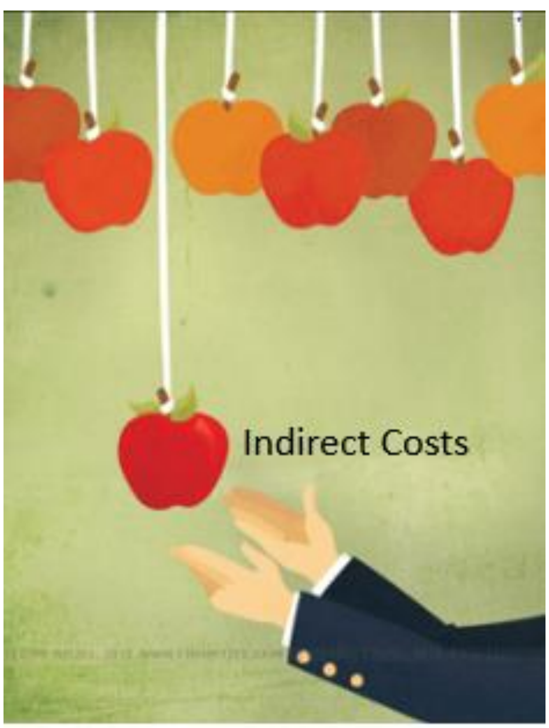
Indirect Costs

The low hanging fruit in Expense Reduction

By Ben Lapscher

In an increasingly competitive environment, companies are frequently forced to reduce costs to succeed in their markets. Managers often think of drastic measures like laying off personnel, reducing direct costs like raw and packaging materials or relocating and closing facilities. These actions are often difficult and uncomfortable to implement and can affect significantly quality of product or service as well as morale among employees.

Though sometimes these measures can be inevitable, in many cases they can be avoided by focusing initially on reducing *Indirect Costs* that often have little, if any, effect on product quality and company morale.



The purpose of this article is to discuss why it makes sense to first take a look at *Indirect Costs* and why they represent the low hanging fruit in Expense Reduction. These are the main reasons supporting this proposition:

Indirect Costs **reductions do not affect quality of Product or Service.** Unlike materials or labor, *Indirect Costs* are costs not directly linked to the product or service. These comprise multiple categories including: Insurance, Energy, Payroll Processing, Courier, Freight, Telecom, Office Supplies, Garbage Removal and Maintenance among many other. As such, managers have the flexibility of making changes to these categories without affecting the quality of the product or service.

For example, if we were to reduce costs of Energy in a manufacturing plant by implementing energy preservation initiatives or by taking advantage of industry incentives, we still could produce the same items without affecting product quality. Same situation will happen with services like Payroll Processing, Telecom or Garbage Removal. In addition, all these cost reductions will go directly to the bottom line.

<u>Cuts on *Indirect Costs* do not affect staff morale</u>

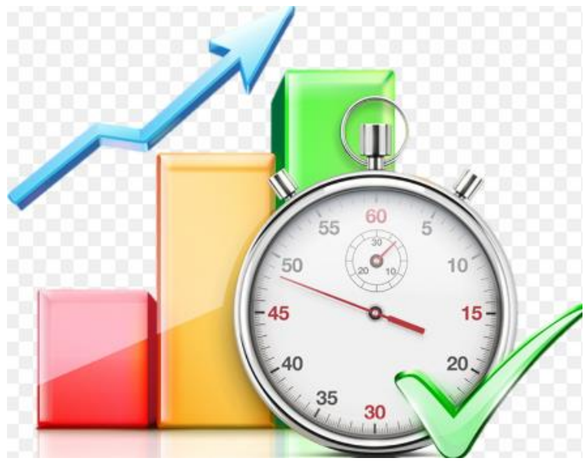
Managing *Indirect Costs* implies dealing with vendors that provide services to the business. Any change on negotiated terms will only involve third party vendors, rather than employees. As a matter of fact, only the people that deal with these vendors will be involved and the process can be totally transparent to the rest of organization.

Recently we were involved in a project where we were able to replace a Telecom vendor for a manufacturer with savings of 67%. The process was managed with extreme care an only the IT and Finance people involved were aware of the change. On another case, we renegotiated better terms for Garbage Removal with current vendor and no operational employees were involved in the process.

As a result, these companies were able to generate additional profit without affecting their headcount or morale.

<u>Reductions on *Indirect Costs* are relatively easier to implement and provide rapid results.</u>

Unlike layoffs, product reformulations and relocating/closing facilities, reducing *Indirect Costs* are usually initiatives that can be achieved quickly, with lower implementation costs and with minimal effect on operations. For example, at a Furniture manufacturer the change of their Property/Liability insurance generated 56% savings, and required only 3 weeks for analysis, quoting and implementation.



Same situation occurs with services like Copying, Merchant Processing, Courier and Freight just to name a few. There are other changes like Payroll Processing, Cellphones or Health Insurance that may imply an extra effort, however, it will compare much favorably to the disruption that a relocation or lay-offs imply. It is always preferable to create some temporary extra tasks than being forced to tell employees they no longer have a job. *Indirect Costs* reduction initiatives also typically represent minimal change in processes, demanding less time from staff.

As a consequence of this faster and less costly implementation, results are shown sooner than longer restructuring or reformulating processes.

Indirect Costs **reductions can yield better than expected savings.** Typically *Indirect Costs* are fragmented in many categories and they represent individually a small portion of total spent. As a result, they get frequently overlooked and slip under the radar. However, collectively they can account for 30-40% of the expenses pie. Carrying out cost reduction initiatives on some of these categories can result in relevant savings.

Recently we were involved with a company that was thinking of letting several employees go. After implementing several *Indirect Cost* reduction initiatives, we were able to save significantly and avoid the need to reduce their headcount.

Final Thoughts

Businesses are frequently forced to reduce expenses. Changes in materials, labor and processes imply risks of affecting quality of product/service and company morale. They are usually harder and take longer to implement and realize savings. On the other side, reductions in *Indirect Costs* can be implemented at a faster pace, lower cost and without affecting product quality or employee morale. That is why they can be considered the *Low Hanging Fruit in Expense Reduction*.

Ben Lapscher is a Principal with Expense Reduction Coaching (ERC) in South Florida. Since 1993, ERC has helped multiple businesses save millions of dollars in indirect expenses. Before ERC, Ben accumulated extensive operational experience in different industries and positions in local and multinational businesses. Ben holds an Industrial Engineering degree from Universidad Católica Andrés Bello and an MBA from IESA, both in Caracas, Venezuela. He has also completed extension programs at Harvard Business School and Kellogg School of Management. Comments: blapscher@ERCcoach.com.