



Using Research Tools to Cut Costs

The deepening economic downturn is forcing painful choices on companies who are trying to stay afloat as demand for their goods and services plummets. Understandably, the new focus is on cost containment, cutbacks, and staff reductions. Costly pay and employee benefits programs, most importantly health care and retirement plans, are obvious targets. At the same time, it goes without saying that employees are key company assets; those companies who are able to attract and retain the best people are the ones who will be most strongly positioned coming out of the economic downturn. Consequently, HR professionals will want to take a leadership role in identifying cost reductions that will achieve the required savings but without significantly reducing the value of their offerings to employees.

This is easier said than done - but tools are available that can be used to understand clearly how employees evaluate alternative cost cutting options. Employees will naturally resist any reduction in compensation and benefits, but a company can mitigate the impact of these reductions by targeting them toward those areas that are of least value to employees, relative to cost. The key for HR professionals, then, is to gauge the relative "bang for the buck" from the various components of a company's total rewards package. This brief note describes how this can be done, using a hypothetical example. By ordering the components of the rewards package from the lowest to the highest bang for the buck, a company can implement a cost reduction program that is most attuned to employee preferences, needs, and values.

To see how this works, we'll start with the following hypothetical example. Suppose the HR staff develops a list of ten possible cost reduction options that adds up to a savings of \$5 million (Table 1):

Table 1: Cost Reduction Options - Initial List

<i>Cost Reduction Option</i>	<i>Savings (\$000s)</i>
1. Scale back disability programs	\$300
2. Increase health insurance co-payment	\$1,100
3. Reduce employer portion of health insurance premium	\$750
4. Impose mandatory one week unpaid vacation	\$350
5. Scale back tuition reimbursement and training programs	\$250
6. Change vision and dental insurance to be employee funded	\$450
7. Reduce employer match in retirement program	\$550
8. Impose 10% cut in salaries	\$900
9. Eliminate employee fitness programs	\$150
10. Reduce subsidy for child care	\$200
Total	\$5,000

If a cut were mandated by senior management, the simplest recommendation would be to rank the list of cost reduction options from highest to lowest cost savings (Table 2) and choose the cuts with the greatest savings:

Table 2: Cost Reduction Options - Ranked by Dollar Amount

<i>Cost Reduction Option</i>	<i>Savings (\$000s)</i>
2. Increase health insurance co-payment	\$1,100
8. Impose 10% cut in salaries	\$900
3. Reduce employer portion of health insurance premium	\$750
7. Reduce employer match in retirement program	\$550
6. Change vision and dental insurance to be employee funded	\$450
4. Impose mandatory one week unpaid vacation	\$350
1. Scale back disability programs	\$300
5. Scale back tuition reimbursement and training programs	\$250
10. Reduce subsidy for child care	\$200
9. Eliminate employee fitness programs	\$150

For example, if a cost reduction of \$2 million is required, HR would recommend an increase in the health insurance co-payment (\$1.1 million) and a 10% cut in salaries (\$0.9 million). If additional cost savings are required, the next highest ranked options in terms of cost (reducing employer portion of health insurance premium, reducing employer match in retirement program) could be selected.

As HR professionals understand, however, this focus on costs neglects the needs and values of employees. Suppose that HR had a means of estimating in dollar terms the perceived loss employees would incur from each of these cost reduction options (Table 3). It would then be in a position to determine that the decision to increase health insurance co-payments and to impose a 10% salary cut is less than optimal. The perceived loss to employees from these changes would be \$2.4 million, which is greater than the savings the company would realize from these changes:

Table 3: Cost Reduction Options - Initial List

<i>Cost Reduction Option</i>	<i>Perceived Loss to Employees (\$000s)</i>
1. Scale back disability programs	\$200
2. Increase health insurance co-payment	\$1,500
3. Reduce employer portion of health insurance premium	\$900
4. Impose mandatory one week unpaid vacation	\$300
5. Scale back tuition reimbursement and training programs	\$100
6. Change vision and dental insurance to be employee funded	\$500
7. Reduce employer match in retirement program	\$700
8. Impose 10% cut in salaries	\$900
9. Eliminate employee fitness programs	\$100
10. Reduce subsidy for child care	\$150
Total	\$5,350

Table 4 illustrates a better way of choosing which cost cutting options to select. It combines the cost saving and perceived loss estimates and ranks the options from lowest to highest "bang for buck" (cost saving divided by perceived loss). A very different picture emerges. By selecting the cost cutting options that have the biggest bang for the buck ratios - the highest cost for the company relative to the perceived loss for employees – an even greater cost saving (\$2.15 million) can be achieved with a substantially smaller perceived loss borne by employees (\$1.75 million). Essentially, the "nice to have" components of compensation and benefits, as perceived by employees, should be reduced or eliminated before the "must have" components.

Table 4: Cost Reduction Options - Ranked by "Bang for the Buck"

<i>Cost Reduction Option (\$000s)</i>	<i>Cost Savings</i>	<i>Perceived Loss</i>	<i>"Bang for the Buck" (Savings / Loss)</i>	<i>Cumulative Savings</i>	<i>Cumulative Loss</i>
5. Scale back tuition reimbursement and training programs	\$250	\$100	2.50	\$250	\$100
1. Scale back disability programs	\$300	\$200	1.50	\$550	\$300
9. Eliminate employee fitness programs	\$150	\$100	1.50	\$700	\$400
10. Reduce subsidy for child care	\$200	\$150	1.33	\$900	\$550
4. Impose mandatory one week unpaid vacation	\$350	\$300	1.17	\$1,250	\$850
8. Impose 10% cut in salaries	\$900	\$900	1.00	\$2,150	\$1,750
6. Change vision and dental insurance to be employee funded	\$450	\$500	0.90	\$2,600	\$2,250
3. Reduce employer portion of health insurance premium	\$750	\$900	0.83	\$3,350	\$3,150
7. Reduce employer match in retirement program	\$550	\$700	0.79	\$3,900	\$3,850
2. Increase health insurance co-payment	\$1,100	\$1,500	0.73	\$5,000	\$5,350

Obtaining the information needed to develop the cost saving estimates is time consuming, but this task is relatively straightforward and is a standard practice for HR. On the other hand, determining the estimates of perceived dollar loss based on employee wants, needs, and values is likely to require techniques unfamiliar to HR professionals. One way of doing this would be for the HR staff judgmentally to develop these gauges of employee wants and needs, combining their own values with their anecdotal understanding of employee preferences. A more precise approach would be to use research tools that estimate preferences. These research tools are used commonly by marketing departments to understand customer wants, needs, and values. The results provided by these tools are used in the design of new products and redesign of existing products to increase market acceptance and company profitability. A view of the "employee as customer" leads logically to the use of these customer research tools to better understand employee preferences.

Preference revelation tools typically consist of a specialized survey of employees and a specific methodology for analyzing the results and developing the above-mentioned dollar estimates of perceived value. International Planning and Research has developed Consultor™, a new software and analysis tool for HR departments, which is an adaptation of a highly reliable customer research tool that is used for just this purpose. This tool is intended to help companies attract and retain employees in the most cost-effective manner by identifying changes in compensation/benefit packages that will realize required cost savings but without unnecessarily compromising the value of their offerings to employees.

For additional information about IPR and Consultor please visit www.iprcorp.com or call Matt Vacaro at (978) 461-2313.