Creating a Culture of Cost Optimization

Incorporating cost optimization into your business strategy on an organization wide-scale.

Expense Reduction Analysts

Contents

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Executive Summary

In any organization, across any industry, there is usually one common denominator—change is a constant.

As technologies such as artificial intelligence, autonomous transportation, and virtual reality applications continue to evolve and make inroads within the commercial sector, the ways in which your organization conducts business will likely transform in the coming years.

Whether business changes are caused by emerging technologies or subsequent disruptors, data protection, or new legislation, your organization will have to develop the nimbleness to pivot operations accordingly.

However, emerging technologies and changes don't only represent potential challenges, they can also signify opportunities to propel your organization forward.

Incorporating cost optimization into your strategic planning

Finding ways to capitalize on industry transformations and the opportunities they represent should be incorporated into your organization's strategic planning efforts. Not only does a strategic planning process help your organization to define bigger-picture initiatives, it can also help answer the question of, "How do we plan to fund our larger goals?"

It's not unusual for organizations to prioritize finding savings from within daily cost expenditures, yet this method often only focuses on short term results. For example, reducing overall costs by a certain percentage compared to the previous year or "freezing" purchases in certain expense areas could do more harm than good. The potential savings gathered by this approach might be unsustainable and also could generate resistance from affected departments and staff.

A more sustainable, long-term approach to fund initiatives can be achieved by actively seeking additional cash flow through strategic cost optimization efforts, driven by a cost-management philosophy embedded in an organization's culture.

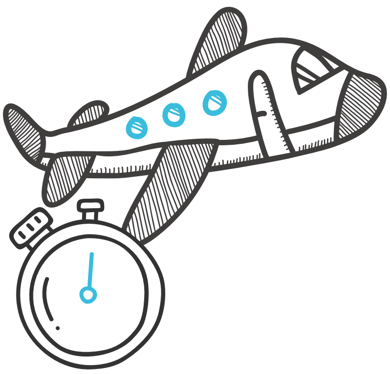
A key to uncovering sustainable cost-savings opportunities from within your supplier base is two-fold. Not only should your organization create a culture of cost reduction by championing expense management efforts across all departments, but also encourage greater familiarization with incumbent and potentially new suppliers and their industries to find opportunities to obtain greater value for the products and services they provide.

Articulate the impact of expense savings

Along with communicating the broader reasons why the organization is taking on cost optimization strategies, explaining the value of cost savings in equivalent terms to revenue and what it does to the bottom line can help employees understand the bigger-picture significance behind cost-saving measures. Staff should understand that no expense area should be considered "sacred" or go unchallenged.

For example...

If staff members realize that $1 million in company savings is equivalent to $5 or $10 million in sales, they could be more inclined to find areas within their department where costs can be reduced or streamlined.



For example...

If documents are always sent to clients using one-day air shipping, considering second-day air or ground delivery on non-time sensitive items could result in savings.

Make cost reduction an organization-wide initiative

In order to foster the development of a culture of cost optimization within an organization, a strategic initiative must be set by the senior management and the motivating factors driving the company's move in this direction must be well-understood by all stakeholders.

To secure maximum staff buy-in, the management must be able to answer "why" the cost savings initiative is needed and how the company will benefit from it.

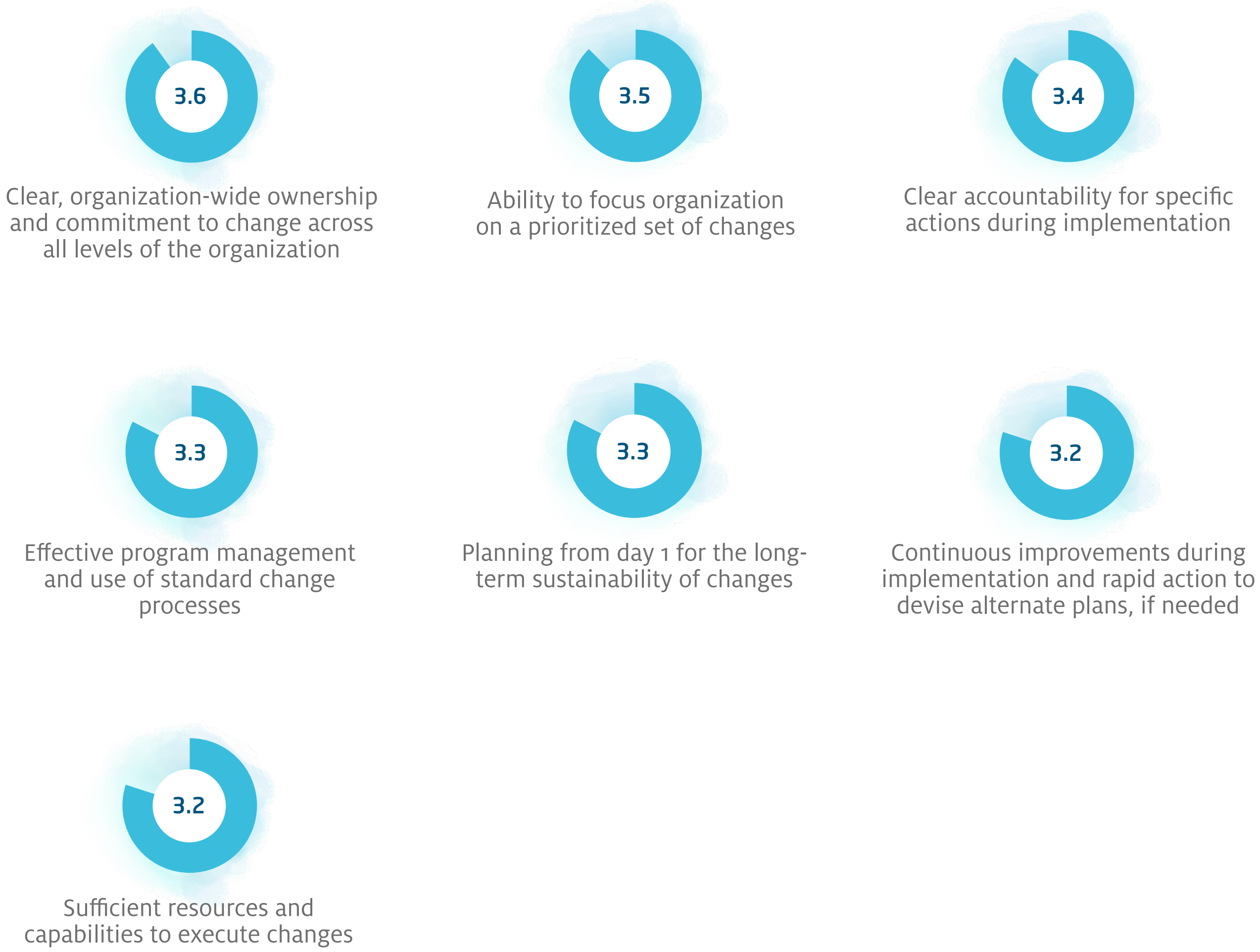
Management should be able to articulate:

- What is the additional cash used for?
- How much is needed or desired?
- How will the organization benefit from such initiative?
- Is there any low-hanging fruit and where else might we find additional opportunities?

Clear communication throughout all levels of the organization will lead to a cost-awareness mindset across departments. Leaders must inspire ownership of the new spend culture, by taking the initiative seriously and by setting an example for others to follow through their own actions.

The companies that best execute organizational changes possess the strongest core capabilities for implementation

Average capability score out of 4



Respondents were asked to evaluate statements about their organizational best practices and capabilities on a scale of 1 ("strongly disagree") to 4 ("strongly agree").

Data taken from McKinsey Global Survey Results - 'Implementing Change with Impact' Whitepaper.

Commit to change in order to achieve sustainable results

Companies will often experiment with making change efforts within their organization, focusing on performance, development and optimization in order to set themselves up for success throughout the business cycle.

The issue that a large proportion of companies will find, is not the ability to develop these change efforts, but how to implement them and to sustain the results over a period of time.

A commitment to change can be the key deciding factor to an effort's success or failure. When high level executives are questioned about implementing change within their business, they most often cite organization-wide ownership of change and the commitment to sustain it as being the determiner for success or failure.

A major motivation for implementing change is that of financial benefits in order to invest back into business. Many executives say that companies can be ill-equipped to translate change into sustainable financial results. The reasoning behind this can be described as a funnel. Initially, numerous employees will have a range of potential ideas for change, how these can be implemented and in what form the success of these changes will look like. As these are developed the ideas are narrowed depending on the highest priority changes that are targeted for implementation. Value is lost at each stage of this process, as it is likely that most initial ideas have a good chance of success and results if implemented.

Good ideas for change are only part of the equation, companies need to have a long term change plan, consider if they are realistic and are likely to be sustainable for the foreseeable future. The skills for implementing this change must be practiced like any other skill, it needs to be underpinned by strong capabilities and organizational practices to assure success. It is also crucial that individuals and the company as a whole be socially aware of the conditions that surround them. They need to know how differences in industry sector, geography and financial climates will all have an effect on a change effort. An implementation plan taking into consideration these factors must be developed accordingly.

To secure maximum staff buy-in, the management must be able to answer **'why'** the cost savings initiative is needed and how the company will benefit from it.

Leverage your suppliers by understanding their industries

As your organization moves towards implementing cost optimization strategies, this is an opportune time to learn more about your suppliers' industries and determine how you can leverage this knowledge to gain the most value from their products and services.

Many organizations have a deep and specialized knowledge of their particular industry. When an organization's sales department negotiates pricing with customers, the team often has intimate industry and company knowledge that the customer likely does not. The same is true of an organization's suppliers. By developing a better understanding of your suppliers' industries, you gain knowledge and leverage that can be useful in ensuring that your organization is getting competitive pricing for the services provided.

Some of the factors that your organization should understand about your suppliers include:

Developing organization-wide purchasing standards

When a client has facilities in multiple locations, it's important for the corporate management team to set a company-wide standard for purchasing supplies. If local managers or department heads chose their own suppliers, overall purchasing power becomes fragmented. Additionally, if each location manager has autonomy to set purchasing standards, managers can set their own rules, which can lead to organization-wide inefficiencies.

By setting purchasing standards by which all managers follow, and using the same products across locations, the client can measure quality assurance and exercise greater control over purchasing to realize greater savings.

Terminology and jargon

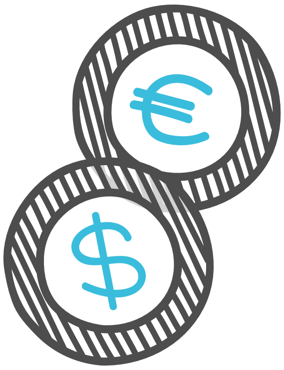
There are times when suppliers will use terminology or jargon to assess a customer's level of sophistication with their business. If they find a customer doesn't understand specific terminology, the representative may use the opportunity to push a client to agree to a purchase that isn't in their best interest. There are also instances when a customer thinks he or she has purchased one thing, only to find out the reality is something different. This happens when customers don't fully understand terms or how to apply apples-to-apples comparisons.

Understanding the complex supplier world and knowing the right questions to ask to uncover opportunities for savings can prove to be very beneficial. For example, understanding the difference between contract and non-contract items, knowing which supplies fall into each category, and understanding the ways in which suppliers price their non-contract items, can yield substantial long-term savings.

Your organization also may be able to leverage newly-gained supplier knowledge to find unique ways to do business going forward. Depending on the business, a client may find that there are unique ways to contract for supplies and services based on industry, location, or other company-specific variables. For example, your organization may not realize that it is common in the industry for a new supplier to pay for the client's contract termination penalties for a current supplier—and still offer a better rate.

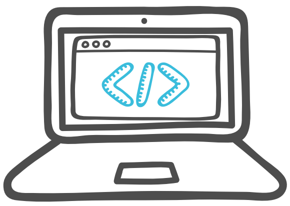
Finding unique ways to contract

When you've gleaned information about your suppliers' industries, cost-drivers and what sets them apart from the competition, you can utilize this information to get the most value from suppliers.



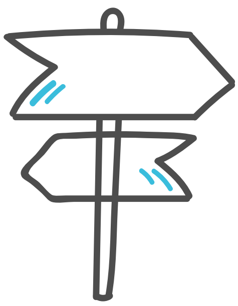
Cost/price drivers

A supplier's cost drivers include average order size, ordering patterns, frequency of orders, location(s), and timing. Each supplier has its own costs to consider. Oftentimes, when clients postpone deliveries until evening, they obtain better pricing because there is decreased dock congestion and fewer error rates. Understanding a supplier's costs can help you to improve decisions and realize the greater savings.



Market trends and new technologies

Electronic ordering and fulfilment provides users with the ability to set up a finite supply list, saving time because the previous orders are pre-populated once the user logs onto your account. By embracing technology and electronic billing, organizations can save money with accounts payable expenses, and also realize the potential for less errors. In short, when used in the right context, technology can yield efficiencies and savings.



Taking the direct approach with suppliers

Another approach to gain information about your supplier is to go to them directly and ask about the factors that impact their business. Meeting with your supplier(s) to understand their cost drivers, clarify any sections of your contract that you don't fully understand, or learn about how your processes impact their costs can help you determine if your supplier is working with you in a collaborative manner. If your supplier is unable to provide satisfactory answers to your inquiries, seek answers from others who use the same supplier or a competitor.

By understanding how your suppliers' respective industries function, your organization can better evaluate whether your current suppliers are providing the best and most up-to-date services available and help you determine if it's time to go out to bid to ensure you are getting the best value for the price.

The true differentiation among competitors

Just because suppliers offer similar products doesn't mean that suppliers are all the same. Special services, such as desktop delivery, equipment repair, product training, inventory management and so on may have equal importance in reducing employee time. By discovering the nuances, special offers, and rebates each supplier can provide, you can determine the right partner to meet supply needs.

Often, clients think their situation is unique and that other suppliers won't be able to match the services of the incumbent supplier. While each supplier has its own position in the marketplace, typically there are a select few that will work the best for a particular company or organization.

Continuing the momentum

When an organization makes a collective effort to implement cost-optimization strategies, the progress can get off to a great start, but the initial efforts and interest can start to wane over time. To maintain momentum, it's imperative to keep staff motivated over the long run. One method of doing this is by incentivizing cost-optimization efforts, so staff continually experiences the value in finding ways to reign in expenses. For example, if an employee or department makes a suggestion that could result in a $10,000 annual savings, a reward such as gift cards, a small cash bonus, or additional hours added to vacation time could provide the drive for staff to take steps towards continuing a cost-sensitive mindset within your organization. Incorporating incentives – and creating an environment where employees feel encouraged to suggest new cost reduction opportunities – can create a more cohesive, and organization-wide effort towards continuing cost-optimization efforts.

By taking a two-step approach to developing a larger culture of cost optimization, both through staff participation and gaining knowledge of supplier industries to better understand underlying cost drivers, your organization can find long-term sustainable savings that can be reinvested in the company for years to come.

About the Authors

John Hall

John Hall has 30 years of management experience in the consumer packaged goods (CPG) industry, including 15 years as a Senior Vice President and company officer for a $240 million privately held CPG company. His many responsibilities covered strategic planning and mergers and acquisitions, including the purchase and ultimate sale of Beech-Nut Nutrition to The Hero Group.

Hall also held sales management positions with Kraft General Foods and Procter and Gamble.

He graduated from Southern Illinois University and has taken professional development classes at institutions that include the University of Chicago Graduate School of Business.

Linda Zager

Linda Zager has 28 years of experience as a business professional at Motorola, Inc. Her background as an Account Management Director includes managing sales activities and customer relationships of $400M+ of the yearly sales to a large account customer.

She has solid experience with large-scale projects, negotiating contracts and establishing successful relationships. Other leadership responsibilities include Director of Quality and Customer Satisfaction, Network Management and Credit Management.

She graduated from Rutgers University and has an MBA in Finance from Seton Hall University.

John Lauchnor

John Lauchnor has held positions as CEO, President, COO, VP-Operations, Purchasing Manager, and other operational and engineering roles for companies such as Cincinnati Milacron, Precision Castparts, ABB, and Royal Precision.

He has a B.S. in Computer Science degree from Clemson University, and an M.B.A. from the University of Pittsburgh Joseph M. Katz School of Business. He holds three U.S. Patents in robotic software and product design.

Lauchnor is Chairman of the ERA Office Supply Practice.

Randy Mackay

Randy Mackay has extensive retail experience, primarily with the May and Macy's department stores. For more than 25 years, he was Vice President/General Manager at locations across the country.

He has an undergraduate degree from the University of Houston.

About Expense Reduction Analysts

Established in 1992, Expense Reduction Analysts is a specialized cost and supplier management consultancy focused on delivering improved business performance to clients of all sizes in both the private and public sectors. Operating in over 25 countries with more than 650 consultants, Expense Reduction Analysts provides deep industry expertise in a wide variety of expense categories, such as Logistics, Facility Management, Operational and Medical Supplies, Corporate and Personnel Services, Banking and Financial Services, as well as Telecommunications and Information Technology.

Expense Reduction Analysts' clients include thousands of mid-sized companies and many well-known names.
To find out more, visit **www.expensereduction.com**

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