Overview

Key Challenges

- Not all procurement cost initiatives are worth the time, effort or investment, as not all cost optimization ideas, opportunities or initiatives have the same value.

- Cost optimization initiatives are often evaluated only on their potential to reduce short-term spending, but many of these initiatives miss the mark for long-term cost reduction.

- Most cost optimization efforts outside of procurement's control fail, as those are often undermined by lack of organizational or business unit leader buy-in, support and consensus, which wastes resources and undermines the CPO's credibility.

Recommendations

Chief procurement officers (CPOs) responsible for direct material sourcing seeking to optimize costs should:

- Engage your peers and budget analysts by identifying and prioritizing cost optimization initiatives.

- Deploy a systematic approach to evaluate initiatives by weighing several factors such as potential benefit, customer impact and degree of organizational risk.

- Secure resources to execute by determining the extent to which business leadership is committed to supporting identified cost optimization initiatives.

- Execute on the stated cost optimization efforts by delivering the results and communicating the efficiency outlined in the initiative's business case.

Introduction
This research is adapted from "Gartner's Decision Framework for Prioritizing Cost Optimization Initiatives," which urges CIOs to leverage Gartner's decision framework to assess their cost optimization initiatives to achieve desired results.

As the impact of COVID-19 spreads and procurement leaders look to reduce costs across the enterprise, they tend to prioritize cost optimization ideas by solely examining the potential cash savings of each action. While potential cash savings are certainly a key consideration, other factors must be considered for inclusion to the cost optimization portfolio.

Recognizing that cost optimization teams usually operate on strict time frames and limited resources, Gartner has created a concise decision framework to help prioritize cost optimization initiatives. This framework considers not only the potential benefit (in terms of cash savings), but the impact it has on the business, time requirements, degree of organizational and technical risk, and investment required (see Table 1).

<table>
<thead>
<tr>
<th>Potential Financial Benefit</th>
<th>Business Impact</th>
<th>Time Requirement</th>
<th>Degree of Organizational Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small: Potential to minimally improve cash flow or generate hard/soft savings</td>
<td>Negative: The initiative will have an adverse impact on business operations or customer satisfaction</td>
<td>Long Term: Savings may be realized either within months or not at all upon full implementation</td>
<td>High: Initiative will create staff redundancies or reengineering of processes and structures</td>
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<tr>
<td>Medium: Potential to moderately improve cash or generate hard/soft savings</td>
<td>None: The initiative will neither have a positive or negative impact on business operations</td>
<td>Intermediate Term: Expected savings can be realized within months of full implementation</td>
<td>Moderate: Limited changes in roles, structures and processes</td>
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<tr>
<td>Large: Potential to significantly improve cash flow and generate hard/soft savings</td>
<td>Positive: The initiative will have a positive impact on business operations</td>
<td>Short Term: Expected savings can be realized within weeks of full implementation</td>
<td>Low: No changes to staff or changes in organization and processes</td>
</tr>
</tbody>
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Analysis

Evaluate Initiatives Based on a Systematic Approach That Weighs Several Factors

During an economic slowdown, CPOs must avoid a knee-jerk reaction and optimize costs to support the business priorities. Because cost optimization rarely happens singularly within the control of the procurement organization, CPOs must work in concert with their peers to evaluate the risks and consequences of proposed optimization ideas to reduce costs. For example, what may seem like a relatively straightforward cut — shifting supply to a lower-cost supplier — has business consequences, such as extended lead times and other risks, that must be taken into account and socialized.

Our clients reveal too often that cost optimization ideas are weighed almost exclusively based on their potential cost savings, without considering the effects such proposed cost savings may have on the business. For example, business risk involved, time to implement and the financial investment required to implement the initiative. This is analogous to prioritizing new initiatives based only on their potential benefits without concern for their impact. Using potential benefit as the only decision criterion could result in a prioritized list of initiatives that could yield significant savings, but it could be risky as well, have negative impacts on the business or most likely fail.

Using the Decision Framework to Evaluate Cost Optimization Initiatives

Procurement leaders should evaluate cost optimization initiatives using six criteria defined in the decision-making framework and explained below. They can do so by selecting for each criterion shown one column that best describes the complexity of each idea. For example, for the “business impact” criterion, an initiative would be rated as negative, none or positive — not all three.

The following is a breakdown of each criteria used in the decision framework:
1. Potential Financial Benefit

Enterprise financial benefit must be measured to get a sense of whether the initiative is worth pursuing. An initiative may sound great and may be implemented successfully, but will the initiative have an impact on the bottom line?

Questions procurement leaders should ask regarding the potential financial benefit:

- How much will the enterprise save if the action is implemented?
- How does the action affect enterprise cash flow?
- Will the financial benefits be truly reflected in the bottom line or will this initiative create additional costs in other parts of the business?

2. Business Impact

Because cost optimization does not occur in isolation, procurement leaders should anticipate and account for how the initiative will impact the business. If business stakeholders fail to grasp how the initiative will impact their day-to-day activities and operations (such as decreased productivity, product time to market or longer lead times), then the initiative may prove unsuccessful.

Questions procurement leaders should ask regarding a potential business impact:

- What impact will this initiative have on the specific business unit’s staff and operations?
- Will this initiative adversely affect business units’ day-to-day activities or operations?
- Will this initiative have an adverse effect on our (end) customer satisfaction?
- Should we measure soft savings (i.e., cost avoidance) with this initiative? If so, how will we define it?

3. Time Requirement

Initiatives identified by procurement leaders will have varying implementation times, which will have a direct impact on realization of savings. The focus here is on estimating when the organization expects to realize and capture those cost savings and improve business value. Savings may be realized within a few weeks, a few months and within the same fiscal year the initiative was fully implemented or longer.

A question procurement leaders should ask regarding the time requirement:

- Can we capture and realize cost savings within the time period required (e.g., this quarter, this fiscal year)?
4. Degree of Organizational Risk

The effectiveness of the cost optimization initiative is partly contingent on whether procurement leaders, their direct reports and the rest of the organization are capable of changing and adapting to the proposed changes. Some changes may require a complete redesign on how the procurement function operates and how it supports business outcomes. Procurement leaders should be capable of articulating the benefits of the cost optimization initiative and the potential impact to organizational processes.

Questions procurement leaders should ask regarding the degree of organizational risk:

- Is our enterprise capable of adapting to the changes?
- Will these changes affect our ability to support business outcomes? If so, what do we need to put in place to counter these deficiencies?

5. Degree of Technical Risk

Procurement leaders must assess how the cost optimization initiative will affect their current operations and the complexity of the proposed change. The degree of complexity for implementing some of these changes will vary, as they may impact regulatory requirements or safety requirements, among others.

Questions procurement leaders should ask regarding degree of technical risk:

- Are there any regulatory or safety considerations that may be impacted by the proposed change?
- Are the proposed changes widely adopted and used by others in our industry or are we the first ones to consider this type of change?

6. Investment Requirement

Before any cost optimization project or initiative commences, the enterprise has to support and agree to fund it. Procurement leaders must present a business case showing how the cost optimization initiative will improve business processes, productivity, time to market and the like as opposed to continuing with the status quo, to include financial investments. It is essential that they must evaluate the level of investment required before the enterprise realizes its savings.

Questions procurement leaders should ask regarding the investment requirement:

- Does the initiative require a large, upfront investment before savings can be realized?
- Is the enterprise willing to make an investment at all?
Determine the Level of Effort That Business Leadership Will Commit to Support Identified Cost Optimization Initiatives

Companies often have more cost optimization opportunities than they can address. Even after using this decision framework, it may be necessary to group ideas together and map them to a grid (see Figure 1) to help determine the level of effort the business leadership is committed to supporting. A graphical representation helps executive leaders visualize the effort required and the relative benefits of each initiative. It also provides an example of how the most common undertakings can be grouped relative to benefits and costs (including time, risk and organizational impact). It also helps illustrate the cost optimization options that have the greatest potential benefit, often require additional investment, take more time and carry more risk versus short-term, reactionary spending cuts (see “Tool: Decision Framework to Prioritize Procurement’s Cost Optimization Initiatives”).

**Figure 1: Example Grouping and Mapping of Procurement Cost Optimization Techniques on a Grid**

Creating a decision framework is only one important step in the cost optimization process. Ideally, this framework should be applied using the portfolio management process of the organization and using that process to feed into its decision-making process or when the initiative is being evaluated by a cross-functional cost optimization team. Procurement leaders must create and execute this framework to expose the strategic and organizational trade-offs to be taken into consideration when doing cost optimization.

To build credibility during uncertain economic times, procurement leaders need to carefully examine the kind of cost optimization they are supporting. Not all cost optimization initiatives are
equally helpful and, in fact, some do further damage to the business. Procurement leaders must work in concert with their peers to weigh the trade-offs of some initiatives versus others.

**Recommended by the Authors**

*Research Roundup: Cost Optimization in Supply Chain*

*Gartner’s Supply Chain Cost Optimization Playbook for Sourcing and Procurement Leaders*

*Gartner’s Cost Optimization Playbook for Supply Chain Strategy and Planning Leaders*

*Toolkit: Supply Chain Cost Optimization Playbook for Logistics and Customer Fulfillment*

*Supply Chain Brief: How Colgate-Palmolive Integrates and Sustains Cost Optimization in Its Culture*

**Recommended For You**

*Use 16 Innovation Catalysts to Widen Your Innovation Aperture*

*Influence Skill Deployment Model (Deployment Co.*)*

*Streamlined Business Sponsor Onboarding (Cadbury-Mutual of Omaha)*

*Two-in-a-Box Program Leadership (Grainger)*

*A 5-Point Plan for Product Managers to Create Compelling Technology Roadmaps*