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Cost Reduction Approaches in Service Businesses

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Abstract

In the highly competitive service industry, effective cost reduction is crucial for the success of service businesses. Properly managing costs not only ensure operational efficiency but also boosts profitability, competitive advantages, and customer satisfaction. This study aims to investigate the various cost reduction approaches adopted by service businesses. Data gathered from magazines, business news sources, and company websites from years 2020 to 2022 were analyzed to explore the cost reduction strategies implemented by various service providers, specifically excluding layoffs. The focus is on extracting information regarding service types and their corresponding cost reduction approaches, which will then be organized into a contingency table. Correspondence analysis will be utilized to identify the relationship between service types and cost reduction approaches. The results of this study reveal three main cost reduction approaches: process improvement, strategic approaches, and collaboration and creativity. Typically, various-service-oriented businesses tend to apply distinct approaches for cost reduction. Professional service prioritizes collaboration and creativity, service shop emphasizes strategic approaches, and mass service and service factory opt for process improvement. The findings have significant implications as they serve as a guidance for service businesses, enabling them to apply effective cost reduction methods, minimize expenses, and prevent wastage. Implementing these strategies will optimize operations, reduce costs, and escalate overall financial performance.

Keywords: cost reduction approaches, correspondence analysis, service types, service process matrix

1. Introduction

The service business landscape today, including healthcare, retail, restaurants, hotels, airlines, and more, is highly competitive. Both large and small businesses have encountered external threats, such as the recent pandemic and the rise in operational cost which has resulted in an increase in the overall cost of service delivery. Consequently, management is under immense pressures to optimize their finances to sustain their operations and find ways to reduce operational costs (IOMA, 2006). Hence, managing costs effectively is imperative for maximizing profitability and gaining a competitive advantage. However, one of the critical



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challenges in running service businesses lies in controlling and minimizing costs while still delivering exceptional services to their customers. Striking this balance is essential for service businesses to thrive in the competitive market.

Numerous academic studies have extensively focused on cost reduction strategies within manufacturing industries. However, there has been limited research dedicated to cost reduction in service-based sectors (Bragg, 2010; Jác et al., 2013). As a result, many service businesses lack guidance on implementing efficient cost-cutting measures while still maintaining excellent customer service to meet customer satisfaction. Therefore, the purpose of this study is to provide a comprehensive view of cost reduction approaches adopted specifically by service businesses.

2. Literature Review

2.1 Concept of Cost Reduction

Cost reduction, as defined by the Chartered Institute of Management Accountants (CIMA) in London, involves achieving tangible and sustainable decreases in the unit cost of manufactured goods or rendered services without compromising their intended use or diminishing product quality. It is a necessary process intended to reduce organizational expenses and drive profitability. Cost reduction comes into play after effective cost control measures have been implemented, acknowledging that no cost is truly at its optimal level. It starts with the premise that current or planned cost levels might be excessive, even if cost control measures are in place and operational efficiency is high (Egbide et al., 2019; Akeem, 2017). From different perspectives, there are several approaches to achieve cost reduction (Bello, 2019; Gaturu et al., 2022). These approaches include a wide range of strategies and tactics that service businesses can implement to optimize their operating costs, such as process optimization, automation, outsourcing, innovation and more. Each service business may find strategies that suit its specific needs and circumstances.

2.2 Service Process Matrix

The service process matrix as shown in Figure 1 illustrates service classification characteristics based on two criteria: labor intensity and service customization. Labor intensity is determined by the ratio of people to machinery, where a low-intensive labor business relies more on technology than human resources to deliver its services while a high-intensive labour business does the opposite. Service customization refers to whether the service is provided in the same manner to all customers or tailored individually for each customer (Schmenner, 1995).

Service process matrix divides service businesses into four distinct service types: service shop, profession service, service factory, and mass service as shown in Figure 1. Service shop

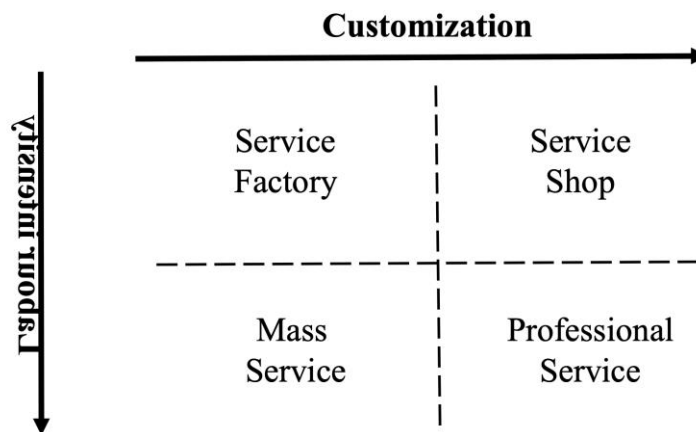


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establishments, such as hospitals, auto repair shops, and restaurants, offer customized services with relatively low labor intensity. Conversely, professional service providers, including doctors, lawyers, and accountants, deliver customized services with a high reliance on labor-intensive processes. On the other end of the spectrum, service factory businesses, such as trucking, hotels, and airlines, deliver standardized services with low labor intensity. Meanwhile, mass service operations, like retail firms, wholesale firms, and schools, provided standardized services but require a higher level of labor-intensive operations.

Figure 1: Service process matrix



Source: Schmenner, 1995

3. Research Methodology

Figure 2: Steps of research methodology



Figure 2 illustrates the methodology used in this research. Initially, a research framework was established by selecting 61 relevant articles from magazines, business news sources, and company websites from the years 2020 to 2022. Subsequently, each article was thoroughly analyzed, and two key pieces of information were extracted: the service organization it pertained to and the discussed cost reduction measures.



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To categorize the service organizations, the Service Process Matrix was utilized. Meanwhile, thematic analysis was employed to group the various cost reduction measures. Subsequently, a cross-tabulation was created to showcase the frequencies of these service types and themes of cost reduction.

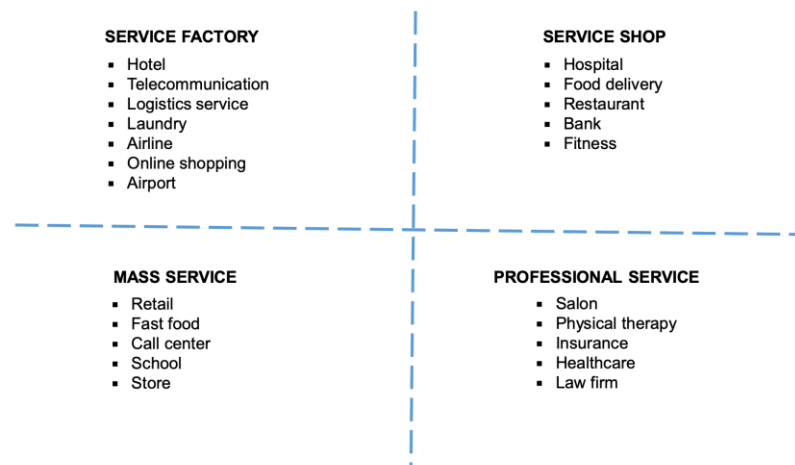
To understand the relationship between service types and themes of cost reduction, a correspondence analysis was conducted. This analytical process sheds light on the interrelation between the two variables within the study's context.

4. Research Results

4.1 Service Characteristics

The framework article identified twenty-two service businesses, which were then categorized into four service types: mass service, professional service, service factory, and service shop, as illustrated in the following figure:

Figure 3: Service businesses in this research



4.2 Cost Reduction Approaches

A variety of cost reduction measures were extracted and categorized into seven distinct patterns, as follow:

1. Elimination: Involves removing unnecessary products, services, processes, or activities, such as selling off obsolete equipment or discontinuing unpopular menu items.
2. Substitution: Focuses on finding cheaper alternatives and replacing existing ones, like switching to less expensive suppliers or using more cost-effective raw materials.



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3. **Combination:** Involves bundling elements together to obtain better pricing, for example, offering package deals or negotiating volume discounts with suppliers.
4. **Optimization:** Aims to make the best use of available resources or situations, such as training staff to perform multiple services or scheduling staff to match demand effectively.
5. **Reengineering:** Entails redesigning business processes to achieve significant improvements in performance, including outsourcing or implementing IT systems to reduce costs.
6. **Innovation:** Involves introducing novel approaches to cost reduction, like developing new processes that use less energy or introducing new menu items to optimize ingredient usage.
7. **Networking:** Focuses on interacting with other organizations to collaboratively reduce costs, such as partnering with suppliers to address cost-related issues or collaborating with third parties to lower expenses.

These seven patterns were grouped into three overarching themes:

Theme 1: Process Improvement - Comprising optimization and reengineering, this theme centers on enhancing efficiency and effectiveness by improving or restructuring existing processes.

Theme 2: Strategic Approaches - Encompassing elimination, substitution, and combination, this theme involves making changes or choices to achieve cost reduction objectives.

Theme 3: Collaboration and Creativity - Encompassing innovation and networking, this theme involves generating new ideas, methods, or services and establishing collaborative relationships with others.

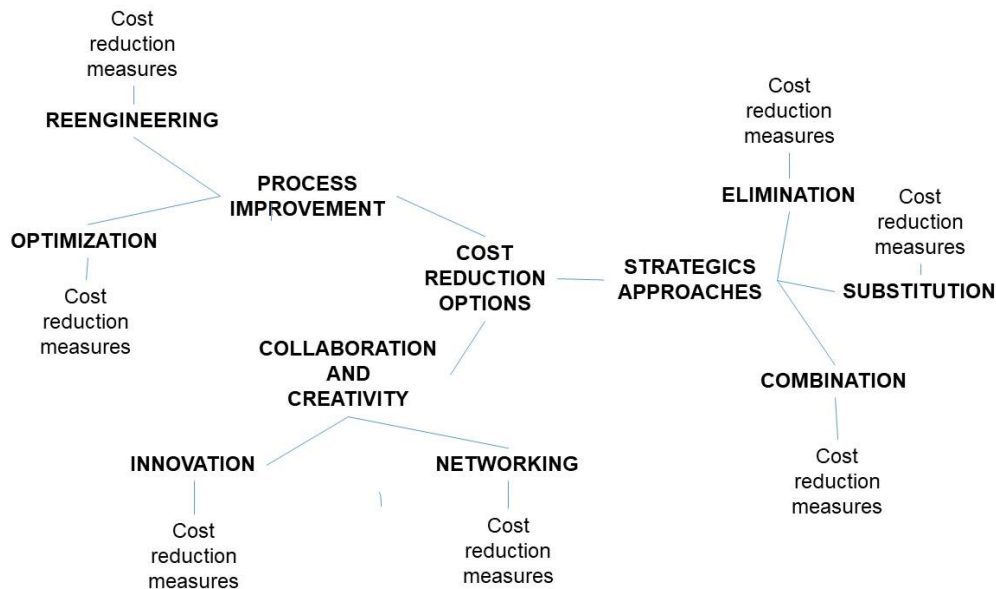
The complete summary of these patterns and themes is illustrated in Figure 4.



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Figure 4: Result of thematic analysis



4.3 Contingency Table

Next, a cross-tabulation or contingency table is created, incorporating two variables to serve as input for correspondence analysis. The first variable represents service types (mass service, professional service, service factory, and service shop), while the second variable represents cost reduction themes (process improvement, strategic approaches, and collaboration and creativity). Table 1 displays the frequencies of each variable pair, providing a comprehensive overview of their interrelationship.

Table 1: Contingency table

| Service Types | Theme of cost reduction | | |
|---------------------------|--------------------------|-------------------------|----------------------------------|
| | Strategic approaches (S) | Process improvement (P) | Collaboration and creativity (C) |
| Mass Service (MS) | 6 | 11 | 2 |
| Professional Service (PS) | 9 | 11 | 6 |
| Service Factory (SF) | 18 | 26 | 6 |
| Service Shop (SS) | 26 | 32 | 9 |



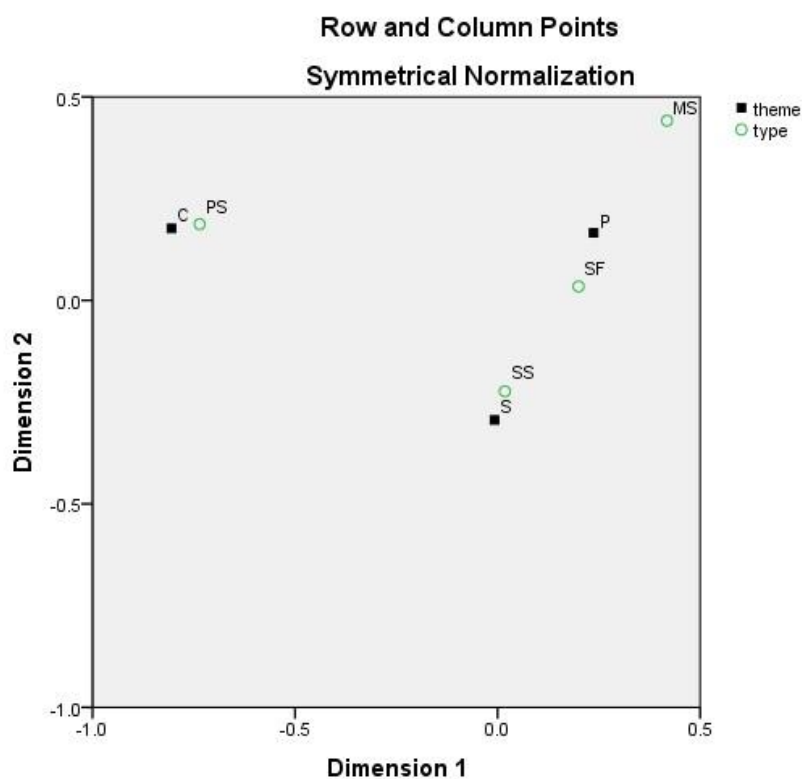
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4.4 Correspondence Analysis

Correspondence analysis uses the contingency table mentioned above as input data and transforms it into a graphical format to illustrate the relationships between the two variables as shown in Figure 5.

Figure 5: Result of correspondence analysis



The proximity of two points on the graph reflects the relationships between cost reduction themes and service types. A shorter distance indicates a closer relationship between them. The analysis of the graphic above shows that different service types adopt various cost reduction themes..

Professional services often embrace the collaboration and creativity theme, while service shops commonly adopt the strategic approaches theme. Service factory and mass service are more inclined to adopt the process improvement theme. These distinctions highlight how different service types align with distinct cost reduction themes.



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Additional results from correspondence analysis reveal that Dimension 1 accounts for 85% of the data interpretation, basically representing the degree of customization, while Dimension 2, with only 15%, represents labor intensity. Therefore, Dimension 1 holds greater significance in data interpretation compared to Dimension 2.

Furthermore, Dimension 1 divides the data into three distinct groups based on the degree of customization: high customization (points C and PS), moderate customization (points S and SS), and low customization (the remaining points). This suggests that service businesses adopt different cost reduction approaches based on their degrees of customization.

Service businesses with a high customization tend to adopt the collaboration and creativity approach to reduce costs. Those with low customization (leaning towards standardization) are more likely to adopt the process improvement approach. Meanwhile, service businesses with moderate customization typically opt for strategic approaches to minimize costs. These findings highlight the relationship between the level of customization and the chosen cost reduction strategies among service businesses.

5. Conclusion

To remain competitive and thrive, service businesses employ various cost-cutting methods. These methods can be categorized into seven distinct patterns: elimination, substitution, combination, optimization, reengineering, innovation, and networking approaches. These seven approaches are further organized into three overarching themes: process improvement, strategic approaches, and collaboration and creativity.

Within the process improvement theme, optimization and reengineering approaches are found. The strategic approaches theme includes elimination, substitution, and combination. The collaboration and creativity theme encompasses innovation and networking approaches. These themes are often tailored to suit the specific needs of different service businesses.

In practice, professional services tend to place a high priority on collaboration and creativity, while service shops tend to focus more on strategic approaches. Conversely, mass services and service factory often lean toward process improvement, with their choice influenced by the extent of customization in their operations.

The implications of these findings are significant. They offer valuable guidance for service businesses, enabling them to implement effective cost reduction methods, minimize expenses, and reduce waste. The adoption of these strategies can lead to optimized operations, cost reduction, and improved overall financial performance.

The limitation of this study lies in the data collection method, which relied on sources such as magazines, business news, and company websites from the relatively short timeframe of 2020 to 2022. This narrow time frame may not fully capture the long-term or evolving trends



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in cost reduction approaches within the dynamic service industry. Consequently, the findings may not be entirely representative of the entire service industry.

For future research, it is recommended to contemplate extending the time frame to encompass a broader range of years. This expansion would enable a more thorough examination of how cost reduction strategies have evolved over time. Such an approach would provide a deeper and more nuanced understanding of the dynamic nature of these strategies within the service sector.

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