



BELT-TIGHTENING BLUES

President Nixon's enactment of the 90-day "wage and price freeze" in 1971 appears to have met with mixed reaction from business circles. This would not seem surprising in view of the fact that the President's announcement climaxed a year of relatively ineffective inflationary curbs, declining corporate profits, and business uncertainties of massive proportions. Throughout most of 1970 and the initial months of 1971, our business community was faced with inflationary rises in operating costs, a soft consumer market, and tighter budgets.

The agribusiness industry in 1971 shared with others the dismal outlook of generally worsening economic conditions throughout. During the 18-month period beginning early in 1970, most firms in the agribusiness industry experienced only modest sales gains. This resulted in an unprecedented attempt to cut expenses -- yet at a time when almost every productive resource was rising in cost. In attempting to save thousands of dollars through ill-prepared-for expense reductions, industry executives, no doubt, wasted thousands of hours implementing poor operational policies and long-term defensive strategies.

By definition, to be effective, expense reductions must exceed the observable imbalances between income and costs of operations. Short-term opportunities that are lost as a result of management's preoccupation with ill-prepared-for expense cuts tend to aggravate this imbalance. To

compound the problem, expense cuts generally come in unpredictable cycles rather than as one-shot occurrences. The end result is that management rarely "plans ahead" for a possible expense cut. Only when the initiation of such a cut becomes blatantly evident does management take the time to build up their defenses. This hastily begun process of dealing with a budget cut generally brings tears to the eyes of even the most hardened executive. His mind suddenly becomes fully occupied with planning a series of counterstrategies designed to evade the cut entirely or, at least, diminish its painful impact. The final outcome can only be described as a case of the "belt-tightening blues."

The agribusiness industry *is* subject to the belt-tightening blues. To protect themselves from arbitrary expense cuts, agribusiness managers have spent great amounts of time during the past 18 months contemplating and initiating counterstrategies. Both the managerial time lost in building up the defense and the cost of actually launching the counterstrategy contribute to the long-term price paid for not having, in advance, a well-thought-out procedure for coping with short-term business reversals. This paper is designed to discuss several counterstrategies to the belt-tightening blues and describe both their advantages and disadvantages. Finally, a series of guidelines are provided which, hopefully, will enable agribusiness managers to better deal with the unpredictable expense cut.

The Genesis

When current conditions and business forecasts dictate the need for a general belt tightening, it's not long before the shock waves grow and reverberate throughout every corner of the business. The general manager is usually the first to feel the shock. He is suddenly faced with a challenging and usually unpleasant task, i.e., asking his staff to review its expenditures and report back on what and how much can be cut. The usual response is that each company division is already understaffed and unable to absorb a cut without "irreparable damage." A wise manager recognizes this ploy and proceeds rapidly into the second stage, i.e., asking his subordinates for an account-by-account summary of expenses, hence forcing the staff to justify their previous claim. If this strategy also fails to yield meaningful results, only one procedure remains, i.e., an arbitrary expense cut.

But, of course, the main problem with an arbitrary cut is that -- it is arbitrary. The arbitrary cut is indicative of management's inability to find a fair and reasonable method of expense reduction. In an attempt to show how necessary and just the arbitrary cut is, management finds it convenient to apply the cut, whatever the amount, equally to everyone. In so doing, management is making an open admission that it is unable to assess the productivity, efficiency, and priorities within its own business firm.

The Ten Percent Syndrome

Now that management has decided that its belt-tightening activities will consist of an arbitrary, but uniform, expense cut, how large is the cut to be? In a study by Earl R. Gomersall at S.M.U. and M.I.T., it was determined that approximately eighty percent of businesses chose ten percent as the magic number for arbitrary cost reductions. In Gomersall's opinion, an income-expense

imbalance of only four to five percent for at least four months is usually large enough to activate expense control adjustments. However, because a four to five percent cut appears too trifling and because things may get worse before they get better, a ten percent cut is believed to be more prudent. In the minds of management, ten percent has an aura of fairness, is large enough to have an impact but small enough so as not to bring complete havoc to operations, i.e., it trims the fat and leaves the lean. I do not deny the existence of this ten percent syndrome. Moreover, I have always found it perplexing that management finds it so easy to justify the need for a cut, yet so difficult to explain the exact amount of the cut.

Counterstrategies

Arbitrary though it may be, let's now assume that a ten percent cut in budget has been levied. What types of counterstrategies can the manager expect to evolve from his staff? More important, how does the manager identify the advantages and disadvantages of each? This discussion shall attempt to answer these questions.

The Sacrificed Future's Strategy: This strategy is evidenced by the experienced executive who, in anticipation of the unpredictable cut, intentionally submits an annual budget request that grows over time. Even though the scope of his operations remains static from year to year, his annual request for funds grows at a modest but steady rate. In this way, a cushion is built up in defense of the cut. If the cut does not materialize, he is praised for conducting his business at less than the allocated budget level. If the expense cut does occur, he simply returns that portion of his budget which he never intended to spend anyway. The returned monies are accompanied by a benevolent statement to the effect that these

funds represent future plans which he is willing to sacrifice for the good of the order.

The advantage of this strategy is that the executive feels he has done the firm a favor by preserving its productive resources to aid in a recovery effort. In addition, this strategy gains loyalty from the firm's employees who are led to believe that their talents are so highly regarded as to evade those cuts which are occurring elsewhere.

The disadvantages of this strategy should be readily apparent. First of all, the superficial increases in the annual budget request eventually may be detected. Second, a type of credibility gap is created within the management team because of the artificial budgets and the paper reductions. Finally, a type of distrust may be created between divisions of a firm, e.g., one division experiencing a painful cut in personnel may wonder why another division is left seemingly unaffected. Suspicions are, thereby, aroused and the eventual return to a period of normalcy becomes most difficult.

The Sink-Your-Buddy Strategy: In a multi-division business concern, it is not unusual for one division to purchase a set of services from another division. For example, the manufacturing division may be charged for its use of trucks from the firm's motor pool. In this manner, each division is held responsible for its own distinct costs and revenues.

The sink-your-buddy strategy calls for an attempt to force all or part of the ten percent cut onto another division without arousing suspicion. In a multi-division firm, this can be accomplished when one division ceases to purchase services from another division within the same firm. Hence, personnel who would normally be released from division A due to the cut are simply re-employed, performing those services which had

previously been purchased, internally, from division B. In this way, division A retains its personnel and when the economic crisis subsides, they can be reassigned to their pre-squeeze jobs and the services again purchased from division B.

What about the division which has not been charging for its services? Here the strategy calls for the institution of a modest charge which, by coincidence of course, just offsets the ten percent loss of funds. Hence, the net expense for the service decreases by the mandatory amount while gross expenditures remain unchanged.

The main disadvantage of the first illustration is that the termination of the purchased services is done at the expense of the non-expert personnel who were reassigned to do the work no longer purchased. Obvious inefficiencies, therefore, evolve. In the second illustration above, the service receiving division has been lulled into expecting the service free, is ill-prepared to perform the service internally, and faces a compounding of its budget problems by dealing with a budget cut and at the same time having to pay for services previously received free. Unless a special exemption from the cut is granted, this division may crumble under the burden and damage the operations of the entire firm.

The Dump-Your-Dependent Strategy: Many agribusiness firms are highly decentralized, or are becoming more so. Many farm supply cooperatives, for example, are regional in nature with branch retail outlets located throughout several states. Decentralization tends to obscure the state of dependency which exists between the head office and a firm's widely dispersed outlets. Yet such a dependency does exist, however, and is very important to a firm's operations.

The head office, in an attempt to abide by an expense cut, finds itself no longer in a position to provide a full line of service to its dependent outlets. It therefore transfers some of the head office personnel to distant outlets with the hope that such services can, thereby, be fulfilled locally. While such service may, in fact, be performed, the firm has only succeeded in dumping an added expense item onto the shoulders of its outlets; making it necessary for them to cut more than the originally requested ten percent from their budgets.

The Hit-Em-Where-It-Hurts Strategy: Most agribusiness managers will recognize this strategy without great difficulty. They have, no doubt, been confronted with it numerous times.

Suppose the general manager is about to levy a ten percent budget cut and asks his staff for a listing of probable repercussions. The staff member operating within the hit-em- where-it-hurts strategy will list the probable loss of those services with the greatest psychological impact on the manager and the firm. The elimination of first-class air travel for management personnel, for example, may seem like a minor item, yet have a considerable impact on the persons concerned. I can recall one manager who, when faced with the loss of his company-paid membership in the local athletic club, decided to take a more discerning look at prospective cuts.

Some managers fall victim of this strategy. While the staff may benefit from this “shock-em” tactic, a manager who does succumb opens a Pandora’s box of similar appeals from every member of his staff.

The Good Samaritan Strategy: Perhaps the most common strategy is that associated with

achieving the expense reductions without the loss of personnel, regardless of the end result.

It is relatively easy for a manager to eliminate inanimate objects, e.g., there is little emotional stigma associated with the shut down or sale of a machine. It is considerably more difficult, however, for a manager to release personnel, many of whom may have been with the organization several years. In order to retain the goodwill of his staff, the good samaritan manager searches his budget for items which are not people-oriented, e.g., travel, office supplies, supplemental equipment, etc.

Besides not adding to the unemployment roles, this strategy has other admirable attributes. Unfortunately, however, it also has limitations. If the cut is severe enough, for example, the manager may have preserved his people, but created a working environment such that no one can perform his job effectively. Ambitious and productive personnel become quickly disgruntled and leave the firm while the “deadwood” remain and entertain themselves in unproductive pursuits.

Preparation Guidelines

Several belt-tightening counterstrategies are described above. As shown, each strategy contains a series of unique characteristics, advantages, and disadvantages. Managers must be able to recognize these strategies, even anticipate them, if they are to survive an expense cut and avoid chaos.

Once the strategies evolve and are recognized by managers, how should they react to them? In answering this question, managers may wish to follow these guidelines:

- 1) Before actually initiating the cut, freeze the organization. Observe all aspects of your operation at a given

point in time. Then proceed to compute a series of pre-cut operating indices relating to levels of sales, salaries, operating expenses, and overhead. After the cut has been initiated, management can recalculate the series of indices and, using them as benchmarks, determine where the expense cut has had the greatest impact.

- 2) Do not permit any division to make any major change in its “modus operandi” just prior to, or immediately following the cut. This will prevent any attempt to evade or camouflage the reduced funding. In particular, prohibit any attempt by one division to divorce itself of the services purchased from another internal division or provided to decentralized outlets.
- 3) Double-check the people vs. non-people oriented phases of your operation. Insist that if people are to be retained, they be provided the tools with which to remain productive. If people are retained for purely humanitarian reasons, expenses are likely to explode to their pre-cut levels as soon as the pressure is off. It then becomes management’s responsibility to determine which of the expense explosions are warranted by increases in productivity.
- 4) When inequities are brought to your attention, deal with each on the basis that top priority must be given those areas where direct or indirect income producing possibilities can be demonstrated.

Prevention; Still the Best Cure

The guidelines listed above are broad and sometimes difficult to follow. At best, they

may only delay or partially alleviate the painful and lasting blow of an unexpected expense cut. One must, therefore, conclude that the least disruptive type of expense reduction is one controlled through ongoing self-regulation. As your business grows and/or declines with a variable economy, so should your expenses adjust themselves accordingly. This process of self-regulation is often referred to as “variable budgeting.” Variable budgeting is a scheme based on the premise that expenditures should vary in accordance with a predetermined business index. The index base is computed from levels of operations over at least a one-year period (the base period). Generally such items as product consumption, average invoice price, and profit on a per unit average price are used to compute the index because they are less apt to give false readings which result when consumer demand changes more rapidly than industries’ ability to respond. Once established, the index base is used to inflate or deflate all budgets in accordance with the current/base index ratio.

Once established, variable budgeting has as its advantages:

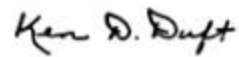
- 1) Establishes a common, predetermined expenditure policy, i.e., budget adjustments geared directly to a total firm barometer.
- 2) Has a recognizable sensitivity, e.g., no lag or lead-time exists wherein unforeseen crisis are likely to occur.
- 3) Forces management to prepare alternative plans of action in advance of the real crisis.
- 4) Provides a management-controlled balancing device for both good and poor economic conditions.

Some caution must also be exercised when variable budgeting is employed. For example, some business activities (such as in administrative areas) do not lend themselves to the direct measurement of output or productivity. Hence the base index becomes somewhat more difficult to arrive at. Also there is no guarantee that the base period to which future variations will be compared is itself a realistic indicator of the “norm” or a period from which future growth may be based.

Summary

Most industries experience periods of business expansion and contraction. To

survive those periods of economic decline, management must recognize the symptoms of belt tightening blues. Threatening expense cuts are likely to evoke numerous counterstrategies by management and/or its subordinates. It behooves managers to recognize these strategies, their advantages, and limitations. Following a series of preventive guidelines and a system of variable budgeting should assist managers in their control activities during periods of both good and bad business conditions.



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