

# Perspective

## Practical ideas for manufacturers and distributors

### Using Indirect Cost Savings to Fund Your Company's Growth

**Is the recession over yet? Can we start growing our business again? Hopefully for your company the answer to both questions is an emphatic "yes."**

According to McGladrey's 2010 Manufacturing and Wholesale Distribution National Survey almost 90 percent of responding executives characterized their business as either holding its own or thriving or growing. In 2009, only 60 percent of respondents held the same opinion. The industry generally believes the economic rebound is close, if not already here.

Unfortunately, in the same survey the executives responded that they believe both direct costs (e.g. raw materials, operating labor) and indirect costs (e.g. overhead, SG&A) will increase significantly in 2011 from 2010 levels. So how can you profitably grow your business at the same time your costs are increasing?

One of the most effective ways to fund profitable growth is to drive down your indirect supplier costs, redirecting those savings to new initiatives. Why focus on indirect suppliers specifically?

- **Bottom line impact:** Because indirect costs do not typically fluctuate with revenue growth, indirect savings drop straight to the bottom line and are easier to isolate into a pool that can fund growth initiatives.
- **Easier to change:** Indirect suppliers are generally not core to your business' operations and are simpler and less risky to change.
- **Easier to sustain:** Because indirect costs are not correlated with business growth or contraction, they should be more stable and predictable year over year. Therefore, indirect savings can be more easily planned, tracked and enforced through strong budgeting and financial management.

### Prioritizing Your Focus

In most companies there are not enough resources to turn over every single rock to find cost savings. Prioritize your focus so that you turn over the rocks (indirect spend categories) that have the largest, quickest payback.

What makes a particular indirect spend category a higher priority?

- **Amount of spend:** The larger the amount of spend, the higher the savings opportunity.
- **Number of suppliers:** The higher the number of suppliers, the higher the savings opportunity.
- **Spend concentration for top suppliers:** Even if you have a large number of suppliers for a particular category, if the top 1 or 2 suppliers already receive 80 percent+ of your spending, the savings opportunity will be lower.
- **Competitiveness in the category:** Many indirect spend categories (e.g. office supplies, freight, information technology) are highly competitive industries where savings can be more easily generated.
- **Internal considerations:** Some indirect spend categories may be politically sensitive (e.g. benefits, legal expenses, marketing) inside your company, and could warrant a lower priority or more measured approach.

### New Cost Savings

Given the economic environment the past 3-4 years, you have probably already implemented a number of indirect cost savings. Therefore, if you want to fund new growth you will need to pursue new cost savings tactics.

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## Indirect Cost Savings, continued from page 1

Even if the tactics outlined below are not new to your organization, applying them in new ways to indirect spend categories may help you uncover savings.

- **Strategic Sourcing:** Put indirect spend categories out to bid through RFP's or reverse auctions, just like you would direct. (Sample Categories: Equipment, Pallets and Packaging)
- **Supplier Consolidation:** Even if you are not a large organization, by consolidating indirect spend categories with 1 or 2 suppliers you can still leverage your spending for additional savings. (Sample Categories: Office Equipment, Janitorial Services)
- **Demand Management:** Reduce the amount of products and services you buy, not just the price. (Sample Categories: MRO, Temporary Staff)
- **Specification Management:** In the same way you manage the specifications of component parts and raw materials, redefine your specifications for indirect products and services to drive down costs. (Sample categories: Information Technology, Print)
- **Policy Compliance:** Often savings can be generated simply through strict enforcement of your existing policies. (Sample categories: Fleet, Travel)
- **Cost Recovery Audits:** Review your past payments to suppliers and request reimbursement for any incorrect invoicing and overpayments. (Sample categories: Freight, Telecommunications)

Hopefully with the overall economy rebounding, the stage is set for many companies to grow again. Will your organization need funds to fuel growth (e.g. investments in R&D or marketing)? Most importantly, will your company grow bottom line profit along with revenue? A continuing focus on indirect cost savings should help you with both.

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## Manufacturing and Wholesale Distribution Executive Summits

### Power Up: The Resurgence of Manufacturing

In the last quarter of 2010, we held several Manufacturing and Wholesale Distribution Executive Summits across the country. Since the manufacturing industry is not immune to the continuing uncertainties of the economy, our summits focused on helping companies cope with economic unknowns; and provided ideas on how to rebuild during the long-term recovery. As one participant put it, the summits provided a valuable opportunity to understand “where the economy is and where it’s going from various business perspectives.”

Those diverse perspectives serve as the basis of this executive summary. Based on insights shared by industry executives and McGladrey professionals during panel discussions and break-out sessions, we created [Ten Ways to Empower Your Organization during the Economic Recovery](#). The summary describes the advantages companies like yours are finding in open innovation, performance management programs, tax credits and incentives, and indirect spending analysis, among other thoughtful ideas.

### The State Of The Industry

As manufacturing executives navigate their way through the recovery, certain key principles can help them cope with the uncertainty.

In the following series of videos – recorded at the McGladrey summits in late 2010 - McGladrey specialists and others discuss

what manufacturers can do to address some of the primary issues and opportunities their organizations are facing.

### Innovation

Open innovation is a shift in thinking that enables companies to innovate more quickly by sharing project knowledge.

To learn more, visit: [www.mcgladrey.com/perspective](http://www.mcgladrey.com/perspective)

### Health Care

There are many unknowns regarding the legislation being implemented for employer-sponsored group health plans.

To learn more, visit: [www.mcgladrey.com/perspective](http://www.mcgladrey.com/perspective)

### Capital Markets

One of the more complex parts of management’s role is understanding how to finance a company’s growth through buyouts

To learn more, visit: [www.mcgladrey.com/perspective](http://www.mcgladrey.com/perspective)

### Going Green

If profitability can be achieved, it may make sense to go green.

To learn more, visit: [www.mcgladrey.com/perspective](http://www.mcgladrey.com/perspective)



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**Manufacturing and Wholesale Distribution Executive Summits**



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