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Core Concepts
For Portfolio Management

Cutting costs: How much is too much?
Evaluating the trade-off between cost reduction and worker productivity

Tough economic times bring increasing pressure to find every last penny of savings. CRE professionals understand that many cost-cutting strategies can reduce worker productivity and limit future flexibility. We also know how difficult it is to measure worker productivity. So how can we determine when our cost-cutting initiatives will be counter productive? And then explain why to senior executives?

Here's one way to look at the trade-off between cost reduction and worker productivity. What if you could make changes that would reduce real estate costs per worker by 10% (sounds good so far), but these change would reduce worker productivity by 2%. Should you make the changes? Probably not. Surprised? I was.

It takes a bit of math to explain why, but it's pretty simple.

First, we need a way to measure a worker's productivity, or in other words, his or her contribution to your organization's revenue. One way to measure that contribution is his or her total compensation, including salary and benefits. If the value of what worker contributes isn't at least as much as their compensation, then it doesn't make sense to keep them on the payroll.

In fact, a worker's contribution needs to be even greater than their compensation because the worker's contribution to revenue has to cover the costs of other resources, such as real estate and technology, as well. To keep the example simple, we will just use the worker's compensation as an estimate of his or her productivity.

The benefits of reducing real estate costs per worker by 10% would be completely offset if these changes reduced productivity by more than 2%.

Next, we need to make some assumptions about average costs for real estate and compensation. Once more, to keep things simple, let' assume the following.

- Average real estate costs per worker - $10,000.
- Average compensation per worker - $50,000.

In this case, a 10% reduction in real estate costs per worker would equal $1,000.

Now let's compare this 10% reduction to worker productivity. If the proposed changes would reduce revenue per worker, or productivity, by $1,000, then there would be no change in profits -- the reduction in revenue would equal the reduction in costs. No change in profits and no benefit.

Assuming that a worker's productivity equals compensation, in this case $50,000, what would a $1,000 reduction in productivity be in percentage terms -- $1,000 / $50,000 = 2%. In other words, the benefits of reducing real estate costs per worker by 10% would be completely offset if these changes reduced productivity by more than 2%.

Even if you have different values for real estate costs and compensation, we get similar results.

- What if the real estate costs per worker were $6,000 rather than $10,000? $600 / $50,000 = 1.2%.
- What if compensation was $30,000 rather than $50,000? $1,000 / $30,000 = 3.3%.

So what should we do when senior executives are challenging us to find every last penny in savings? Focus on opportunities to reduce costs without reducing productivity. Disposing of surplus space makes sense. Squeezing workers into half the space they usually use won't make sense if it reduces their productivity.

This result means portfolio managers need to be careful as they review current recommendations to reduce the empty seats that result because workers are off-site or are in meetings much of the time. If all you do is share workspaces, productivity is likely to suffer. Instead, follow the example of organizations that have increased workspace sharing and increased worker productivity at the same time by providing new types of workplaces or more workplaces that increase productivity -- more conference rooms, quiet rooms, and spaces to meet on an informal basis.

With this realization of how easily you can offset the benefits of cutting costs, it's even more important to understand your business, to look for ways to improve productivity, and to find opportunities to cut costs without reducing productivity. At Critical Core, we know there are other opportunities out there. Take a look at some of our other articles to find out.

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