

Newsletter : Cost Containment Specialists Article 14
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Summary

Controlling indirect spending should now be a top priority for CFOs. Although there are a range of tools and techniques available, relatively few companies take advantage of them today.

Finance executives should consider taking the following five steps:

- **Establish** spending policies that account for the needs of employees, and then enforce them strictly.
- **Centralize** the management of expenses to ensure compliance with policies and processes.
- **Use Web-based technology** to improve expense report filing and data access, and take advantage of the online tools offered by suppliers and corporate card providers.
- **Use corporate or Procurement cards** for indirect expenses in addition to travel and entertainment spending.
- **Leverage** the spending data available in corporate systems to manage suppliers.

Leadership Practices in Expense Management:

After several years of recession and slow economic growth, CFOs continue to search for ways to improve the financial health of their businesses. They have pulled the obvious levers: slashing payroll, consolidating suppliers of direct materials, and streamlining processes. Many CFOs have also contributed to efforts to find new sources of income and profits.

Finance executives should also be expanding their cost containment focus to indirect costs-expenses such as office supplies, computer equipment, express delivery, telecommunications, etc. Companies have traditionally neglected these lower-cost, high-volume purchases when looking for ways to save money.

Managing indirect expenses presents a significant opportunity for finance executives. Such spending typically comprises 10 to 15 percent of a company's spending. Although CFOs are currently more optimistic about the economy's growth prospects than last year, they remain cautious and are determined to rein in this area of spending.

Controlling indirect expenses should rank alongside new revenue creation and cutting direct costs as the top strategies CFOs are pursuing to improve their business's financial situation.

Even though it's not a very large part of our overall cost structure, it should be a priority to control indirect expenses. There are tremendous savings that could be realized if you really focus on the areas that would otherwise be taken for granted.

Improvement Needed

Unfortunately, managing indirect expenses is not strength for most firms. Companies generally have good controls and systems in place on the direct raw material cost-of-goods-sold side, but on the indirect side they generally have very poor controls and procedures.

We have found that few CFOs are satisfied with the way their companies are managing indirect expenses. Only 43 percent are "somewhat satisfied," and a mere seven percent consider themselves "very satisfied."

CFOs see a range of problems with expense management for their companies-in fact; only seven percent of companies do not identify any obstacles. Their main concern is the amount of time finance employees must devote to processing expense transactions-time that could be spent on more value-added activities.

Other challenges include an absence of mandated spending policies, inadequate detail on spending, and an inability to monitor the effectiveness of sourcing contracts. This last problem appears to be a greater concern for larger companies (those with over \$250 million in annual revenues), whose sourcing contracts often span multiple business units.

The good news is that there are mid-size companies who excel at managing indirect expenses. In many cases, these practices are different from those at Fortune 500 firms, which are more likely to have the resources to invest in expensive systems and the scale to demand deep discounts from vendors.

Expense Management Today

What is the current state of expense management at Middle Market companies? Our experience shows that companies have made significant progress in several areas since last year, but still have a long way to go to be more effective.

Access To and Use of Aggregated Information

Most companies review aggregated spending data -89 percent reported that they review data from at least one source. For most companies, this is aggregated information from the general ledger. Other sources of more detailed information include vendor invoices, ERP systems, and corporate card reports.

The most common use for this data is in budgeting, forecasting, and tracking project and employee spending. Fewer take advantage of this information to negotiate supplier discounts-only 41 percent do this today. This number is low, considering the widespread belief among CFOs that their companies are not getting the best rates from suppliers.

Our experience also suggests there will be a significant increase in the number of CFOs using the data as a basis for advising the business on how to be more profitable. This reflects a broader shift among finance functions away from strict back-office work to a more value-added role.

Finally, statistics show that 32 percent feel that they lack adequate detail on how money is spent, indicating a lack of quality in the aggregated data being reviewed. CFOs should consider more comprehensive ways of gathering and analyzing aggregated spending information.

Understanding Best Practices

Based on our experience as expense management experts, we have identified five areas of best practice. The recommendations have been tailored to suit mid-size companies, but not every practice will relate to every company. For example, some small firms may not have the resources necessary to support an investment in technology solutions. Similarly, a company with a very relaxed culture may not adapt well to strict policy mandates. Still, all of these approaches have been proven to be effective.

Establishing and Enforcing Spending Policies

Mandating spending policies is the first best practice. Compliance can still be a major problem even when companies establish uniform policies. Our experience suggests several steps companies can take to increase the number of employees who follow the rules.

First, make sure the process of creating the policies includes those who will be affected. In some cases, these employees will have useful knowledge about the quality of vendors or thoughts about how to create an effective policy. And, if the policies take their needs into account, employees may be more likely to follow them. You have to have the message coming from the top and obtain buy-in from staff. One way to do this is to form a task force that includes the company's key spenders and representatives from different departments to look into ways the policies can be improved.

Second, make it clear that there are consequences to not complying with policies and spending limits. While this may be obvious, many companies do little to enforce their policies. This breeds complacency and overspending. It's important to consistently enforce spending policies to avoid certain employees operating under the assumption that forgiveness is easier to receive than permission.

Centralized Management of Expenses

The placement of expense management responsibilities within the organization has a major effect on the CFO's ability to monitor and control policy compliance. Typically, a company manages indirect expenses in different parts of the organization or not at all. This is true even in companies disciplined in the area of direct materials procurement.

When every department or business unit orders its own supplies or arrangements, it is difficult for the CFO to discern how much money is being spent overall, let alone determine if employees are complying with policy. This leads to problems: it compromises the ability to control expenses across the organization, impedes the budgeting and forecasting process, and makes it nearly impossible to approach suppliers as a single company.

The obvious solution is to establish central oversight for indirect spending. These organizations have identified a range of functions that can benefit from central control. Budgeting, negotiating, purchasing, payment, and reporting can all be facilitated by the central discipline of monitoring and control of behavior. Some companies have taken this control to an extreme, requiring CFO approval for every purchase over a certain dollar amount and routing all other purchases through one person, such as an office manager. Others set policies centrally and allow decentralized enforcement. An example of this would be a committee of top executives setting spending policies, and requiring business units to implement them. Another method is to consolidate methods of payment in order to track more comprehensively how money is spent.

Regardless of the structure or methods of oversight, centralizing control can create hard-dollar savings as well as process improvements. In the area of process improvement, centralized expense management can facilitate better purchasing decisions and enable the finance function to provide more value-added advice to the businesses.

Using Web-based Technology

A third best practice is to use Web-based technology for expense management functions including travel booking, automated expense report filing, and a variety of e-procurement. Such technology can take several forms—including vendor Web sites, client-hosted systems, and Web-hosted applications. Our experience with CFOs indicate that Web technology can be an inexpensive way of obtaining better visibility into expenses, controlling spending, and streamlining internal processes.

Online technology can improve compliance with indirect spending policies. For example, using office supplies as an example category a vendor's site can be used to allow employees to place orders directly. The company can negotiate discounts with the vendor, and establish limits for what employees can purchase; this information is embedded in the suppliers' Web site. This way, everybody feels like they're independent and free, but they're buying pre-specified items from the vendor. Employees don't have to go to an office supply person and wait for their supplies; they can get exactly what they want when they want. Furthermore, greater process efficiencies are available since many B2B supplier Web sites allow companies to download transaction reports directly into their own finance systems.

Using Corporate Cards

Company-issued credit cards are another tool for controlling expenses. Like Web-based technology, corporate cards can yield better information about spending and lead to easier expense processing. Additionally, employees often view corporate cards as a convenience since they allow them to avoid mixing business and personal expenses on their own cards. However, these benefits are only maximized when usage is mandated and all employees are using these cards.

The most common fear for CFOs regarding corporate cards is that employees will overspend and the company will be liable for the charges. However, with a corporate card, financial managers can set overall spending limits and restrict the use of the card to certain spending categories, such as air travel, hotel, or retail.

Some companies are finding additional benefits from their corporate program beyond the typical T&E expenditure. A corporate card can create efficiency by eliminating multiple invoices for numerous indirect expenses. Companies can eliminate a lot of single invoices by putting them on one big summary invoice. Given that most companies are making increased back-office efficiencies a priority, further leveraging a tool already in place may offer immediate opportunity for improvement.

Supplier Management

A fifth area of best practice is to consistently work with suppliers to reduce costs. The idea of aggregating spending information and using it to obtain better prices is not new—most companies already do this in the direct materials area. However, few apply the same discipline to indirect spending. According to purchasing experts, the principles of strategic sourcing can easily be applied to indirect expenses: determine how much the company as a whole spends with which suppliers, choose the best ones, and consolidate the spending with them in exchange for better prices and perhaps customized service.

Such an approach can produce large savings. One company we have worked with recently saved \$175,000—against annual revenues of \$160 million—in part by finding one supplier to provide facilities services (such as janitorial and lawn maintenance) for all three of its facilities.

Then, by using the data from the general ledger, supplier invoices, e-procurement systems, and/or corporate card reports, companies can look for savings across all spending categories. Aggregated information, with supplier-level detail, provides a key advantage in reviewing and utilizing spending data in vendor negotiations.

At the same time, companies should be sure to utilize all of the discounts already available to them. Often, industry groups, professional associations, and corporate card providers offer pre-negotiated discounts on common business expenses to their members. Especially for smaller companies that may not have the spending volume to negotiate discounts on their own, these rates provide a simple way to reduce expenses and improve the bottom line.

The most overlooked point when it comes to supplier management is simply to ask for a better price. You should actively negotiate with key suppliers. In this market, most suppliers are willing to offer either a discount or more favorable terms.

Of course, none of these steps is a substitute for common sense and commitment by the CFO to find new ways to save money. There are always different ways to approach the issues, different technology you can use to improve them, but at the end of the day it's the CFO making people focus on it and pay attention.

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