

Cost Reduction or Cost Improvement!

Most of us do not differentiate between COST REDUCTION and COST IMPROVEMENT. These are two commonly interchangeable terms. But they are completely different activities.

COST REDUCTION is an activity driven by a change in the business environment. Often initiated by management due to volume reductions, poor financial results, cash flow problems or indeed a combination of all of these, sometimes even due to economic downturns.

Common to most COST REDUCTION efforts is the requirement to provide short-term results to counter-balance the negative factors mentioned above. COST REDUCTION activities are often knee-jerk decisions, quickly planned and executed. By nature the measures defined in these activities can be referred to as low hanging fruits, and most often these activities do not address structural change, rather they address activities such as personnel numbers, plant closures, travel restrictions, short working weeks, hiring embargos, etc. etc..

These are mainly short-term effects, which are often reversed as soon as the original problem fades. It can be argued that COST REDUCTION efforts cost the company or industry more in the long term, as redundancy costs, social payments and later rehiring costs, not to mention lost opportunities need to be taken into account.

In the German Automotive industry today, we see precisely the results of such activities. During the Financial Crisis many of the OEMs laid-off their temporary workers, stopped hiring new employees, and worked short weeks. 18 months later, the temporary workers are back, instead of short working conditions, vacation is being postponed or shortened and these companies are even complaining that they can't find skilled engineers, and have to engage headhunters. Volume ramp-up is slower than it could be.

COST REDUCTIONS are activities to bolster or bridge profitability problems. They usually do not address structural issues and cannot improve the medium or long term profitability of the company.

We do not argue that Cost Reduction is wrong or unnecessary, however, we do believe that it has its place, but should be understood as a blunt instrument, which is over utilized.

The alternative to Cost Reduction is Cost Improvement. COST IMPROVEMENT is a long-term approach to improving the fundamental use of the organizations resources. One can argue that Profit Improvement would be a better description, however, we consider that to be only one of a number of possible outcomes, rather than the main activity.

COST IMPROVEMENT is a continuous improvement activity. It looks at the entire cost base of the company, and takes a step-by-step / year-by-year approach to ensuring the better use of these resources and improving overall productivity.

It is a very strategic approach. The management as part of its strategic planning and/or the budgeting process defines a target for the improvement. This target is in the best cases also reflected in management incentive packages. Using a project management approach, measures are identified to achieve or exceed the target and these are then implemented under the framework of a cost improvement program, being carefully tracked and monitored to ensure success and no year-end surprises.

COST IMPROVEMENT makes a company healthier in the long term. Staff and employees become aware of waste and make conscious and often unconscious efforts to reduce it. Some of the companies, which weathered the Financial Crisis successfully, were ones, which we know to practice COST IMPROVEMENT on an ongoing basis. We see this particularly in the airline industry, where the legacy carriers particularly in the United States, but also in Europe fared very badly from the crisis, while some of the Discount Carriers, who practice extreme COST IMPROVEMENT as a core competence remained profitable.

A good opportunity now exists to introduce COST IMPROVEMENT PROGRAMS. The recession is coming to an end and we have time over the next years to put in place the structures and processes to make our organizations long-term healthy, and to be prepared for the next downturn when it comes, and it will.

About Cost Improvement

Our focus is continuous cost improvement – Our speciality is structuring cost savings programs – Our value proposition is target achievement.

We work with customers who recognize the need to implement a cost savings, cost improvement or turnaround program, and see the benefits of managing the cost saving activities under one project or program. We bring the structure – Our customers bring the savings ideas – although we can help here too, if requested.

Cost Improvement Consultants has its roots in the global Automotive Industry. Each partner has at least 15 years of hands-on operational experience. We represent many industry sectors and business functions. We understand the importance of working in a pragmatic, no-nonsense spirit with our client's team.

As an international team, we understand the challenges faced by cross-cultural and matrixed organizations, and can therefore operate effectively both nationally or internationally. Over the years, we have seen a lot of cost-improvement activities. Some were good, but many were only marginally successful. This experience together with the events of the Financial Crisis, gave us the drive to set-up the practice, with the vision of establishing a far higher standard in the area of cost-improvement.

We hope you share our vision, and look forward to working together.