

Effective Cost Management : Key to Surviving and Thriving in Uncertain Times

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The Perspective

These are unprecedented times; confronting many businesses with challenges and questions they never faced before. The Covid-19 pandemic has caused significant disruptions to the way businesses operate. Consequently, cost, operating and business models have drifted away from each other. During such crises, the unprepared are quickly confronted with a plummeting top-line and are struggling to adjust their cost model.

There is no question that the COVID-19 situation has or will result into a cost optimization exercise for many companies. Temporary freezes on new hires, renegotiation of key contracts, review or delay of CAPEX investments, optimization of inventory levels or cut of performance rewards. These are examples of typical tactical short-term oriented cost-savings actions. Nevertheless, there is more to tell about the cost story: whilst short-term initiatives are necessary to cope with the current situation, a more structured and strategic reflection on cost models is required to boost recovery and prepare the business to thrive during these uncertain times.

The situation many organizations are confronted with today is the consequence of a limited, structural focus on costs prior the virus outbreak. Whilst time and effort were mainly spent modelling future revenues, little attention was given to the supporting cost model. The current COVID-19 outbreak, highlights two major flaws when paying little attention to your cost model

A lack of cost transparency preventing a central steering, a structural control and a strategic reorientation of the bottom line, and Business and finance working as stand-alone departments resulting in a lack of mutual understanding. As a consequence, many businesses are losing track of where costs reside, their origin, their nature

COVID-19: Rethinking how to manage cost in a time of crisis

To be prepared facing a new crisis such as the COVID-19 pandemic, companies have to swiftly adjust their cost models relying upon a truly agile and scalable business, including: Decreased amount of effort and costs dedicated to non-strategic activities Minimized effects of organizational weakness Reduced level of inefficiencies Improved flow of resources to areas of strategic importance.

Short-term

The perception and reality of cost and value transformation

provides an accurate picture of an organization's costs and value drivers, including the relative cost of various capabilities and processes, the balance of which may have shifted during the crisis. Benchmarking against peer organizations, industry leaders, and even the "art of the possible" can help identify and map the biggest pockets of spending for cost optimization to stabilize cash flow and reduce risk

The following cost optimization strategies may be carefully looked into in terms of their potential to align costs to the Organizational activities and bring about the desired outcomes :

- **Do without:** This boils down to asking the question 'what can we do without'. The key to answering this question is identifying costs that serve as drivers of profitable growth (good costs) and differentiating such from costs that are not directly linked to business capabilities (bad costs). This decision is based on the management's discretion.
- **Do better:** This indicates how existing processes can be simplified to reduce error and costs. Each process within the organization should be reviewed. As a result of such review, duplicated roles can be discovered and eliminated. Also, areas where automation is needed can be identified and implementation is made.
- **Do with less:** The important question here is 'how can I get the same results but with less costs?' Identifying portfolio of assets that are unproductive to be disposed off or reduced without affecting the present result is key.
- **Do differently:** Management must finally ask the question of 'If we must do this, can we do it differently?' Activities that are not core to the business can be outsourced to save cost and create more time to focus on core activities.

Long Term

In determining the right level of organizational capacity for the long term, organizations should recognize that vendor negotiations, direct and indirect spend reduction, and IT spend optimization can often create more desirable long-term impact. Our analysis of past recessions teaches us one more lesson: Companies which have not only focused on cost management but have – in addition – used the recession for more strategic and transformational moves like M&A, portfolio optimization or re-organizations have come out of the recession faster and more profitable than those with

short-term cost focus. Companies that are strong enough for such moves and with leaders who have the appropriate strategic vision have a unique opportunity. Seize it.

Categorize Your Costs

- **Strategic vs. Nonstrategic** : Strategic costs directly contribute to building advantages and enhancing activities, while nonstrategic do not. Determining whether a cost is strategic or not requires you to have a strategy. Strategy revolves around making decisions about trade-offs and allocating scarce resources.
- **Avoidable vs. Non avoidable** : Avoidable costs are variable expenses that can be easily eliminated without impacting your business either operationally or contractually. Avoidable costs are not fundamental to operations. Therefore, cutting these costs should not cause significant or lasting detriment to the business.
- **Opportunity Costs** : Opportunity costs are the benefits your organization forgoes when choosing an alternate option. For example, reducing expenses for employee training, on the surface, may appear to minimally impact short-term operations. However, the intangible impact of this cost cut goes deeper.

Cost Optimization Approaches

- **Cost management strategy from “Save-to-Transform**: Organizations need to evolve into a “Save-to-Thrive” mindset, in which they should accelerate strategic transformation actions specifically in response to challenges posed by COVID-19 to make shifts to their operating models, products and services and customer engagement capabilities.
- **Use “now, near, far” framework for recovery planning**. This framework involves understanding how the business is performing financially right now, managing resources in the near term to support long-term strategies, and creating a strategic path for the future.
- **Your cost baseline is transparent** : There must be consistent and aligned data on addressable cost categories with a clear view on cost kinds (e.g. personnel, supplier spend, etc.), cost nature (fixed, variable, etc.), cost drivers (e.g. activity volume asset size), and cost origin (e.g. transfer pricing, cost re-charges)
- **Have a cost governance structure in place** : The cost savings initiatives should be endorsed by the leadership team. There must be processes, skills and tools available to deliver and monitor these initiatives
- **Employ consistent frameworks, clear measures of success and cross-functional collaboration**: consider the business and operating model – not just cost savings, understand trade-offs between costs, income, impacts on customer service and risk, adjust or eliminate underperforming operations or investments, prepare to invest in certain cases to get a better outcome, embed a culture of high performance and cost leadership.

- **Be thoughtful about costing strategy** : Being thoughtful about costing as well as continuously looking for ways to improve on costing accuracy involves using modern tools to support strategic decisions. The old model of costing where we wanted to get more accurate information always involved a tremendous amount of extra effort and more resources. Today, there are a lot of ways we can bring in new sources of data, increase the accuracy but also automate all of those processes. We can do both today. We can be more efficient in our costing, and we can also increase the accuracy of all the data that's coming in and the reliability and the trustworthiness of that data.

This requires a strategic approach to cost management

World-class companies view costs as inputs to drive current and short-term revenue growth and innovations to sustain these in the medium- or long-term horizon. But it's the management of these costs – their transparency and consistent interrogation – which sets the bar and differentiates cost line-items and their levels across the spectrum of effectiveness or redundancy. In short, the optimization of cost occurs when it achieves appropriate alignment between the company's strategy and its execution.

This requires an enterprise-wide assessment of costs, across all divisions and throughout the value chain. The objective is to improve all-round enterprise effectiveness – operationally, in terms of customer satisfaction, employee engagement, and returns. Fine-tuning budgets to allocate spending where it can strengthen key initiatives supports the principle of a relentless commitment to CI

Checklist to align costs to strategy

- Take an enterprise-wide view, not divisional or functional.
- Zero-base. Scrap the ‘last year plus a percentage’ budgeting framework. Re-evaluate costs based on their necessity in delivering the company's value proposition and enabling competitive capabilities.
- Have all processes and systems been evaluated for agile and flexible capabilities
- Streamline, cut or outsource underperforming systems or projects.
- Benchmark. Have key performance areas been targeted against goals, referencing internal benchmarks, industry averages, and specific leading competitor data?
- Are layers of cost complexity reduced?
- Does the strategy include a plan to accelerate automation?
- Invest in technologies which improve visibility, data accessibility and decision-making support tools such as predictive analytics.
- Empower cross-functional teams to identify and

implement improvement measures and profit improvement projects. This will foster a permanent cost awareness and feedback culture.

- Look forward. As a crisis response, cost-cuts have become necessary. Now, make the exercise iterative – a regular review of efficiency and effectiveness reinforces the discipline of improvement.

Set a Strategy for Future Growth with a Crisis Cost Management Analysis :

Crisis cost management analysis focuses on the six key imperatives to successfully navigate disruption.

- **Strategy** : Defining new business strategy during disruption is crucial. Every element where you compete, in terms of geography, product, customer and product segments, and value proposition needs to be validated and adjusted to set the course to a sustainable outcome.
- **Operating Models** : Though it may seem counterintuitive, now may be an appropriate time to pursue ,analyze and restructure operating model of the company for a quicker return with strategic expertise and enhanced capabilities.
- **Risk and Tradeoff** : As you identify potential opportunity areas during this period, it's important to also assess the risk they present. This can be done through various actions: Establish cost baseline and profit margins that sustain the business, Set criteria to assess risk appetite and sensitivity analysis for downside scenarios, Establish framework to compare risk against opportunity costs, Evaluate M&A as a strategic alternative to gain market share
- **Scenario Analysis** : With uncertainty ahead, it's important to envision how implemented strategies could play out. To perform a scenario analysis, your company could : Assess production reorganization, Assess risks to ensure continuity of supply, Estimate supply chain restructuring impacts, Determine back-

office consolidation options, Evaluate technology and process improvements

- **Financial Analysis** : Understanding the profitability of your different customers, channels, and markets may uncover costs that could be eliminated immediately. This could be an opportune time to double down on core and profitable products. These analyses can be done: Develop cost structure for new operating model, Assess working capital, cash management, and asset utilization, Reduce discretionary expenses such as travel, bonuses, and hiring, Prepare zero-based budgets and assess options for variable cost models
- **People and Communications** : To implement new business structures and models, you'll want to make sure employees are aware of what actions and responsibilities are expected of them.

Conclusion

As the world continues to combat COVID-19, having cost optimization strategies for navigating remediation is essential. However, cutting costs without clear segmentation during an economic downturn is not the recipe for success. Cost adjustments do need to be made, but the goal should be to strike the right balance between targeted, sustainable and smart spending to fuel your organization for growth. Initiate cost adjustments to streamline and simplify business operations. Concentrate your spending on areas of the business that drives the greatest value and differentiation.

The economic crisis caused by coronavirus (COVID-19) is only just beginning and many industries have already been impacted .Cost optimization is about improving capabilities –not just cost cutting. Identifying the right cost opportunities and having a plan will avoid unnecessary negative impact to your business, customers and staff.. Manage the lifecycle of this crisis – not just the event. Proactive businesses that renew their focus on costs and act before they are forced to will emerge stronger. ■

Congratulations!!!



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Fellow member and Ex-Chairperson of Nashik Ojhar Chapter of Cost Accountants of India has been designated as member on National Advisory Board of Women Entrepreneurs Development Council. WEDC is initiated by SME chamber of India, India International Trade Center & Start Ups Council of India.