Cost cutting for growth: take advantage of the pressures of recession

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Is cost-cutting what you do in a recession or a crisis? Or can you cut your way to growth? A lot has been published about reducing costs while taking advantage of the end of recession. We have looked at the common themes. Reducing costs without a clear growth strategy is, as Bain says, like driving into a carwash with the convertible top down, but a recent survey shows that most companies do so. The effect is to solve some problems and create others.

Some companies use cost cutting as a chance to rethink the organisation. Those that are good at this cut their costs based on a clear understanding of:

1. ***What the sources of future growth will be:*** based on a fresh look at the market, customer needs and the competitive landscape
2. ***What the business model will be:*** how it will make money and what the key levers are to drive it
3. ***What the core capability is:*** the defining strengths that enable it to compete.

Getting the focus right

If cost cutting is focused on reducing, closing or selling activities that are not supporting these, then not only will it reduce costs, it will simplify the organisation, reduce complexity and free people to be better focused.

Zara can designs produce and distribute small batches of new clothes very quickly. Its cost base is higher than competitors, but it sells 85% of stock at full price (industry average 65%) with margins 55% higher. It has grown by protecting its core capabilities and business model. It has cut costs in IT, non-core purchasing and by delaying upgrades of existing stores. Sales and profit have grown through the recession.

US retailer Home Depot sacked CEO Robert Nardelli after he cut costs without this understanding. Home Depot’s strength used to be the experienced store staff that help DIY customers solve problems. These were laid off and replaced with fewer, younger, cheaper employees without the time or knowledge to provide advice. The core business was damaged and parts of the group had to be sold to restore finances.

Focus on supporting the right markets, service lines and customers

Understanding sources of growth means knowing ‘good’ customers from ‘bad’. Losing bad ones can save money. Amex offered cash to some customers to close their accounts. Costs can be focused on aspects of service or product that drive customer loyalty. One bank stopped a cash-machine upgrade and focused instead on making sure existing machines never ran out - more important to customers and it saved money.

Getting out of cherished projects that are not delivering, or much-loved older businesses with low potential is another way to save and focus – even if you sell them off at a low price. The key barriers to closing or selling activities are psychological biases in leaders, including the confirmation bias (looking for data that backs up the original reason for an investment and giving less weight to data that contradicts this) and focusing on a distorted view of sunk cost (saying “this has already cost us £100m and we have to make it pay which means spending more”). That is why Avon CEO Andrea Jung took Ram Charan’s advice to mentally “fire yourself and hire yourself” to help her quickly look at everything with fresh and objective eyes.

What the published material confirms is that cost cutting can be strategic, improve focus and drive growth.