

MODULE 2

COST OPTIMISATION

PART OF A MODULAR TRAINING RESOURCE

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COST OPTIMISATION

INTRODUCTION

The purpose of this Module is to explore opportunities to reduce expenditure in the organisations. However, in certain instances it may be more appropriate to retain the cost and seek to drive/generate more revenue.

Often, an investment is required to support the implementation of cost savings initiatives. The success of any cost reduction programme is dependent on obtaining 'buy-in' from all stakeholders as well as the ability to accurately measure expenditure savings.

KEY DEFINITIONS

The following table describes the most useful terms to understand throughout this Module.

Term	Definition
Break cost	Expense or charges incurred when a borrower terminates a fixed-rate loan contract before the expiry of the fixed-rate period.
Direct cost	Expense directly related to the revenue earned; for example, wages incurred for delivering a particular programme.
Discretionary cost	Expense which is not essential to the operation of an organisation; for example, entertainment.
Fixed cost	Expense incurred which is independent of the level of revenue earned/received; for example, rent.
Indirect cost	Expense not directly related to earning revenue; for example, utilities.
Non-discretionary cost	Expense required for the operation of an organisation; for example, insurance.
Variable cost	Expense which fluctuates depending on the level of activity taking place or revenue earned or received; for example, transport.

PROCESS

The following describes activities for exploring opportunities to reduce costs. Each category of costs should be reviewed regularly to assess the ability to reduce them.

UNDERSTAND THE COST STRUCTURE OF THE ORGANIZATION

DETERMINE DRIVERS

Identify the key driver of each cost and determine if there is any opportunity to change the key driver. For example, for rent, location and floor space are key drivers. Is there any opportunity to relocate to cheaper premises or reduce floor space? Or sub-lease to a third party (to generate revenue)?

CLASSIFY COSTS

Classifying costs into fixed versus variable, direct versus indirect, and discretionary versus non-discretionary may assist with determining whether there is any scope for reducing costs. For example, certain entertainment costs may be considered discretionary and could be reduced very quickly.

Some costs may also have a component of each classification. It is important to identify how much of a cost is fixed versus variable as there may be some scope to change the cost structure mix.

BENCHMARK COSTS

Organisations can benchmark costs against competitors or industry to understand where there may be opportunities to reduce costs.

For example, the IBIS March 2015 report identified the following cost structure for organisations operating in the employment placement and recruitment services in Australia.



Source: IBIS World

CONSIDER PROFITABILITY OF ACTIVITIES/SERVICES PROVIDED

Prepare a profit and loss statement by cost centre or major activity. This will assist with:

- Identifying expenses associated with lost contracts (and therefore revenue). Direct costs should be easily identified, for example, wages incurred in delivering a programme. The challenge is to identify indirect costs. This will require some analysis and will require allocation on some basis, for example, time spent, level of activity, percentage of revenue received.
- Determining if cross subsidisation occurs. This is when a profitable activity is funding a loss making activity. Loss making activities should either cease or change.

CONSIDER HOW THINGS CAN BE DONE DIFFERENTLY

All activities should be reviewed to determine if they can be done differently. Any task or control which does not contribute to the delivery of an activity should be removed.

This includes:

- challenging the need for a task altogether
- identifying any duplication in activities
- determining the frequency of activities.

REVIEW SUPPLIER/LANDLORD AGREEMENTS

All key supplier contracts should be reviewed for:

- pricing
- services received
- identification of break costs. It may be worth incurring a break cost if the ongoing savings more than offset this cost.

FOCUS EFFORTS ON LARGE COSTS

Focus on larger costs in the first instance as they are likely to have greater scope to be reduced. However, it is important to remember that savings across a number of minor cost categories can also accumulate a meaningful level of savings.

SEEK TO OUTSOURCE OR CREATE ALLIANCES

Consider whether there is an opportunity to outsource or seek alliances for back office costs such as IT, finance, payroll, etc.

ENSURE THERE ARE CONTROLS

Once costs are determined and agreement from those people affected by any changes has been obtained, various controls should be established such as use of budgets, purchase orders and approval limits.

Relevant staff should be allocated the responsibility for maintaining costs and also held accountable through regularly comparing budget to actual expense levels (monthly comparisons would be appropriate).

ANALYSING EMPLOYEE EXPENSES

Employee expenses are not just salary expenses. There are a number of additional factors which make up your total employee expense. Outlined below are some considerations when analysing employee expenses and potential optimisation:

- Consider headcount by reviewing the organisational structure (please note that if redundancies are required you should quantify the redundancy cost - see Module 3 for more information regarding redeployment of staff).
- Identify employees who are directly associated with lost revenue or business, for example, those staff who worked directly on the JSA or other employment services and may have skills that could be assigned to other lines of business.
- If rosters are used, consider whether the staff mix is rostered appropriately. Are there opportunities to utilise permanent staff as opposed to casual or contract staff?
- If contractors are used regularly, identify where it may be more cost effective to hire an employee.

- Clearly communicate when there is a hiring freeze and when vacancies exist to ensure there is no inadvertent hiring.
- Review salary packaging arrangements. Fringe benefits are taxed at a lower rate than wages for NFPs. A public benevolent institution (PBI) does not pay fringe benefits tax (FBT) (subject to a \$30,000 capping threshold per employee). An NFP which is not a PBI receives a 48 per cent rebate on FBT (subject to a \$30,000 capping threshold per employee). Organisations should seek independent salary packaging advice or have their arrangements revisited.
- Manage accruals of staff entitlements
- Consider job descriptions to ensure there is no duplication of roles and activities.
- Consider whether staff can be retrained to undertake different roles and tasks, rather than being retrenched.
- Review how and when training expenses are incurred and assess whether training is making a significant contribution to the organisation and therefore whether it is needed.

ANALYSING OTHER EXPENSES

There are other expenses which may provide opportunities for optimisation. Outlined below are points to consider when analysing these costs.

PREMISES

- If the property is owned, consider whether underutilised space could be leased to generate rental income or whether the property should be sold in favor of leasing premises.
- If leasing, sublease any under utilised floor space where possible.
- Review the lease to ensure the organisation is not incurring outgoing costs which the landlord should be paying.
- Identify when a lease is due to expire. Endeavour to negotiate a lower rental or consider relocating to cheaper premises. Even if the lease is not due to expire, consider whether it is worth breaking the lease to relocate to cheaper premises.
- Merge/consolidate multiple sites.
- Reduce floor space with the use of shared desks for staff that spend time offsite rather than allocating permanent desk space which is not fully utilised.
- Consider offsite storage for archived filing rather than using valuable floor space.

UTILITIES

- Review contracts and pricing for each utility organisation.
- Seek alternative quotes to ensure you are receiving the most competitive rate and service.
- Ensure premises are adequately insulated to minimise energy costs.

CLEANING

- Consider contract versus in-house cleaning arrangements.
- If there is a contract cleaner consider frequency of cleaning.
- Promote use of recycling office and general waste.

MOTOR VEHICLE COSTS

- Challenge the number and use of motor vehicles. For example, can a motor vehicle be utilised as a community/pooled resource rather than be used exclusively by one individual?
- Review fuel card expenditure.
- Consider the frequency of motor vehicle maintenance.
- If finance has been used to acquire the motor vehicles, has the most cost effective form of finance been used?

COMMUNICATION (INCLUDING TELEPHONE, MOBILE PHONES AND INTERNET)

- Review contracts for pricing and services received.
- Seek alternative quotes to ensure you are receiving the most competitive rate and service.
- Bundle services to reduce costs.
- Review usage to ensure there is no personal use which is increasing costs.

GENERAL AND ADMINISTRATION

- Review insurance premiums for level of cover, excess and premium.
- Review IT costs.
- Minimise printing costs by challenging the need to print, and, if printing is required, promote double-sided printing and avoid colour.
- Avoid use of costly unessential stationery items and encourage recycling of paper.

- Given the overhead nature of this category, critically challenge costs.