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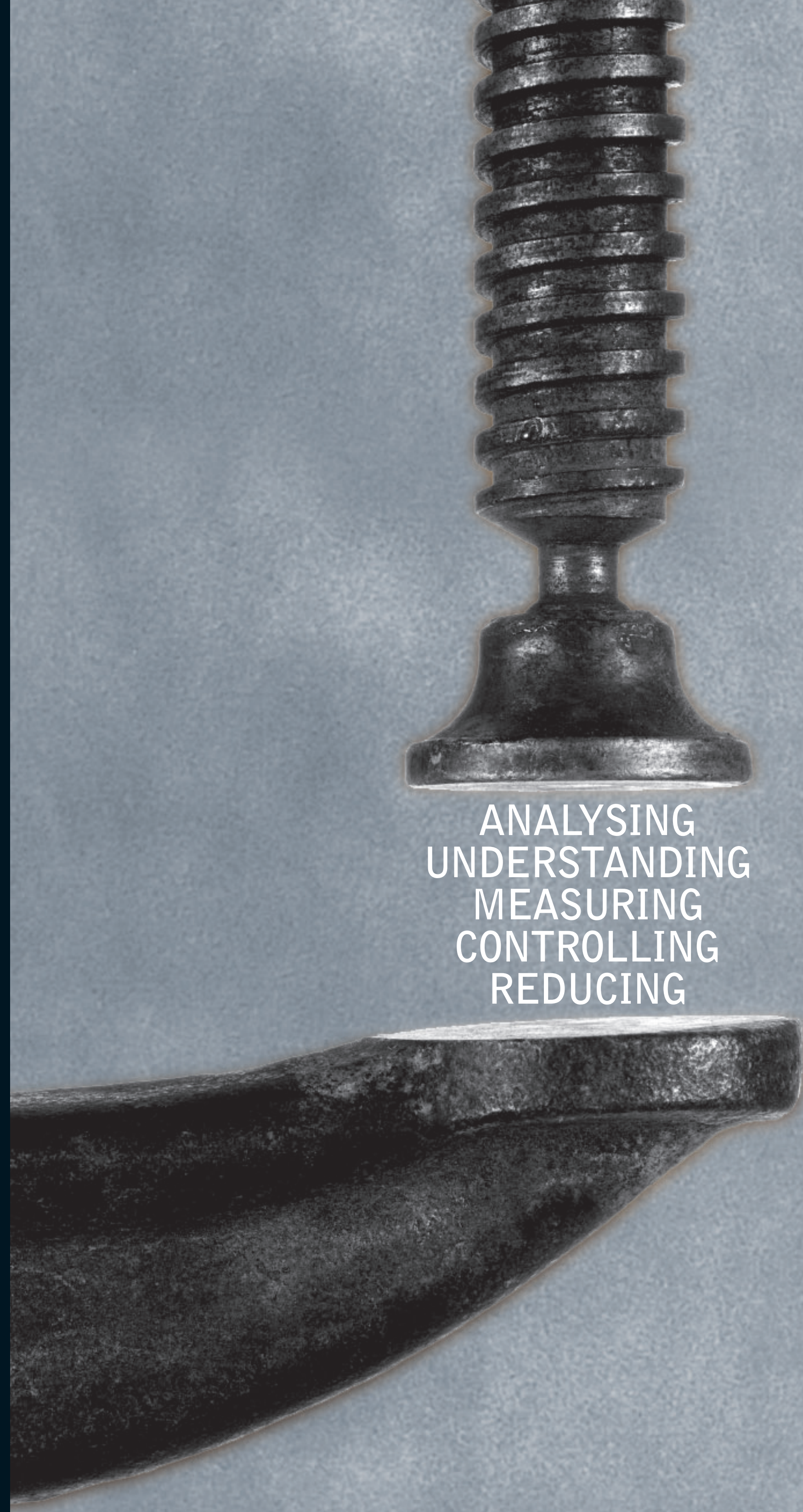


Managing costs

ANALYSING
UNDERSTANDING
MEASURING
CONTROLLING
REDUCING

Collinson Grant

analysing | understanding | measuring | controlling | reducing

All managerial actions incur costs. And little new can be achieved without extra investment. So it is slightly surprising that some senior executives pay scant attention to costs until external factors threaten sustained pressure on margins and profits. This document reflects our work with clients to drive down their costs and then set up efficient processes to keep them under strict managerial control. The ideas are neither radical nor over-complex. It is our experience that successful businesses are the ones that are able to embed these straightforward disciplines in managers' day-to-day responsibilities.

Contents

1 Cost fundamentals

Unknown companies often come from nowhere and overtake established market leaders without appearing to break sweat. Peter Drucker pointed out that the newcomer invariably enjoys a tremendous cost advantage, often in the region of 30 per cent.

The reason – the new business has a superior method of managing costs along the supply chain from procurement to the customer.

And Drucker's paper was written long before the Chinese and Indian economies were as vibrant and threatening as they are today. Competition and unstable financial conditions are pushing the need to control and reduce costs to the top of the managerial agenda.

The companies that perform best stand conventional business thinking on its head. They replace a long-established emphasis on products and revenues with increased focus on customer and profit-centric business models. The result is processes that maximise the full profit potential of every customer. This approach is made possible through the application of systems that keep track of transactions throughout the business.

Here we share our experiences gained from working in large businesses over the last thirty-five years. In that time our beliefs about managing costs, reducing complexity and the pervading influence of organisational design have crystallized. These 'Home Truths' have remained constant.

Home Truths
Profit should always be the first charge against sales. This determines the costs that the business can afford.
Any business that does not constantly emphasise profit will ultimately make a loss.
Any organisation, system, procedure or individual left undisturbed for three years will have become inefficient.
Managers should treat all overhead costs as variable. If volumes fall, overheads should be cut even faster: if volumes rise, overheads should be held.
Costs should be regarded as **core** – adding value to products and customers, **support** – needed to maintain the organisation and **improvement** – required to change and improve the business. This change of mindset helps managers in their approach to restructuring.
Organisational structure is the primary determinant of the overhead cost of a company. Its design should reflect and put into effect the strategy for the business.
People consistently elaborate rather than simplify their work.
Human resources functions cluster on tasks that have a minimal impact on profitability.
Any activity managed only on technical criteria will be unprofitable.
The optional extras demanded by people can double the costs and timescale for any development.

2 Cost is a strategic issue!

The budget, the most widely used mechanism for controlling costs, assumes a more or less steady state of business. In the past this might have been a reasonable proposition. But demand is now much more volatile. Customers change specifications quickly. New products replace older ones. Competitors spring up overnight – usually with a much lower cost base. Budgets are not a way of containing costs but rather a mechanism for retaining them. To be capable of responding to increased uncertainty, organisations need to be more flexible. It is essential to find out how all costs add value to a product or service.

As the cost structures of many businesses have changed, different considerations have come to the fore:

- Direct workers now constitute a far smaller proportion of the workforce, so apportioning costs on them has no validity. Activity-based costing allocates costs much more accurately.
- Competition is increasing. And the life-cycles of products and services are shortening. Understanding their real costs and margins is the starting point in improving profitability.
- In order to gain a thorough understanding of costs and margins, managers should focus on the total value chain, from receipt of materials to delivery to the customer. Business processes should be stripped down and tested to make sure they still fulfil customers' needs.
- Successful businesses now focus on managing their relationships with customers. Long-term customers buy more, take less of a company's time, are less sensitive to price and often help to bring in new accounts. Calculating the profitability of each customer is an essential part of competitive strategy.
- Traditional divisions between direct and indirect costs are now less relevant. All costs should be viewed as variable and attributed to the activities that initiate them.
- The productivity and pay of people throughout the business are critical in maintaining cost competitiveness and the long-term prospects of a company.

When volumes decline managers need to move quickly and decisively. This may require radical restructuring or less dramatic but carefully co-ordinated initiatives to reduce costs. To make substantial savings, the business will have to shed people. Managers should have a persuasive business case – based on robust information – accurate analysis and a carefully considered plan for implementation.

3 Impact of costs on profit

Small improvements in costs can have a dramatic impact on profitability. A 10% improvement in labour efficiency and overhead with a 5% improvement in use of materials will boost operating profits by 70%. If this accompanied by a 5% rise in revenues, operating profits increase by 120%!

Correspondingly, net profit margins rise from 10% to a staggering 21%. This 'ratchet' effect demonstrates the benefit of controlling costs, even when revenues are rising.

Under-performing products and services need to be rooted out. The profitability of separate products is often hidden in the operating profit, but analysis of a company's profitability by customer and product can be revealing.

It pinpoints opportunities:

- to increase selling prices, particularly when they do not reflect fully the importance of the product to the customer. To increase the price of a product may also be a way to accelerate its withdrawal from the range
- to manage the allocation of costs for products and services with special features that are generating only low margins
- to subcontract products or services because the resources required are outside the company's central competence
- to cut costs selectively without jeopardising the investment in resources for the parts of the business that are performing well.

Section 4 sets out a framework of tools and techniques for managing and reducing costs.

Implementing the basics
Analyse past trends
Evaluate the current position objectively
Concentrate on the few targets vital for improvement
Determine the steps for achieving each goal
Work out the detail, line by line
Plan and manage the change
Measure progress continuously and openly
Communicate the principles to everyone
Signal your intention by making an immediate start on removing excessive costs

4 A framework for reducing costs

All businesses are under pressure to increase profits each year. In mature markets, it is often impossible to boost revenue without resorting to risky acquisitions. The only alternative is to improve profitability by reducing costs. Full scale restructuring (which is beyond the scope of this document) demands careful examination of the business model and structure. This is where the largest savings will be found. But restructuring will also embrace the approaches set out below.

Most companies can find initial savings of up to 10%. But to reap the full benefits, they need to make major cultural change and:

- to extend the scope of cost reduction beyond isolated transactions. It must be part of the company's overall strategy
- to emphasise the need to sustain reductions by changing operating practices, doing things in new ways and using technology to create more efficient and simple processes
- to stop arbitrary, across-the-board cost-cutting, and concentrate instead on those activities that contribute little to the business but are of high cost or duplicate other functions
- to apply technology wisely so that investment yields benefits that are in line with the business strategy
- to assess the profitability of products and customers. Most managers have an instinctive understanding of Pareto analysis – 80% of effect is realised from 20% of the cause – but sophisticated software tools quickly provide much fuller and useful analyses
- to remove complexity and introduce more standardisation.

This simple framework sets out the opportunities in most businesses for making early and substantial reductions in costs:

Organisational design	Structure Transfer pricing Equivalent units
Procurement	Purchasing framework Negotiation
Profitability of customers and products	Analysing profitability Value analysis
Overheads and processes	Process activity analysis Analysis of work content Shared services Good housekeeping
Productivity of labour	Working practices Pay and conditions Recruitment and retention
Productivity of assets	Initiatives to improve New investment

An integrated approach reveals those costs that can be reduced selectively without diminishing the overall performance of the business. Each cost-saving initiative can be managed as a separate project with specific targets and timescales or combined into an overarching plan to manage costs throughout the business.

Wherever you start, there are some guiding principles for all initiatives to reduce costs:

Analysis	Costs can only be reduced when they are properly understood. Does every manager who authorises expenditure understand what precise value is added to the business by that cost? How can resources/activities continue to contribute value to the business but at a reduced cost?
Relationships	Maintaining relationships with customers and suppliers costs money. Does everyone understand the value to the business of each customer and supplier, the cost of maintaining the relationship and its strategic importance? Can these costs be reduced and the important relationships strengthened at the same time?
Accountability	Costs can only be reduced when it is clear who is accountable for them. What changes can be made to improve their transparency? Can accountabilities be re-stated so that they act as powerful incentives for improved performance?
Targets	Costs can only be reduced when clear targets have been defined and published. How are the targets for reduced costs translated to increase value for customers and improve overall profits? Do the targets for improved profitability fully reflect the potential for reducing costs?
Measurement	Costs can only be reduced when there are systems for measuring change. Are Key Performance Indicators (KPIs) constructed to monitor clearly the changes in total unit costs? Do managerial reports trigger action or merely record historical performance?

Organisational design

Structure

A company's structure should reflect its business model and central competences. When there has been a major change in the business, such as an acquisition, there can be duplication in functions and redundant activities.

There are different approaches to designing new structures, influenced by the history of the company, its supply chain and the underlying business processes. The 'shape' of an organisation determines its effectiveness and cost. Wide, flat structures tend to be more efficient: tall, narrow ones raise costs, slow responses, and lower productivity.

Fewer managerial layers make for flatter and more cost-effective structures. This facilitates communication from the top to the bottom and from the bottom up. Flatter structures focus accountability more sharply because they delegate less. More layers spread and diffuse the responsibility for measurable outputs. Many firms have loads of people with managerial status (and pay) but no clearly defined managerial responsibility. Managers should be responsible for the work of others. If they do the same tasks as those they manage, they are more likely to be 'team leaders'. Those who do specialised work or are classed as 'expert' and manage or supervise nobody should not be called managers.

A review of the structure reveals what opportunities there are:

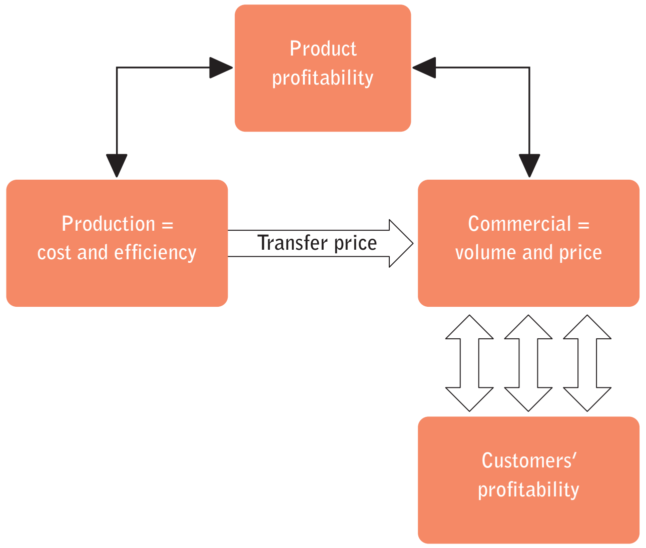
- to increase the spans of control (the number of people who report to a manager)
- to minimise the number of managerial layers in the structure
- to organise similar work in groups (departmentalise) in order to reduce the number of people needed
- to balance the staff to meet the workload (cut the staff, or add people to clear bottlenecks)
- to improve productivity by re-organising work around the process – to minimise handoffs, distance, and 'process owners'
- to cut out activities, reduce or stop services, and focus on the priorities for the business and customers
- to contract out functions and activities
- to rationalise/consolidate sites and facilities.

Cut out 'managerial' jobs that have no measurable output

Transfer pricing

Transfer pricing reinforces the business strategy, confirms managerial accountability, and underpins the underlying culture of the business. It creates a framework for monitoring cost and margins along the entire value chain of the business. There should be firm rule-setting from the centre, which can help to apply a strong downward ratchet on costs. There is benefit in using transfer prices set at actual or targeted unit costs that incorporate fully absorbed overheads. Margin is best not 'shared' or 'allocated' between commercial and operational units, as this obscures accountability.

Transfer pricing in practice



Managerial action
Build cost-effectiveness into the structure
Reduce complexity: it adds costs and slows reaction time
Create a managerial philosophy based on margins, not volumes
Design flat structures and cut out elaborate committee networks
Insist that operational communications follow the profit chain
Confirm managers' commitment to personal targets
Devolve decision-making to the lowest possible point
Move from 'passive acceptance of the inevitable' to 'hold unit costs constant'

Equivalent units

Equivalent units (EU) are part of an integrated approach to monitoring the performance of operations. They measure the 'value added' for each product and affirm the fundamental relationship between productivity, added value, cost and profit. Equivalent units are a non-financial measure of outputs and an effective mechanism that takes account of changes in product mix. They are also unaffected by inflation. Monitoring trends in conversion costs per EU is a powerful mechanism for the sustained control of costs.

Procurement

Purchasing offers immediate opportunities to reduce costs. It is a critical lever that a business can engage quickly in an economic downturn. By concentrating attention on procurement, companies should reduce the overall cost of purchases by 10 to 15 per cent. Managers should adopt a systematic approach to purchasing: aggressively controlling product specifications and managing negotiations with suppliers better.

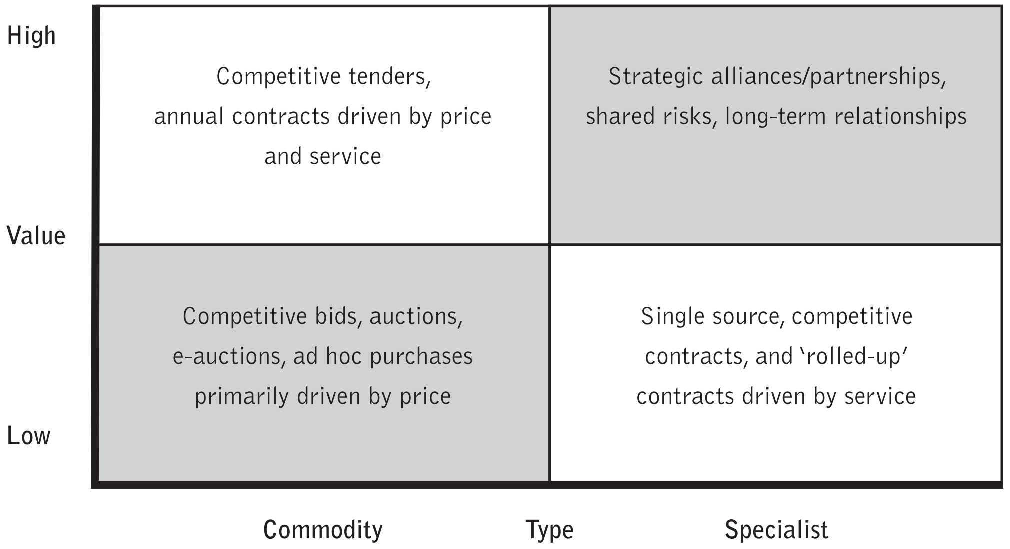
There are a number of underlying factors:

- Managers fail to review the specifications of products regularly enough to determine whether costs are aligned with the value provided to customers or with their competitors' costs. Opportunities to find less expensive materials are missed.
- Negotiations are not as rigorous as they should be – cosy relationships with suppliers become entrenched.
- More than 70% of the cost of most commodities is determined by their specifications and 30% by suppliers' competitiveness.
- Longer-term contracts offer opportunities for savings but should preclude options for automatic price increases triggered by external events.
- Timing is critical – don't buy before you need to. Lean systems should make products and services available at the right time.
- The savings from volume purchases must justify the extra cost of holding more stock, deterioration and obsolescence.

Start by scrutinising all purchase orders and questioning the rationale, price and terms

Purchasing framework

Most purchases fit readily into a matrix of high value versus low value and commodity versus specialist. Purchases should be managed in accordance with their location in the matrix.



Negotiations – dos and don'ts

1 Define the framework for negotiation. Confirm the objectives for cost reduction, quality and service.

2 Determine the points of 'leverage' and a credible plan for switching suppliers.

3 Choose a negotiating stance based on the options for switching, the number of suppliers and targets for reducing price.

4 Draw up a step-by-step plan. Confirm the senior managers' involvement and define the checkpoints for monitoring progress.

5 Do not overlook payment terms. Avoid dealing with suppliers who demand early payment. That just increases working capital.

Make an early impact by meeting major suppliers and setting targets for increased value

Profitability of customers, products and services

Decide quickly which products or services should be jettisoned

There is often a wide variance in the profitability of different products and services. It is essential to spot the winners and to draw up plans to cut out the others. Lower-margin activities usually absorb more overheads than are fully accounted for. Close analysis of the profitability of products can inform the decision whether to adjust prices, cut costs, apply value engineering, or delete the product altogether. When considering withdrawing products, salespeople often claim that they 'need product A to sell product B'. But they should only retain product A if the price reflects an accurate allocation of costs.

Similarly, not all customers are created equal. Segmentation divides them into groups according to their underlying needs and the characteristics that influence their buying decisions. It allows managers to understand which customers offer the best potential. Truly distinct customer segments will respond to different propositions and require different approaches.

A specialist database can reveal the true profitability of products and customers. It challenges managers' instincts and prejudices. It allows them to analyse trends, to model complex new scenarios for costs, prices and volumes, and to see the effect of a radical refocusing of products and services. And it provides authoritative evidence to support difficult decisions.

The analysis can often reveal:
- products and services that are failing to make sufficient contribution
- 'specials' with under-estimated overheads, which are not reflected in the price
- opportunities to promote products or services that had wrongly been considered less profitable
- the extra costs of service and options for increasing profit.

Value analysis

Value analysis helps managers to find and cut out unnecessary costs at all stages in the product's life cycle – to avoid unnecessary costs for new products and to reduce costs for current ones. It is not a substitute for technical knowledge of products but a system for getting the best returns from the use of this information. By this means, managers can continually remove superfluous costs while maintaining, or enhancing, the functionality and quality of products as perceived by the customer.

Unnecessary costs are those that do not contribute to the function or value of the product but result from:
- inadequate or excessive specification
- over-design and/or redundant features
- poor performance and lack of functionality
- inappropriate materials
- outdated manufacturing methods.

Value analysis should focus on products with high annual costs and low margins in order to get the best returns.

Overheads and processes

In most companies overheads have risen as a proportion of total costs. Traditional concepts of indirect and direct costs no longer apply. Many businesses do not base the recovery of cost on direct labour. Activity-based costing provides a rigorous mechanism for determining the activities that add value and which, consequently, should be designated as cost drivers.

The productivity of direct labour was a major influence on profitability. Now managing the productivity of overheads is just as critical. This requires a thorough understanding of inputs/outputs, of activities that add value, and of their associated costs. When costs have to be cut, it is difficult to decide how much, and where.

Process activity analysis

Process activity analysis (PAA) is a powerful technique for reducing overheads. It reveals overlapping activities and processes that are of low value to the business but that incur high costs. PAA allows managers to make informed decisions when the scale of the changes dictates a more fundamental approach to reorganisation and job losses are necessary. It is an essential tool for restructuring core processes when cuts of more than 10% are required. Most importantly, PAA shows how costs can be reduced without diminishing the overall performance of the business.

PAA will produce a plan for reducing the indirect, headcount-driven cost base. The initiative should secure the commitment of the managers who are accountable for those costs. This becomes more likely when the urgency for reduction is communicated to senior managers, accepted by them at the outset, and sustained to the end of the exercise.

PAA tackles the problem directly. The benefits are threefold:

First, it is based on questioning and gathering data from the people in the organisation itself. In other words, the solution has the merit of being 'home grown'.

Secondly, the majority of the project team are from the business itself, which minimises the assertion that the organisation is being 'done over' by outsiders hired to cut out jobs. Nevertheless, the approach is robust and is led by experienced practitioners.

Thirdly, the process has an excellent record as the most penetrating and least damaging way of reducing the staff. Trades unions will reluctantly endorse the methodology, once they are persuaded that managers are determined to take action.

It is necessary to analyse the staff, not only department by department but also by processes and activities, asking 'What do people actually spend their time doing? 'rather than 'Which department do they sit in?'. Costs should be in three categories:

Core – adding value to products and customers

Support – needed to maintain the organisation

Improvement – required to change and improve the business.

Typically, support should be in the region of 20% of costs, improvement no more than 5%, and 75% of overall effort concentrated on adding value. This approach, which focuses on processes, is far more revealing than the conventional, functional method.

Process activity analysis reveals:

Duplication – the same work being done, unnecessarily, in different parts of the organisation.

Disproportionate resources – the total effort expended on processes categorised as support or improvement may not be appropriate to their overall importance.

Over-devolution – attempts to move processes and activities from a central department nearer to the front-line may have gone too far. Obvious economies of scale may have been ignored.

Centralisation – conversely, the opportunities to consolidate tasks in central services – possibly within a shared services centre – should be examined.

Outsourcing – transferring whole functions or processes to an external provider offers some advantages in cost and service, but does not necessarily increase flexibility.

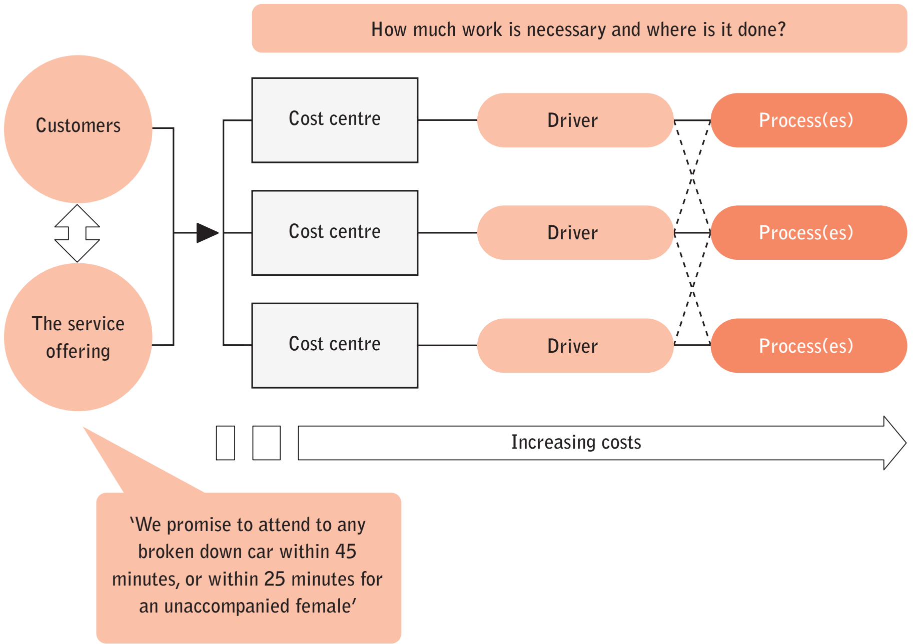
Maintenance tasks – resources devoted to maintenance are often poorly controlled and excessive.

'Specials' – non-standard tasks are likely to consume disproportionate resources. Why? Is it justified?

> Implement incremental improvements in stages, without waiting for agreement on major organisational reform

Analysis of work content

This approach allows managers to build up a cost model from first principles. It is sometimes known as 'zero-based budgeting'. An accurate evaluation has to be made of what work needs to be done in a defined period: how this is broken down into different tasks; how long each task should take; what allowances should be built in for supervision, management, training, absence etc; what support functions are necessary (HR, finance, purchasing) and what their cost will be. A useful starting point is a map outlining how customers are served, what separate cost centres are involved, what the main drivers of costs are, and the key processes.



This provides a robust model to find out the best size and shape of the business and hence its cost. However, it relies heavily on managers describing precisely what work needs to be done and how much effort is necessary. There is a real risk that the very inefficiencies and duplication that should be revealed and cut out in order to reduce costs might be actually endorsed and embedded in the revised structure. This is particularly the case when the work is complex, with few repetitive transactions and no directly relevant comparators. Judgements tend to be made on subjective criteria rather than on objective reasoning.

The model of costs can be compared with the actual costs, but this does not necessarily reveal where and how savings should be made. The review should encompass core processes, structure, procurement, overheads, technology and employment practices.

Pinpoint and cut out redundant activities and duplication quickly

A thorough analysis will define the cost centres, drivers and core processes. For example:

Cost centres	Drivers	Processes
Operations Manufacture/produce products and services to agreed specification	Number of products/services Complexity of products/services Purchasing behaviour – method of production Frequency with which products/ services change	Design and specification Manufacturing and assembly Quality control Research and development
Logistics Provide services/products to the agreed specification in the right place and at the right time	Number and location of customers (and suppliers) Number of warehouse/distribution centres Frequency and timing of deliveries Complexity of orders Security of deliveries Stock holding	Order picking and packing Route planning Delivery (different options) Handling queries/complaints
Marketing and selling Increase sales from existing customer base and attract and convert new prospects	Number, location and loyalty of existing customers Principal sales channels and methods of selling – catalogues, web sites, sales literature Number of sales visits, after sales service Ordering mechanisms Pool of prospects	Maintaining contact with existing customers Promotional campaigns – mailing, exhibitions, advertising, events Estimating and quotations Visiting customers and prospects
Finance – credit control Collect cash from debtors Maintain a strong cash flow	Number of customers Number of invoices Frequency of invoicing Average value of invoices Nature of debt	Credit rating Credit control – telephone and written contact Litigation Outsourced debt collection
Human resources Recruit, retain and motivate an effective workforce	Number of employees Labour turnover (and recruitment) Attendance rates Amount of training Employee relations/collective bargaining	Recruitment Performance management Payroll Discipline and dismissal Training and development

Shared services

Shared services generate real savings by reducing labour costs, applying consistent standards and focusing on key, value-adding activities. They should exploit economies of scale and provide the critical mass necessary for the cost-effective implementation of improved systems. But, they are usually remote from their own internal customers and not exposed to day-to-day problems in the field. And every new structure within a business creates its own raison d'être and rigidities – and attracts its own particular costs.

There can be other pitfalls:
- consolidating resources in one place tends to diminish rather than improve the flexibility to reduce costs quickly in difficult times
- a 'centrist' approach can discourage innovation and stifle the essential initiative to respond promptly to change
- service level agreements are not infallible; performance has to be measured and managed robustly
- costs can escalate rapidly when new tasks are taken on board without a thorough review of how else they could be done.

Savings in the region of 20% should be achieved by the introduction of shared services for transactional financial services and internal customer services such as payroll. For other functions, training, legal services and property, for example, the benefit will show in improved service. Initial cost savings can be quickly eroded without rigorous control and clarity in accountability.

To maximise effectiveness, managers should seek:
- to install accurate measurement of results and related rewards
- to analyse carefully the organisation's current costs and levels of service
- to define the core processes with adequate flowcharts and supporting narrative description
- to benchmark existing practices internally and with external companies
- to use metrics that are simple, tangible and acceptable to everyone
- to focus on 'leading indicators' of business drivers to forecast results
- to establish processes for continuous review and improvement.

And, assess carefully the impact of proposed changes on the relationships with customers and agreed service levels.

> Don't proceed without a clear plan that demonstrates the return on investment (with a healthy contingency for the cost of IT)

Good housekeeping

Dealing with the basics might seem to be common sense. But it is often overlooked. The removal of what may appear to be a trivial cost sends a powerful message around the company: no option for removing costs is off the agenda. Is the use of bottled water really justified? Does anybody know how much it costs to maintain the plant arrangements?

Excess stocks of materials and sundry office items often cost more than is realised. Few businesses have removed filing cabinets as quickly as they have adopted electronic storage. Space is costly but decisions about reducing its use are put off because the expenditure is thought to be fixed. There may be options for sub-letting or relocating some functions. In each location – operational and office – somebody should be responsible for monitoring and reducing energy costs.

There are always savings to be made in the management of net current assets – cash, debtors, work-in-progress, and what is owed to creditors. Are invoices sent promptly? Is credit control up-to-date and efficient? Are suppliers paid too early? Are banking arrangements as competitive as they should be? How long is it since the terms were re-negotiated?

> Simple operating ratios are the quickest way of assessing how quickly progress is being made

Productivity of labour

In many companies the proportion of direct to indirect labour has fallen considerably. This is not a reason for ignoring this important element of cost.

There are always opportunities to examine and improve working practices. It is too easy to allow the day-to-day control of core processes, of overtime, and of shift and related payments to slip. These weaknesses create unnecessary costs that become a big drain on profits.

Managers should, as a matter of routine:
- introduce short-time working when the pattern of demand justifies it
- try to reduce the number of grades and the levels of decision-making
- remove costs faster than volumes decline
- manage and control absolute headcount (including part-time)
- recover annual pay increases as a matter of routine through increased productivity
- hold absolute unit costs and use accurate measures of productivity.

Success depends on an attitude rather than on any particular technique. Imposing changes in working practices without disrupting production, service or quality demands determination. Continuous review and early action are preferable to confrontation and fudged trade-offs.

Employment practices

Large reductions in costs arise from major change – when fewer people are required than before and/or when the nature of the work becomes radically different. But when this happens it also affords an opportunity to review employment practices and to resolve long-standing anomalies and inconsistencies. It should cover:

- **Pay drift** – poor controls on pay inevitably lead to higher than planned costs. 'One-off' benefits are always worthy of further examination.
- **Recruitment and selection** – in many companies, poorly co-ordinated recruitment processes lead to duplication and higher costs. In tight labour markets managers seriously underestimate the costs of finding recruits. So allocate those costs properly.
- **Replacement of leavers** – a decision to replace an employee who leaves should only be made after a critical appraisal has been made.
- **Unproductive time** – how much time is being spent on meetings, travel, managing e-mail, social events and other activities of questionable benefit? The underlying rationale must be challenged.
- **Use of temporary and contract workers** – many firms run with lots of agency workers, but fail to find out their costs or to manage their performance. What employment rights do contract workers have? Why have managers pursued this policy?
- **Overtime (paid or unpaid)** – too much or too little use of overtime indicates that people have been poorly apportioned to tasks. There should always be slightly more work than people to do it. Challenge all requests for overtime and only authorise work that is crucial.
- **Managerial time** – a comparison of how managers in different parts of the firm use their time can be revealing. Signs that they spend a lot of time on the same tasks as subordinates should be examined.

Place an immediate ban on overtime and on hiring more temporary workers without authorisation from a senior manager

People, skills and costs
Assess the skills needed to re-build and compete
Examine the total employment package:increasing pay is a short-term response
Learn the lessons (costs and capability) from labour turnover
Review recruitment standards and procedures. 'Sell' the company better
Take another look at present employees for possible promotion and transfer
Review controls on absence. Make better use of working hours
Productivity of labour must at least absorb inflation and reductions in volumes

Productivity of assets

Most companies initiate action to improve the productivity of their assets. They create just-in-time inventory systems, improve the turnover of working capital, devolve non-strategic activities to more efficient suppliers, and, in some cases, take the first steps toward reconfiguring their entire supply chain.

These steps are necessary and important. But they may not go far enough. Confronted with increasing pressure from investors to improve value for shareholders, managers need to think of more radical improvements to the productivity of assets.

One of the main ways to increase value for shareholders is to maximise the productivity of all assets. Increasing their efficiency is more than just another programme to improve operations. It is a fundamental part of value management (and staying in business). When executives' compensation is linked to movements in the share price, estimating the impact of operational improvements on the creation of value helps build strong internal support for them.

Many companies still approach this task in a piecemeal fashion. Either they focus on a single asset in isolation or they multiply internal projects for improvement without paying attention to the dynamic interactions between them. Managers should understand how improvements in one class will affect performance in others. And they need to do so not only inside the business but also along the entire value chain. By pinpointing those interactions and acting on the total system, companies can manage tradeoffs and focus their efforts on the improvements that yield the biggest benefit.

Make sure that the board reviews the total productivity of all the company's assets

Too many initiatives remain well-intentioned efforts led by the corporate staff, and are not sufficiently taken up by the line managers who really run the business. Unless local managers push for improvements, even the most elaborate programme is likely to be ineffective.

Nevertheless, the corporate centre still has an important part to play. Sometimes the greatest impact on the productivity of a company's assets comes not from improving the efficiency of existing assets but from making smart choices about opportunities for investment.

As competitive forces put a premium on the efficiency of assets, companies that pursue this stratagem aggressively are finding it a powerful mechanism for creating new ways to compete. The payoff is not only enhanced use of assets and substantial improvements in value for shareholders but also more competitive strategies and, in some instances, a radical restructuring of the business.

5 Putting it into action – sustainably

Once a decision to reduce costs substantially has been made some actions can be taken straight away. But arbitrary 'slash and burn' will always create as many problems as it solves. It may take five to six weeks to investigate carefully which parts of the business deserve attention and two or three more weeks to draw up plans for action. This is the best way to get managers and other members of staff to endorse the objectives. Implementation can follow on immediately – but on the larger projects it may take several months before results come through.

There are some pointers to success:

- make sure at all times that customers' needs are not being compromised – even though service levels may change
- understand the requirements of the business and the capabilities it must maintain to serve customers
- maintain consensus on ambition, direction and targets
- communicate these values widely in the business
- act speedily and decisively – leave no doubt that plans will be implemented
- design new controls to assess progress now and regularly in the future
- use simple measures of productivity – cost ratios and margins
- decide how progress will be reported
- create powerful incentives for those managers who can achieve results
- demonstrate the value of more efficient ways of work – to employees and the business
- promote a culture of continuous improvement and cost consciousness.

Successful managers create a sustained pressure to review and control costs. The techniques outlined here are an essential part of their day-to-day armoury – but are by no means mutually exclusive or exhaustive. We have used all these approaches to reduce costs for clients in many different types of business and in the public sector. The most successful assignments are those in which a permanent managerial culture is created to assume responsibility for costs and their underlying drivers. In a world where markets are rapidly becoming more homogeneous and products and services more difficult to distinguish, cost is assuming a more and more important position as a true differentiator between competitors.

6 Collinson Grant

Collinson Grant is a management consultancy with a history of profitable growth. We help large organisations all over Europe and in the United States to restructure, merge acquisitions, cut costs, increase performance and profit, and manage people. Building long-term relationships has allowed us to work with some clients for over thirty years.

Our emphasis is on implementation, results and value-for-money. We expect to give a good return on the investment in us. So we do not recommend action unless we are sure that the outcome will be worth it. We are not afraid to give bad news, or to champion ideas that may not be welcome.

Most of our work is on three themes – organisation, costs and people. We use this simple framework to manage complex assignments – often with an international dimension – and to support managers on smaller, more focused projects.

We help them:

- to restructure and integrate – following acquisitions or to improve profits
- to cut costs. We make systematic analyses of overheads, direct costs, and the profitability of customers and products. This helps managers to understand complexity, and to take firm steps to reduce it
- to improve the supply chain. We examine every process and interface to improve efficiency and service
- to set up financial and managerial controls. We create robust systems to improve decision-making and reduce risks
- to refine business processes and introduce lean manufacturing. We analyse and improve how work is done, and use new ways to create change and make it stick
- to manage people. We draw up pay schemes and put them into effect, guide managers on employee relations and employment law, get better performance from people, and manage redundancy.