



WHAT TO CUT & HOW TO CUT

IN THE MIDST OF A PUBLIC HEALTH CRISIS

The coronavirus has created a humanitarian crisis. COVID-19 is a serious threat to the most vulnerable populations in every community. Protecting the health and safety of employees, partners and communities will be job one for leaders around the world during the coming months.

The dramatic declines in global equity markets also make clear that leaders are going to have to manage the economic impact of this public health crisis. The gyrations in markets from country to country and from day to day illustrate the complexity of this situation. The pace, duration and impact of the crisis are nearly impossible to calibrate.

At a minimum, this event will be a disruption for business. Whether you are in the airline business or running a single restaurant, the coronavirus will hurt your ability to generate revenue in 2020. In that way it is starting to feel like 2008. But before we dust off the playbook we used during the financial crisis, let's take a look at some of the ways that this crisis is different.

**THIS IS A HUMAN CRISIS,
NOT A FINANCIAL CRISIS.**

In 2008, banks stopped lending and investors stopped investing. During this crisis we will be tested by our ability to find new models for managing employees. We will have to use new tools and new leadership models to keep teams engaged as we practice "social distancing".

**WE EXPECT THIS TO BE A DISRUPTION,
NOT AN ENDURING REDUCTION IN
ECONOMIC ACTIVITY.**

Like other viruses that came before it, coronavirus will eventually be contained. That means the decisions we make should ensure that we are prepared for a near-term return to a level of production that is close to what we experienced during most of 2019. Protecting the fundamentals of the economy is the current focus of policy makers around the world. And protecting capacity will be a priority for business leaders. That was not true in 2008 and 2009. It was clear then that we would have to adjust to much lower levels of economic activity.

**THIS DISRUPTION WILL START IN
OUR COMMUNITIES, NOT AT WORK.**

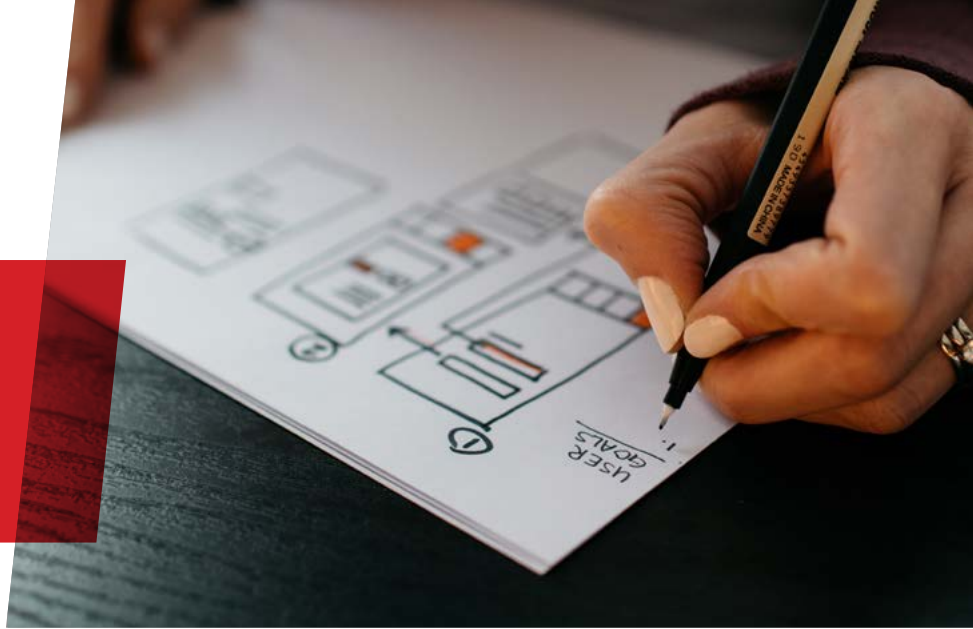
Schools are closed. Travel is discouraged or restricted. Community events from sports to entertainment to political rallies

are cancelled. And, as we have seen in Italy and China, it may take even more serious restrictions to control community spread of the virus. Leaders will need to think about their employees much more holistically.

In many ways, the economics of this crisis will be much more difficult to manage. For most businesses, a decline in revenue is inevitable. But the response to that decline isn't as simple as a corresponding reduction in headcount. Businesses will be working hard to preserve production capacity. This crisis will require more creativity, more attention, and more leadership. The businesses that immediately reach for the capacity reduction lever will find themselves running from the back of the pack when the virus is finally contained.



SCENARIO PLANNING



The first step for most organizations is to evaluate the likely impact of the crisis on the economics of their business. There are two major forces impacting the economics for their business.

The first is the change in demand. How far and how fast will demand disappear in their industry? In sectors like airlines and hospitality, the change in demand was immediate and severe. For other industries, the changes have been less consequential. Telecoms, life sciences firms, even technology companies are seeing more modest changes – and in some cases those changes are positive.

The second variable every leader is monitoring is the length of time it will take to contain the virus. This is harder to assess. We are sifting through the experiences of China and Italy for lessons. We are watching for signs that governments and citizens are acting to control the crisis. And we are all listening to the public health officials for updates on how this virus might behave.

At a high level, those two dynamics produce four types of scenarios that companies will need to consider.



Leaders will need to develop a point of view about which scenarios are likely for their organization. And they will need to establish a dashboard of metrics that helps them to assess how quickly each scenario is approaching. That dashboard will include traditional business metrics. It will also include public health data, insights about potential government actions and real time economic data.



COST CUTTING TACTICS

What should a leader do to protect the economic health of their business? There are a wide range of options to consider as the depth and length of the crisis becomes clear. The first set of moves (Wave One Tools) are designed to deliver one-time, near-term expense savings.



TAKE-OUT TACTICS

It is not a surprise that the travel industry is being hit hard by the virus. For short-term savings, most organizations will turn first to actions like eliminating travel, cancelling an event, or skipping an annual program.



TIMING TACTICS

Timing tactics are delays – delaying new hires, delaying product launches, delaying an office opening. Those moves soften the earnings impact of a short-term revenue decline.



CAPTURING VARIABLE EXPENSE SAVINGS

Variable expenses will naturally go down as revenues decline. Bonuses go down, sales incentives go down, materials spend goes down. That helps to absorb a short term shock like this. Companies will have to consider how much of those savings they want to capture to keep suppliers, customers, and employees engaged.

These are the first moves, but they may not be enough. As employers seek to balance the need to protect capacity with the need to reduce expense, they will have to use other tools in the toolkit – Wave Two Tools.

WAVE TWO TOOLS

Many of these tools increase efficiency – delivering the same level of output with a lower level of expense. And they can deliver savings in this calendar year. We can expect that large organizations will start to deploy these tactics in the second and third months of the crisis. They include:



OPTIMIZING REWARDS SPEND

Most companies don't have a good sense for the value they are creating with rewards investments. This may be a good moment to gather that insight and use it to optimize your rewards investments. For most companies this exercise can save you at least 5% in your spend and increase the value you are delivering to employees.



STOPPING GRADE /TITLE INFLATION

Far too often we elevate high performing employees into new roles that don't have a level of accountability that is commensurate with the pay or title they have been awarded. Establishing a job taxonomy and a career framework can deliver significant salary savings and employee growth.



ADJUSTING MANAGEMENT SPANS

An audit of the level of people management responsibility across your company almost always reveals underutilized management capacity. Consolidating manager roles can be a quick source of enduring savings.



AUDITING YOUR OPERATING MODEL FOR REDUNDANCY

The tremendous volume of M&A activity over the last five years has not been accompanied by a corresponding level of integration work. Businesses who have completed an acquisition are likely to see opportunities to consolidate certain activities into shared service centers or centers of excellence.



TACKLING PROCESS EFFICIENCY

Most organizations have a handful of costly and complex processes that would benefit from a fresh look. There is almost always an opportunity to deploy new technologies and to restructure the roles involved in delivering process outcomes.



SUPPLIER CONCESSIONS

While 60% of the expense for most large companies is spent on labor, external spend is still a major area of focus for companies. They will start to renegotiate some of the agreements with suppliers.



TARGETED HEADCOUNT REDUCTION

The actual savings from some of the tactics above will come from a reduction in the number of employees at the company. These reductions will likely be smaller in number than we might expect should the crisis deepen.



TARGETED FACILITY CLOSURES

This may be the time for companies to begin to shutter operations that are underperforming.

WAVE THREE TOOLS

For many industries, we expect to see changes that involve more foundational restructuring (Wave Three Tools). They require absolute clarity about an organization's priorities and a collective effort to eliminate these costs. These activities may result in cash flow declines in the near term due to the cost involved in undertaking the actions.



RIGHTSIZING LAYOFFS

Companies will begin to start taking costs out of line functions (e.g. sales, manufacturing, service) across the board at a level that is commensurate with expected revenue declines.



DIVESTITURES

We will likely see a lot of M&A activity that is designed to reduce the overall levels of capacity in a hard hit industry. That may start with divestitures of businesses that are a drain on cash flows.



CAPEX CUTS

In hard-hit industries, the protection of cash flows will be critical. This is going to have a big impact on the level of expenditures in capital projects.



OUTSOURCING

In an effort to cut ongoing operating expenses, many companies may choose to outsource existing functions that don't directly differentiate the company's offerings in the eyes of customers.



A man in a dark suit and tie stands by a large window, looking out. The window reflects the interior of a modern office with glass partitions and a wooden floor. The lighting is soft, coming from a lamp above.

MAINTAINING ORGANIZATIONAL RESILIENCE

Realigning the cost structure is hard on employees. The anxiety about health issues already has many of us on edge. Anxiety about job loss and job security is going to make that even worse. Throughout this process, be sure that your communications from leaders incorporate the following:



EMPATHY FOR DISRUPTION

Starting now, make sure your employees know that you are focused on helping them to cope with the disruption in all aspects of their life. Take steps to support them with adjustments in child-care. Equip them with tools to collaborate. And, above all, provide access to supplies and information to protect their health.



COMMUNICATING THE CONTEXT

If you are displacing employees during the crisis, be sure to help your entire workforce understand the context. How has the crisis impacted the company? What steps have already been taken to reduce expenses? Why are the cuts happening now? How will displaced employees be supported?



NEW TECHNIQUES TO MAINTAIN ENGAGEMENT

Your employees may be working remotely when cuts are made. Make sure that you provide virtual forums for employees to share their concerns and for leaders to provide transparency on any cost cutting that results in job loss.

Policy makers will continue to seek solutions to prevent the virus from infecting the economy. That said, the behavioral changes needed to fight the public health threat will result in an immediate decline in revenue for most businesses. The right response to those economic challenges will help to ensure a full and quick recovery.



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ASK THE EXPERTS: *Leading Through and Beyond COVID-19*