

## Cost Reduction vs. Optimization

*By Zahid Khalid  
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When revenues are threatened due to a weak economy, the only viable option for protecting cash flow and profits that is not controlled by the economy, the customers, or the competition seems to be cost reduction. Unfortunately, too many businesses translate cost reduction into headcount reduction or scaling back on products, services, and quality. Taking this approach to cost reduction neglects how the “capability” of the organization is impacted. After all, the existing headcount was in place to support the necessary processes. Unless those processes are changed, a simple reduction in headcount often leads to a diminished capability to deliver goods and services at a quality level that the customer values. In addition, it demoralizes the remaining staff as they have to pick up the slack created by the headcount reduction in a process that still demands a higher headcount for excellence in execution.

There *is* a better way that is catching on with world class companies – *Cost Optimization*. This approach has a different focus than simple cost reduction. The focus instead is on balancing *Cost* and *Capability*. Ideally, a business would be able to attain 100% of

needed capability at 0% of the cost. This, however, is not possible. So the challenge is to determine the optimal level of capability that the enterprise needs and then find a way to achieve that capability level at the lowest possible cost. The target level of capability depends on the unique objectives, strategies, culture, and other elements of a business. This is not a one-size-fits-all matter. The reward of achieving this balance is **sustainable maximum profitability** at any given level of revenue. This higher level of profitability results from:

- Improved EBITDA due to lower overhead expense (lean process = lower cost)
- Higher Working Capital turns due to a shorter Cash Conversion Cycle
- Improved use of cash due to faster cash flow

Achieving this balance demands a scientific approach to process improvement. Such an approach has to be very data-driven, facts-based, and rigorous and supported by tools that enforce objectively in decision-making.

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