

Back to Thinking About Unit Costs

With the patchwork economy, increased savings, and shaky consumer confidence, you would be forgiven for questioning whether we are in a boom. However, it really is a mixed economy. This article will be addressing one of the consequences to this environment– an increased focus on costs.

Many of you will have already been thinking about costs, and many will have been doing something about it. However, there are different ways to conceptualise the cost challenge: some of which can get you over a short term challenge; some of which can lead to a downward spiral; and some of which can lead to genuine innovation and creativity. In this article I provide some insights into all three scenarios.

Short Term Actions

Often organisations begin with a classic review of discretionary expenditure, literally by looking at cost categories within the profit and loss statement. This cost category focused analysis can certainly address the small changes such as cutting the biscuits in the coffee room, or terminating newspaper subscriptions. *However*, it can also cut more deeply, for example, by reviewing buyer expenses or addressing sales force expenses. In many senses this is the simplest of the cost cutting scenarios. Unfortunately, even this apparently easy approach to cutting costs carries inherent dangers.

Firstly, some of the changes may in fact reduce morale without having much impact on costs. One needs to be very careful in deciding whether the action being taken is a signal to staff, or a real cost cutting activity (i.e. it delivers a real financial return). Cutting the staff's biscuit allowance or reducing meeting catering may seem like the most inconsequential of changes, however, one must question whether it is worth while raising the hackles of staff without a significant financial return. In some of these cases you will need to assess the costs of productivity losses, against the savings of the actions you undertake.

Even more significant changes need to be carefully balanced. For example, if done clumsily the cutting of sales force expense budgets can damage the productivity of high performing sales people. The end result might be a sales force which feels that they are not trusted, and are shackled from achieving revenue targets.

However, it is not all bad news. Much of the success you can achieve at the smaller item end of cost reduction comes down to the strategy you are pursuing. For example, if you wish to build a sustainable cost conscious structure in a low margin industry then you can use the difficult trading conditions to create a rationale to bring staff with on a journey to cost consciousness. If delivered with appropriate communication and implemented intelligently (by assessing the value of the costs not just their absolutes), then cost cutting activity can help you create much greater commercial awareness in the workforce. For many this is the real game- creating a sustainable cultural and capability change. Now to do this means you need to approach cost reduction more carefully, with more analysis and a lot more communication. This can be a great opportunity.

Watching for the Vicious Cycle

This starts to take us to the second cost cutting scenario whereby the executive inadvertently leads the team into a downward spiral. This is the challenge of the old adage “it is hard to shrink to prosperity”. Vicious cycles can emerge, many of which are difficult to foresee, simply because the world is so complex. For example, we might look at training expenditure. This is an absolute classic for short term spending reductions. Where training is ill conceived and not fit for purpose, then cutting the training budget might be valid. However, in many cases cutting the training can lead to a downward spiral. For example, one organisation had reduced its sales force training consistently for three years. The consequences were far from happy because the sales force ended up with: insufficient product knowledge; insufficient understanding of the processes for ensuring timely and accurate product delivery; and little understanding of the way in which the brand was to be represented. As you can imagine, this led to declining sales, poor information capture at the sales front end (leading to errors), and even to problems in brand perception. The first round of cuts only led to a vicious cycle of later cuts as the organisation tried to shrink in order to make profit objectives.

Seeing the Underlying Opportunity

The good news is there are ways to approach the costs question to deliver lasting benefit. In one example it transpired that the sales staff were spending much more time correcting delivery errors than they were planning for and executing sales activity. This was happening for two reasons: the organisation’s processes just did not work well; and many members of the sales team had become more comfortable with customer service than with sales.

Under these circumstances this enterprise had the opportunity to make a real breakthrough by concentrating on the value of its costs. Actually the sales force cost a great deal more than the training, and most of the sales force time was not spent on selling. So taking the whole story into account, the costs needed to be restructured not just reduced.

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So what did they do? Well the logical steps were taken:

1. A customer service team was built in order to take on those “service recovery” tasks which had been previously conducted by the sales force;
2. Process improvement was deployed to dramatically reduce the incidence of customer service failures (because the costs of many customer service failures are hidden – but they get you in the end);
3. Training was redesigned and initiated for the sales force;
4. Sales activity and closure targets were reset to take the sales team to real sales growth.

The end result of this story was increased sales. Actually, some of the sales team left (because they did not want to do the new job) and some of the sales team really found their wings. Customer service problems reduced over time, but in the meantime a customer service team dealt with more of the issues at a lower real cost than using the sales force.

Overall, costs reduced significantly as a percentage of sales. This is an example of digging deeper into the cost problem by seeing it for what it often is – a business design problem. In this case, if your business has designed the wrong role for the sales team it is going to consistently underachieve.

Another example further illustrates the point. Offshoring of administrative and customer service activity is common (indeed increasingly so). It can deliver significant benefits but often the control costs are very high. What I mean by this is that the process of handing off to the offshore partner, and of controlling the quality of the deliverables, becomes much higher than anticipated in the business case. In one example we saw up to 30% of the activity that was sent offshore was returned to personnel in Australia with a query.

This is just a waste of money and, of course time. This is a business design problem that must be addressed by looking at the root cause of the problem (which may be in process, in form design, in training, in behaviours etc).

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Once resolved, this can liberate costs, free up time, and improve customer service. It is not an examination of the P&L by itself that has driven this opportunity, but an examination of the way the business works. It is a design issue. It means asking more questions to dig deeper.

In conclusion

The Bevington Group has conducted hundreds of studies with many of Australia's largest and most respected organisations. All have had opportunities to save costs, all have had opportunities to lift service, and many have had opportunities to lift revenue. These are intimately connected factors, so much so that it is possible to reduce unit costs and raise revenue through the right business design. However, the only way to get to the opportunity is to consider the underlying drivers of some of your costs and to ask more questions. This provides the opportunity to understand the value of your spend and design a more effective business solution. Of course this questioning should not constitute an excuse for analysis paralysis. This journey must be pursued with sense of urgency, so the quick changes can still be done. However, even with the low hanging fruit would advise that a little time is taken to design the right communications and to target the culture you really want.

Opportunity abounds in most businesses, the right mindset (one of business design) and the right questions (to dig deeper) will maximise the returns.

This article was written by Roger Perry, Managing Director of the Bevington Group. An edited version of this article will appear in the next version of Retail World Magazine.

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