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The House of Rolling Heads

Traditional restructuring efforts have always demanded workforce reductions. However, those companies where restructurings truly have impact more often rely on methodologies that don't disappear once the heads have rolled. Anand Sanwal and Sandeep Arora explain how to put your company on the path to continuous optimization.

BY ANAND SANWAL AND
SANDEEP ARORA

THIS YEAR IS A LEAP YEAR, and like February 29 — which comes around every four years — it seems that restructuring efforts unfortunately come into vogue in a big way only every few years in response to some economic issue or malaise. You need to just read through any number of recent company earnings announcements to see that many organizations are taking restructuring charges and lowering their earnings as a result. Restructuring is generally a euphemism for “heads are rolling,” and despite the significant impacts to the organization and its people, restructuring efforts are often undertaken in quite a haphazard and arbitrary way. Organizations often find that while restructuring may cause everything to change, nothing is actually different once completed.

Traditional restructuring efforts, whether in the finance organization or across the company, tend to suffer from three primary problems:

- **They do not discriminate.** Restructuring efforts generally treat all expenses the same. Edicts to “cut expenses by 5 percent across the board” or “reduce head count by 10 percent” are not uncommon and fail to consider that all expenses are not created equal.

- **They don't solve the fundamental issues.** The funda-

mental problems reside in inefficient and poorly constructed processes. Traditional restructuring only goes after the visible signs of substandard performance — it doesn't get at the underlying causes.

- **They are generally reactive.** Restructuring typically happens in the face of economic challenges that are hurting the organization, so such efforts are often “imposed” on the organization because of exogenous issues or factors.

The fact is that organizations should always be restructuring and optimizing how they do things. This ongoing optimization can be likened to the well-known philosophy of Toyota, which seeks continuous improvement. This notion of a well-defined Process and Cost Optimization methodology, we have come to refer to as “PaCO.” And it is our belief that those companies that adopt the PaCO methodology will weather economic turmoil better than their competitive peers, and endow themselves with a greater capacity to invest in and capitalize upon opportunities. However, before a successful PaCO methodology can be adopted, three steps must be completed by company management.

STEP 1: REFLECT

When we talk about reflecting, we are not talking about a “New Age-y” or existential reflection about your expense base. The reality is that all expenses are not created equal, so before thinking of restructuring, organizations should reflect on the nature of their expenses to determine which are strategic and which are nonstrategic.

Strategic expenses are those that are highly critical to the organization's short-, medium-, and long-term growth, innova-

VIDEO

Now watch Anand Sanwal discuss the steps required to adopt a continuous cost optimization methodology. www.bfmag.com

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tion, and flexibility as an organization and are those that directly impact customers and/or the company's products and services. A central tenet of the PaCO methodology is that it advocates a departure from managing all expenses as items that need to be minimized and instead pushes for different but interrelated disciplines to manage expenses based on the criticality of those expenses to the organization (see chart below).

Expenses that directly and actively contribute to the future health of the business through contributions to growth, innovation, and/or flexibility should be considered as investments in the business — not expenses. The remaining expenses that are not discretionary and that should be managed using PaCO are the remaining 60 to 75 percent of the operating expense base. In a sense, these are the expenses of the company that are required to keep the lights on but do not directly drive the growth of the organization.

At the conclusion of Step 1, you have reflected on and distinguished between two types of expenses: strategic, which are better characterized as investments, and nonstrategic. With this bifurcation of expenses in hand, you are now equipped to move to Step 2 of the PaCO methodology.

STEP 2: REPAIR

The repair phase of the PaCO methodology focuses on optimizing the underlying processes of these nonstrategic expenses. Before you can take action, you need to understand what is good, bad, and ugly about a specific process. In essence, you must diagnose the problem before you prescribe a solution.

At the start of this diagnosis exercise, a comprehensive inventory of processes needs to be developed, supplemented by information related to key skills required and the number of full-time equivalents (FTEs) supporting each of these processes. Process Maps can help here. In a hierarchical manner, they display how a transaction is processed, iden-

tifying a stream of activities that transforms a defined set of inputs into predefined output(s). How does this understanding of activities, inputs, and outputs translate to repair? The “devil” as they say, is again in the “details.” A process map at the “30,000-foot” level will usually not yield an area to repair. But start digging deeper and you will uncover numerous opportunities.

Now, let's examine the finance organization in more detail, and put it through this “30,000-foot” reflection of core finance processes. Identification of key skills and FTEs at this level will provide some understanding of the organization and underlying costs but will not be enough to bubble up any repair opportunities. Here again, unless otherwise evident through some anecdotal evidence, priority should be given to the process with the largest cost base. Now, let's take the “Payroll” process and drill down further (see chart: Finance Level 2 Process).

At this next level, below the finance core Level 1 processes, you will start unearthing more details related to different process steps, key skills required, and the number of FTEs required for each of the process steps. Very rarely — in processes that are extremely broken — opportunities may surface at this level, but more likely you will have to dig deeper for any sizable impact.

Within the Payroll process you may now choose to drill down further into a “Level 3” process map. (To view an illustrative example of a Level 3 process map, access an extended version of this feature at www.businessfinancemag.com.)

The Level 3 process map offers a level of detail at which the first real signs of opportunity emerge. At this level, you will start seeing:

- **A clear pattern** of how a faulty input impacts the predefined output.
- **A cause-and-effect relationship** within a work flow and

EXPENSES COME IN TWO FLAVORS

Expense	Strategic Expenses (Investments)	Nonstrategic Expenses
Description	Expenses that directly contribute to the growth, innovation, and flexibility of the organization. Expenses that are more closely customer-, product-, and/or service-facing.	Critical processes and capabilities that ensure the ongoing operations of the organization but do not directly drive organizational growth, innovation, or flexibility. These expenses do not directly impact customers, products, and/or services.
Examples	Marketing, advertising, sales, innovation, R&D, growth-oriented IT and operations investments	Payables, receivables, IT infrastructure, operations infrastructure, real estate, finance, human resources, legal
How to Manage	Corporate Portfolio Management discipline	Process and Cost Optimization (PaCO) discipline
Management Goal & Focus	Maximize value derived from these investments — not focused on minimizing amount invested.	Minimize costs through process and scale efficiencies — contribute to margin expansion by continuously shrinking the nonstrategic expense-to-revenue ratio.

an ability to start mapping information related to input, output, FTEs, skills, and cost to each step of the process.

- **An ability to benchmark cost and efficiency**, etc., internally and externally.

Some examples of repair opportunities that may emerge are:

- **Too many defects** due to manual processing or faulty, out-of-date capabilities supporting the process.
- **Too many FTEs** for each input level due to lack of technology or lack of scale efficiencies.
- **Rework driven by lack of clearly defined hand-offs** at each step of the process.
- **Higher-than-benchmark costs**— due to a higher number of FTEs, higher overhead, geographic cost differences, etc.

To ensure a standardized way to look at the repair opportunity, it is advisable to adopt one process improvement protocol across the corporation. This will ensure a standard way of identifying opportunity and measuring success. Six Sigma is one such common and popular protocol used within a number of corporations today.

From this analysis of the process, you've created the foundation for ongoing business transformation, a systematic program to optimize processes and capabilities so that the right set of people with the appropriate skills at the optimal locations are conducting the process(s) with the most efficient and optimal use of capabilities.

This is not easy, however, because it does require long-term organizational buy-in, a strong will, and effective program management. But with this repair mantra ingrained

within the organization, you'll be in a position to constantly evaluate the company's processes and improve them on an ongoing basis.

With this understanding of what requires repair, you're now ready to take action and move to Step 3 of the PaCO methodology.

STEP 3: REAP

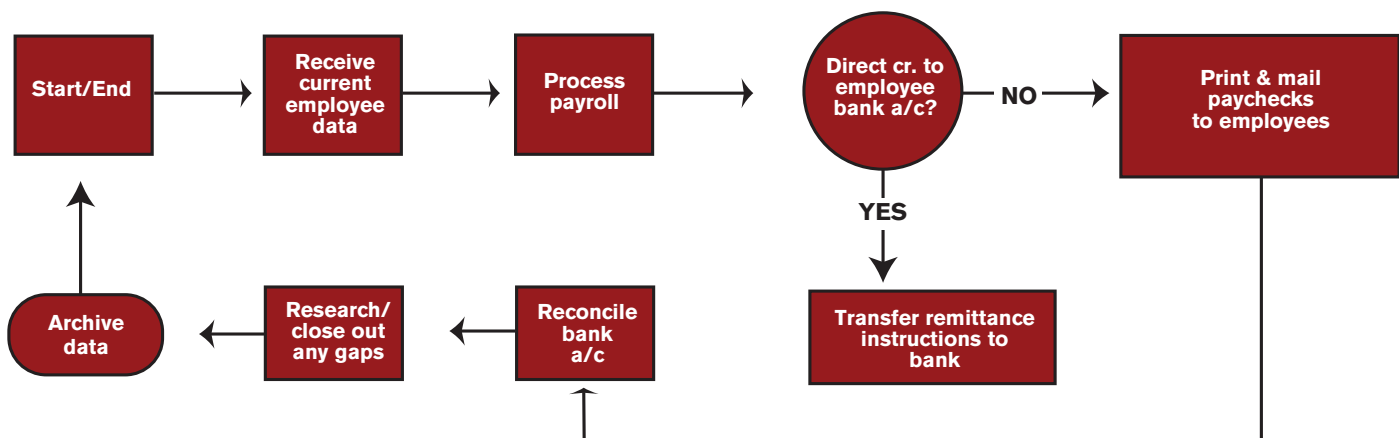
During the reflect phase, you've done the hard work to understand your expenses in greater detail and have broken them down into the strategic and the nonstrategic. Then you evaluated the nonstrategic expenses and their underlying processes as part of the repair phase and have determined how these processes should be carried out correctly. With that information in hand, you are ready to take action, reap the rewards of your efforts, and actually optimize your cost base.

How do you go about doing this? For the most part, you will leverage a lot of the work done in the reflect and repair phases, but from here on you will need a framework for assimilating all of the information above and developing a set of specific recommendations that will deliver savings that you can literally take to the bank.

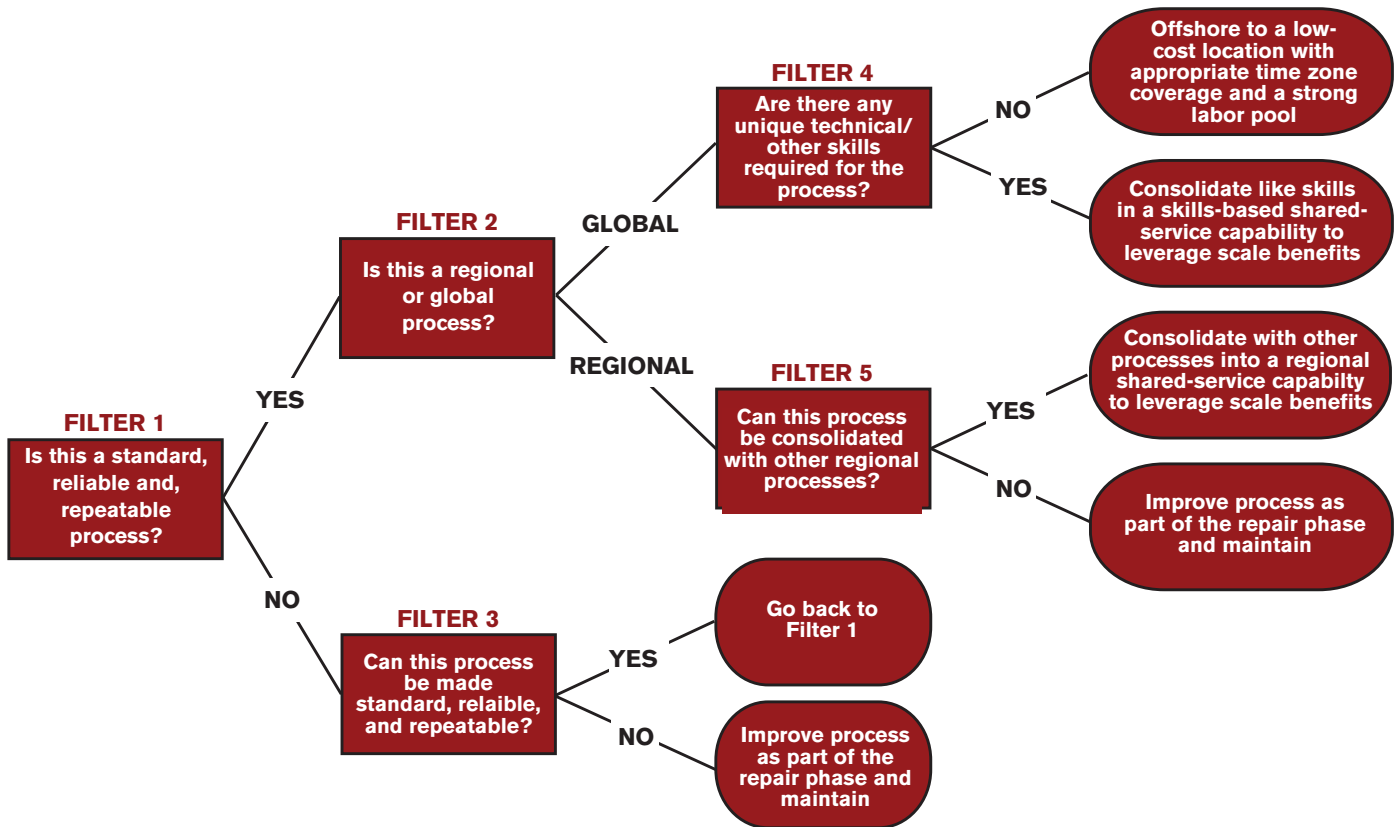
At the top of the adjoining page, a chart displays a solution/recommendation framework that will enable you to take the inventory of processes, skills, and FTEs gathered during the repair phase and develop a set of recommendations that you can use to reap real process efficiencies and cost savings.

From this framework, it is important to understand the relative complexity and ease of implementation of these recommendations. This will ensure that the organization is

FINANCE LEVEL 2 PROCESS: Payroll Example



REAP SOLUTION/RECOMMENDATION FRAMEWORK



appropriately focused on getting the quick wins while managing expectations around recommendations that are more complex and difficult to implement. Using this framework, the recommendations can be categorized as follows:

- **Quick wins/low-hanging fruit:** Global, standard, reliable, and repeatable processes that can be migrated offshore right away to leverage the low-cost advantage that these offshore locations provide.
- **Medium-term opportunities:** Recommendations related to process improvements to make them standard, reliable, and repeatable; consolidation of like skills or regional processes into shared services capabilities.
- **Long-term transformations:** Processes that are outliers to the above framework and will need significant improvement or potential redesign.

As you tackle the short-, medium-, and long-term opportunities, your investment in and embrace of the PaCO methodology can yield eye-popping results. We've seen

organizations achieve a 15- to 20-fold return on such efforts, and with the ongoing nature of a PaCO model, these returns continue to be enhanced over time.

Restructuring does not need to be a “four-letter word” within the organization if a more thoughtful, proactive, and disciplined approach to optimizing costs and processes on an ongoing basis is adopted.

Use of the Process and Cost Optimization (PaCO) model allows you to be relentless in your efforts to carve out inefficient processes and costs on an ongoing basis. It also lets everyone know that inefficiency will not be tolerated at any time.

Ultimately, executives and managers will be best served by establishing an organizational discipline that focuses their energies on creating ongoing cost and process efficiencies that provide a real advantage — and away from those that are reactionary and knee-jerk and just provide short-term, illusory benefits. **BF**

To access an extended version of this article featuring multiple process maps, visit www.businessfinancemag.com.