



How to Optimize When Managing Costs

by [Andrew Cooke](#), [Blue Sky GPS](#)

How to identify which costs need to be addressed, their importance and impact, and how to develop and prioritise your cost management program for the optimal effect.



Many businesses are concerned with the changes that are occurring in their marketplaces. Changes in expenditure by major industry players, pressure for changing economic conditions, government policy and actions and a myriad of other factors are coalescing to raise the issue of managing costs to the fore.

In an [earlier post](#) I distinguished between managing costs and cutting costs and why you should manage costs and *not* cut them. They are fundamentally different - cost-cuttings takes the perspective of costs being a problem and are seen as being inherently negative in their nature; managing costs sees costs as an opportunity from which to create alternative positive futures for the business. In this article we are adopting the lens or perspective of *managing costs*.

But what do we mean by costs. For the purposes of this article I would like to provide an operational definition of costs as being:

- a payment before something can be done or acquired
- an effort, loss or sacrifice necessary to achieve something
- a loss or unpleasant consequence

When we look at cost-cutting we are generally looking to reduce the first, to try to avoid the second, but we often end up with the third! Why is this? Especially when we are looking for an opposite outcome?

There are 3 main reasons for this:



1. *Costs are not just financial* - people tend focus on the financial aspect of costs as they are the most visible and easiest to measure, they rarely look beyond the numbers;
2. *Costs do not exist in isolation* - people do not understand the extent to which costs have an impact beyond their direct area or function, or how they interrelate;
3. *Costs have opportunity-costs* - if you are not measuring them it does not mean they do not exist.

Managing Costs & Your Return on Investment (RoI)

When we are looking at managing costs there are 3 key areas we need to understand before we can begin the process:

1. **Outcomes** – *what are the business outcomes and results that we are looking to achieve?* Underlying this you also need to understand what the individual drivers are for those who are making the decision and/or implementing the cost management process. The individual drivers are often stronger than the business drivers, and will determine the effectiveness of the plan to manage costs.
2. **Metrics** – *how will you know that you are making progress in this?* Do not restrain yourself to financial metrics here; you will be missing a world of opportunity. Metrics can be quantitative or qualitative, subjective or objective, or anecdotal or observed.
3. **Value/Benefits** – *how will the business and the individuals concerned benefit from achieving the outcomes identified? What will it mean for the business and for them?*

We need to do this prior to starting the work. Why? Because we need to understand what the potential Return on Investment is from doing this.

The RoI, although financial in its origins, also needs to be understood as regards non-financial aspects. For example, there are financial benefits in reducing employee turnover – a common rule of thumb is to take the employee's salary and multiply it by a factor of 1.5. However, the benefit of being able to retain key people includes aspect such as the



continuation of key client relationships, retention of corporate knowledge and experience, maintenance of performing teams etcetera. What value do you put on these? Saying it is too difficult to assess is not a response. These 'soft benefits' are often intangible, hard to evaluate in quantitative terms, but are highly visible when they are not present. Do not ask yourself "What is the financial ROI?" ask yourself this instead:

"What are the 'soft benefits' associated with this initiative, if we do not realise them then how will this impact our ability to achieve the outcomes we seek?"

Understanding Your Costs

Let's take a step back. When we are managing costs we need to understand their key attributes. In doing this we need to avoid looking at the costs in their silos, and adopt an enterprise-wide view of what they are, where they are, their influence and their relative importance. This includes the costs':

1. **Shadow** – *not all costs are equal, and some are more equal than others!* This looks at the extent to which a certain area, for which there are clear costs, cast a "shadow" and influences other costs. For example, the design aspect of a project is small in terms of overall costs – but is significant in terms of its "shadow", in how it influences subsequent costs in the construction and/or production stage of the project.

We can assess the 'shadow' in 3 dimensions:

- **Length** - how far down the line does the output from that cost have an effect.
- **Breadth** – how far along the process in which that cost occurs does the cost have an effect.
- **Duration** – does this impact last for a long-time or it ephemeral in its nature as regards the output/outcome.



For example, the costs incurred in the design aspect of a project has a shadow that can be described as below:

| Factor | Impact | Description |
|-----------------|------------------|---|
| Length | Long | The output of the design produces the plan which determines how the building is constructed and finished. This goes to the completion of the project. |
| Breadth | Short | The design process occurs mainly at the start of the project. Once it is finalized the next step of the process begins which incur other costs. |
| Duration | Permanent | The final output /outcome of the design costs, the building itself, is long-term, it is the building itself. |

2. Size – the dollar/euro/pound sterling costs incurred with a particular area or function as a value, and as a percentage of the whole process and/or sub-process.

3. Scope– this looks at how these costs are interrelated to costs and revenue streams elsewhere in the business. In looking at these you also need to be aware of the associated opportunity-costs in reducing or increasing these costs, or if you change the ‘blend’ of costs. For example, increasing the level of automation on a production line will impact the variable costs, as well as the fixed costs. However, it may enable a wider range of products to be produced from the same production line and contribute to the creation of new revenue streams.

Andrew’s Six Factors for Prioritising When Managing Costs

Once you have a holistic understanding of your existing costs; and you are clear on your outcomes, metrics and benefits/value; you need to prioritise which costs to address and how. In doing this consider:



1. **The Scope of Managing the Costs** – how extensive will this cost management program be? If you work on a silo-basis you are likely to incur costs in managing the costs, and are likely to reduce the benefits and returns you are looking for.
2. **Growth Opportunities** – where are the current and future growth opportunities? Where are they *not*? You need to manage costs carefully; improper cost management can be detrimental and could damage the business, or you could miss out on opportunities.
3. **Long-term Commitment** – are you willing and able to take a long-term perspective. Short-term 'slash-and-burn' approaches associated with cost-cutting tend to destroy value and capacity.
4. **Manage the Change** – how will you communicate this process/program throughout the business and *engage* the workforce in it. Failure often comes at the tactical level when people either implement poorly due to misunderstanding what has to be done and why, or may be sabotaged through passivity. You need to create commitment, not compliance.
5. **Strategic Investments** – be clear on what your strategic investments are, those areas which are critical to sustained performance and profitability.
6. **Understand Your Business Model** – thoroughly understand the components of your business model, how they integrate, and how the business model could be improved.

What do you do to manage your costs? What are the problems and barriers that you are faced with? How do you overcome them or not? Share your ideas, insights and experience – ask your questions here!

Until then share your thoughts and ideas here, and feel free to share this blog and articles with any colleagues, clients or friends you feel may find this of value. If you have any particular areas of interest you would like article on then please let me know.

Share your ideas, and share the wealth!



About Andrew Cooke and Blue Sky GPS (Growth & Profit Solutions)

Andrew Cooke

An experienced executive coach, business facilitator, and management consultant Andrew has more than 25 years' national and international experience, working across a range of industries and businesses. He is passionate in helping people, teams and companies to unlock their individual and collective potential, enabling them to achieve their personal and business goals and, in turn, to help them unlock the potential of others.

Andrew has extensive experience in dealing with both blue-chip and start-up companies, and has had extensive international experience in the UK, the Middle East and Ireland across a range of industries.

He has post-graduate business qualifications with a Master's in Business Administration (MBA) from the London Business School. He is an accredited associate coach for Marshall Goldsmith Stakeholder Centered Coaching in coaching executives and leaders.

Blue Sky GPS (Growth & Profit Solutions)

Andrew runs [Blue Sky GPS \(Growth & Profit Solutions\)](#), working with individuals, teams, groups and corporate so they can unlock their potential, that of others, and create a life and a job they love and choose to lead.

Through customized development programmes using experiential learning, backed by group workshops, individual one-to-one coaching and on-going support the individual and group development needs are addressed, the skills and capabilities are unlocked and the people can grow and achieve both personal and business outcomes on a sustainable basis. His blog, Growth and Profit, can be found at <http://growthandprofit.me>.

To find out more about this visit the [Blue Sky GPS website](#) or contact Andrew at andrew.cooke@business-gps.com.au or on +61 (0)401 842 673.