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Keeping Costs Cut

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Keeping Costs Cut

When it comes time to cut costs again, look past the traditional structural approaches to the company's DNA.

by Matthew Ericksen, Elizabeth Powers, and Frank Ribeiro

It's corporate cost-cutting time once again, and once again most companies will resort to the usual methods: slashing budgets across the board, taking out layers from the org chart, offering voluntary severance and retirement packages, and ordering layoffs. Such efforts, targeted primarily at the company's overall structure, never seem to lead to lasting change — and yet whenever budgets get bloated, these approaches get dragged back into service.

The trouble is that these approaches simply don't take into account why corporations' costs were escalating in the first place, guaranteeing that the root of the problem will remain in place and cutting back will be a regular exercise. Going after structural issues alone while ignoring the three other critical strands of every organization's DNA — decision rights, information, and motivators — is no recipe for successfully cutting costs and keeping them down. Excising layers of management may reduce costs for a while, but not if the managers remaining fail to use these three levers to manage to specific expense goals.

First, no company can maintain a rational cost structure if the people making decisions involving expenses don't know how much things cost. That's why transparency of information about all manner of expense — from the costs of shared services such as IT to manufacturing and distribution costs — is central to any sustainable cost-cutting effort, in addition to the metrics required to monitor these costs. Typically, business units and departments without access to such information tend to act as though they have a blank check. One company in our experience, for instance, did not charge IT services back to its departments or even share information on IT budgets with departments. The result: Because they had no idea how much their requests for services cost, departments simply asked for what they wanted, the requests were put in a queue, and eventually, IT provided the services. Under this regime, not surprisingly, the company's IT costs exploded.

Information is power, and with real transparency on the price of goods and services, the law of supply and demand can take hold. Companies can allocate services by forcing departments to make decisions on the basis of fixed prices for services or by open, competitive bidding between internal and external service providers.

Once information on the real costs of corporate services becomes available, companies can use that information to make better, more sustainable cost-cutting decisions — but only if their governance structure is clearly defined, logical, and consistent. Decision rights — perhaps the most important aspect of every organization's DNA — involve identifying who has the

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responsibility, the authority, and the accountability to make various decisions. If the decision rights are concentrated at a high, centralized level, companies will bog down while waiting for top executives to make critical decisions; but if decision-making authority is too decentralized, redundancies and inefficiencies result as divisions and departments replicate one another's efforts. Even worse is the company that hasn't defined decision rights clearly, creating a situation in which decisions are made by everyone, or by no one at all.

The happy medium requires senior managers to push decision rights further down the org chart while carefully monitoring the decisions their direct reports make. That expands the senior manager's span of control and ensures a more efficient decision-making process based on local knowledge. And given good information, those decision makers become more efficient, lowering the cost of the decision-making process itself.

Structural change is at play here, as well. Giving managers more responsibility for larger areas of influence can save money by slowing the increase in organizational layers. But that effort must be accompanied by the thoughtful use of motivators — a system of incentives that is critical to every organization's DNA. On one level, that means creating a bonus system that rewards managers who meet specific cost targets, not just business targets. On another level, it means developing a promotion strategy that goes beyond standard vertical promotion schemes that accomplish little more than adding layers of management and creating a cadre of highly paid individual performers with little real managerial responsibility.

Instead, companies should strive to develop strategies for top performers that emphasize lateral promotions, which confer more responsibility and higher salary without a move up the management ladder. Such moves serve not only to put the brakes on the build-up of excess management layers but also to open up the channels of communication, thanks to the increased movement of managers from department to department.

Putting together the whole package — combining structural changes with better managed decision rights, a new approach to incentives and motivators, and the access to cost information on which it all depends — involves taking an integrated approach to a sustainable cost management program. A consumer-goods manufacturer that was looking to cut costs offers a good example of how all of these factors can come together: Top managers knew that distribution — inventory, sorting, shipping, and returns management — was a considerable expense. The problem lay in the fact that distribution costs were treated as fixed costs, and were charged back to sales teams as a percentage of sales. Yet executives also knew that teams' expenditures on distribution varied widely, due to special requests for services such as more frequent delivery and expedited shipping.

The answer to the problem, top managers decided, clearly shouldn't involve making distribution decisions themselves, using their knowledge of costs as a guide; such a system would have gummed up the works and kept the customer teams from acting quickly and flexibly. Instead, the company decided that the effort to fix the problem should begin at the level of information transparency. The introduction of a "rate card" that clearly defined specific charges for added levels of service — at prices competitive with outside distribution services — forced the customer teams to make decisions within a true supply-and-demand regime. At the same time, lower-level managers within each team were given the rights to make decisions on the basis of the information available on the rate card. Finally, their incentive structure was changed to reflect not just their sales gains but also their ability to keep costs low.

The results were dramatic: Costs came down even more than the company expected, and they stayed down. Newly empowered managers who were then promoted to different divisions took the rate-card mantra with them. And these changes allowed each division to maintain its lean structure, given team managers' expanded spans of control and greater flexibility in making distribution decisions.

It's not enough simply to cut costs; they have to stay cut. And the only way to do that is to reach deeper into a company's makeup to put in place an integrated program that takes into account all four of its DNA strands. +

Resources

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The Organizational DNA Web site: Booz Allen Hamilton has developed an online assessment tool, the OrgDNA Profiler®, that allows individuals to diagnose their organization's culture. www.orgdna.com/

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