Best Practices for Cost Containment

Presented by

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Resources Global Professionals
Agenda

- Definitions and Terminology
- The Challenges of Today’s Business Environment
- Types of Cost Containment Initiatives
  1. Goods and Services
  2. People and Processes
- Take a Total Cost of Ownership Approach
- A Practical Approach to Cost Containment
- Summary
<table>
<thead>
<tr>
<th>Options</th>
<th>%</th>
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<tbody>
<tr>
<td>A. Yes, it is one of our highest priority objectives and we continue to pursue additional savings opportunities across the organization.</td>
<td>82%</td>
</tr>
<tr>
<td>B. Continues to be an important objective, but it is not the most pressing at this time.</td>
<td>18%</td>
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<tr>
<td>C. We have been successful in keeping costs under control and do not feel additional savings can be achieved in the coming year.</td>
<td>0%</td>
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</table>
• **Cost Containment**: A detailed plan and process of maintaining organizational cost and purchased prices within *certain specified target limits* over a period of time.

• **Cost Avoidance**: An effort to *prevent or reduce supplier price* increases and ancillary charges through the use of value analysis, negotiations, and a variety of other techniques. (Although cost-avoidance efforts prevent increased spending, they do not result in a tangible budget savings and there is a continuing debate over how reporting of cost-avoidance savings should be handled.)

• **Cost reduction**: A *reduction in the costs* incurred by an organization which has tangible results; i.e., a reduction in outside spend and/or the availability of funds that can be used for purposes other than originally intended.

*In Today’s Climate, Companies are Seeking Improvement in All Three Categories!!*
All companies are faced with challenges in today’s economic climate. These include:

1. Containing spend and reducing costs are the highest priorities
2. Accomplish this containment and reduction with less help
3. Achieve results without interrupting critical business operations
4. Targets need to be achieved in a timely manner and THIS YEAR!!

Accomplishing these cost containment and cost reduction objectives requires:

1. Experience
2. Functional Knowledge
3. Strong project management
4. Correct business analysis skills
5. Ability to effectively manage the change and make it stick.  
   This may be the most difficult part!!
Types of Cost Containment Initiatives

LONGER PAYBACK PERIOD / SHORTER IMPLEMENTATION

- Workload Reengineering
- PMO Implementation
- Close Optimization
- ERP/HR System Optimization

SHORTER PAYBACK PERIOD / SHORTER IMPLEMENTATION

- Strategic Sourcing – IT/Telecom
- Fraud Detection / Prevention
- Vendor Audits

- Strategic Sourcing – Direct Materials
- Reengineering of Compliance Management System &/or Processes

- Cycle Count process / Inventory Utilization
- Strategic Sourcing – Indirect Materials

- Report Consolidation / Optimization
- Cost per Hire
- Contract Administration Audits

LONGER PAYBACK PERIOD / LONGER IMPLEMENTATION

- Workforce/Resource Planning

SHORTER PAYBACK PERIOD / LONGER IMPLEMENTATION

- Systems Integration
- Distribution Network Design
- Tax Strategy

- Procure-to-Pay Outsourcing
- Shared Services
- Disaster Recovery Plan Optimization

- HR / Payroll / Benefit Outsourcing
- Demand Planning / Forecasting

Probably not a near term focus in Cost Containment Initiatives
Two types of Cost Containment areas:

1. Goods and Services
2. People and Processes
1. **Revisit Core Spend Areas and agreements**

   a. Review existing agreements to ensure that pricing is in line with current market conditions

   b. If appropriate, re-negotiate current agreements
      - Pricing
      - Performance metrics (quality, service levels)
      - Specifications (are they too tight and rigid or out of date?)
      - Provide incentives to incumbent suppliers to offer savings ideas and share in the savings achieved (gain share)
      - Payment terms and conditions
2. Identify and address areas of spend that have not been previously evaluated

   a. Work collaboratively with business units where the spend may have been previously “off limits” (i.e. legal services, marketing/events, benefits, etc.)

   b. Look for areas that have a short implementation and a short pay back period. What was “not on the radar screen” previously, may be appropriate now:
      - Travel *(Policy will drive the most savings)*
      - Transportation and freight services,
      - Mail services & Couriers,
      - Print, and business forms,
      - Office supplies,
      - Catering,
      - Office services,
      - Office equipment and service agreements
      - Security services
      - Facilities
      - Utilities
Our Client –
A former publicly traded provider of health insurance products.

Business Challenge –
Dramatically reduce spending throughout the organization, including reducing its outside legal budget by more than 50% percent, or in excess of $11 million annually.

How We Helped –
• Gathered and analyzed internal and external legal spend data
• Interviewed various stakeholders concerning the quality and responsiveness of the legal department
• Consolidated outside legal service providers
• Drafted new contract terms and conditions for services and equipment contracts
• Created standardized contracts for all future services and equipment purchases
• Submitted recommendations to help achieve savings targets on an ongoing basis
• Created standard engagement letters and settlement procedures
•Outlined alternative billing arrangement options
• Ensured that services needed were performed by appropriate Legal expertise (i.e. does a high hourly rate lawyer need to do paralegal work?)

Result –
The legal department exceeded their goal. The client estimates the savings will be in excess of ten times the amount expended on this project.
3. Capital Projects

a. Reality is that in these economic times, our companies are either:
   1. Proceeding with scheduled work.
   2. Delaying the capital project
   3. Reducing the scope of work to be accomplished
   4. Cancelling the work altogether.

b. Capital Project cost containment opportunities are:
   1. Renegotiation scope of work (if appropriate)
   2. Delaying equipment delivery and payment
   3. Seeking alternate equipment and services from the supplier(s) that would be less expensive but yet fulfill the material requirement.
1. **Optimize Inventory**
   
a. Results of recent Resources Survey: 90% of SCM leaders stated that their inventory is not optimized and that this will be a major focus for 2010.

b. Inventory restricts cash flow. *Ask any CFO or Controller*

c. Inventory has a cost. Research reveals that cost to hold inventory item for one year is 20-60% of the original cost of the item*
   1. Storage Cost
   2. Obsolescence
   3. Capital Costs
   4. Insurance & Taxes

d. **Worst case scenario:** purchasing of items when you did not know they were in inventory. Perfect opportunity to review materials management system.

e. Review, strengthen, or implement demand planning and forecasting process. Poor forecasting is a major cause of unnecessary or higher than needed inventory levels.

f. Vendor Managed Inventory programs will assist in keeping inventory optimized.

g. Establish goal of minimizing write offs:
   1. Ensure that you can find the item(s)
   2. Change policy and procedure if LIFO method is adopted (IFRS will not allow this)
   3. Have system and process to value inventory correctly. This is also a Sarbanes issue.

*Research accomplished by The Institute of Supply Management & Texas A & M
Our Client –  
Fortune 100 Oil & Gas Company

Business Challenge –  
After the acquisition of several oil and gas companies over a five year period, the company recognized the need to identify and consolidate warehousing and materials management activities since they discovered they “could not find their stuff.”

How We Helped –  
• Optimized individual business unit inventories and ensured that existing inventory is used first as material requirements become known through an improved communication process.  
• Identified usable inventory and established procedures to ensure that inventory was reviewed for all new material needs  
• Created and documented policies for inventory management

Result –  
Our teams were deployed throughout the company’s North American operations and helped achieve significant one time and recurring savings. New processes and policies provided new insights for continued improvements in process and strategy.
2. Warehousing and Distribution

- Warehousing layout & design review offers opportunity to maximize people time

- Distribution Center Consolidations: Too many and are they in the correct locations?

- Are we maximizing our Freight Lanes (review our Less Than Truckload shipments)
Our Client –
Fortune 200 gaming company Headquartered in Las Vegas

Business Challenge –
After the acquisition of other gaming companies in the Las Vegas area over an accelerated 3 year period, they recognized the need to evaluate and determine the correct number of warehouses for their operations.

How We Helped –
• We performed a detailed review of their existing locations and identified redundancies.
• Provided a roadmap and plan to go from 15 warehouse locations to 1
• Designed their centralized warehouse and optimized their processes, procedures, and systems

Results –
✓ Significantly reduced the number of personnel in their warehousing operations
✓ Converted the previous warehouse areas into gaming rooms for additional revenue
3. Purchase to Pay (Source to Settlement) Process Improvement
   a. Most best of class companies have either completed or are in the process of reviewing.

   b. Resources Survey results: 80% of the respondents stated that they have either:
      - Completed this review (57%)
      - Currently in the process (13%)
      - Have intentions to begin in 2010 (10%)

   c. The Objectives of such a review are:
      - Implement sustainable, standardized, and simplified processes
      - Remove bottlenecks in the process (Lean principled)
      - Increase service level response to internal customers
      - Reallocate personnel
      - Maximize the efficiency of personnel (streamlined processes means less people to accomplish desired result)
      - Perform service functions at reduced cost (reduced overhead)

   d. Purchasing Card Program: Review to determine if robust and implemented properly
People and Processes

4. Quality Management

Quality issues will result in additional and unnecessary added cost such as:

- Expediting
- Reprocessing
- Plant scheduling
- Branding is put at Risk (customer sensitivity)
5. Supplier Relationships

✓ Do we check to see if we are actually being billed at the agreed to pricing

✓ Are the stated indices and other methods for price increases / decreases verified for correctness in the invoicing and payment process

✓ Best of class organizations with robust Supplier Relationship Management (SRM) programs rely on suppliers for innovation and cost reduction suggestions.

✓ Vendor Managed Inventories will assist in keeping inventories optimized
Our Client –
A global Fortune 1,000 manufacturer of paint and resins with over $3 billion in annual revenue

Business Challenge –
The bulk of this company’s raw materials are purchased on cost plus or other formula driven price calculations. The client was not able to determine the accuracy of the prices charged to them. In some cases, the suppliers were also competitors.

How We Helped –
• The client had the contractual right to audit a supplier. We assisted the client by supplying an auditor who was:
  • An independent professional, as required by the contract
  • Experienced in both manufacturing and internal audit

• We reviewed all invoicing for the contract period, verified invoice prices to the underlying support and reperformed all calculations.

Result –
We discovered several calculation errors, the largest of which resulted in the client recovering over $500,000 in overcharges.
6. Information Technology

✓ Project and Spending Transparency – make sure you know what projects are being worked on or considered, and the cost associated with each. Prioritize with short term ROI in mind.

✓ Selective Control – Reallocate spending to high value areas. Use BI tools (e.g., Hyperion, Business Objects, Cognos) to better understand where revenue is produced and costs are incurred.

✓ Shared Services – inventory all systems and processes to identify and eliminate redundancy. Take advantage of shared service departments.

✓ Process & System Optimization – review all non-revenue generating processes (e.g. HR, Marketing) and the supporting systems for inefficiency. Asking “Is this required” or “Is this required by law or regulation”

✓ Life Cycle Management – retire underperforming hardware and software. Replace End User Computing (EUC) solutions (e.g. spreadsheets, access databases, etc.) with already purchased ERP modules that have not been implemented or “turned on”.

✓ Eliminate unnecessary system reports

✓ Reduce Implementation time by becoming better at Project Management
People and Processes

7. Other Functional Opportunities

✓ Reduce bank fees by reducing the number of depository banks
✓ Audit, Risk, and Compliance
  a. Vendor audits
  b. Fraud detection/prevention
  c. Contract administration audits
✓ Outsource HR Benefits, payroll processing, etc.
Our Client –
Public Fortune 200 Global Retailer

Business Challenge –
To reduce the number of depository banks nationwide in order to reduce bank fees, improve float, and benefit from administrative efficiencies.

How We Helped –
• Analyzed and determined possible savings to be gained from depository bank consolidation
• Performed a detailed study to determine average store volumes by service and average monthly store deposits over the past year
• Prepared the RFI and RFP, helped identified banks to receive the proposals, evaluated responses, and checked references provided by the banks
• Performed a proximity study to determine which banks, in which locations, would achieve the objectives
• Identified optimum solution and possible savings; addressed the sensitivity of existing lending relationships
• Designed an implementation schedule in coordination with the banks, armored car company, check printer, internal store operations and accounting to ensure optimum scheduling and communication; managed the process until internal personnel were able to take over (implementation completed in six months)
• Selected locations in an order that would maximize savings into the current year and also reduce the number of banks as soon as possible
• Worked with all asset and account owners to verify their understanding and created the final balance sheet
• Supported administrative and servicing functions post implementation and until the final arrangements were made and new employees were on-boarded

Result –
Achieved $500,000 savings in bank fees from the beginning of the implementation stage to the end of year. For subsequent years, savings will be in excess of $1.2M per year. Reduced number of banks to 5, from 17. Created comparable analysis statements across all banks. Improved vault cutoff times, resulting in faster access to cash.
The Role of Total Cost of Ownership (TCO) in Cost Containment Initiatives

*It boils down to:*

**Our ability to articulate across the enterprise that:**

- Price is certainly an important factor
- But there are other elements of “total cost” that we must also address to achieve cost reductions
It is imperative to focus on all aspects of the Total Cost of Ownership approach. Working **COLLABORATIVELY**, we can identify areas of cost improvements.
*Group Share Discussion*

What are some areas/projects that you have either completed or in the process of completion that you are willing to share with others in this room?
Please list the top 3 challenges that you will face in the coming year to build a “best of class” supply management organization.

**Summary of Responses**

1. Resources (people) constraints (budget)
2. Limited budget funds for professional development
3. Flexibility to quickly change sourcing strategies to rapidly changing market conditions
4. Margin pressures and pressures on us to provide substantial cost improvements/reductions
5. Finding and retaining employees with high leadership and process improvement skill sets
6. Resources and budget funds to implement systems
Containing costs is most successfully achieved by following an organized and strategic, but practical approach. We recommend the following steps:

1. **ASSESSMENT:** The first step to containing costs is understanding your current cost structure.

2. **ANALYSIS OF FUTURE BUSINESS PLANS & RELATED COSTS:** Developing a sustainable solution requires an understanding of the future cost structure.

3. **DETERMINE YOUR TIME FRAME:** Are you looking for quick cost saving hits or are you looking to implement long term strategic cost containment initiatives? Both will factor into your approach.

4. **CREATE THE COST CONTAINMENT ACTION PLAN:** Apply one or more of the following...
   - Validate costs and review spend detail and agreements
   - Optimize functions and/or technology
   - Create efficiencies (via people and/or technology, i.e. purchase to pay review)
   - Reprioritize, consolidate efforts
   - Implement/revise policies and procedures
   - Outsource/in-source

5. **Execute the Cost Containment Plan** for successful project management and for sustainable change.
   
   This is a cultural issue
In Today’s Economic Climate, How do you Effectively Achieve Cultural Change??

You either

“Change the People”
(their mindsets),

or You

“Change the People”
Cost Containment requires reviewing areas that previously were considered “off limits” or “out of scope”

The CEO and Board are expecting cost reduction results but without disruption of the company operations... And they want it now

Cost Containment initiatives will require extreme COLLABORATION among the functional groups

Look for areas that have short payback periods and also short implementation periods

Policy can drive cost reductions and in most cases is just as important as “price reductions”
Thank You!!

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713-403-1979
APPENDIX A

(Types of Cost Containment Initiatives)
## Types of Cost Containment Initiatives

### Supply Chain Management

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<tr>
<th>Initiative</th>
<th>Timeframe</th>
<th>Cost Factors</th>
<th>Benefits</th>
<th>Payback</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic Sourcing – (Indirect</td>
<td>2-6 months</td>
<td>Consultant costs; internal time</td>
<td>Purchase price savings, maintenance savings, efficiencies (5-20%)</td>
<td>6-15 months</td>
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<tr>
<td>Materials, Direct Materials, IT</td>
<td></td>
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<td>/Telecom, Services)</td>
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<tr>
<td>Cycle Count Process / Inventory</td>
<td>4 months</td>
<td>Consultant costs, inventory write-offs, internal costs, lease termination</td>
<td>Inventory accuracy; Increase in available cash; inventory carrying costs reduced (ISM research: to hold one year carrying cost is 20-48% of purchase price)</td>
<td>1 year</td>
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<tr>
<td>Utilization</td>
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<tr>
<td>Demand Planning / Forecasting</td>
<td>8-12 months</td>
<td>Consultant costs; technology integration; internal costs, lease termination</td>
<td>Inventory reduction; inventory carrying costs reduction (better planning results in reduced inventory)</td>
<td>&gt;1 year</td>
</tr>
<tr>
<td>Distribution Network Design</td>
<td>6-12 months</td>
<td>Consultant costs; technology costs; lease termination; moving costs; build-out</td>
<td>Inventory reduction; improved service levels and lead times</td>
<td>&gt; 1 year</td>
</tr>
<tr>
<td>Procure-to-Pay Outsourcing</td>
<td>8-18 months</td>
<td>Consultant costs; technology integration; termination costs/severance</td>
<td>Lower headcount; lower transaction costs; improved service level</td>
<td>&gt;1 year</td>
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<tbody>
<tr>
<td>Report Consolidation / Optimization</td>
<td>2-4 months</td>
<td>Consultant time; reduced development time</td>
<td>Information accuracy and timeliness; lower headcount</td>
<td>6-12 months</td>
</tr>
<tr>
<td>PMO Implementation</td>
<td>4-6 months</td>
<td>Consultant costs; recruiting/hiring costs; technology integration</td>
<td>Improved project success; lower project budgets</td>
<td>10-18 months</td>
</tr>
<tr>
<td>ERP System Optimization</td>
<td>3-9 months</td>
<td>Consultant costs; internal costs; technology costs</td>
<td>Improved information; improved business process (i.e. increased functionality of system); lower headcount; improved compliance</td>
<td>10-14 months</td>
</tr>
<tr>
<td>Systems Integration</td>
<td>3-9 months</td>
<td>Consultant costs; internal costs; possible technology costs (such as interfaces)</td>
<td>Automate processes; more accurate information; increase cash flow (integrate A/P &amp; customer payments collection systems); reduce labor (integrate billing &amp; CRM systems)</td>
<td>10-14 months</td>
</tr>
<tr>
<td>Disaster Recovery Plan Optimization</td>
<td>3-9 months</td>
<td>Consultant costs; infrastructure costs, if needed (purchasing redundant servers, etc.)</td>
<td>Quickly return to business operations post-disaster; reduce the risk of compromised sensitive data (business continuity)</td>
<td>&gt;1 year</td>
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<td>Initiative</td>
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<tr>
<td>Close Optimization</td>
<td>6-8 months</td>
<td>Consultant time; technology integration; internal costs</td>
<td>Reduced close time; simplified business process; lower headcount</td>
<td>12-18 months</td>
</tr>
<tr>
<td>Tax Strategy</td>
<td>12-18 months</td>
<td>Consultant time; technology integration</td>
<td>Lower effective tax rate</td>
<td>12-18 months</td>
</tr>
<tr>
<td>Shared Services Strategy and Implementation</td>
<td>8-12 months</td>
<td>Technology integration; consultant costs; headcount reduction costs</td>
<td>lower transaction costs; improved service levels; lower labor costs</td>
<td>2-3 years</td>
</tr>
<tr>
<td>Initiative</td>
<td>Timeframe</td>
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<td>Benefits</td>
<td>Payback</td>
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<tr>
<td>Vendor Audits</td>
<td>1 to 4 months</td>
<td>Consultant time; technology cost; internal cost</td>
<td>Verification of supplier calculated costs, reduced cost of materials, labor, services</td>
<td>Immediate</td>
</tr>
<tr>
<td>Fraud Detection/ Prevention</td>
<td>1 to 6 months</td>
<td>Consultant time; technology costs</td>
<td>Elimination of the cost of fraud, greater reliance on controls to prevent fraud</td>
<td>1 to 12 months</td>
</tr>
<tr>
<td>Reengineering of compliance management system &amp;/or processes</td>
<td>2 to 6 months</td>
<td>Consultant time; internal costs</td>
<td>Increased efficiency and cost effectiveness of compliance programs</td>
<td>3 to 6 months</td>
</tr>
<tr>
<td>Contract Administration Audits</td>
<td>1 to 6 months</td>
<td>Consultant time; technology integration; internal cost</td>
<td>Price verification, increased revenue and decreased costs from improved contract compliance, performance metrics monitored and measured</td>
<td>1 to 6 months</td>
</tr>
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<tr>
<td>HR / Payroll / Benefits Outsourcing</td>
<td>12-18 months</td>
<td>Technology integration; consultant costs; headcount reduction costs</td>
<td>Lower transaction costs; improved service levels; lower labor costs</td>
<td>1-2 years</td>
</tr>
<tr>
<td>Cost per Hire</td>
<td>2-4 months</td>
<td>Sourcing, interviewing and screening (background check) candidates; head-hunter or recruiting firm fees</td>
<td>Reduce search time, increase success rate of securing qualified candidates time, eliminate contingency fees</td>
<td>6-8 months</td>
</tr>
<tr>
<td>HR System Optimization</td>
<td>3-9 months</td>
<td>Consultant costs; internal costs; technology costs</td>
<td>Improved information; improved business process; lower headcount; improved compliance</td>
<td>10-14 months</td>
</tr>
<tr>
<td>Workforce/Resource Planning, reengineering, aligning roles and responsibilities</td>
<td>2-4 months</td>
<td>Consultant costs; Internal costs; headcount reduction</td>
<td>Improved business process; lower headcount; retention of key talent</td>
<td>10 months --2 years</td>
</tr>
</tbody>
</table>