Measuring the true cost of a process

By Zahid Khalid
October 12, 2008

When calculating the Return on Investment (ROI) for a process optimization initiative, a surprisingly large number of organizations ignore certain cost components such as the opportunity cost of doing nothing. These cost components taken together often constitute a significant part of the total ROI. Ignoring these costs dilutes the ROI to such an extent that either the initiative does not meet the organization's approval criteria or the true drivers of business objectives are lost in the data. As a result, an opportunity for increasing enterprise value materially is lost.

For example, when measuring the cost of any of the Working Capital (WC) processes, such as Accounts Payable, Accounts Receivable, and purchasing, one cannot ignore the impact on Cash Conversion Cycle (CCC) that each of these processes has. Why is that important? Because CCC times the average daily sales is a measure of the funding needs of the organization. Companies that don't get this right find themselves in a liquidity crisis sooner or later. Therefore, when measuring the cost of these processes, one must include the very real benefit to be gained by improving metrics such as Days Sales Outstanding (DSO) through process improvement.

Processes are hard to measure for those not skilled in the task. It is a very scientific exercise and requires the right skills, mindset, tool, and methodology. It also requires data-driven objectivity which is one of the most critical elements missing in an in-house effort to execute this task.

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