



May 2009

Cost-Cutting Strategies in the Downturn

A Delicate Balancing Act

Pulse Survey Report

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Executive Summary

Earlier this year, we surveyed over 600 HR executives in the U.S. about the nature and focus of their cost-cutting efforts as the downturn worsened. What we learned is best summed up by comments from two HR executives.

One spoke for many when he noted simply, “Talent retention *is* a primary concern.” While cost pressures remain intense, the data confirm a widespread view that cutting too deeply into an organization’s muscle — its talent — could seriously hamstring a fast return to growth.

The other comment underscores how companies are balancing the competing needs of cost reduction and talent management: “What differentiates the winners is their ability to use a scalpel and not a machete.” In other words, pick reduction targets carefully — whether those targets are programs or people. Smart organizations are undertaking thorough assessments to understand people’s roles and contributions — and the return on investment they’re getting from various programs — to determine how and where to make cuts without adversely affecting business results both now and over time.

This reinforces the other message coming through clearly in the data and in our work with clients: a realistic sense of the nature of the challenge and the balancing act required to maintain engagement and performance in the face of tough financial choices. Respondents anticipate a relatively slow return on their investments in cost cutting and appear prepared for continuing challenges on the cost side while doing what they can to keep employees involved and focused.

Our specific findings follow.

The Current State

As *Exhibit 1* shows, the first wave of cost cutting, which began late in 2008 and continued through the first quarter of 2009, has been fairly traditional in approach. The number one action has been salary freezes, both for the workforce as a whole and for executives. This may reflect companies' increased sensitivity to setting a good example at the top of the house and living the "shared destiny" theme we've seen in our research with employees, who tend to be more engaged when they feel leaders are "with them" in meeting challenges.

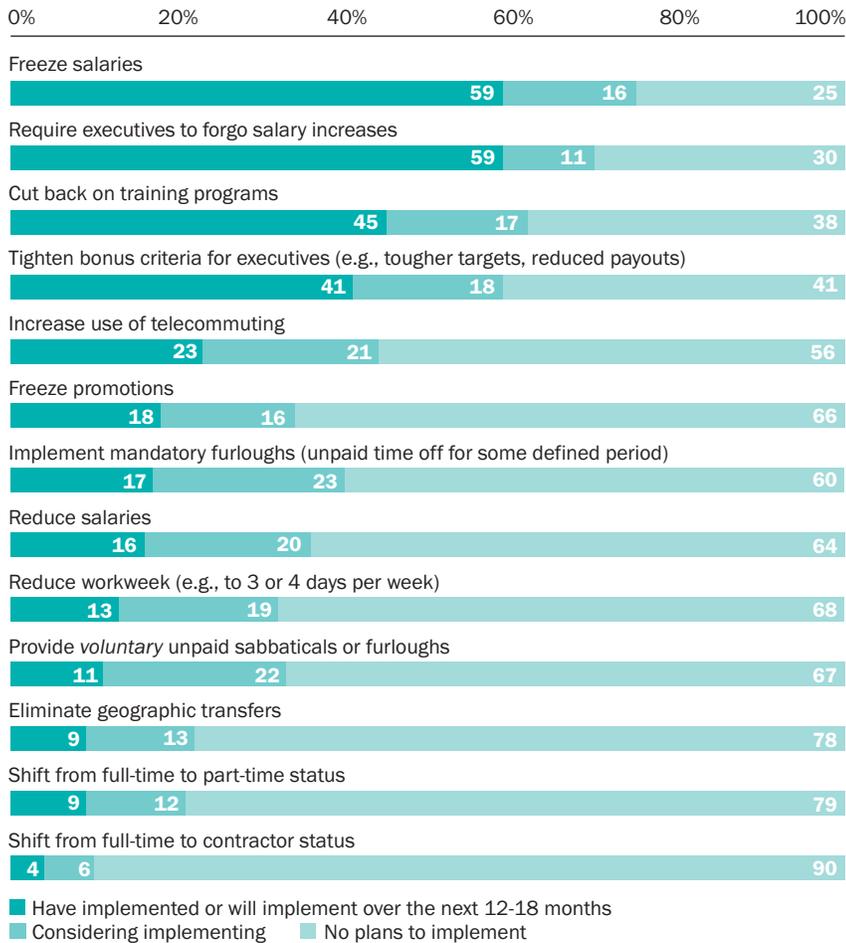
But looking ahead to actions under consideration, any subsequent waves of cost reduction may take a more creative shape. The theme here is unpaid

leave in various forms, whether via a mandatory or voluntary furlough or a shorter workweek. This is consistent with steps many organizations have already taken to minimize the impact of required cutbacks on their workforce and avoid job loss to the extent they can.

As *Exhibit 2* on page 4 shows, training programs remain a tempting target, especially those covering the workforce broadly. But cutting training can prove shortsighted, limiting an organization's ability to keep pace with the capabilities and skills needed in a recovering economy. Reducing training may also inadvertently signal a lack of organizational commitment to growth for employees and can impact employee engagement over time.

"What differentiates the winners is their ability to use a scalpel and not a machete."

Exhibit 01. The Shape of Current Cost Cutting



“Looking ahead, subsequent waves of cost reduction may take a more creative shape.”

Also worth noting in this exhibit is the extent to which approaches differ by workforce segment — further evidence that companies are tailoring their actions to fit the roles and skills of those segments. Among the professional/technical staff, the top cost-cutting approach is moving to outside contractors — allowing greater “flex” in meeting the peaks and valleys in demand for specific skills. By contrast, for nonmanagement staff, companies are shifting people from full- to part-time status, perhaps in combination with methods like job sharing to meet workload demands with fewer full-timers on board. At the more senior management levels, the savings come almost entirely through cutbacks in compensation, whether in salary, bonus or both.

Finally, note that voluntary furloughs appear to be a more popular choice than mandatory furloughs for companies applying the concept across their workforce. On the other hand, where furloughs are

aimed at specific segments — whether management or professional/technical — the trend flips, with slightly greater reliance on required time off (although use of furloughs generally remains lower for specific segments, particularly management).

Results

While just under half of the respondents have had some success in meeting financial objectives, relatively few see their efforts as an unqualified success. What’s more, as *Exhibit 3* on page 5 shows, nearly one in five respondents report limited or no success in reaching cost goals. And for roughly a third, the jury is still out. Note, too, that respondents’ expectations don’t change greatly regarding the impact of their actions on longer-term financial results. Slightly over half think the impact of current cost reductions will continue to be positive, while about one in five think it will be negative.

Exhibit 02. Where Cuts Are Being Made Across the Workforce

	Across the board	Management	Nonmanagement (staff)	Professional/technical employees	Other
Cut back on training programs	86%	9%	9%	7%	3%
Freeze promotions	68%	21%	12%	13%	8%
Freeze salaries	64%	28%	14%	18%	10%
Eliminate geographic transfers	61%	19%	15%	17%	15%
Increase use of telecommuting	59%	18%	19%	31%	4%
Tighten bonus criteria for executives (e.g., tougher targets, reduced payouts)	54%	43%	7%	11%	4%
Provide <i>voluntary</i> unpaid sabbaticals or furloughs	53%	14%	26%	26%	13%
Require executives to forgo salary increases	46%	46%	6%	9%	11%
Reduce salaries	34%	43%	15%	15%	28%
Implement mandatory furloughs (unpaid time off for some defined period)	33%	19%	36%	33%	33%
Reduce workweek (e.g., to 3 or 4 days per week)	19%	6%	46%	27%	40%
Shift from full-time to contractor status	8%	4%	32%	56%	32%
Shift from full-time to part-time status	5%	5%	61%	41%	28%

Perhaps the more interesting question is whether these actions are just a temporary solution to the crisis, or whether companies plan to use the downturn as a rationale to make more systemic changes to processes and programs that would be harder to push through in good times. While the data tell a somewhat mixed story, only 22% definitely do not plan to maintain these cost-reduction programs when the economy turns around. The majority expect to keep at least some of these efforts in force, and the balance of what they will keep versus eliminate will likely shift over time as the financial impact of these programs becomes clearer.

If the financial impact of cost-cutting actions hasn't been quite as stellar as hoped for, it's also true that the impact on employees has not proved as negative as many might have feared. In fact, as *Exhibit 4*

shows, respondents reported that employees are generally quite supportive of efforts to cut costs, with only a small percentage reporting a negative reaction.

Again, this demonstrates the mood of shared destiny we've seen in other research. While employees are clearly concerned about their jobs and their financial futures, they also have a realistic sense of the challenges their companies face, and they're accepting cutbacks in workplace programs now with surprisingly good attitudes to help improve the chance for collective success and rewards in the future.

Their grace under fire may also stem from a greater degree of involvement in shaping solutions to financial challenges. In keeping with the broad trend

Exhibit 03. The Effectiveness — and Staying Power — of Cost-Reduction Efforts

0% 20% 40% 60% 80% 100%

How well cost-reduction actions have met immediate financial objectives



Extent to which company expects to maintain programs when the economy turns around



■ To a great extent ■ To some extent ■ To a limited extent ■ Not at all ■ Too soon to tell

Long-Term Impact

Expected effect of cost-reduction actions on business performance longer term



■ Positive impact ■ Neutral ■ Negative impact

Exhibit 04. How Employees Are Reacting

0% 20% 40% 60% 80% 100%

Impact of cost-reduction actions on employees



■ Supportive reaction ■ Mixed reaction ■ Negative reaction ■ Too soon to tell

Employee Involvement in Cost-Reduction Efforts

Extent company is engaging employee work teams in creative ways to reduce costs while preserving jobs



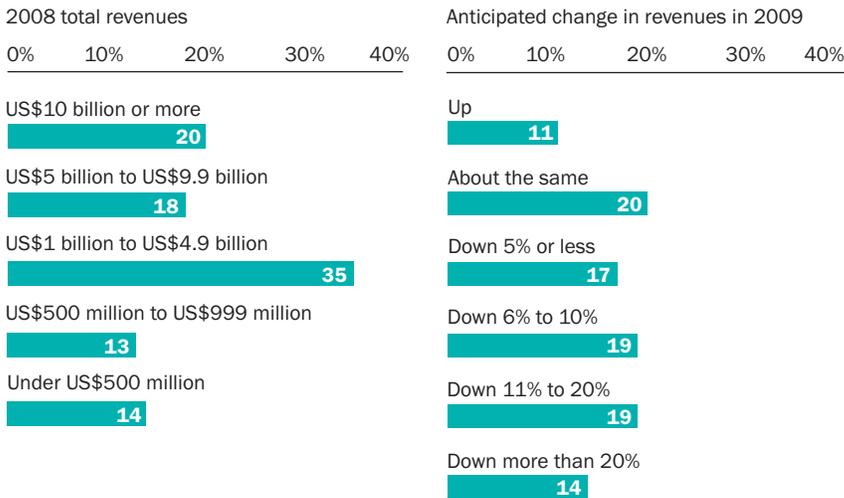
■ To a great extent ■ To some extent ■ To a limited extent ■ Not at all

toward increased employee involvement in business processes — a driver of engagement — just under half of respondents tapped employee creativity by actively bringing their workforce into the problem-solving process (Exhibit 4).

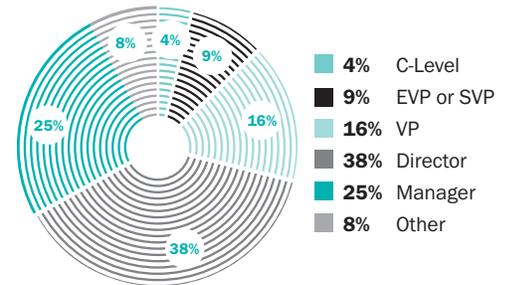
While it's too early to tell whether further rounds of cost cutting will take place, or how they might take shape, the pace of reductions — particularly layoffs — appears to be slowing. And what is apparent in the responses to this survey, and in our experience

working with companies over the last few months, is that leadership has focused on strategic and creative cost-cutting approaches to a degree beyond what we've seen in prior downturns. Flexibility has been a major theme for many organizations as they seek ways to trim budgets without trimming talent or derailing the processes and programs that will help them move ahead quickly when the economic tide finally turns.

A Look at the Respondent Companies



A Look at the Respondents



About Towers Watson

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