

Cost Reduction (without tears)

1: How did we get here?

A good place to start is a few years, or stages, earlier and understand the reasons why the business is at its current position. Read the approval applications, the business plans and so on. Who made the decisions and on what information? This will identify the stakeholders in the changes that will be needed.

2: Some rules, before we start

'Cost reduction' is a game with important rules which should be set down in a written brief, recording the limiting factors such as timescale and available extraordinary funding. That way, later there will be no selective memory as to why some areas were explored and others omitted.

3: Net cost savings

Build credibility by always stating savings on a net of costs basis. Consider stating potential savings with their probabilities, say, 'near certain' say 90%, 'most likely' say 70%, 'probable' say 60%, along with time to realization on the P&L or balance sheet. Avoid overly sophisticated approaches such as Monte Carlo simulation.

4: Sustainability

Cost savings are usually stated as one-time or recurrent (e.g. annual). Some recurring savings don't actually last forever (e.g. the lease will eventually expire) so make this clear

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to avoid other people mistakenly overstating their magnitude.

5: Timescales

Timing of savings can be a big issue, particularly if there are balance sheet reporting deadlines. Indeed, some savings are meaningless after a certain date. You need to carefully control the knowledge of deadlines, as prior knowledge by others can hold you hostage, e.g. a buyer can exploit the need to close before a certain date. Public announcements are best avoided for similar reasons.

6: Extraordinary costs

Some one-time costs may need to be expended to deliver on a plan. This leads to a front loading of costs before the savings can kick in. You will need to ensure that this funding is available before developing front loaded cost reduction plans. What is an acceptable budget?

7: Information is everything

You will need a lot of information to formulate proposals, and will spend a lot of time assembling data from many different sources. You will spend even more time refining it into presentations etc. Consider giving this aspect of the project to an appropriately skilled person.

8: Trusted data

Always distinguish data you receive and act on as green or red, trusted or untrusted. Green data is usually assembled by independent parties who place their reputation (insurances?) on the line. Red data has no such assurances attached.

9: Cost centres and recharging

Are all the costs being tackled controlled by the cost centre with the management control? E.g. the energy being consumed by business

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units may be accounted for in the facility manager's budget; and vacant space that has been given up by business units that may still be paying for it.

10: Benchmarking

What is achievable in terms of cost reduction may well already be the norm for your competition. Factor this possibility into the brief by measuring achievement relative to competition in critical areas. A good example of this is relocation of back-office functions to low cost districts and adoption of new workplace strategies.

11: Motivation issues

Do the people affected by the initiatives see any benefit for themselves? Lack of alignment here will have to be addressed at some stage; how long have you got?

12: Cultural sensitivities

Some cultures place a lot of importance on appearance. Not having that corner office is hard to explain. Closing down a branch office signals poor performance or bad product. If this is the prevailing view and it stops the saving being realised, at least the business will know the true cost of holding on to so called 'cultural values'.

Cost Reduction (without tears) continued

13: Gather supporters

The best cost reduction projects are multi-disciplinary. You need supporters from IT, HR and so on. Have they got the same brief (see point #2)? Is there a possibility that when that extra mile is called for, they will be unsupportive (see point #16).

14: Nine box grid

We use a standard model for defining cost saving initiatives in real estate and facilities management, placing initiatives into a grid of 9 'boxes' (see diagram). Across the top is the time horizon, and on the vertical axis is the value. Some marginal initiatives are worth it for other reasons. Every estate has a natural cost saving profile arising out of events such as lease renewals. This grid captures those and then brings them forward in time, while trying to preserve net value.

15: Driving through change

Post approval, when the reality of what is going to happen sinks in, progress can grind to a halt. Suddenly there are lots of 'show stopping' reasons why this cannot continue. The best ones are technical e.g. the IT guys say it is not possible to relocate the systems. Can show stopper issues be isolated early and worked on as sub-projects?

16: Dead opportunities

Some potential ideas get killed off at birth – or do they? Try to keep as many initiatives alive for as long as possible. Keep a note of initiatives passed over. Things change, and people see the (political) sense of supporting something

	SAVINGS THIS YEAR	SAVINGS NEXT YEAR	SAVINGS IN 3+ YEARS
HIGH NET VALUE	Re-organise so as to delay spend projects	Renegotiate lease	Relocate to less expensive space
MEDIUM NET VALUE	Re-negotiate service contract service levels	Improve space utilisation	Adopt new ways of working; downsize further
LOW NET VALUE	Improve energy efficiency	Adopt low energy consumption policy	

Example of nine box grid savings initiatives

(This diagram shows only one initiative per box, usually the specific context gives many.)

which one week earlier they would have gladly buried.

17: Sale and lease back projects

If this is so good, why not do it at the height of the market? As a cost reduction exercise, it's one short of a fire sale and will have long-term repercussions on flexibility of tenure, etc. For this reason, it is not to be undertaken lightly. Best to view as balance sheet engineering.

18: The 'too difficult to do right now' shelf

Most senior managers have one of these and would love to reach up and grab that tricky project. Now, this real estate cost reduction initiative may be just the opportunity (smoke screen). Proceed with caution: **whose victory are you fighting for?**

19: Killing the messenger (again)

A by-product of cost reduction exercises is the opportunity to observe how a business makes wrong decisions, or makes good decisions unsustainable. Reporting on this sort of dysfunction needs to be handled with care.

20: Recognition

There is a saying "you can get almost anything done in this world, as long as you are willing to give the credit to someone else." There will always be people along the way who are hung up on recognition and will only co-operate if they get all the credit. Don't sweat it, it comes with the territory.

This document is part of the "20 Thoughts on..." series, available at www.casp-r.com

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