Akenhurst Consultants

Lean but not Mean

The Intelligent Way to do More with Less

Sometimes a business arrives at a point where its revenues simply do not support its cost base. Given the way the economy is heading, it is more likely than it has been for many years that you will need to take action on profitability in the near future. The way you do this can make the difference between a necessary or even beneficial correction, or the start of a vicious downward spiral. Here are some guidelines to make sure that any action you take leaves your business stronger, not weaker.

Keep Sight of the Objective

There is a real risk, when reducing costs, of losing sight of the objective. You're thinking things like "two redundancies in this department, outsource that and save 10%, don't replace three people there, renegotiate the energy contract...". So what happened to the vision ? "Vision" may seem a rather grand word in these circumstances, but all it means is a simple statement like "we sell these products to these customers, using these market channels. Customers buy from us rather than competitors because..."

That last sentence is particularly important because it defines your point of difference. Lose sight of that while reducing costs and you are finished. If great customer service is one of your key differentiating factors, avoid at all costs actions which might compromise it. If it is quality that really distinguishes you, don't do anything that might risk reducing it.

Involve People

How often have you seen it ? Painful cost reductions are on the agenda, and the top management team goes into a huddle, developing plans in great secrecy. Or worse, the Chief Executive retreats into his own head, presenting plans as a fait accompli. The message to those excluded from the decision is "this is something unpleasant that *we* are doing to *you*". Think about sending a different message; "This is an unpleasant problem that *we* need to deal with together". You will gain more commitment, and almost certainly some good ideas on what to do.

There is another reason for involving others as well. You may as well admit it - as a senior manager you don't really know what goes on day to day. You don't know who or what is actually essential at the front line. You don't know where the real risks are. You may have another problem as well - nobody dares to tell you the truth. I have seen several very powerful, very dominant chief executives come completely unstuck when they have handed out objectives and just expected people to "get on with it". People accept objectives that they have no idea how to achieve, that may not even be possible. For months they swear blind that everything is going to plan, while the company disintegrates around them. In the end problems surface and someone (often me) is sent in and reports that things are one hundred times worse than anybody thought.

So if you are the man or woman in charge, ask yourself some very hard questions. What happens when your managers push back ? Do you listen to them ? If they come up with alternatives to your proposals, do you give them serious consideration ? If they tell you about risks you hadn't considered, do you take them seriously ? Or maybe they don't do any of these things, in which case you may have a *real* problem. What if you have a established a level of dominance where you can command people to do the most insane things and they will agree without demur ? Of course, you may be omniscient, but if you're not, take care.

Remember to Generate Options

Beware of tunnel vision. However urgent the task, the first idea you come up with not necessarily the best. Here are some ideas for generating options:

- reduce investment (marketing, product development), vs reduce current costs (manufacturing, customer service). The option you choose here may depend on how rapidly the business needs to change and develop. The faster-moving your environment or the greater the pace of technological change in your industry, the more you need to beware of reducing investment;

- increase efficiency (do more with less by identifying waste or overcapacity) vs increase effectiveness (move resources away from low profitability customers or products to higher profitability customers or products). Here you need to make an honest assessment of how efficient you are now; if you have previously prided yourself on efficiency, why would you now be able to reduce costs without damage ?;

- make small reductions over many areas vs make very large reductions in a small number of areas.

One good way to generate different options is to involve different people with different perspectives. State the objective, let them develop their own proposals, and *listen carefully* to what they come up with.

Think about Risk

The financial markets understand this. Security A offers a 6% return, while security B offers 12%. Why the difference, and why would anyone buy security A ? The difference is in the risk. Security A is backed by the Government, security B is backed by a small company with few assets in a volatile industry.

The different options you generate will also involve different levels of risk, but how often do you actually formally quantify the risk ? I'm not suggesting that you bring in a team of rocket scientists with fancy mathematical models, but just ask, for each option:

- what could go wrong ?
- if it did go wrong, how bad would the impact be ?
- how likely is it to go wrong ?
- what could you do to prevent or mitigate the effect ?

Thinking systematically about risk won't take more than an hour or two, but will greatly clarify your options. If option A has lower risk than option B and they both produce the same benefit, then option B can be discarded. When you then implement option A, you know where the risks are and how you can manage them.

Beware of Salami Slicing

"We need to reduce costs by 5%, so we need to take 5% out of each department". Why is this a bad idea ? The reasons are almost endless:

- customer service has always been efficiently run, and is key to maintaining the company's competitive position. Any reduction here will cause long term damage;
- the finance department is overstaffed, because it hasn't exploited technology as far as it could. Costs here should reduce by 15%, but if they don't deal with the efficiency

issue and just lose staff, they won't be able to collect cash from customers and the whole business will suffer;
- widget production has the most efficient widget production unit in Europe. You couldn't reduce costs at all without reducing widget volumes. The problem is, though, that the Chinese are moving into widgets in a big way and there is no way we can compete. We need to get out of commodity widgets, either abandoning that product line altogether or moving towards high-tec robot-controlled widgets that work underwater.

Exploit the Product Lifecycle

If you have more than one product, you can almost certainly divide your portfolio into:

- new products, still establishing themselves, lots of potential but small profits at present;
- established products, the "cash cows", large profits but limited or no growth;
- declining products.

It is often tempting to cut investment in the new products - after all, they aren't making that much, and so there is a short term benefit. The problem with this approach is, what happens next year, or the year after ? Instead, look the more established products. It is here that you may be overinvesting. Reducing investment in declining products may hasten their decline, but you can probably afford to be more brutal - after all, they are well established.

Cut Out Underperforming Activities

This is the better alternative to salami slicing. If you have been in business any length of time and reached any sort of size, you have:

- customers who actually cost you money, because of their special discounts, extended payment terms, customisation required or just the general aggravation of dealing with them;
- products that lose money. For example, I recently did some work with a manufacturing company which had acquired a product portfolio from another group company. On examination, 15% of sales turned out to make no money at all once manufacturing costs had been taken into account. If you have this sort of drag on profitability, and if you haven't done the analysis work you almost certainly do have, then no amount of cost reduction will produce good profitability.

By identifying underperforming areas and eliminating or fixing them, you not only improve profitability in the short term but improve the long term health of the business.

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