HOW TO **CHANGE THE WAY COST-CUTTING IS DONE** AND **GET SWIFTER RESULTS**

A five-step guide to making it work in your organisation

exago

By

Andreia Agostinho Dias

Sales Executive

Experienced in a wide range of IT sales and passionate about innovation and communication, Andreia works to accelerate our idea management software's expansion in key geographies. She has developed the capacity to understand clients' needs and questions about how particular solutions can help them meet their goals in over a decade of sales service and digital commerce practice at IBM. Excellence and resilience mark her work.

> *Executive leaderships have long understood that cost cuts cannot be blind, but need instead to be aligned with business strategies, and seen as a way to prepare people and processes for present and future growth. Managers must then help to build and promote an internal cost-conscious culture, engaging every employee around cost planning and removing all fears typically associated with the use of the word "cut" in corporate environments.*

Diana Neves de Carvalho

CEO

Blending consultancy, management and information technology expertise, Diana's problem-solving talents, 'make it happen' spirit and passion for innovation brought her to Exago's leadership in 2016. She had been our vice president of business services since 2013, capitalising on her previous solid experience in two of the Big Four companies, KPMG and Deloitte.

> *Cost-cutting and improvement are key aspects of each organisation's Innovation Agenda. Within incremental innovation processes, this requires an ongoing effort and feedback loops to embed a cost-conscious mindset in the organisation culture. At Exago, we privilege a bottom-up approach, because we believe in the power of collective intelligence and know that an engaged internal workforce will likely be more thorough than a dozen experts when addressing micro cost-cutting and improvements strategies.*

ABOUT EXAGO

Exago collaborative innovation management software brings together all the right people and their collective expertise to solve your key business challenges, within and beyond corporate walls.

From more sustainable operations through to a new and more competitive offer, Exago platform editions and expert end-to-end services allow you to easily find, manage, assess and bring to life ideas that deliver value to both your workforce and your company as a whole. Social and gamification features, the US-patented predictive markets and a range of diverse evaluation mechanisms ensure solid engagement levels and optimal results.

Leading companies worldwide, such as Barclays, Ageas, Unilever, Altice, CTT and Carrefour, are successfully using Exago.

Executive Summary

In times of uncertainty, when business models are challenged, managers and financial directors are bound to cut costs, to make organisations more agile and robust, and adaptable to change. Leaders with a clear vision then tend to use cost-cutting and improvement to align costs with business strategy, to lower costs, focus on the aspects of the business that are controllable and free up resources to fund transformation and future growth.

However, aggressive cost-cutting tactics will not salvage companies under pressure. The change must go deeper, reaching a strategic and cultural level. This means that a company's most valuable assets, people and their talents, must be mobilised to innovate and to find new ways of doing that not require high investments in new products' research and development. Together you can save substantial amounts of time and money.

We show you how to add strategic cost-cutting and improvement to your innovation agenda, and how the development of an innovation culture is a powerful tool to align people's focus, change behaviours, save costs and deliver continuous and effective results. To make it work, we guide you through the following five steps:

1 **Define your strategic cost-cutting goals, which can be incorporated in your innovation agenda.**
You need to have a clear view of your company's strategy and map out good and bad costs for programme intervention, at macro and micro levels. On the one hand, bad costs should be seen as those which do not align with the growth strategy. On the other hand, good costs are those that support business capabilities to achieve growth and may be worthy of more investment.

2 **Guarantee C-Suite engagement from the beginning and have a clear direction for your cost strategy.**
You should deliver cost optimisation with the CEO's and top managers' support, defining areas of improvement from the beginning, as well as how to address each of these areas.

3 **Invest more on bottom-up approaches, engaging and having your people contributing.**
Simply externalising tasks and reducing headcount are often ways to overshadow a complex problem. You need to call on people's knowledge and experience to help you separate the wheat from the chaff and find concrete and innovative solutions.

4 **Be resilient in creating a cost-conscious culture for continuous optimisation of resource use.**
Over time, as you seek new ways to rationalise and optimise costs, a new culture of strategic cost-cutting will be embedded.

5 **Explain to your workforce your shared mission and remove fears**, ensuring that both needs and strategy are consistently understood across the organisation. Your employees must feel they have a role to play and can have an active voice in the decision-making process, being welcomed in the discussion about the best ways to reach the proposed goals.

A well-structured innovation management programme for strategic cost-cutting and improvement can be particularly useful to get employees identifying ground-level enhancements, with several additional advantages: allowing you to develop a cost-conscious culture, easily uncover bad costs and inefficiencies, assure more dialogue and engagement and build up an ongoing, resilient process.

Strategic cost-cutting is never blind cutting. It is, in fact, a method to accelerate the discovery of new and more effective ways of doing business, at a lower cost, challenging you to look at the larger picture, to seek the root cause of the problem. It should be seen as a way of questioning how we do things, even why we do them, exploring new innovative routes and building the foundations of tomorrow's growth.

I. Uncertain times require strategy and costs reduction alignment

At the end of the 20th century and in the early 21st century, CEOs were mainly focused on growth and innovation and on how these combined to deliver real results in organisations. Yet CEOs have become more pessimistic in the last decade, as world turmoil has intensified, innovation has failed to deliver the promised land and growth has become a more elusive and complex goal to reach.

Long-term stability is highly unlikely, and we all have questions and uncertainties churning in our heads, CEOs included. They are, right now, looking for answers and for ways to include their organisations in possible solutions. But too much indecision remains: How will the European Union redefine itself and what will it mean for trading within and outside its borders? What impacts will Trump's election have in the medium to long term, in the US, with its main partners, and also around the world? What's next for the United Kingdom? Will Turkey still be in NATO in two years' time? And how does all this combine with the ongoing work and technological revolution?

Political uncertainties can strongly impact the volatile financial markets, as the Euro area recovers from the banking crisis, deals with Brexit, with the refugees' migration crisis and with the impacts of the US election on the European currency. The huge Chinese economy is also expected to continue reflecting weak exports and decelerating investment and its growth has slowed to its lowest rate in 25 years (though still near 7 percent). Japan is stuck in a decades-long recession, while the US economy is highly dependent on political decisions, with outcomes difficult to foresee.

In a weak growth environment, with low investments and rising risks, companies gamble on cost-cutting to ensure that they are prepared and equipped to grow stronger, as they wait for better times to come. In its 2013 third biennial cost survey, 'Save to grow. Cost-improvement practices and trends in the Fortune 1000', Deloitte underlined that cost-cutting was seen more and more as a 'way to drive growth, rather than as way to survive or avoid insolvency'.

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With recession, macroeconomic concerns, digital disruption and commodity price fluctuations fuelling uncertainty, Deloitte's 2016 data further illustrates this shift from survival to growth. Its fourth biennial cost survey shows that the 'save to grow' strategy of 'using cost reduction to fund growth initiatives' remains prominent today.

However, in 2016, many US companies were 'simultaneously pursuing seemingly conflicting goals of aggressive growth and aggressive cost improvement'. Deloitte calls this the 'thriving in uncertainty' paradox. Then, whatever the future holds, the key to cost programme success lies in 'choosing a cost management strategy that aligns with your company's needs and is capable of delivering the required level of savings'. In this context, tactical initiatives to pursue aggressive cost targets will not be enough, and are likely to be 'a recipe for failure', the report adds.

The change has to go deeper then, beyond tactics, reaching a strategic level. This means that a company's most valuable assets, people and their talents, become top priorities, 'consistent with a growth mindset, since having qualified workers and deploying them effectively is key to successful growth', writes Deloitte.

Deloitte's first biennial global cost survey report, "Thriving in uncertainty in the age of digital disruption", published in late 2017, reaffirms that cost can be a strategic differentiator in a "rapidly changing global business environment". The study also focuses on how advanced technologies can impact costs and transform cost structures. Robotic process automation and analytics/cognitive technologies in particular are "enabling new levels of operating efficiency that can turn cost into a major competitive advantage".

A successful cost-cutting strategy is then connected to the organisation's capacity to evolve, to innovate, and to do it as whole. Companies can, in fact, keep innovating in ways that do not require high investments in new products' research and development, and which can save substantial amounts of time and money.

This process should start internally by capturing the wisdom of each employee, but can also reach external stakeholders, harnessing their potentially powerful insights, creating communities around the company and building communication bridges with clients and suppliers. By listening to all these voices, and collecting their workforce's diverse expertise and know-how, organisations can avoid waste, concentrate energies and operate in a more efficient way – thus getting prepared to react and adapt to continuous change. Losing 'fat', as we know, makes us more agile, and agility is key in our times.

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In this sense, leaders with a clear vision tend to use cost-cutting to align costs with business strategy. 'Strategic cost-cutting' helps companies lower costs, focus on the aspects of the business that are controllable and free up resources to fund transformation and future growth. Innovation management does not offer magic formulas to do this, nor to mitigate slow growth. Yet sustainable growth, by its essence, cannot exist without ongoing innovation.

In this paper, we seek to understand in more detail what a strategic cost-cutting approach is and how it can be important for companies in our economic environment. We highlight also how an innovation culture is fundamental to implement it, guiding you through five major steps to make it work in your organisation.

II. How to map and classify costs to open the path to growth

At the top of the CEO's agenda today, we find overregulation (79%), geopolitical uncertainty (74%) and exchange rate volatility (73%), according to PWC's 19th Annual Global CEO Survey. Global growth is something CEOs are not putting faith in during these times of uncertainty, as Figure 1 shows.

Only 35% of CEOs believed, at the beginning of 2016, that their own companies could grow during the year. This was the lowest percentage since 2010 and, as the political agenda unfolds, optimism is likely to fall again in 2017.

1. CEOs' confidence in global economy and business growth prospects in uncertain times

From PWC 19th Annual Global CEO Survey, January 2016

Political instability, terrorist acts across continents, the refugees' crisis in Europe, the BRIC's slowing economies, stock market volatility, the Brexit process, the US elections... Tumultuous events in the news are putting CEOs on guard. In such an edgy environment, management is naturally driven to use cost-cutting to align costs with business strategy. Strategic cost-cutting is a path companies take to resist hardships, become resilient and prepare for more solid growth opportunities. It focuses efforts on business areas that can be controllable, freeing up resources for transformation and future growth.

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All companies have encountered this reality in the last decade. However, blind cost-cutting, not aligned with strategy and sustainability concerns, may be dangerous. An arbitrary, opaque and misunderstood corporate cost-reduction policy will alarm employees and disengage them from business strategy and leadership's main goals.

Cost-reduction programmes have time and again failed in the past. In its 2012 report, 'Stop cutting and start optimizing IT spend', KPMG says these initiatives flop due to unclear cost drivers, overly cautious cost strategies and the fact that cost discipline is not embedded in a company's culture. Success depends on cost discipline as well as on changing behaviours.

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So what should you change? Where exactly should you cut? And how can you do it to make sure you move forward, finding new and better products and services and building a company fit for any future scenario?

To help you establish a strategic cost-cutting strategy within your innovation management initiative, we next share five major steps you can take to ensure that your business remains competitive, relevant and able to maximise its potential in the face of less favourable circumstances.

STEP #1: Define your strategic cost-cutting goals, which can be incorporated in your innovation agenda

Have a clear view of your company's strategy and map out good and bad costs for programme intervention, at macro and micro levels. Understand which costs can be cut and improved within your innovation agenda.

The starting point for any strategic cost-cutting initiative is a clear understanding of a company's strategy – of where you want to go to and how you believe you can get there. You will need to determine priority areas and find the right cost-cutting structure, given the strategy you want to pursue in the near future, but also in the mid to long term. Some cuts are fundamental and highly advantageous, but more difficult to make, and imply structural change and preparation for that change physically, technically, and even mentally.

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Having in mind your company's vision and strategy, you need to set your programme's specific goals. The cuts you may want to make and the ideas you may implement to meet those goals should position your organisation for growth, and can be done at both macro and micro level.

2. The nature of macro and micro-level cuts

Macro-level cuts and improvements (transformational and structure-related/top-down and board level)	**Micro-level** cuts and improvements (operational and ground-level related/both top-down and bottom-up)
Diagnosis and implementation: facilitated, typically contracting external experts **Sources of knowledge:** inside management knowledge + external expertise **Decision-making:** by the leadership **Target:** focused on transformational improvements that typically affect more than one business unit or department; these can include process outsources, product and service lines redesign, workforce adaptation, etc. **Financial and risk impact:** Potentially higher returns (>25%), but with higher risk/lower probability of success.	**Diagnosis and implementation:** collaborative, typically involving employees **Sources of knowledge:** daily and practical information + harness expertise and knowledge (may include stakeholders' expertise) **Decision-making:** by the leadership + company's collective intelligence **Target:** focused on streamlining and/or redesigning business processes, procedures, products, materials and practices in specific business unit or departments. **Financial and risk impact:** Potentially lower (5–25%), but with low risk/high probability of success.

Innovation management platforms are particularly useful for companies to identify relevant cost-cutting or cost improvements at micro level. These tools give voice to employees from different departments and across borders, leveraging the cumulative business knowledge and allowing voices and ideas to surface and reach management in an effortless and efficient way.

Nevertheless, let's not oversimplify the subject – that's exactly what you should avoid. Both macro and micro-level-oriented strategies have value and they often make more sense combined.

1.1. Identify the bad and the good costs, at both micro and macro levels

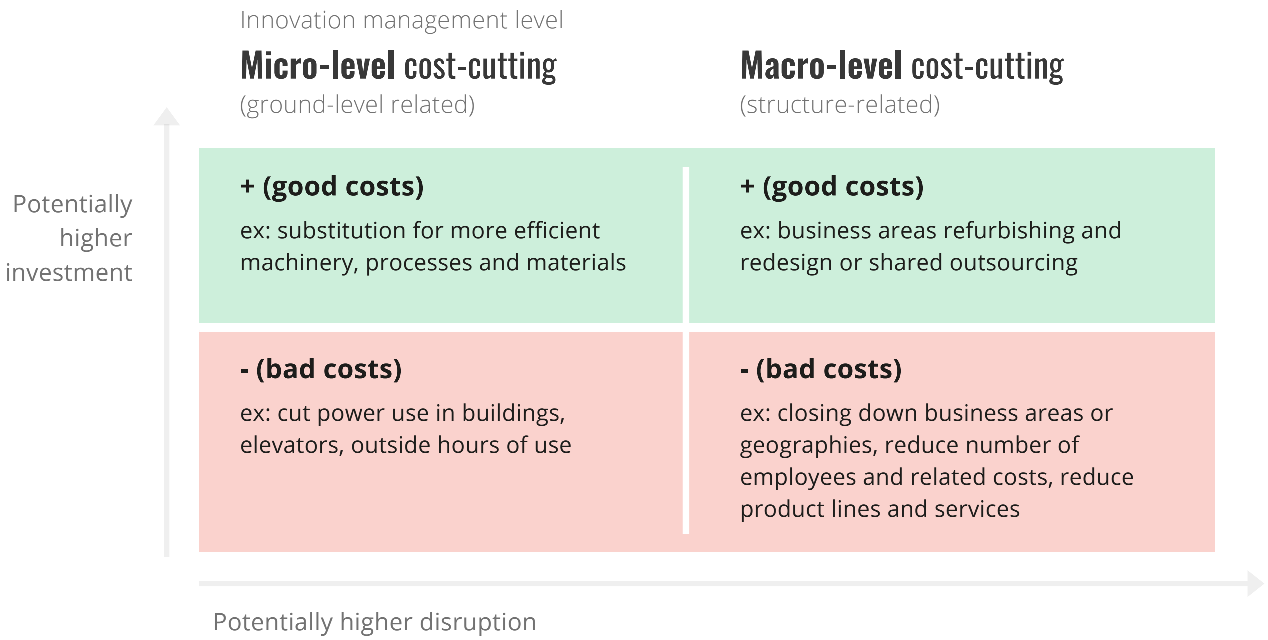
At a more tactical level, and in line with your strategy, you also need to look at your whole organisation and differentiate between the critical 'good costs' and the non-essential 'bad costs':

- Bad costs are those not aligned with the overall growth strategy of the company;
- Good costs support the business capabilities needed to achieve the overall growth goals.

In an online article in Forbes, PWC's strategist, Rodger Howell, says that 'once a company's costs are classified, strategic cost-cutting and improvement become a process of minimising exposure to bad costs and maximising investment in the best ones'. He adds that this practice helps to 'create a more resilient growth model', which is 'particularly important during times of uncertainty'.

These bad and good costs can happen at both micro and macro level, as Figure 3 shows. It is key that you keep this matrix is mind when defining your strategic cost-cutting and improvement initiative and its goals and how to address each quadrant.

3. Strategic cost-cutting matrix



Overall, the bad costs are waste and an outcome of inefficiencies, which can and should be reduced. Do not underestimate them. Even micro-level bad cost-cutting, such as reducing power and resources use, can have tremendous impact in your balance account. Not only are these costs easily identifiable by your employees, but they can also be incorporated in your incremental innovation agenda in ongoing challenges, so that you are always capturing and addressing new and existing inefficiencies.

Measures to cut bad costs at a macro level, such as closing units or laying off people, may however, have a stronger, higher and more immediate impact on your financial balance. But is it the way for your growth? We are not saying it isn't part of it, but there are other ways you should always consider as well. These costs are better leveraged by external teams carrying out a strategic analysis to understand which costs are no longer aligned with the organisation's strategy and can therefore be eliminated without negatively impacting core business.

On the other hand, good costs are those that support business capabilities to achieve growth goals. They may be, in consequence, worthy of more investment, so that in the mid to long term you end up saving more or increasing return.

At a more macro level, they will likely imply some investment and a more disruptive transformation, but can also have a larger financial impact. For instance, if you decide to redesign a profitable business area, you can open doors to new clients and markets and to higher returns.

At a more micro level, for example, by changing a product material or a method of doing things, you can also pave the way for an unexpected internal revolution. Here again your internal workforce can provide useful insights to redefine current products, services and processes. There is always space for improvement, and including this quest in your innovation agenda will help you structure and centralise the process, thus reducing investment in external advisory services and bringing interesting and relevant inputs for your business aligned with your needs.

There is no magic formula and no equation tells you how and where to cut exactly. Our main message is: remember to look at the bigger picture and understand which methods are more efficient in which situation, so as to develop an effective strategic cost-cutting and improvement strategy.

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This process of employee engagement and empowerment will also make your organisation more future-fit and will create a cost-conscious culture, essential to creating a sustainable cost-cutting and improvement strategy.

STEP #2: Guarantee C-Suite engagement from the beginning and a clear direction for your cost strategy

Deliver cost optimisation with the CEO's and top managers' support, helping you clearly define areas of improvement from the beginning, as well as how to address each of these areas.

A cost-cutting initiative needs to be run as a strategic initiative with the same board sponsorship, direction and accountability as any other critical initiative. It is important to ensure central governance, senior management agreement and employees' engagement. The centralisation of a cost-cutting initiative is vital to avoid project duplications, to benefit from synergies and to focus on clear areas of improvement.

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However, the initiative should also have branches and an army dispersed across the company, mobilising directors and managers of the different areas around this movement and opening minds to collect insights from every contributor. Right from the point of planning your initiative, make sure you identify the sponsors from each business area of the strategic cost-cutting and improvement programme.

People with the capacity to take decisions based on employees' insights must be mobilised and should have defined timeframes to gather specific insights and execute changes. In other words, the cost strategy should be promoted by the company's leadership, sponsored by the management team and be engaging enough to capture employees' participation.

STEP #3: Invest more on bottom-up approaches, engaging and having your people contributing

Call on people's knowledge and experience to help you separate the wheat from the chaff and find concrete and innovative solutions, mainly at micro level.

Employees deal daily with inefficiencies in your company. They often have diverse and powerful ideas related to organisational processes and products. They also have opinions and insights concerning the areas and processes in which it could make more sense to cut or to invest in.

Top-down approaches sometimes bring your initiatives from micro level to macro level, relying on transformational opportunities to reduce costs. Yet they do it without looking at the whole picture, unable to identify the real inefficiencies, unable to create a sustained way to drive costs and to change inefficient spending behaviours.

You can save time and money by having your employees contribute ideas for the cost-cutting strategy, as well as cost-optimisation ideas that can transform and impact the company positively.

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Any 'reductions' or 'cuts' should aim at building a more robust organisation, in search of innovative ways to redefine itself. There are limitless options according to your reality. Have a look at some sample results from customers who incorporated a cost-cutting strategy in their innovation agenda:

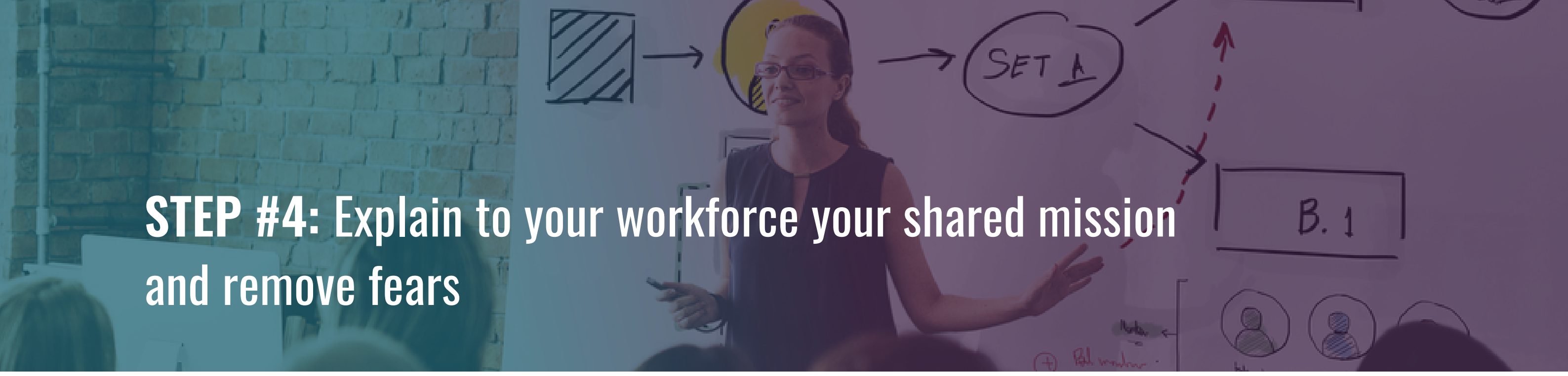
- A client was able to streamline its call centre customer support efficiently, improving service quality and vastly reducing the number of calls received by the customer service department, simply by adopting different colours for cables, routers and set-top boxes;
- They also saved €2M with a new, eco-friendlier packaging system;
- By selling in-stock obsolete assets to employees interested in buying them, an organisation generated a new revenue source and freed storage space, allowing a much more rational use of space;
- Another client embraced distribution of administrative documents by bike, a cool and eco-friendly idea with significant results: by replacing 30% of the motorcycles with bike couriers, costs for distribution were reduced and almost a ton of CO2 emissions was saved in just seven months.

Simple ideas such as ‘set as default printing on both sides’, ‘reduce the number of floors or buildings being used during night or weekend shifts’ or ‘use more efficient watering systems in the green areas of the company’ can have significant impacts on your costs. What’s more, they can boost morale by promoting a culture of sustainability, in all corners of your company.

In large multinational companies with multi-regional presence, it may, however, be difficult to listen to all your people on the ground. Through its capacity to engage employees across borders, an innovation management platform becomes a powerful tool. If this is the case in your organisation, make sure you get a solution that offers multi-language features – where employees can have access to the content and strategic cost-cutting challenges presented by management in their native language and make use of their business knowledge to create ideas and help others improve theirs.

Your idea management platform should be centralised, but allow for the creation of target and country communities to which specific challenges can be issued. Think, for instance, how remote the problem of wasting paper bags in your stores in the US can seem to someone building components in Asia.

Gamification elements are also valuable, as they are designed to capture different types of participants, to develop greater loyalty and promote higher use. Participation will be more frequent when users feel their ideas and insights are valued and turn into real solutions.



STEP #4: Explain to your workforce your shared mission and remove fears

Ensure that both needs and strategy are consistently understood across the organisation.

Typically, cost-cutting is an expression that frightens employees. It immediately suggests salary reductions, job cuts and increased individual workload.

It is therefore important that the community clearly understands that a strategic cost-cutting and improvement strategy can assume an innovative role in the company. It doesn't relate strictly to cost reduction for specific areas but it can, instead, help you collectively find and assess new and more effective ways of developing a process or product at a lower cost, cutting redundancies and waste.

> *It is important that the community clearly understands that a strategic cost-cutting and improvement strategy can assume an innovative role in the company.*

From the beginning, the communication and marketing departments should be involved in the programme, to present a comprehensive plan capable of reaching the entire workforce. Your goal is to inform employees, help them understand what is being done and why, and create empathy with the common challenge faced.

Aligning employees with the companies' goals will contribute to aligning costs with strategy. Remember that everyone in a company can play an essential role in identifying 'bad' and 'good' company costs, mostly at the micro level. Besides the innovation management platform, brainstorming sessions with employees and among teams can also be very useful to categorise the existent costs and to collect insights on future good costs and potential investments needed.

This continuous engagement of your workforce will also make your employees more cost-conscious, imposing a more effective cost and spending culture.

STEP #5: Be resilient in creating a cost-conscious culture for continuous optimisation of resource use

Over time, as you seek new ways to rationalise and optimise costs, you embed a culture of strategic cost-cutting.

Your ultimate drive is to create a cost culture that sustains itself over time and is not forgotten three months after being announced by the leadership. Your ultimate goal is that your workforce feels that the organisation's investments are personal investments, which can benefit all.

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Still, organisations are living creatures in changing contexts. So, strategic cost-reduction priorities should be regularly reviewed and updated in the same way as business opportunities are.

And so we find ourselves where we started: needing to map out intervention areas, both at micro and macro level, both good and bad costs, and clearly define and (re)align everyone with your cost strategy over time. Ensure that you have in place the best methods to address each area in an efficient way, using top-down yet privileging bottom-up approaches.

For bottom-up approaches, also review the communication plan at hand, to help your employees understand the tweaks and turns. Let them have an active role in the process of building the company's future together.

It will take time and some effort, since resistance is normal under less favourable circumstances. It will take people's commitment. Yet, with strong leadership, a clear and well-defined strategic cost-cutting programme and the awareness of shared responsibilities, an organisation can reinvent itself and learn how to do so continuously, as models are challenged and new opportunities arise.

III. Transforming cost-cutting into growth

In times of uncertainty, when business models are challenged, managers and financial directors are bound to cut costs, to make organisations more agile and robust, and adaptable to change. Books do not set out which costs are good or bad for a specific company, or how they impact business strategy and operational reality. No measure fits all.

A successful strategic initiative thus implies the definition of specific priorities and mapping out what can be potentially bad and good costs, at different organisational levels:

- On the one hand, bad costs should be seen as those which do not align with the growth strategy. They are waste and an outcome of inefficiencies which can and should be reduced;

- On the other, good costs are those that support business capabilities to achieve growth goals, and may be worthy of more investment – so that in the mid to long term you end up saving more or increasing return.

In this process, it may seem easier to make centralised decisions at the board level, at a more macro level, with potentially higher impacts. Yet, simply externalising tasks and reducing headcount are often ways to overshadow a complex problem. Strategic cost-cutting challenges you to look at the larger picture, to seek the root cause of the problem, and to transform the system and its architecture.

In other words, the change must also happen from the bottom up, always with the right leadership and sponsorship, to define the areas of improvement clearly. The employees' community has to understand what's happening, and to share and collaborate with the company's challenges. They must be aligned with the business strategy and feel they have a role to play and can have an active voice in the decision-making process. As an interested party, they must be welcomed in the discussion about the best ways to reach the proposed goals.

A well-structured innovation management programme for strategic cost-cutting and improvement can be useful to get employees identifying ground-level enhancements, with several additional advantages:

BUILD A COST-CONSCIOUS CULTURE

Involving employees and challenging the organisation's cost and waste culture will help you develop a cost-conscious culture for a more sustainable business approach. Keep cost optimisation as a strategic priority, even when there is no immediate pressure on costs;

AN ONGOING AND RESILIENT PROCESS

Having your cost-cutting and improvement strategy embedded in your innovation management programme will bring you continuous results, building a sustainable process and putting more robust and flexible foundations in place before introducing transformational initiatives.

EASILY UNCOVER BAD COSTS AND INEFFICIENCIES

Engaging and empowering everyone in the organisation, from shop floor to top management, will expose inefficiencies that would not usually be identified in a typical consulting diagnosis project. Your employees know more about your everyday business than anyone else, so tapping into their knowledge and efficiently getting everyone involved in signalling cost improvements will deliver interesting results for your strategy;

MORE DIALOGUE AND ENGAGEMENT

With effective and transparent communication regarding cost cuts and improvements, companies can face less resistance from employees and more easily ensure business management support. It can also bring higher employee engagement, as more frequent interactions are needed between finance and the operating managers and between managers and teams to keep costs aligned with business and to track results;

Strategic cost-cutting is never blind cutting. It is, in fact, a method to accelerate the discovery of new and more effective ways of doing business, at a lower cost, which is even more relevant in difficult times. On the whole, it should be seen as a way of questioning how we do things, even why we do them, exploring new innovative routes and building the foundations of tomorrow's growth.

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