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How to cut costs — and get your employees to help

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About the author

Jon Katzenbach is a senior executive advisor with Strategy&. He is one of the co-founders of Katzenbach Partners LLC and has expertise in helping clients mobilize their informal organization to realize performance advantages.

Introduction

As companies facing the 2008 current economic downturn launch cost reduction initiatives, the prudent ones will make cuts in a way that works with their company's culture, rather than against it. Many companies ignore the critical need to secure employee commitment when making cost cuts, which is one of the reasons why only 10% of companies sustain cost reductions after three years[1]. Specifically, it is critical that companies planning cost reduction initiatives obtain the positive emotional commitment of their employees to support decisions and to commit to behavior change that reduces costs. A truly committed workforce can reduce costs more and sustain the reductions longer than a workforce under duress.

Of course, no one is arguing that headcount reductions are intrinsically motivating. Still, some companies have implemented cuts in a way that links the cost reduction to a more motivating objective, fostering employee involvement and commitment. For instance, in 2007, Novartis cut $1.6 billion in costs, including a 10% reduction in headcount at headquarters. In parallel, the company put in place a new strategy to enhance its focus on high-growth brands, including a new business unit structure and improved capabilities in brand agility and field sales. In other words, Novartis' cost reduction was approached in a way that harnessed employees' commitment to building a stronger and more nimble company focused on growth. While reducing headcount was not a highly motivating objective, strengthening the company for future growth clearly was.

The task of securing employee commitment to cost reductions is not easy, and it rarely depends on money alone. Rather, it requires paying close attention to a set of principles through an approach we term motivating cost discipline (MCD), which enables fast and sustained cost reduction in a way that involves and motivates employees. There are six principles in the MCD framework.

1. Institute a **fair process** based on shared values

2. Establish **leadership cohesion and commitment**

3. Create the **emotional** as well as the rational **business case**

4. Enlist the help of **frontline motivators**

5. Involve the organization in **considering costs from four angles**

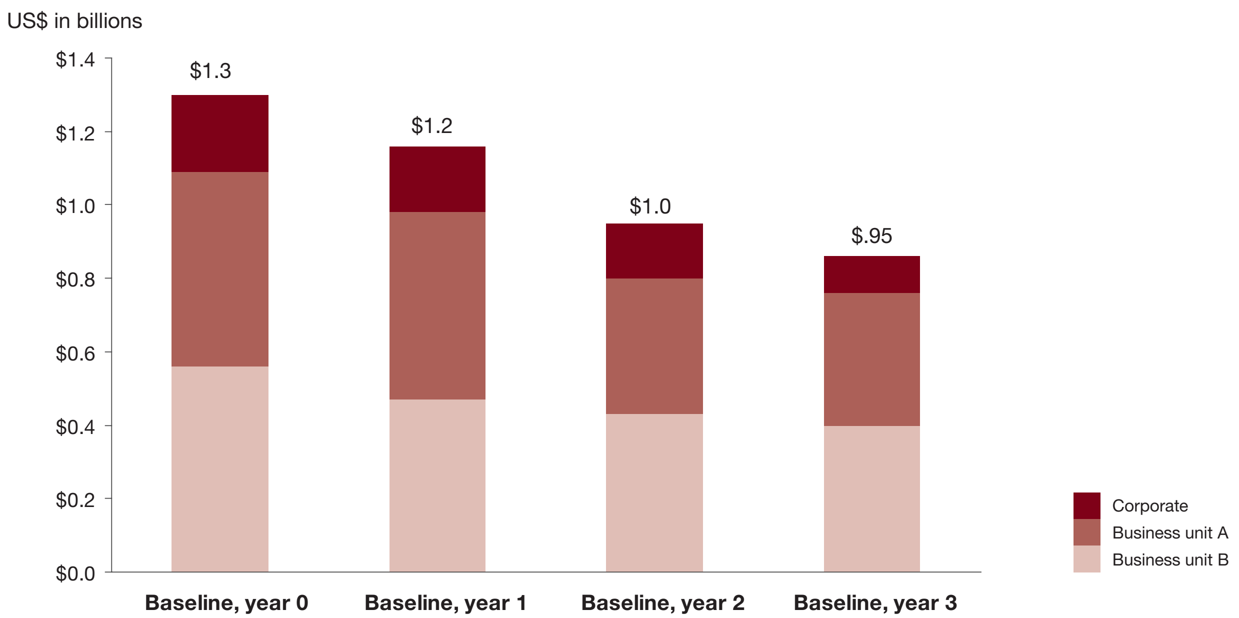
6. Implement **organizational solutions** that create lasting behavior change

These principles were effectively applied by a leading energy company that significantly reduced its cost base by integrating critical leadership objectives with a positive motivating approach (*see Exhibit 1, next page*).

At the same time, the company saw a twenty percent lift in measures of employee satisfaction and pride (*see Exhibit 2, page 6*).

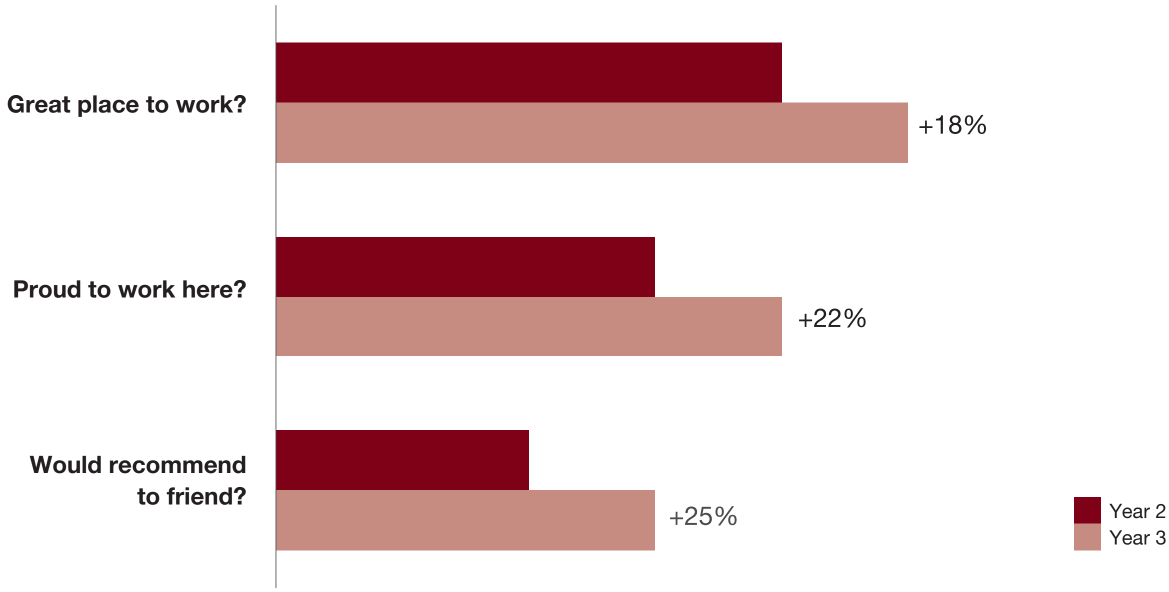
What is it that successful cost-cutting "motivators" do that allows positive feelings to counter-balance negative fears?

Exhibit 1
Impact of motivating cost discipline principles at a leading energy company



Source: Strategy&

Exhibit 2
Motivating cost discipline principles at a leading energy company — increasing employee satisfaction



Source: Strategy&

1. Institute a fair process based on shared values

Nearly all cost-reduction initiatives have a simple four-step process at heart: Structure the effort, including where a set of teams will focus efforts to uncover cost reduction opportunities; analyze the opportunities and make recommendations; decide on what cost reduction actions will be taken; and implement those actions. Companies need to apply a set of motivating cost discipline principles against these four steps (*see Exhibit 3, next page*).

Unfortunately, many cost reduction initiatives are not well-executed. The objectives are unclear, the process is not transparent, key constituencies feel excluded, and the initiative focuses on arbitrary objectives (e.g., pursuing cost reduction in only one part of the business). Such poor process discipline not only leaves money on the table, but is also demotivating to employees. When employees believe they are being treated fairly — when they feel heard, understand how and why decisions are being made, and believe they are respected — they are more likely to buy into a cost-alignment initiative. A lot of hard work is required — careful and frequent two-way communication, detailed process- and meeting-planning, and reaching milestones. Effective cost-cutters pay attention to these critical details and as a result, achieve a cost reduction process that is transparent, representative, fact-based, well-executed, and highly motivating. Some specific things they do include:

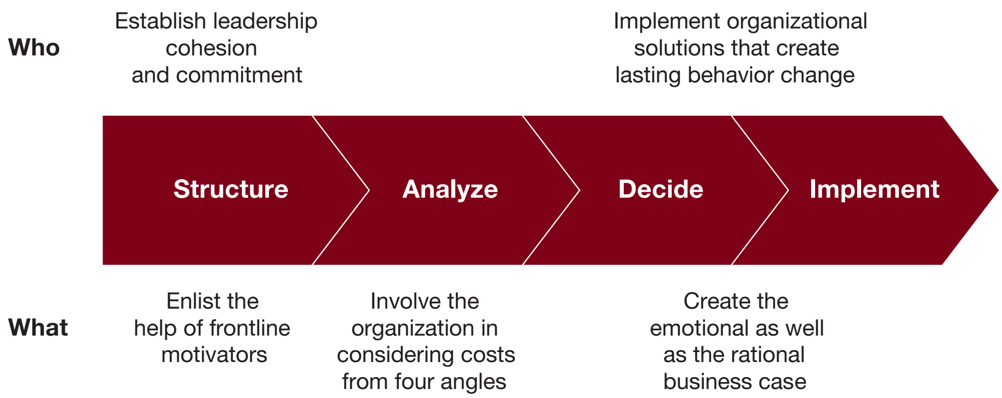
- **Communicate early and often** — Engage employees through a clear communication plan with several touchpoints (e.g., town hall discussions, blogs)

- **Solicit input** — Targets to force thinking are important, but targets may appear arbitrary without organizational input — Cost reduction teams need to have a say in how targets will be achieved

- **Move quickly** — Delays breed uncertainty, so it is important to establish a detailed timetable and to stick to it

Effective cost-cutters achieve a process that is transparent, representative, fact-based, well-executed, and highly motivating.

Exhibit 3
Fair process



Source: Strategy&

- **Provide support** — If layoffs are to be made, employees need adequate severance packages, counseling, and outplacement support. Managers need training to make alignment decisions, handle difficult discussions, and support remaining employees

- **Plan everything** — Have a well-thought-out process that anticipates employee concerns. Develop a set of guiding principles and business rules on de-selection before implementation to ensure that decisions are made fairly and consistently

Following these actions not only wins employees over but gains employees' initiative, support, and commitment to sustain lower costs.

Starting at a senior management retreat that launched the initiative, the energy company's leaders were always clear that the cost-cutting effort had five major elements.

To ensure a fair process, the company balanced this central mandate with significant local autonomy. Different groups were allowed to pursue savings on their own schedules, subject to an overall corporate time frame. Significantly, there was no "Black Friday" of job losses on a single day.

Key elements of cost reduction strategy at a leading energy company

1. Setting aggressive cost reduction targets — to ensure the company would be competitive under different industry scenarios
2. Building commitment from executives and frontline managers — to execute and sustain cost-reduction measures
3. Streamlining the organization — to strengthen it for future growth
4. Aligning compensation with market levels — to ensure people felt fairly rewarded
5. Redesigning critical processes — to integrate and sustain the cost reductions

2. Establish leadership cohesion and commitment

Too often, when a cost-reduction effort is launched, employees hear different messages from different senior leaders. Moreover, the exact role and authority of the program management office (PMO), let alone various leadership bodies, is often unclear with regard to the initiative. A cost-cutting effort may bounce between governance bodies that are competing for influence, creating inefficiency and confusion.

A motivational approach to cost-cutting requires leadership cohesion. Senior leadership must be visible, credible, and objective. A cost-reduction initiative must have clear governance (e.g., a steering committee) whose authority is clearly delineated vis-à-vis other leadership bodies, and which can drive execution through a program management and motivation office (PMMO) that pays close attention to stakeholder engagement. *Exhibit 4, next page,* illustrates this framework and some of the most critical factors to keep in mind.

Senior leadership must be visible, credible, and objective.

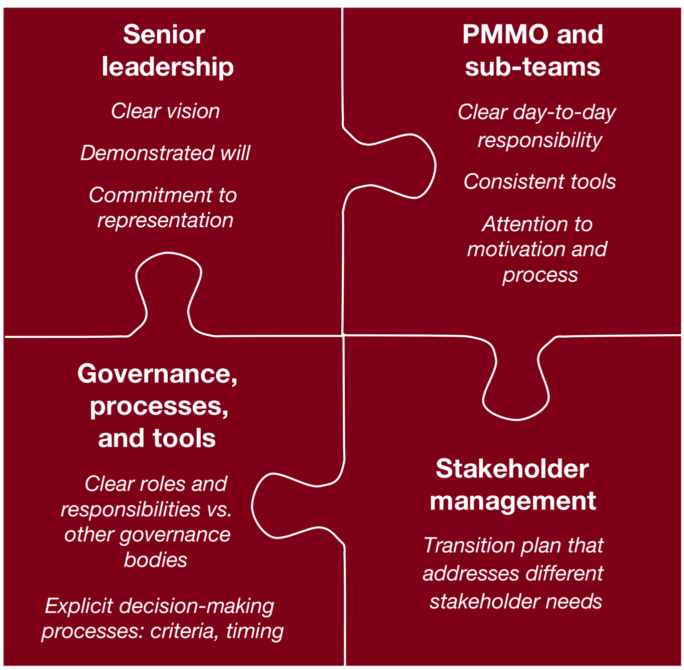
The energy company quickly established leadership cohesion and commitment and the leadership team drafted a set of values that would guide the company through a process of cutting its costs by over 30%. The team narrowed in on three values:

- Absolute integrity
- Collaboration, support, and respect
- Open, honest, and frequent communication

The leadership team committed to living these values as they guided the cost reduction effort. They began by creating many informal as well as formal opportunities for open and honest communication. For example, they hosted events like “Weekly Talks,” a forum where people from across the organization could hear a senior leader share his or her perspective on the issues at hand, and where employees could ask hard-hitting questions about the company’s future. Executives and employees started referring to the discussion at these events as

"Straight Talk." The phrase became a summary of what everyone was committed to: Talking and acting together — with integrity — to accomplish what needed to be done. A closely-working leadership team ensured the consistency of these messages.

Exhibit 4
Leadership cohesion and commitment



Source: Strategy&

3. Create the emotional as well as the rational business case

Executives can accept cost cuts based solely on a financial business case, but employees require an emotional case as well. Both cases need to be clear and well-reasoned. Companies need to develop an emotionally appealing theme (e.g., one that evokes pride, courage, respect, and/or care), as well as decide on the primary carrier or carriers of that theme (e.g., the company, the community, key customers, internal teams and networks, individual leaders) through facts, not guesswork. Like Novartis, they need a motivating objective beyond lower costs. *Exhibit 5, next page,* illustrates the sort of arguments that a company might consider using.

Companies need to develop an emotionally appealing theme.

The energy company conducted a survey of employees and learned that the two most important potential sources of pride were the company's reputation and the quality of its people. Consequently, at a time when significant reductions needed to be made, employees and leaders rallied around the company and each other. For instance, the head of the customer service group used informal events to make the emotional case for change, talking through the issues and taking action where needed.

Exhibit 5
Adopt an emotional case for cost reduction

Rational arguments

- Cost reduction will increase margins
- Cost reduction will increase shareholder value
- Cost reduction will enable efficient growth
- Outside providers will have lower cost/higher quality
- Etc.

Emotional arguments

- Sustained cost management will free up funds to, e.g.,
  - Fuel the creative process
  - Realize our mission
  - Improve fairness and transparency
- Streamlined processes will eliminate the barriers to doing what we love to do
- Outside providers will allow us to focus on what we are really good at
- Etc.

Source: Strategy&

4. Enlist the help of frontline motivators

Leadership on the frontline is at least as important as executive leadership. It is seldom possible to motivate significant behavior change by treating everyone the same; thus it is difficult to generate widespread behavior change in a top-down manner. Only direct supervisors can make personal connections that are individually meaningful. As a Campbell's Soup plant manager explained, "you need the right people on the bus and in the right seats." We call these supervisors who are able to positively motivate people to change their behaviors "pride-builders" because they are masters at making people feel proud of what they have to do every day, even when it involves intrinsically unpleasant tasks like rigorous cost control.

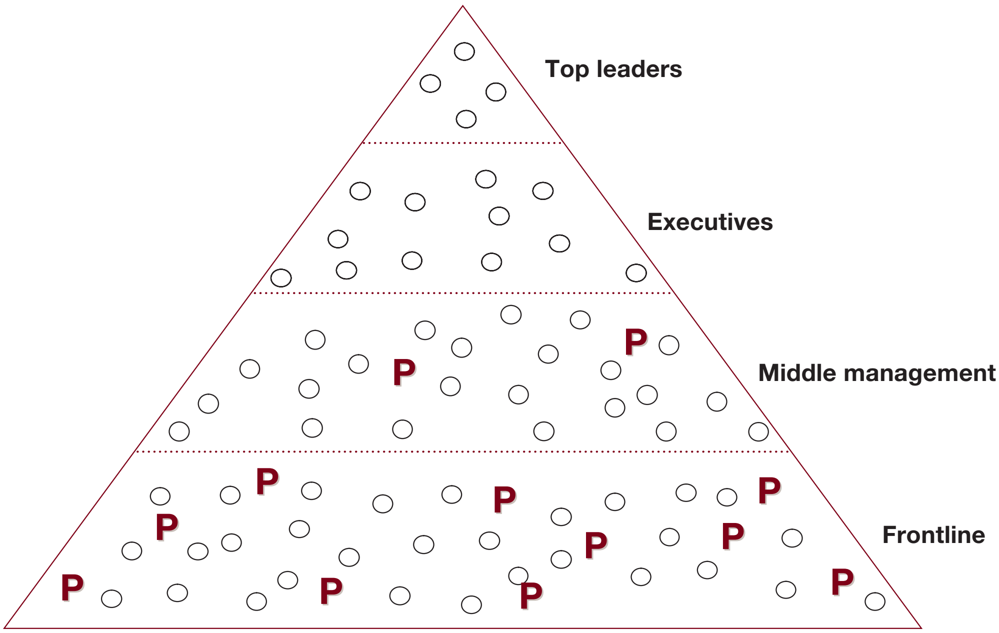
These frontline motivators are the supervisors who their people "would never want to disappoint." They have such deep understanding and respect for and from their people that they sometimes do things in their own way. For instance, when a frontline motivator at TNT, a leading distribution company, was asked to implement some headcount reductions, she took a distinctive approach. After announcing the restructuring and being very clear that it was inevitable, she consciously allowed for a mourning period for her people rather than rushing through a communication workplan and next steps. While that communication approach is not something that could be mandated from above or that would work in every situation, it worked for this particular supervisor in the situation she was facing. The "on the scene" motivator invariably creates unique sources of pride for each of his or her people.

Only direct supervisors can make personal connections that are individually meaningful.

A precious few of these influential motivators are located within every organization, though not necessarily in positions of formal authority (*see Exhibit 6, next page*).

How does one find and mobilize these pride-builders, marked "P" in Exhibit 6? Companies can usually locate the very best of them easily through interviews and referrals. Some "exemplars" stand out from the crowd. The more interesting challenge, however, is to find the "potential pride-builders" who have been hiding in the wings. To identify these critical leaders, it is worth considering a more rigorous

Exhibit 6
Frontline motivators and pride builders



Source: Strategy&

search such as Organizational Network Analysis (a systematic analysis of connections and exchange across an organization which, among other objectives, can identify which individuals have the most significant influence). Once a few of the pride-builders are identified, companies can leverage them in two ways. First, they can encourage the formation of communities of potential pride-builders focused on their emerging common interests and on objectives that may or may not involve cost. Pride-building behaviors can usually be spread "virally" among potential pride-builders more rapidly than through formal training programs. Second, they can ensure that potential frontline motivators are part of cost-cutting teams so that these teams are strengthened and gain respect and insight from these people's involvement and presence.

The energy company recognized that key influencers at all levels were needed to push the cause forward on the frontlines. Therefore, the company identified and mobilized frontline motivators in a systematic way, defining and setting responsibilities, budgets, and performance objectives through the process of what they called "Motivation Governance (MG)." The more formal elements of MG included a Motivation Champion, a Motivation Squad, and most critically, Local Connectors, who were responsible for carrying through motivation activities locally (e.g., a series of celebration events for achieving company objectives) as well as providing frontline perspective and upward feedback to the Motivation Champion. By striking the right balance between discipline and consistency on one hand, and flexibility and creativity on the other, the company was able to maximize the impact of its motivational efforts.

Ensure that potential frontline motivators are part of cost-cutting teams so that these teams are strengthened and gain respect.

Leaders need to take actions to support these emerging motivators and pride-builders, as well as reinforce the principles of leadership cohesion and developing an emotional business case.

"Top ten" leadership actions to motivate low cost behavior

1. **Adopt a credible motivating theme:** You need a rallying cry that is connected to people's positive emotions. Therefore, it is important to obtain the support of frontline supervisors who are respected for their integrity, realism, and unique ability to motivate their people.

2. **Prioritize what needs to change:** To realize your cost imperatives you need to be clear on the frontline behaviors that are most important to change.

3. **Identify a "critical core" of positive motivators:** Start with a dozen or so frontline supervisors who are well-known motivators

(pride-builders); often the people who leaders turn to for "getting tough assignments done well."

4. **Learn what they do that is unique:** True pride-builders invariably do a few things that most other good managers do not do. Determine what they do differently to motivate their people in difficult situations.

5. **Enlist their active help:** Once the "critical core" believes you are serious about needing their help, they are the best source of ideas for spreading their capability to others.

6. **Focus on a few key behaviors:** Concentrate on the three or four frontline behaviors that need to change in order to drive lower costs. Pride-builders can motivate virtually any behavior, provided they understand which ones matter most.

7. **Build pride-builder bench strength:** Develop a larger body of potential pride-builders (as many as 1,000).

8. **Develop informal "spreading" mechanisms:** Formal mechanisms are never enough to enable potential pride-builders to connect with one another in ways that spread and reinforce positive motivational elements.

9. **Nourish this emerging community:** Provide regular and clear information and credible stories about what produces cost containment behaviors. Find ways to ensure that it expands, circulates and builds momentum across the enterprise.

10. **Keep it positive, personal, and simple:** It is all about getting a growing cadre of frontline supervisors who can connect emotionally to help drive cost imperatives.

5. Involve the organization in considering costs from four angles

Executives require objective data to make critical decisions about where and how to cut costs. Multiple approaches are required to get everyone onboard. Too often, companies adopt one method (e.g., benchmarking) and impose it on the organization, ignoring the complexity of what actually drives excessive costs. Companies need to systematically consider costs from four angles, asking four key questions:

- **Product support level.** What is our organization doing that results in oversupporting products or producing unnecessary deliverables?

- **Organization efficiency.** Where do our structures and processes duplicate and create unnecessary cost?

- **People productivity.** How can we make improvements in the productivity of our employees by "shifting the curve" of people productivity?

- **External opportunities.** Where does our organization perform activities that others could do more cost effectively?

Some of these four cost areas may have more relevance than others to a given company's situation, but each should be considered. For instance, in considering "organizational efficiency," it is important to recognize that costs are often caused by too many layers or too many hand-offs. Companies need to explore these areas not only to capture the appropriate savings, but also to achieve employee buy-in. It is extremely frustrating to managers and employees to see that certain types of cost are "on the table" while other areas are treated as "sacred cows." Some examples and opportunities are laid out in *Exhibit 7, next page*.

Companies need to explore these areas not only to capture the appropriate savings, but also to achieve employee buy-in.

Exhibit 7
Consider costs from four angles

Product support level

Product support: Assess product costs vs. growth, profitability; reduce where needed

Activities: Eliminate lower-value activities through bottom-up, participative approach for generating ideas to reduce overall workload

Purchasing: Identify cost savings by seeking ways to align silo organizations against shared purchasing opportunities

External opportunities

Outsourcing: Assess opportunities for outsourcing internal functions/people based on understanding of relative costs and organizational needs

Labor mix: Evaluate mix of temporary and permanent employees based on need, cost, areas deployed, flexibility requirements, and expertise required

Organizational efficiency

Layers: Reduce duplication and inefficiency from excess hierarchy

Interfaces: Reduce costs of ‘hand offs’ between groups by restructuring responsibilities, reporting, and processes

Duplication: Evaluate similar activities performed by multiple groups and determine potential for consolidation

People productivity

Benchmark: Understand best practice output per employee

Relative productivity: Understand and address lower productivity employees

Compensation: Level set compensation compared with company/industry norms

Source: Strategy&

6. Implement organizational solutions that create lasting behavior change

A cost-cutting initiative needs to have impact beyond its own life, long after the PMO has disbanded. It is critical to avoid making a cost reduction initiative seem like a one-time event. Companies need to consider solutions that take full advantage of both the formal and the informal elements of the organization — integration and balance are key. A number of different organizational solutions are outlined in *Exhibit 8, next page*.

For instance, if employee attitudes and behaviors are causing excessive costs, it is important to adopt solutions that help address those behaviors. An example of a formal organizational solution would be to redefine and clarify job responsibilities. For example, AT&T Wireless was able to better control costs by creating better P&L discipline among its managers. At the group level, there may be a need to get different parts of the organization to work together in a way that reduces costs over time, often by employing informal organization solutions. For example, at Scholastic, there was a need to create a shared services organization to better manage spend across business units. Rather than creating an expensive new formal organizational structure with the associated hand-offs, the company created a council with clear authority and the right balance of membership.

The energy company's approach to locking in cost reduction was to focus on metrics that reflected extensive employee input, and consequently resulted in more buy-in than top-down imposed metrics. For instance, early in the costcutting effort, the customer service group identified four key metrics-related goals:

- Cut operating costs by $15 million
- Achieve 80% customer satisfaction
- Improve overall customer service rating to 90%
- Improve employee engagement, as measured by the company-wide survey

Companies need to consider solutions that take full advantage of both the formal and the informal elements of the organization — integration and balance are key.

Exhibit 8
Organizational solutions to create lasting behavior change

Examples

- Councils and teams that address cost reduction on a continuous basis without adding overhead
- Communities of practice that build, share, and practice cost discipline
- Connecting cost experts with those who can benefit from their expertise
- Communication and training to build capabilities and mindset for a "proud to be thrifty" culture

Examples

- Formal responsibilities for cost reduction (e.g., P&Ls)
- Metrics to incent low-cost behaviors
- Changes to decision-making processes to place more emphasis on cost as a criterion
- Systematic organizational and process redesign

Source: Strategy&

With these targets set, the customer service team pinpointed specific steps to reach their goals. For example, they began to focus on quality assurance rather than call time. The group also focused on the internal error rate. The customer service group achieved success on all four goals. Importantly, these targets were set and realized by members of the customer service group, rather than being imposed from outside. Moreover, the metrics were not just about cutting costs but rather about improving the business. As a result, the group achieved sustainable savings.

Summary

Cost-cutting can be motivated in an emotionally compelling and positive way by trying the effort to a positive outcome for the company and its people. Doing so requires rigorous structuring and execution of efforts that obtain employee buy-in and commitment to necessary decisions and behavior changes. It also requires a credible motivating vision of what the company can become. You may be able to mandate your way to an immediately lower cost structure, but if you motivate people in positive ways that produce emotional as well as rational commitment, you will get more costs out sooner, and the benefits will be more lasting.

Endnote

[1] "Managing Overhead Costs," Suzanne P. Nimocks, Robert L. Rosiello, and Oliver Wright, *McKinsey Quarterly,* May 2005.

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