunity to mitigate with the implementation team.

An effective operational risk model utilizes a weighting system in its assessment of an organization's cost-saving opportunities. The model must be able to accurately weight the impact of the cost savings initiative if the organization experiences a failure in people, processes or technology. Impact can reach further into an organization than just the cost of executing the work; it can have a significant impact on the balance sheet. For example, if an organization's business model relies heavily on overnight shipping and a decision is made to switch shipping suppliers, a failure by the new supplier during the transition will likely have an adverse impact on the organization's revenue. And depending on the importance of the organization's products, a critical supplier failure could have long term reputational impacts.

An effective risk model must also give proper weight to the probability of success. To complement the model, the organization must also possess the skills and experience necessary to understand where the possibility of failures exist, what the organization can do to mitigate risk, and what it needs to have in place with its suppliers to ensure quality.

It is often helpful to have a neutral party facilitate the completion of the risk assessment. This helps to cancel out the noise and maintain a consistent result across multiple categories. If performed correctly, the output is powerful; not only will you have a roadmap of what can be accomplished but risk mitigation strategies will have been developed upfront to address the possibilities of failure and their consequences.

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Published on FINalternatives: <http://www.finalternatives.com/node/8517>

