Cost Optimization Initiatives: 10 Best Practices

White Paper

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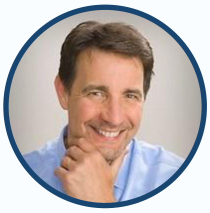

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Best Practices

Introduction

Operating at high levels of effectiveness, efficiency, and agility are essential to success in today's fast-moving, rapidly changing, highly completive business environment. Cost optimization is a key component of efficiency.

Also see my post "Efficiency vs. Cost Cutting: They are not the same thing, and the distinction is crucial!" to glean deeper insight into the concepts of effectiveness vs. efficiency vs. cost cutting vs. cost optimization.

In my companion post to this post - "Cost Optimization: Three Essential Strategies" I discuss three essential cost optimization strategies - Eliminate, Automate and Delegate. While not a prerequisite, reading the "Cost Optimization: Three Essential Strategies" post will provide the reader with additional context for this post.

1. Designate Cost Optimization as a Strategic Objective

An organization's strategic planning process results in strategic objectives aligned with the organization's forward-facing vision. Strategic objectives are communicated and cascaded to division/business units for execution at appropriate levels of the organization.

Designating cost optimization as a strategic objective helps ensure that cost optimization receives sufficient mindshare, visibility, and urgency from leadership to operational management where changes/improvements are identified, operationalized, and implemented.

If cost optimization is not a strategic objective it becomes just another "thing" that operational management needs to balance in terms of budget, time, talent and focus with many other competing "things" and the likelihood of cost optimization being addressed in an aggressive manner, particularly from a cross enterprise perspective, is low.

In any given strategic planning cycle there are many potential strategic objectives and perhaps cost optimization does not make the cut in a particular planning cycle. No problem. It's my experience that when the time is right, someone in leadership will connect with the concept of cost optimization and advocate for (and own) cost optimization as a strategic objective.

2. Ensure a Common Understanding of Cost Optimization

Business concepts, such as cost optimization are often ambiguous and lack clear consistent meaning across the organization. The concept of "Agile" is a great example. It's essential that everyone that is part of a cost optimization initiative have a clear, common, consistent understanding of the concept, …

and the distinctions between cost optimization and related concepts such as effectiveness, efficiency and cost cutting.

To add to the confusion there are a range of industry standard definitions of cost optimization. Conceptually they are all pretty much equivalent. A commonly referred to / accepted definition, put forth by the Gartner Group is: “Cost optimization is a business-focused, continuous discipline to drive spending and cost reduction, while maximizing business value.”

The important takeaway from that definition is that cost optimization is not simply cost cutting, it’s about getting maximum/optimal value from the investment in cost optimization opportunities.

3. Perform Cost Optimization from a Cross-Enterprise Business Process Perspective

Cost optimization can be performed on a stand-alone basis or, ideally, as part of a Business Process Reengineering (BPR) initiative. Regardless, it’s essential to analyze cost and identify opportunities to optimize cost from a cross enterprise business process perspective.

Three reasons:

A) Mitigates Process Sub-Optimization

Sub-optimization refers to optimizing a business process component (work activities, procedures, and/or workflows) within a functional silo (department, work team, etc.) in such a way that the optimization of the component within the silo negatively impacts (diminishes the effectiveness and/or efficiency) of the end-to-end business process as a whole across the enterprise.

The components of an end-to-end business process are interconnected. Accordingly, changes in a component in one part of the process could have unforeseen negative impacts on components of the processes that are performed in other functional areas. For example, the reduction in cost in one functional area could result in an increase in errors/defects that are discovered downstream in the process in another functional area.

Accordingly, any cost optimization opportunity needs to be evaluated across the process end-to-end to validate that the opportunity is indeed cost optimization not indiscriminate cost reduction within a functional silo.

B) Mitigates Process Cumulative Error

Cumulative error refers to the impact of the propagation of errors and defects through a business process. Simply stated, as an error or defect propagates through a process linearly, the cost of...

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remediating the error or defect grows exponentially.

Or, as I like to say regarding business systems requirements – the best time to identify and correctly specify a business systems requirement is during business systems analysis. A very bad time to discover that you missed a requirement or identified the requirement but “got it wrong” is when the systems “goes live” in production.

The same type of thinking applies to cost optimization. The best time to identify and properly analyze a cost optimization opportunity is during the analysis phase of a cost optimization initiative.

However, getting the analysis “wrong” in terms of cost-to-value leads to sub-optimal selection of opportunities from the opportunity backlog. The concept of an opportunity backlog is discussed in more detail in Best Practice #5: Approach Cost Optimization from an Agile Mindset

C) Promotes Process Harmonization

Process harmonization refers to the standardization of multiple instances of the same business processes within an organization.

For example, an organization could have a customer billing team in Atlanta that serves the East, Southeast and Southwest regions of the organization and another customer billing team in Phoenix that serves the Midwest, Mountain, and West Coast regions.

From a Business Process Reengineering (BPR) perspective the objective is to ensure that the Atlanta billing team and the Phoenix billing team are performing customer billing consistently between the two teams.

Also, from a BPR perspective we would also want to analyze the potential to consolidate and centralize the two teams. An important component of the decision to centralize vs. remain decentralized is the cost-to-value of each option.

4. Foster and Facilitate Collaboration

Cost optimization is a collaborative process. Cost optimization requires analysis and input from multiple stakeholder perspectives including hands-on staff performing work activities in business processes and related supervisors and managers; staff, supervisors and managers upstream and downstream in the process flow (see Sub Optimization above); IT professionals that support the technology and systems enabling the processes; customers and vendors as applicable; and any other stakeholders connected to the business process work activities within the scope of the cost optimization initiative.

Collaboration is about working together to achieve shared goals. It involves mutual engagement, sharing of knowledge, resources, and responsibilities, and is characterized by cooperative efforts rather than competitive ones. Collaboration is more than people talking together as a group. Collaboration is a shared creative process where the results (ideas, decisions, analysis, etc.) of group collaboration are greater than the sum of any individual efforts. All stakeholders contribute their unique perspectives and expertise, fostering innovation and problem-solving.

Collaboration requires high levels of sophisticated engagement among stakeholders to achieve shard goals. In my experience, collaboration does not happen organically in most organizations. Collaboration typically requires an impartial (objective and detached), but knowledgeable, facilitator (internal or external to the organization).

5. Approach Cost Optimization from an Agile Mindset

The concept of Agile is often misunderstood. Agile is not necessarily about being fast (although Agile can be fast). From the perspective of cost optimization, Agile is about 1) identifying, analyzing, and ranking opportunities based on cost-to-value (CTV); 2) adding those opportunities to a backlog of opportunities; 3) selecting opportunities to operationalize and implement that have the largest impact on the organization based on time-to-value (TTV) constraints (e.g., time, budget, talent, etc.).

Clearly, I am overly simplifying the concept of Agile a bit. However, for the purpose of this discussion the above captures the essence of an Agile mindset regarding cost optimization.

6. Operationalize and Implement Opportunities in Cohesive Sprints

Continuing our discussion of approaching cost optimization from an Agile mindset, in addition to cost-to-value (CTV) and time-to-value (TTV) considerations, cost optimization opportunities are…

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The concept of a "sprint" in Agile is a high-intensity, short-duration (typically 2-5 weeks) tightly scoped project to operationalize and implement a set of opportunities from the backlog. The opportunities comprising the sprint are related based on some form of affinity among the opportunities.

For example, perhaps the opportunities included in the first sprint are low-tech/no-tech quick-win changes that are not dependent on other changes. Or, for example, a set of opportunities are included as a sprint because they are enabled by a related set of changes in application software functionality.

Some sprints can be performed in parallel with other sprints. Other sprints are performed in a serial relationship with other sprints because the operationalization and implementation of the opportunities in a particular sprint are dependent on the operationalization and implementation of opportunities in a prior sprint.

7. Identify and Track Performance Metrics and KPIs

Performance metrics measure the performance of activities that are associated with successful outcomes. Performance metrics are measured on an on-going relatively in-the-moment basis to track current performance vs. goals. Performance metrics are operational/tactical and enable analysis to support mid-course corrections.

A Key Performance Indicator (KPI) is a performance metric that indicates how effectively an organization is achieving key business/strategic objectives. KPIs are typically linked to organizational strategy in terms of, for example, revenue growth, market share, etc.

Performance metrics and KPIs in connection with cost optimization are primarily related to Cost-to-Value (CTV) and Time-to-Value (TTV)

CTV

Cost-to-Value (also known as the cost-benefit ratio) measures the benefits or value of investments in smart cost reduction opportunities and in productivity/yield opportunities.

Smart cost reductions are based on efficiency – reducing the cost of operations while still achieving specified levels of effectiveness. Productivity/yield is based on improving operational performance via smart investment in, for example, technology, people, etc. See best practice #10 below: "Spend Money to Make Money"

TTV

Time-to-Value is a metric used to measure the amount of time it takes to realize the benefits or value from the investment in a cost optimization opportunity. It represents the duration between the initiation of a cost optimization initiative and the point (and waypoints along the journey) at which the desired outcomes are achieved

Regardless of the metrics that you choose to track cost optimization opportunities it's essential to define the current state value of each metric, the target future state value of each metric and estimates of the value of each of the metrics at various time intervals along the journey to the future state to assess and enable mid-course corrections.

8. Transition From Strategic Objective to Continuous Improvement

There are two types of business change initiatives - transformational change initiatives and incremental continuous change (improvement) initiatives. Transformational initiatives are strategic, typically disruptive to the current state, move the needle towards the organization's future state strategic vision, and are conducted periodically. Incremental continuous improvement initiatives are ongoing. The focus is on incrementally, but continually, identifying and implementing changes that improve the current state. Both transformational and incremental change initiatives are essential to the continuing success of an organization.

Best practice #1 in this whitepaper is "Designate Cost Optimization as a Strategic Objective." Accordingly, if an organization has traditionally treated cost optimization as a series of ad-hoc informal incremental improvement initiatives, it's time to step it

up and move forward with a transformational cost optimization initiative to move the needle towards the organization's strategic vision. This will result in cost optimization opportunities from incremental to strategic and from low-tech/no-tech to tech driven changes.

Upon completion of the transformational initiative, transition cost optimization to ongoing incremental improvement. In other words, cost optimization becomes part of the organization's culture at every level of the organization and everyone in the organization becomes cost optimization aware. At this point, cost optimization typically becomes one of the assessment criteria in quarterly and/or annual reviews of staff, supervisors and management.

9. Apply a Best Practice Framework

A framework is a broad set of guidelines or principles that provides a basic structure that guides various types of complex initiatives such as Business Process Reengineering (BPR), Cost Optimization, Agile Development, ITIL/ITSM, etc.

A framework differs from a methodology in that a framework is descriptive (rather than prescriptive) – providing a general approach or a structure for organizing and executing a type of initiative such as cost optimization. Unlike a methodology, a framework does not specify specific steps, it provides guidance regarding how to approach the problem, leaving room for flexibility depending on the specifics of the initiative and the organization's knowledge, experience, and expertise in the space.

The cost optimization best practices presented in this whitepaper provide a starting point for developing a cost optimization framework tailored to your organization. Alternatively, start with an industry standard framework and integrate these best practices into the industry standard framework.

10. Spend (invest) Money to Make Money

It's important to remember we are talking about cost optimization not indiscriminate cost cutting. Indiscriminate cost cutting leads to sub optimization (see best practice #3: Perform Cost Optimization from a Cross-Enterprise Business Process Perspective) which can, and typically does, negatively impact customer and business value. Indiscriminate cost cutting is a short-term survival tactic, not a sustainable strategy.

Cost optimization is a strategic value driven concept. Smart investment in technology, education, etc. typically results in significant Cost-to-Value (CTV) return on investment. For example, Robotic Process Automation (RPA) enables organizations to automate recurring, rules-based, mechanical steps in business process work activities, procedures and workflows that are currently performed manually. The resources currently performing this work can then be upskilled and assigned to higher-value knowledge and judgment-based work.

Summary

Apply the best practices presented in this white paper to provide a basis for consistent repeatable success in cost optimization as a strategic initiative and as you transition from cost optimization as a strategic initiative to cost optimization as continuous improvement.

Another key takeaway is that cost optimization as a strategic initiative and cost optimization as continuous improvement unlocks funds that can be allocated to other strategic initiatives such as Business Process Reengineering to further increase the effectiveness, efficiency, and agility of your organization.

Next Steps

Let's start a conversation regarding your cost optimization goals and objectives and how our **cost optimization solutions workshop** can assist in your journey. (https://www.inteqgroup.com/business-process-workshops-series#cost-optimization)

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