

Can Cost Management Be Sustained?

Sherman Tan

29 Jan 10

Golden Age for Asian Economies

At the Commonwealth Economic Forum held in Taipei on 18 Jan 2010, Dr Tony Tan, deputy chairman of the Government of Singapore Investment Corporation (GIC) said that the global financial crisis has provided Asian financial institutions and markets a "golden opportunity" to breach the gap over the next few quarters to develop the regional financial and capital markets as he noted that the Western banking system, hampered by capital constraints and re-regulation, will likely not be able to intermediate the massive capital demand needed to finance Asian growth.

Dr Tan added that "The global recovery has generally been stronger than most analysts' expectations and could further surprise on the upside..." With such positive outlook, banks and companies in the region have resumed their hiring. Take DBS for instance, the largest bank in South-East Asia has plans to fill more than 500 positions across the region. In Singapore, the latest Hudson Report said that 51% of their surveyed respondents indicated they will increase hiring in the first three months of 2010 – a significant jump from the 34% in the previous quarter. The banking and financial services sector leads the field with 69% planning to hire more staff compared with 43% in the last quarter.

Reinforcing this positive economic outlook, the Global Economic Prospect 2010 Report released by the World Bank last week has raised its global growth forecast for 2010 to 2.7%. Notably, East Asia is expected to expand 8.1% this year faster than its previous forecast of 7.8% made in November 2009.

Cost Cutting Measures

Since Sep 2008, many financial institutions have embarked on a number of cost cutting measures ranging from hiring freeze, non-labour cost reductions (travel, entertainment, purchases, service contracts, etc), capital asset reductions (facilities and equipment) and curtailment or postponement of project implementation.

Other banks have taken on drastic cost cutting measures including the reduction of head counts and sale of business units/assets. In Feb last year, Royal Bank of Scotland announced drastic plans to cut some 10,000 to 20,000 jobs which were in addition to the 13,000 jobs it had cut in Apr 2008. The bank had also sold off part of ABN that it had acquired earlier. Other measures include employees taking pay cuts, bonus reduction and reducing the number of working days in the year.

Besides banks, many companies in other industries took similar cost cutting measures with the single purpose of tiding over the global economic crisis. Labour unions and employees have responded positively in view of the extent and impact of the crisis. However, as the global economy is showing signs of recovery, many organizations are pondering how to sustain these cost cutting measures as the impacts from the withdrawal of government stimuli and funding programmes are still uncertain.

In an online survey conducted by McKinsey in Nov 2009 ⁽¹⁾ covering 300 respondents around the world, 4 out of 10 respondents indicated that at least some proportion of the costs their companies cut since Sep 2008 will return. For those who doubt that their companies' cost cutting measures are sustainable are more likely to work for companies that implemented cost cutting measures "across-the-board". In contrast, executives who are confident that their companies' cost cutting measures can be sustained over the next 18 months are those that have taken on "targeted" cost reduction measures.

The authors of the survey finding also noted that while companies that employ an "across-the-board" cost reduction approach are often able to implement these measures relatively easily, quickly and appears "fair" to affected business units and other stakeholders, their experience noted that the more "targeted" approach will be more effective over a longer term and more likely to be sustainable.

Strategic Cost Management

In another study by Accenture⁽²⁾ that focus on the banking industry, it recommend that financial institutions adopting cost cutting measures must strike the right balance between short-term, tactical cost reduction (eg: headcount reduction) and longer-term, strategic cost initiatives (eg: streamlining processes and outsourcing of non-core functions such as HR, Finance and accounting).

During the global financial crisis, there were many organizations that went on to take some drastic immediate actions including taking very deep cut in their resource base. In my previous article in Nov 2008 "Leadership in Crisis", I explained that some organisations have chosen an immediate response to manage a crisis – this is often referred to as a technical or tactical response to a situation. It is not unlike a fireman putting out a fire. We have many such examples including DBS Bank which was the first bank in Singapore to lay off some 900 staff across the region in Oct/Nov 2008. Earlier in my article, you would recall that the bank is now planning to hire some 500 new staff. Organisations that take a longer term perspective will adopt a more adaptive approach. This approach often entails examining critically how to transform its cost base through strategic initiatives such as building organisation capabilities, optimizing operational processes and improving the process to bring products to the market.

The global financial crisis showed that size doesn't matter and the painful experience of pouring in so much tax payers' money to rescue mega banks that are deemed too large to fail has world leaders putting in measures to prevent banks from growing into such size. In the past, mega mergers have often been pegged on achieving economies of scale but such leverage no longer holds in the future.

Banks looking at embarking on cost cutting measures have to ensure that there are strategic imperative and most of all, the ability to sustain such cost management initiatives over time. For instance, HR departments will have to review staff hiring arrangement so that greater flexibility can be built into contracts to aid re-deployment, manage headcount and develop new capabilities in response to changing market conditions. Organisations that adopt the hire during good time and fire during crisis will lose out to those that build organisation capability throughout cyclic market conditions thus ensuring that core competencies and institutional knowledge remain within the organisation.

Managing cost reduction in a sustainable manner is a major strategic question not only for the management team but managers at all levels of the organisation. Interrogating each business and operational processes at each step of the value chain to ensure efficiency and risk compliance, removing silo sub-units that duplicate services, simplifying product manufacturing and distribution channels and organisation strengthening are some of the areas to be examined critically.

Notes:

⁽¹⁾ *What worked in cost cutting – and what's next: McKinsey Global Survey Results, January 2010. McKinsey Quarterly.*

⁽²⁾ *A Strategic Approach to Cost Reduction in Banking, 2008, Accenture.*

The writer is the Principal Consultant & Director at Innovar Pte Ltd (www.innovar.com.sg). He can be contacted at office@innovar.com.sg.