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Gartner Risk Management Leadership Council

Actions for Effectively Planning Your Cost Optimization Initiative

Overview

Enterprise risk management (ERM) is typically both a support function and a cost center. During an economic downturn, the function is expected to contain costs and align with the organization's plan for dealing with uncertainty. To quickly save costs, this often manifests as cuts to major components of the budget, such as personnel. This approach focuses on short-term wins but does not consider long-term functional objectives. By enabling heads of ERM to meet the organization's expectations in the short run, it erodes the value ERM provides to the organization in the long run.

To support enterprise growth in uncertain times, ERM heads should establish a continuous process to preidentify, plan and implement cost optimization initiatives to maintain business and functional momentum.

Key findings

- ERM teams struggle to monitor the economic business cycle and anticipate times of economic uncertainty because their limited subject matter expertise makes it difficult for them to analyze the comprehensive economic data received from other functions.
- ERM functions are slow to adapt to a changing environment and rely on established mindsets and ways of working that harm long-term functional growth.
- ERM functions are also ineffective at communicating with employees on the changes arising from economic uncertainties and the reasons for them.
- ERM heads find it difficult to have transparency and an overview of functional cost drivers during times of uncertainty, as the company's next move may not be clear.

Recommendations

To respond to business slowdown and effectively plan and manage risk response cost optimization strategies for the function, ERM heads should:

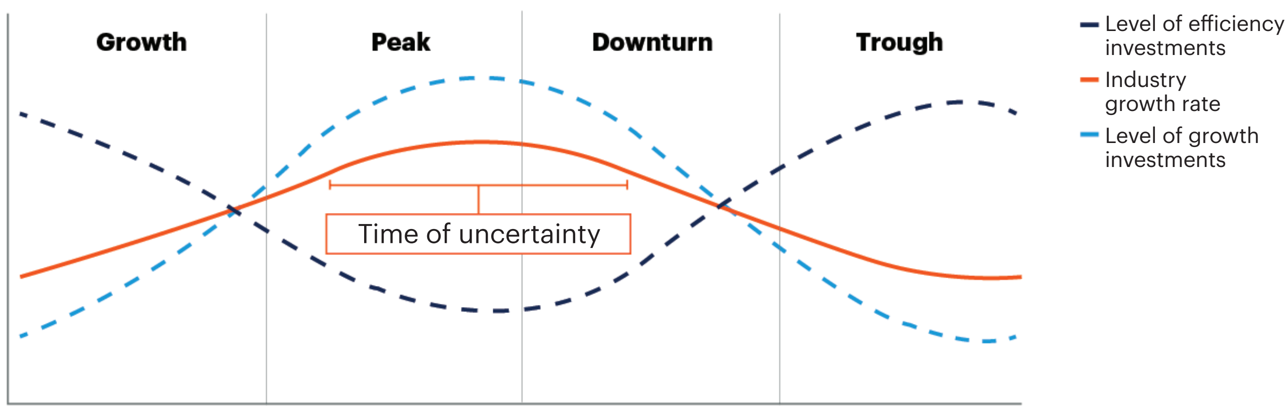
- Establish a continuous process that allows them to monitor key risk indicators and anticipate periods of uncertainty.
- Collaborate with functions such as finance and strategy to understand changes in economic conditions and communicate approaches to stay ahead of economic developments.
- Increase the ERM team's awareness of uncertain economic times by actively involving employees in preparing for economic turns through scenario planning.
- Establish cost-driver transparency by regularly benchmarking functional investments.
- Implement sustainable cost-cutting measures to drive short-term efficiency and effectiveness while still enabling long-term growth.
- Brainstorm and agree any "non-negotiable" scenario-independent growth initiatives (for example, digital investments).

Introduction

The nature of the economic business cycle adversely affects how organizations plan and manage their activities, resources and capacities. Often, enterprises struggle to predict and prepare for the phases of an economic slowdown because they tend to assume the peak phase of the cycle will sustain itself. This is especially true during economic uncertainty, which we define as the period between a peak and a downturn when economic conditions become less clear and appear to be on the verge of declining (see Figure 1).

Figure 1: Industry growth rate versus level of investments

Illustrative



Source: Gartner

Organizations that fail to recognize and prepare for uncertainty are forced to cut costs in an ad hoc way once the slowdown negatively affects the business. The lack of preparation can have severe consequences for an enterprise in the short term (such as low-quality decisions on how to overcome the decline) and the long term (such as reduced productivity, falling market shares or competency and skills shortages). ERM is responsible for helping reduce the organization's exposure to such risks.

To support the organization during a downturn while not eroding the function's value, ERM must be prepared. Though the function is not involved in the budgeting process, ERM heads are typically informed about budget cuts once the decision has been finalized. This gives them a very short time frame to reconcile budget lines and take cost-cutting measures.

To avoid this situation, ERM heads must establish a continuous process to identify functional cost optimization initiatives, ahead of time, that will quickly drive short-term efficiency and effectiveness to overcome a slowdown. This will ensure ERM is prepared to cut costs effectively whenever asked.

ERM heads struggle to guide their own function through uncertain times because of the following two challenges.

Failure to anticipate a potential slowdown

The first challenge is the failure to use data-based indicators to anticipate a potential slowdown. Although various early warning indicators are available within an enterprise, we find most ERM heads do not collaborate with other functions such as market intelligence and strategy to procure and leverage existing data.

There are three reasons why ERM functions find this challenging:

- ERM teams do not have access to economic data and must depend on other functions to access it. Functions such as strategy and marketing are closer to, or provide data for, decision making at an organizational level, so they have better visibility than ERM.
- ERM teams do not have the capacity and subject matter expertise to analyze comprehensive data and understand the functional implications.
- ERM teams have not actively established ongoing working relationships with enterprise stakeholders to analyze and interpret the economic data.

Changing ERM employees' mindsets

The second challenge is changing employees' mindsets and their approaches to work in the context of an impending slowdown. ERM functions find this particularly challenging for the following reasons:

- ERM teams work at full capacity throughout the year and asking them to do more with less resources makes additional cost-efficiency initiatives challenging.
- ERM teams are not a part of budgeting discussion (as most organizations follow a top-down approach) and so are not informed about cost cuts until after the decision is made. This forces the ERM team to adopt a reactive approach to cost cutting, with little time to plan and communicate cost optimization initiatives.
- ERM is also responsible for managing other risks, such as the financial and talent risks the organization may be exposed to due to recession.

Four actions to plan your cost optimization initiatives effectively

To overcome these challenges and successfully plan and implement cost optimization initiatives, ERM heads must:

1. Continuously monitor KRIs and collaborate with other functions to understand economic conditions.
2. Manage employee perceptions through uncertain economic conditions.
3. Establish transparency of all functional cost drivers.
4. Develop a robust action plan to effectively implement cost optimization initiatives and recognize non-negotiable, scenario-independent growth initiatives.

1. Collaborate and understand indicators for change

ERM teams can best plan for economic uncertainty by linking early warning indicators to various internal and external data sources. The more these indicators are backed up by data aggregated from different organizational functions (such as strategy or finance), the more accurate and precise the economic forecasts will be.

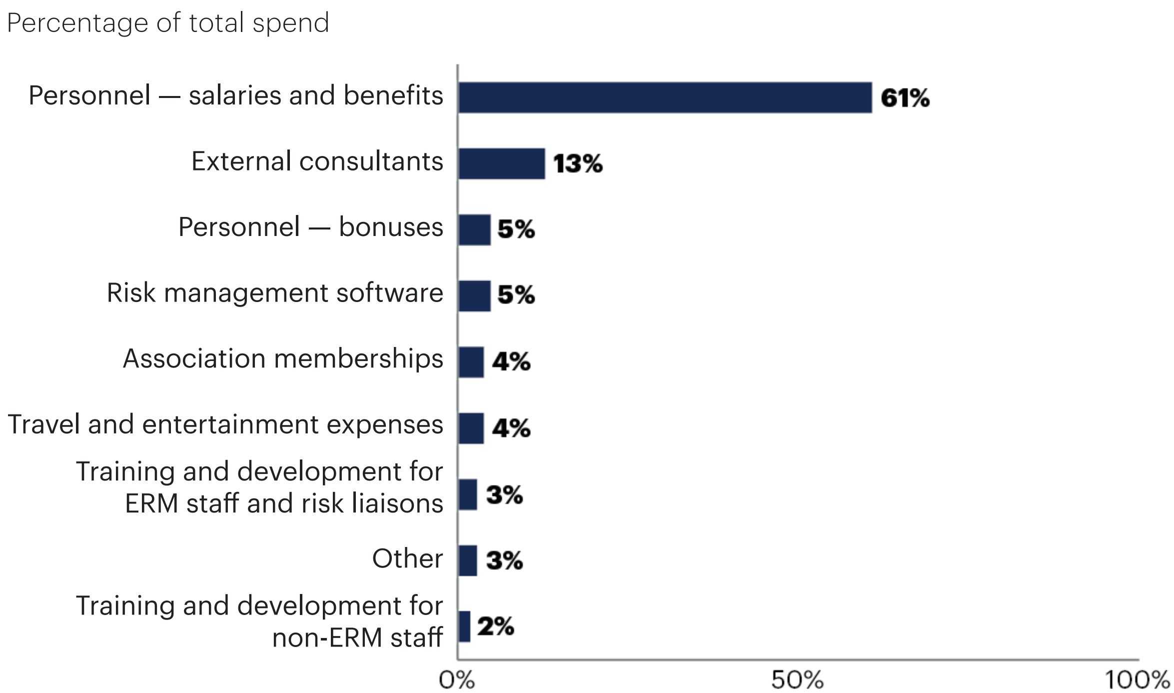
ERM heads should not only watch their function-specific indicators but also collaborate with other business leaders to leverage cross-functional dashboards that can forecast periods of economic uncertainty as accurately as possible. One way to do this is by collaborating with cross-functional leaders and external consultants/subject matter experts to build a cross-functional working group and regularly agree on functional indicators to stay ahead of economic developments.

2. Manage employee perceptions through uncertain economic conditions

According to our 2019 Gartner State of the ERM Survey, 66% of ERM's budget goes into paying employees' salaries and bonuses (see Figure 2). In case of a budget cut, we assume personnel will be among the first places management will look to curtail costs.

ERM heads therefore may hastily look at culling components from the functional budget, such as personnel costs, for quick savings. This could provide a short-term reprieve to the budget but will be detrimental to functional strategy in the long term. ERM heads should look at their functional objectives, both short-term and long-term, and then evaluate which cost, if cut, will minimally affect progress toward those objectives (for example, nonessential costs such as travel). ERM heads can reconcile staffing costs with reduced budgets where necessary by giving employees extended leave of absence or reclassifying them as contractors to avoid a "fire and hire" cycle.

Figure 2: Mean allocation of ERM funds



n = 115
Source: Gartner (2019)

However, despite such measures, uncertain economic times make it hard to retain valuable talent and improve employee productivity lost to distractions. To handle this, ERM heads should coordinate with the communications function to create a compelling summary of the results of a potential slowdown and the risks of not acting on it, and use existing channels to communicate it to employees as early as possible. ERM heads should also continually analyze communications sent through these channels to ensure they emphasize the message of planning and being prepared for the changes in the economy.

Apart from providing tools and resources to help managers understand the coming change, ERM heads should also help managers by facilitating conversations about this information with their teams. Review the checklist in Table 1 to ensure you meet your commitment to supporting managers.

Table 1: Checklist to support manager communication when anticipating uncertainty

Ensure managers comprehend crisis messages.	Check managers clearly understand the organization's crisis messaging around cost; if managers are confused, they will not effectively cascade information.
Facilitate dialogue.	Provide managers with talking points an alert them to potential areas of employee pushback to facilitate effective dialogue. Promote dialogue in formal and informal situations to help establish the norm of managers serving as a point of reference for employees.
Help managers grasp employee communications preferences.	Contribute to managers' understanding of their employees' preferences for and receptivity to challenge messaging by sharing insights from past experiences, other business units' communications efforts and/or employee survey results.
Provide managers with communications tools.	Determine cultural differences and address alignment challenges before deal closures.
Coach managers in appropriate delivery and follow-up procedures.	Provide managers with communications coaches, where available, to help build confidence in their ability to communicate effectively.

Source: Gartner

Another way to save cost is to look for measures to decrease dependence on contractors or external consultants. For example, ERM heads can increase team productivity by investing in training and workshops to enhance in-house capabilities. This will reduce the need to hire expensive external consultants and save cost.

3. Establish transparency of all functional cost drivers

ERM heads and their teams can navigate the turns by maintaining an overview of all short- and long-term investments throughout their function. During all phases of the economic business cycle, ERM should regularly benchmark functional cost drivers against externally and internally available data to gather all necessary information and enable sound decisions about cost optimization opportunities. Further, to identify the biggest opportunities for combined cost optimization across functions, heads of ERM should also encourage other business leaders to benchmark cost drivers in their respective functions.

4. Develop a robust action plan

ERM heads can identify and agree on potential cost optimization initiatives before the enterprise enters a slowdown. This helps them respond effectively when an economic slowdown arises. In general, cost optimization measures fall under at least one of the following major categories:

- Implementation of dedicated activities directly aimed at immediate cost savings
- Reprioritization of current services throughout the function
- Reallocation of current capacities throughout the function to drive short-term cost optimization while accounting for long-term growth

Three steps to establish a culture of sustainable and ongoing cost optimization

- Identify areas in scope for ERM cost optimization. Gather feedback on the ERM team's performance from inside and outside ERM and benchmark against peers to shortlist the top areas for cost optimization.
- Identify and prioritize ERM cost optimization initiatives. Review priority areas and evaluate the corresponding initiatives on criteria such as expected financial benefits, business impact, investment needed and time and work involved.
- Build and communicate the ERM cost optimization roadmap and present it to leadership.

Review our implementation guidance (see Table 2) when creating a cost optimization roadmap.

Table 2: Implementation guidance

Pitfalls	Keys to Success
Focus disproportionately on financial savings Being under high time pressure, leaders disproportionately focus on financial savings while selecting and prioritizing ERM cost optimization initiatives. Neglecting other criteria, such as needed time, investment and risks for the ERM function can lead to a negative business impact and a lack of stakeholder buy-in.	**Evaluate on multilevel criteria while planning ERM cost optimization initiatives** Analyze your potential functional cost optimization initiatives considering cost savings as well as further criteria (e.g., impact on the function and employee experience, strategic relevance, investment, time and risk for ERM activities).
Exclusively select and plan initiatives with functional leaders Business leaders and other stakeholders outside of ERM are left out of the decision process and are only informed, if at all, once an initiative is about to be implemented. The ERM function selects initiatives without considering their impact on the business's day-to-day work.	**Engage with stakeholders early to secure their buy-in** When designing the cost optimization roadmap, include stakeholders from the business and other relevant functions (e.g., HR) early in the process. Base your cost optimization approach on the business strategy and let stakeholders support you in choosing the cost optimization initiatives that yield a high business impact.
View functional cost optimization as a point-in-time activity Leaders often view ERM cost optimization initiatives as projects with a start and end date that only need to be started once the organization faces budget cuts.	**Embed ERM cost optimization as a continuous discipline** Create a culture of continuous cost optimization through tactics such as rewarding cost optimization ideas from the functional staff and including cost optimization metrics in functional dashboards and employee MBOs.

Source: Gartner

Key questions to ask yourself when creating a cost optimization roadmap

Think through the following questions as you create your cost optimization roadmap.

Cost cutting and project management

- What plans do you have in place for cost cutting? Have you identified areas where you can reduce organizational waste (e.g., office supplies, travel and expenses)?
- Have you identified what current and planned projects are essential, rather than "nice to have"? What will be the trade-off from deferring some high-investment projects?
- Are you investing in projects and technology capabilities now that will allow you to operate more efficiently during the downturn?
- How is your risk appetite set in terms of taking on additional projects as a result of the expected slowdown?
- What steps will you take to effectively manage projects under tightened budgets?
- What recent changes to your operations may increase the risk of a business incident or disruption?

Team

- How will your team be affected by potential cost-cutting measures?
- Have you considered alternatives to employee layoffs, such as hiring contractors and offering extended leave?

Scenario planning and risk monitoring

- Are you looking at scenario planning or modeling? If so, are the discussions based on realistic assumptions, data and/or events?
- Are you monitoring function-specific KRIs? Which KRIs are you monitoring?

Conclusion

Most ERM functions are not involved in the budgeting process and are only informed about budget cuts after the decision is finalized. As a result, ERM heads can find themselves reacting to the economic turns by taking ad hoc cost-cutting measures without accounting for these measures' long-term implications on business growth. Instead, ERM heads should take actions such as the following to navigate economic uncertainty and effectively plan and implement their cost optimization initiatives:

- Monitor economic indicators from a variety of internal and external data sources.
- Manage employees through uncertain economic conditions.
- Build knowledge of the function's cost drivers.
- Create a robust action plan.

About Gartner

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