

08-10

OCTOBER 2008

EXERCISING LEADERSHIP

Seven Principles Controllers Can Use to Permanently Lower Administrative Costs

Many companies now face a difficult cluster of cost challenges. In particular, their business complexity has increased in both the front and back office, their products and services are increasingly expensive to introduce and support, and their budget cuts have delivered temporary, not sustained, cost reductions.

In general, controllers at such businesses say their CEOs are aware of these problems, especially if margins are narrowing. Even so, they say their CEOs want more than operating cutbacks that lower costs for a quarter or two.

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KEEPING CONTROL

Schonfeld Forecasts Costs Per Employee in 136 Industries

In today's perilous business environment, CEOs have asked their controllers to monitor two key benchmarks—sales per employee and gross margin per employee—with extra vigilance. Reason: CEOs want to receive the earliest possible warning if revenue at their companies falls behind costs.

CR points out that rising costs and weak sales have become a real concern at many businesses. The most recent *Economic Trends* survey of the National Federation of Independent Business, for example, states that widespread price increases in the

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STAYING CURRENT

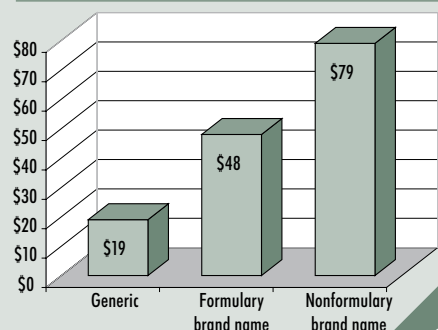
Average Expenses for 401(k) Plans at 0.63% of Assets

Many CR readers are getting tougher questions about fees from participants in their companies' 401(k) plans. Reason: When the stock market is rising, participants often pay little attention to fees. But when markets and the assets in 401(k) plans decline, participants often become acutely aware of fees, which seem to take a noticeable and undeserved bite out of their savings.

Interestingly, a new survey from Deloitte

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Average Prescription Drug Copays: Mail-Order Plans.....See page 8



(Source: Mercer)

Accounts Payable Buyer's Guide—see insert—

401(k) Expenses

CONTINUED FROM PAGE 1

suggests that such questions may require additional digging about fees at 36 percent of companies. *Reasons:* In this survey, 64 percent of plan sponsors answered "yes" when asked if they had performed a detailed fee analysis and had a thorough understanding of all plan expenses. But 12 percent of respondents answered "no" while 24 percent had no opinion.

At the same time, this survey reveals that such digging for expenses and hidden fee arrangements is not necessarily easy. *Reason:*

- In response to the statement, "We have no difficulty obtaining a clear description

of all the revenue-sharing arrangements that the recordkeeper has with the mutual funds included in the plan," 13 percent of respondents disagreed and 27 percent had no opinion.

- In response to the statement, "We have no difficulty learning what it costs our provider to administer our plan," 20 percent disagreed and 28 percent had no opinion.

At the same time, this Deloitte survey developed additional information about 401(k) fees that has interest for controllers. In particular:

- *What is the average expense ratio?* The average ratio for fund expenses as a percentage of total assets was 63 basis points

How Are Your 401(k) Plan's Recordkeeping/Administrative Fees Paid?

| | | |
|--|-----|-----|
| All fees are paid through investment revenue | | 46% |
| Direct fee charged by recordkeeper | | 40 |
| Company | 64% | |
| Participants | 23 | |
| Pro rata allocation | 33% | |
| Equal dollar allocation | 47 | |
| Both the company and the participants pay this fee | 11 | |
| Fees in the form of wrap fees or added basis-point charge on the investments | | 5 |
| Other | | 9 |
| Total | | 100 |

(Source: Deloitte)

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(0.63 percent). This distributes as follows: up to 0.5 percent, 18 percent of plans; 0.51 percent to 0.85 percent, 44 percent of plans; 0.86 percent to 1.25 percent, 20 percent; more than 1.25 percent, 1 percent; and confidential, 28 percent.

- *Who pays the annual recordkeeping and administrative fees?* The associated table shows that plans pay these costs through investment revenue at 46 percent of companies and 40 percent pay a direct fee charged by the recordkeeper.

- *Who pays when there is a direct fee?* For 64 percent of respondents, the company pays the direct fee, according to our table. Meanwhile, employees pay these fees in 23 percent of plans or split these fees with their employers (11 percent).

CR gives the final word to Deloitte: "The need for improvements in overall fee disclosure still exists."

(Source: Deloitte)

Compensation

The associated table provides an overview of planned merit increases for 2009 in 12 industry groups. Developed by *Report on Salary S*

SS says companies awarded this year but above the actual 3.6 percent increase in 2007.

Importantly, this survey, which reflects planning at roughly 300 companies in May, shows upper-quartile merit increases at 6.5 percent next year, with these salary raises as high as 8.4 percent in the wholesale and retail trades. In contrast, lower-quartile increases will average a mere 1.6 percent. Among businesses, this bottoms out at 1 percent, also in wholesale and retail trade. *Frame of reference:* In the 12-month period ending in July, the Consumer Price Index was up 5.6 percent, due to soaring fuel and food costs.

Points of comparison: In August, Mercer projected an average pay raise of 3.7 percent for all employees next year. In July, a competing survey from Watson Wyatt Worldwide foresaw a 3.5 percent average increase.

CR points out that the 4.9 percent differential in upper- and lower-quartile raises in this RSS survey captures an important trend that is helping companies maximize the impact of merit pay: Award the bulk of merit-pay budgets to the best employees.

Clearly illustrating this strategy is the August survey from Mercer, which shows companies budgeting an average 5.6 percent increase for top performers (14 percent of participant workforces) next year. In contrast, these companies allocated only

Expected Average and Range of Merit Increases for 2009, by Industry

| | Average | Low | High |
|-----------------------------|---------|------|------|
| Manufacturing | 4.1% | 2.0% | 6.7% |
| Financial/banking/insurance | 3.7 | 1.3 | 7.8 |
| Business services | 4.2 | 2.0 | 6.9 |
| Transp./util./comm. | 3.8 | 1.8 | 6.1 |
| Wholesale/retail trade | 3.6 | 1.0 | 8.4 |
| Health care | 3.4 | 1.6 | 5.5 |
| Nonprofit | 4.6 | 1.5 | 5.2 |
| Government | 2.2 | 0.2 | 2.4 |
| Education | 3.5 | 2.2 | 4.6 |
| Arch./eng./construction | 3.8 | 1.9 | 7.0 |
| Biotech | 3.7 | 1.3 | 6.8 |
| Other | 3.8 | 1.8 | 6.9 |
| Overall | 3.8 | 1.6 | 6.5 |

(Source: *Report on Salary Surveys*)

a 0.6 percent salary boost to their lowest performers (7 percent of their workforces). *Upshot:* In a difficult economy, organizations are shifting what they have to their top performers.

Key point: This strategy of shifting resources to the best employees is even more pronounced in bonuses. *Proof:* According to Mercer, executives who are top performers will receive bonuses that average 66 percent of their base pay in 2008, substantially above the 20 percent bonuses of low performers. Likewise, bonuses for top-performing managers will average 36 percent of base, well above the 8 percent bonuses of low performers.

Nonetheless, many controllers who review the findings of this RSS survey will be rightfully concerned about the power of merit increases to motivate. After all, a

6.5 percent upper-quartile salary increase barely keeps a valuable employee ahead of inflation.

For such CR readers, we provide two other findings from the Mercer study, which reveal other compensation trends that help to reach and motivate employees who are not executives or managers. These findings are:

- Eighty-six percent of organizations give workers bonuses. In the last three years, moreover, 24 percent have extended bonuses to workers at more levels.
- Companies continue to hand out one-time cash awards to employees whose work exceeds expectations or represents a major milestone.

(Source: Report on Salary Surveys, Mercer LLC)

IT Spending

THIRTY-NINE PERCENT OF COMPANIES HAVE REDUCED IT BUDGETS IN 2008

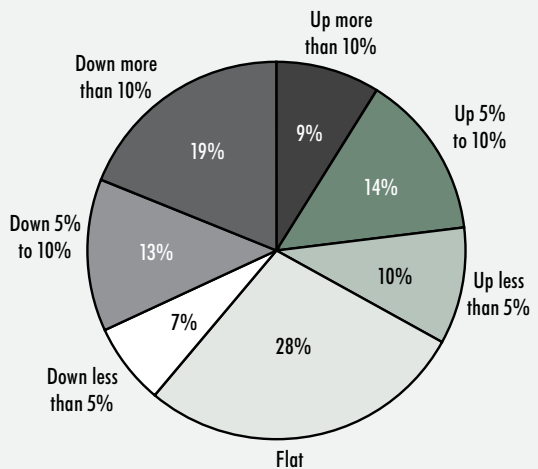
Useful benchmarks for IT spending and strategy are available to controllers in a recent survey by *Information Week*, a leading trade magazine. *Key point:* In comparison to their 2007 budgets, spending so far this year at this survey's 612 respondents is lower, 39 percent; stable, 28 percent; and higher, 33 percent. Other survey findings include:

- *In response to concerns about the economy, are you being asked to ratchet back IT spending?* Yes, asked to cut a percentage on our IT budget, 32 percent; yes, asked not to increase spending on IT as much as planned, 29 percent; yes, asked to cut specific projects, 24 percent; no, concerns about the economy have not affected the IT budget or spending plans, 35 percent.

- *Which types of projects or investments are you most likely to scale back?* New hires, 72 percent; infrastructure upgrades, 60

percent; new application development, 46 percent; new outsourcing engagements, 29 percent; end-user technology, 25 percent; and other, 5 percent.

How Will Your Company's IT Spending This Year Compare With 2007?



(Source: Information Week)

- *Did your company's IT spending plans change much in the second quarter?* No, the 2008 budget is unchanged, 55 percent; yes, we decreased spending relative to our original 2008 budget, 40 percent; yes, we increased IT spending relative to original 2008 budget, 5 percent.

CR gives the final word to *Information Week*: "Any CIO worth his or her Blackberry

is putting together the Plan B list—the projects/efforts/areas that can be deferred or eliminated if things get worse. Now is the time to ask, 'Where exactly is the IT budget being spent? Which projects are critical, which have tactical short-term benefits, and which can be put on hold?'"

(Source: *Information Week*)

P&C Rates

JULY'S 11 PERCENT DECLINE IN P&C PREMIUMS MAY BE THE MARKET BOTTOM

An indexed measure of renewal rates for 13 lines of P&C insurance declined 11 percent in July, the same rate as in May and June. Even so, these drops in rates in June and July were less than their 14 percent declines in this index one year before.

Key point: MarketScout, the Dallas-based insurance exchange that promotes this index as its P&C Market Barometer, calls this "the largest year-on-year rate moderation in the last three years." Adds Richard Kerr, the CEO of MarketScout, "This pattern suggests we may be near the bottom of the soft P&C market."

Background: This index last showed an overall increase in P&C premiums in January 2005, when average premiums rose 1 percent. At the same time, declines in this index peaked at 16 percent in December 2007. Since that date, other monthly rate declines at renewal have been 15 percent in January, 14 percent in February, and 12 percent in March and April.

Nonetheless, CR points out that the buyer's market for P&C coverage remains in place. *Proof:* For July, this index pegged year-to-year price changes as follows:

- *By coverage:* commercial property, down 14 percent; business interruption, down 9 percent; inland marine, down 8

percent; general liability, down 11 percent; umbrella/excess, down 11 percent; commercial auto, down 9 percent; workers' compensation, down 7 percent; and directors and owners liability, down 7 percent.

- *By account size:* small accounts (those with up to \$25,000 in commissions), down 10 percent; medium accounts (those with \$25,001 to \$250,000), down 12 percent; large accounts (those with \$250,000 to \$1 million), down 11 percent; and jumbo accounts (those with over \$1 million), down 10 percent.

- *By industry:* manufacturing, down 13 percent; contracting, down 9 percent; service, down 12 percent; habitational, down 11 percent; public entity, down 10 percent; transportation, down 19 percent; and energy, down 9 percent.

CR emphasizes that today's depressed and erratic stock market, as well as the disastrous guarantees that some insurers have provided for mortgage-backed securities, is forcing insurers to generate more profits from their underwriting. *Key point:* In buyer's markets, insurers offer coverage at razor-thin margins, expecting to make money through investing premiums.

For controllers, these facts raise two joined questions: How and when will this

affect premiums? Here, Kerr answers the how question with the statement, "While write-downs are not directly related to insurance underwriting results, they ultimately will impact an insurer's appetite to continue rate cuts." Meanwhile, an analysis of the

P&C industry by *National Underwriter*, a trade paper, addresses when. This analysis says there is "little indication change will come soon."

(Source: MarketScout.com)

Property Coverage

PROPERTY PREMIUMS DECREASED 12.6 PERCENT IN SECOND QUARTER

On average, CR readers who renewed their commercial property coverage in the second quarter saw premiums decrease 12.6 percent, according to the most recent membership survey by the Council of Insurance Agents & Brokers (CIAB). *Frame of reference:* In the four preceding quarters, average premiums for this coverage decreased 14.8 percent (first quarter of 2008), 13 percent (fourth quarter of 2007), 15 percent (third quarter of 2007), and 12.2 percent (second quarter of 2007).

Controllers who review the associated table will see that this average premium decline took somewhat different forms in the five regions of the CIAB survey. *Proof:* Declines were most commonly in the 1 percent-to-10 percent range in the Northeast (50 percent of these respondents) and Midwest (45 percent). Meanwhile, the most common declines were in the 10 percent-to-20 percent range in the Pacific Northwest (56 percent) and Southwest (50 percent).

Declines in the Southeast spread evenly across the 1 percent-to-30 percent range.

CR emphasizes that these declines in property premiums largely reflect policy renewals that preceded the flooding in Iowa in June. *Qualification:* Although property and flood insurance are different policies, there is often spillover in the pricing of insurers.

Nonetheless, *Business Insurance*, a leading trade newspaper, did not even mention the effects of this flooding on pricing in a recent overview story of the property insurance market. Instead, "Property Rates Plunge Further Despite Losses," which *BI* published June 30, features various industry sources who observed:

- "The market is awash with capacity, so companies are competing for business and rates are falling."
- "It's classically a buyer's market. But with one puff of wind, all that can change."

Changes in Premiums for Commercial Property Coverage for Quarter Ending on June 30, 2008

| | Down 30%- 40% | Down 20%- 30% | Down 10%- 20% | Down 1%- 10% | No Change | Up 1%- 10% | Up 10%- 30% | Up 30%- 100% | N/A |
|-------------------|---------------------|---------------------|---------------------|--------------------|--------------|------------------|-------------------|--------------------|-----|
| Northeast | 0% | 17% | 29% | 50% | 0% | 0% | 0% | 0% | 4% |
| Southeast | 7 | 30 | 30 | 30 | 3 | 0 | 0 | 0 | 0 |
| Midwest | 0 | 14 | 18 | 45 | 14 | 0 | 0 | 0 | 9 |
| Pacific Northwest | 0 | 0 | 56 | 31 | 6 | 6 | 0 | 0 | 0 |
| Southwest | 0 | 25 | 50 | 13 | 13 | 0 | 0 | 0 | 0 |
| National | 2 | 18 | 34 | 35 | 7 | 1 | 0 | 0 | 3 |

(Source: Council of Insurance Agents & Brokers)

Meanwhile, CIAB offers this perspective from one of its survey participants:

"Rates over the past two years of CAT property in the Southeast increased dramatically, and brokers are now willing, after two years of calm winds, to grant generous reductions from 2007 rate levels. Rates are now approaching pre-Katrina levels."

CR emphasizes that premium information in this survey is based on a small sample—only 105 respondents. Even so, the CIAB claims to represent brokers and agents that annually place 80 percent of all U.S. commercial property and casualty premiums.

(Source: The Council of Insurance Agents & Brokers)

Audit Fees

FEES FOR ROUTINE AUDITS OF LARGE COMPANIES DECLINE 0.3 PERCENT

Average audit fees paid by large companies increased only 3.2 percent in 2007, according to a new study by *Compliance Week*. **Key point:** Fees at a handful of large companies with special audit issues skewed this average upward. And without these outliers, average audit fees actually decreased 0.3 percent. Other findings of interest to controllers from this survey include:

- The median total auditor cost for these companies—426 of the S&P 500—was \$6.9 million, while median audit fees were \$5.6 million. On average, the total fees paid to auditors—including audit-related costs, tax fees, and other fees—rose 3.7 percent.

- Median audit-related costs were \$401,000, and median tax fees were \$400,000.

- On average, audit fees were 83.9 percent of a company's total fees paid to auditors.

CR emphasizes that this decline in average audit fees at the bulk of surveyed companies—that is, those *not* involved in acquisitions, divestitures, or extraordinary transactions and that were *not* restating their financial statements due to material errors—is highly unusual. **Reason:** These fees, like other professional costs, generally rise steadily, although they may plateau when the economy is weak.

At the same time, basically flat audit fees in 2007 reflect the routinization of Sarbanes-Oxley (SOX) compliance. **Background:** When large public companies first began to comply with SOX in 2003, they commonly experienced double-digit increases in their audit costs as they established procedures for documenting and certifying their internal controls. But by 2007, most of these companies had become cost-efficient at updating their previous year's work.

In the early days of SOX, moreover, audit firms were also implementing a highly prescriptive new auditing standard—Auditing Standard No. 2 (AS 2) *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*—which auditors interpreted conservatively. Observes *Compliance Week*, "The level of attention to detail stretched the audit profession beyond its human resource capacity, leading to a classic supply-and-demand push on pricing."

Key point: The Public Company Accounting Oversight Board (PCAOB) decided the costs of AS 2 outweighed its benefits and rewrote the audit rules. This effort yielded Auditing Standard No. 5, a scaled-down, principled-based version of the original. Note that the decline in average fees at

most big companies in 2007 shows the effects of this more relaxed standard.

Finally, CR emphasizes the routinization of audits and audit services has also restored the ascendancy of fixed-price audits. *Background:* Audit services are generally fixed-fee arrangements with conditions, which give audit firms hourly flexibility if

they encounter surprises during an audit. But the ascendancy of fixed-fee pricing weakened somewhat when activity and pricing spiked. Now, fixed-fee arrangements are the norm—a development that is also moderating audit fees.

(Source: *Compliance Week*)

Prescription Drug Costs

MAIL-ORDER COPAYS AVERAGE \$79 FOR NONFORMULARY BRAND-NAME DRUGS

The overall cost increase for prescription drugs declined for the seventh straight year in 2007. At the same time, the average cost of this benefit rose faster than the overall cost of health benefits. *Background:* At large organizations (those with more than 500 employees on staff), recent cost rises for prescription drugs and health benefits are 9.3 percent and 5.1 percent in 2007, 9.9 percent and 6.1 percent in 2006, 11.5 percent and 6.7 percent in 2005, and 14.3 percent and 9 percent in 2004.

Last year, only 16 percent of companies, most of them very large, offered prescription drug benefits through carve-outs. In this case, companies hired a pharmacy benefit manager to administer the prescription drug benefit under a separate contract. In contrast, other companies try to contain these costs through the design of their prescription drug card plans (available at 63 percent of large organizations) and mail-order plans (91 percent). *Details:*

- In recent years, the majority of large companies using such card plans have implemented three-tiered copayment designs. Here, companies require a relatively low copayment for generic drugs, a higher copayment for brand-name drugs on the plan's formulary, and an even higher copayment for brand-name drugs not on the plan's formulary.

- Last year, 72 percent of large companies had three-tiered drug card plans. Here, copays were \$10 for generic drugs, \$25 for formulary brand-name, and \$42 for nonformulary brand-name.

- In 2007, 68 percent of these companies had three-tiered mail-order plans. In this case, the copays were \$19 for generic, \$48 for formulary brand-name, and \$79 for nonformulary brand-name drugs.

- Twenty percent of large employers now require coinsurance payments in their card plans, and 15 percent use coinsurance in their mail-order plans. Across these employers, 11 percent also set coinsurance maximums, and 9 percent have coinsurance minimums for their leading card plan. For mail order, the use of maximum and minimum payments is 8 percent and 6 percent, respectively.

CR points out that so-called evidence-based clinical practices are this year's hot concept for making the most out of prescription drug spending. Here, companies actually reduce cost-sharing for maintenance drugs used by asthmatics and diabetics. *Key point:* This supports usage and compliance with physician orders. Says Mercer, "While only 5 percent waive copays for such drugs, the high level of employer interest in evidence-based design suggests adoption may accelerate."

(Source: Mercer LLC)

Health Benefit Rate Trends

HEALTH INSURERS FORECAST 10.6 PERCENT INCREASE IN HMO COSTS

The associated table presents projections for increases in health care costs for six 12-month periods, the most recent beginning in spring 2008. *Key point:* Many surveys of health benefit costs reflect actual employer spending. In contrast, the increases in this table reflect the opinions of 70 leading health care insurers.

For controllers, this different perspective offers valuable input as their employers consider health plan design and strategy. Explains Aon Consulting, which developed this information:

"This survey reports the expected future increase in employer-provided health plan claims cost before any plan changes, based

on the opinion of health plan actuaries. As a result, this data helps employers evaluate the competitiveness of health insurance premium renewals. For employers with self-funded plans, this trend data also helps them develop future claims estimates for budgeting purposes."

On the bright side, Aon's data do show a decline in projected medical cost increases. For example, projected increases in spring 2003 for HMOs, PPOs, and POS plans that offered prescription drug coverage are roughly 5 percent higher than those for the current 12-month period. Meanwhile, forecasted increases for general pharmacy costs were

CONTINUED ON PAGE 12

Projected Health Care Cost Trends for 12-Month Periods Beginning . . .

| | Spring 2003 | Spring 2004 | Spring 2005 | Spring 2006 | Spring 2007 | Spring 2008 |
|---|----------------|----------------|----------------|----------------|----------------|----------------|
| Medical—Actives & Retirees <65 (with Rx) | | | | | | |
| HMO | 16.4% | 14.1% | 13.2% | 12.2% | 10.9% | 10.6% |
| POS | 16.1 | 14.1 | 13 | 11.9 | 10.8 | 10.5 |
| PPO | 15.7 | 14.2 | 13 | 12.4 | 11.2 | 10.7 |
| Indemnity | 17.2 | 15.3 | 14.6 | 14.4 | 12.7 | 12.4 |
| CDH | - | 14.1 | 12.7 | 12.5 | 10.7 | 10.5 |
| Medical—Actives & Retirees <65 (without Rx) | | | | | | |
| HMO | 14.7 | 13.4 | 12.9 | 12.0 | 11.0 | 10.8 |
| POS | 14.5 | 13.5 | 12.7 | 11.8 | 10.9 | 10.5 |
| PPO | 14.4 | 13.5 | 12.7 | 12.3 | 11.3 | 10.9 |
| Indemnity | 16.4 | 14.7 | 14.6 | 14.4 | 13.1 | 12.6 |
| CDH | - | 13.3 | 12.4 | 12.3 | 10.7 | 10.3 |
| Medical—Retirees Age >65 (with Rx) | | | | | | |
| Medicare Supplement | - | - | - | 11.5 | 11.2 | 7.3 |
| Medicare Advantage | - | - | - | 10.2 | 9.2 | 7.7 |
| Medical—Retirees Age >65 (without Rx) | | | | | | |
| Medicare Supplement | - | - | - | 9.9 | 9.0 | 7.3 |
| Medicare Advantage | - | - | - | 8.0 | 8.0 | 7.0 |
| Dental | | | | | | |
| DHMO | 4.8 | 5.0 | 4.7 | 4.8 | 4.5 | 4.2 |
| PPO | 7.6 | 7.3 | 7.1 | 6.7 | 6.1 | 6.3 |
| Indemnity | 7.6 | 7.7 | 7.6 | 7.1 | 7.1 | 7.0 |
| Pharmacy | | | | | | |
| General | 17.7 | 14.4 | 13.1 | 12.2 | 9.5 | 9.2 |
| Specialty | - | - | 22.5 | 17.0 | 15.1 | 12.2 |
| Vision | 3.8 | 3.9 | 3.9 | 3.6 | 3.1 | 3.1 |

(Source: Aon Consulting)

THE CONTROLLER'S FORUM

USE SELF-INSURANCE TO CUT HEALTH BENEFIT COSTS

Challenge: Devise lower-cost self-funded programs that meet employee needs.

Action: We now partially self-fund our health benefits. What we do is contract directly with a network of doctors. And we have designed these contracts so that our associated self-insured health plan duplicates, as much as possible, the insured products that we offered previously. We have a PPO and now an HMO look-alike. We also have a strong professionally managed wellness program. While this approach moves costs around a great deal, it lowers increases in our total benefit spending to the 5 percent range. —*Controller, manufacturing, 600 employees, Florida.*

CUT BACK HEALTH BENEFIT SPENDING BY FINE-TUNING MANAGED CARE

Challenge: Make our PPO more cost-effective.

Action: During the past year, we negotiated a new rate directly with our hospitals, which brought us a small savings on the stays by our PPO enrollees. We also implemented new health plans, using a national PPO that will give us discounted rates throughout the country. Before, we only had discounted rates with hospitals in Chicago, which is our largest location. —*Assistant controller, manufacturing, 850 employees, Illinois.*

DOWNSIZE THE MARKETING DEPARTMENT WITHOUT UNDERCUTTING ITS EFFECTIVENESS

Challenge: Achieve the same with fewer resources in marketing.

Action: The marketing department had a director, two product managers, two market research staffers, one administrative assistant, and one marketing communications manager. We eliminated all but the director of marketing title, with the responsibilities shifting to the marketing manager, who now wears many hats. Meanwhile, we placed three of the five downsized employees in other

jobs. The marketing manager has a more stressful job, but the change is saving the company over \$100,000 per year. —*Controller, services, 350 employees, Indiana.*

CUT BACK ON MARKETING COSTS BY USING THE INTERNET

Challenge: Get our story out to prospects at lower cost.

Action: We made all our sales literature available on the Internet. This Internet delivery cut our mailing costs by 20 percent, boosted inquiries, and eliminated the costs and problems of obsolete literature. It also lowered printing costs. Our salespeople say this system uncovers new prospects, although they are careful to spend time only with recipients of our literature who are ready to take the next step. —*Assistant controller, manufacturing, 1,000 employees, Tennessee.*

LOWER PURCHASING COSTS BY SHRINKING OUR SUPPLIER BASE

Challenge: Get our buyers to support this fundamental change in purchasing.

Action: We've begun to leverage our spending with fewer vendors. Our goal is to have one major, one minor, and a third in the closet for each category of part or commodity. So far, we have been able to negotiate better discount and contract programs for our division, with costs lower by 5 percent or more for certain items. We've also received improved service, and our suppliers are showing greater concern with quality. —*Division controller, medical devices, 1,100 employees, Arizona.*

IMPROVE THE COST-EFFECTIVENESS OF OUR MAIL-ORDER PRESCRIPTION DRUG PROGRAM

Challenge: Adjust plan design to hold down costs.

Action: We have a three-tier structure in mail-order prescription drug plan. This year, we

THE CONTROLLER'S FORUM

did not change copayments for generic, preferred, and nonpreferred usage—\$19, \$48, and \$79, respectively. But we did introduce coinsurance. For the three tiers, this is 20 percent, 25 percent, and 40 percent, respectively. We believe coinsurance achieves better cost transparency and allows us to share costs with employees, even when prescription drug costs fluctuate. —*Controller, manufacturing, 1,100 employees, Texas.*

EMPLOY A RANGE OF TACTICS TO CUT WORKERS' COMPENSATION EXPENSES

Challenge: Get the entire company focused on workers' compensation costs.

Action: We used a variety of programs to lower this cost. These were (1) employee in-service training, (2) modify work programs, (3) create interactive safety committees, (4) undertake post-accident drug testing, (5) hold adjusters accountable for closing claims, (6) involve our managed care network, (7) gain the commitment of employees to lower this cost, (8) improve screening methods, and (9) revise our appraisal system. Overall, these tactics, in combination with state reforms, have reduced this expense by roughly 15 percent in the last two years. —*Assistant controller, services, 2,000 employees, Iowa.*

RAISE PAYBACK OF COMPENSATION COST BY ADJUSTING THE MIX OF SALARY AND BONUS

Challenge: Shift toward performance-based pay.

Action: We've implemented a number of new tactics in the last 12 months. This includes tying our bonus plan to net revenue and new bonus goals. We also implemented some bonuses for certain project completions and other one-time events. Finally, we shifted sales force compensation to variable pay. Our goal is to keep compensation costs flat this year, while keeping staff motivated. —*Controller, manufacturing, 130 employees, Massachusetts.*

IMPROVE BACK-OFFICE EFFICIENCY BY IMPLEMENTING IMAGING

Challenge: Use the Internet to cut processing costs.

Action: We used imaging to move access to our invoices to a portal on the Internet. This way, any person needing duplicate copies of invoices can get their forms by going to our Web pages. So far, this has saved us the cost of several people at central billing who did nothing but print duplicates and invoices and about five FTEs in various offices throughout the United States who did the same. —*Vice president and controller, transportation, 10,000 employees, California.*

REDUCE INVENTORY COSTS WITH PERVASIVE USE OF COMPETITIVE BIDDING

Challenge: Get better and cheaper vendors to bid for supply contracts.

Action: We now actively source new, best-in-class suppliers that do not yet do business with us. Then we bring them into our competitive bidding process, where we buy key commodities. One recent initiative was for an electric part that is a commodity. Our system yielded actual savings of \$3,000 on an annualized basis. We calculate a \$22,000 future value. —*Controller, manufacturing, 2,000 employees, Indiana.*

Coming in future issues of *The Controller's Report*

- New Benchmarks for Workers' Compensation Insurance Premiums
- Fees for Pension Plan Administration by Asset Type and Size
- Sales Compensation Benchmarks by Revenue and Industry
- How Much Do Companies Spend to Make a Sale? New Metrics
- Benchmarks for Purchasing Department Spending in 20 Industries
- Average Training Budgets Per FTE in 18 Industry Groups

Health Benefit Rate Trends

CONTINUED FROM PAGE 9

17.7 percent in spring 2003, substantially higher than the current 9.2 percent.

On the other hand, this exhibit does show that current projected medical cost increases are only slightly below those that participants forecast in spring 2007. *Key point:* This is troubling, since most businesses cannot really sustain this rate of health-benefit cost increase and remain competitive. Meanwhile, the cost-sharing necessitated by this rate of increase is a big bite from employee take-home pay.

Controllers who examine this table will also note that the projected cost increase

for consumer-directed health plans (CDHP) is 10.5 percent, the same rate increase projected for PPOs. *Background:* With a CDHP, an employee enrolls in a plan with a high deductible—say, \$2,000. Then, the employer contributes part of the cost of this higher deductible to a health savings account for each employee.

Key point: The number of CDHPs is relatively small. Further, CDHP performance varies considerably from employer to employer, depending on plan design, enrollment, and the degree of consumer education. As a result, CDHP forecasts are somewhat suspect.

(Source: Aon Consulting)

ERP Payback

BEST-IN-CLASS COMPANIES LOWER ADMINISTRATIVE COSTS BY 15 PERCENT WITH ERP

When they implement enterprise resource planning (ERP) systems, companies lower their investments in inventory, shorten basic administrative tasks, and improve customer service. These facts are illustrated in the associated table from the Aberdeen Group, which quantifies the benefits that manufacturers receive from their ERP system in nine performance categories.

Even so, this table also shows that some implementations are significantly more successful than others. For example, it shows that best-in-class companies—the top 20 percent in aggregate performance—reduce their inventory levels by 20 percent. This is an 8 percent larger reduction than at surveyed companies in the middle 50 percent and 15 percent higher than at laggards—those in the bottom 30 percent of this sample.

Benefits of ERP Implementations: Three Company Categories

| | Top 20% | Middle 50% | Bottom 30% |
|--|----------|------------|------------|
| Reduction in inventory levels | 20% | 12% | 5% |
| Inventory accuracy | 97% | 92% | 83% |
| Reduction in operational costs | 14% | 9% | 4% |
| Reduction in administrative costs | 15% | 10% | 6% |
| Days to close a month | 3.3 days | 5.6 days | 7.1 days |
| Manufacturing scheduling compliance | 95% | 89% | 76% |
| Improvement in manufacturing scheduling compliance | 18% | 12% | 5% |
| Complete and on-time shipments | 97% | 92% | 92% |
| Improvement in complete, on-time shipments | 18% | 12% | 6% |

(Source: Aberdeen Group)

Fortunately, this survey, *2008 ERP in Manufacturing Benchmark Report*, identifies many of the factors that improve the payback of ERP investments at best-in-class respondents. Some of these factors, which fall within the purview of controllers, include:

- “Companies in all three categories choose ‘visibility across functions and departments’ as a top strategic priority. But laggards are 44 percent less likely than best-in-class to have full real-time visibility into the status of all processes from quote to cash. As a result, laggards are 54 per-

cent less likely to anticipate exceptions and respond proactively.”

- “ERP investments are often owned by the IT department. In these situations, the perceived success of the implementation is often based on costs and how quickly the go-live milestones are achieved. Meanwhile, true ROI, measured in cost reductions and performance improvements, is overlooked. But at best-in-class companies, line of business executives are 51 percent more likely to own the success of the implementation than at laggards.”

- “The top two strategic actions of best-in-class manufacturers are to standardize and accelerate processes in both manufacturing and non-manufacturing. The combination of these actions touches many departments across an organization as it executes the quote-to-cash cycle. As a result, formalizing and documenting these two actions form the foundation for automation and acceleration. Otherwise, automating poor processes means you continue to operate poorly, only faster.”

(Source: Aberdeen Group)

Inventory Turnover

MEDIAN WIP INVENTORY TURNS AT 15.6X AT U.S. MANUFACTURERS

Benchmarks for inventory turns at manufacturers are available to CR readers in the associated table. Developed by the Manufacturing Performance Institute (MPI) and published in its report *Manufacturing 2007*, this table shows inventory turns for raw material, work in process, finished goods, and total inventory according to quartiles and average in a universe of 943 North American manufacturing plants.

Definitions: In this study, inventory turns are calculated as the annual cost of goods sold divided by the average value on hand of each inventory category—that is, raw material, WIP, finished goods, and total inventory.

Controllers who review this table will see a significant difference in the rates of inventory turns at 25th- and 75th-percentile performers. *Example:* At 75th-percentile U.S. companies, work-in-process inventory turns are 40.9 times, more than five times the 8.0 rate at 25th-percentile performers.

Keypoint: Such performance benchmarks provide a frame of reference for controllers as they work to minimize spending on inventory at their companies. *Caveat:* These MPI

benchmarks ignore important manufacturing factors that have a significant effect on inventory turns. These include the primary product of a plant, the primary value chain of a plant, and the mix of its operations.

On the bright side, this MPI study shows that many companies are increasing their inventory turns. In particular, it shows that 52 percent of U.S. companies increased their inventory turnover rate in the three-year period ending in 2007. Furthermore, another 24 percent of respondents held their turnover rates steady in this period.

Details:

- *U.S. plants:* turnover increased more than 20 percent, 9 percent of respondents; increased 11 percent through 20 percent, 15 percent; increased 1 percent through 10 percent, 32 percent; stayed the same, 24 percent; decreased 1 percent through 10 percent, 12 percent; decreased 11 percent through 20 percent, 5 percent; and decreased more than 20 percent, 3 percent.

- *Canadian plants:* turnover increased more than 20 percent, 7 percent of respondents; increased 11 percent through 20 percent, 10 percent; increased 1 percent

through 10 percent, 23 percent; stayed the same, 30 percent; decreased 1 percent through 10 percent, 17 percent; decreased 11 percent through 20 percent, 7 percent; and decreased more than 20 percent, 5 percent.

Upshot: At more than 75 percent of U.S. companies, turnover rates are *not* contributing to rising investments in inventory. This is a critical accomplishment in a period of rising costs and in an environment when customers push back against price increases from manufacturers.

At the same time, this MPI report shows that the effects of increasing inventory turns are not enough to overcome today's powerful rise in costs for materials. It observes, "Nine of 10 plants report that costs for components and materials rose in the last year. More than one-fourth of plants were hit with cost increases that exceeded 10 percent. This leaves most manufacturers with little to do but pass along higher costs to customers. Indeed, 72 percent of plants increased their price for primary products in the past year."

(Source: Manufacturing Performance Institute)

What Are the Plant's Inventory Rates*?

| | All Plants | U.S. | Canada |
|------------------------------|------------|-------|--------|
| Raw material turns | | | |
| Number | 606 | 538 | 68 |
| Median | 10.0 | 10.0 | 9.7 |
| Average | 21.9 | 21.3 | 26.3 |
| 75th percentile | 18.0 | 18.0 | 16.0 |
| 25th percentile | 5.0 | 5.3 | 5.0 |
| Work-in-process turns | | | |
| Number | 536 | 472 | 64 |
| Median | 15.6 | 15.6 | 15.5 |
| Average | 115.1 | 119.0 | 86.4 |
| 75th percentile | 40.3 | 40.9 | 39.4 |
| 25th percentile | 7.5 | 8.0 | 6.3 |
| Finished goods turns | | | |
| Number | 552 | 490 | 62 |
| Median | 12.0 | 12.0 | 11.4 |
| Average | 44.3 | 42.7 | 56.6 |
| 75th percentile | 24.0 | 24.0 | 40.0 |
| 25th percentile | 6.0 | 6.0 | 5.0 |
| Total inventory turns | | | |
| Number | 645 | 573 | 72 |
| Median | 7.0 | 7.0 | 7.0 |
| Average | 12.6 | 11.2 | 23.7 |
| 75th percentile | 13.1 | 13.0 | 15.0 |
| 25th percentile | 4.0 | 4.0 | 4.0 |

* Inventory turns calculated as annual cost of goods sold divided by the average value on hand of each inventory category: raw material, WIP, finished goods, and total inventory, respectively.

(Source: MPI)

Overhead Strategies

FIFTY-SIX PERCENT OF COMPANIES PLAN SIGNIFICANT EXPENSE REDUCTION EFFORTS

Controllers who examine the associated table will see that companies are steering a prudent path in 2008. Published originally in *Managing Cost and Growth in Uncertain Times*, a new white paper from Towers Perrin (TP), this table shows that:

- Two of the three business actions with the highest "likely" ratings this year involve cost control. These actions and their highly likely ratings are significant expense reduction effort, 56 percent, and small-scale and targeted reduction in workforce, 41 percent.

- Two of the four "most likely" actions are meant to expand sales, either through offering new products or expanding into new markets. In this case, these actions and their ratings are offer new products or services, 56 percent, and expand into new global markets, 40 percent.

- Four of the five actions with the lowest highly likely ratings are desperate measures that companies often take when they can't cover their operating costs. Here, these actions and their ratings are large-scale reduction in workforce, 11 percent; major shift in business strategy, 16 percent; significant outsourcing or offshoring, 18 percent; and significant change in organization structure, 30 percent.

Altogether, these ratings show strong awareness of cost but a nearly equal commitment to expansion. *Upshot:* The respondents, midsize and large U.S. companies, considered use of draconian measures to be remote. Observes TP:

"Companies are taking a more sophisticated and balanced view of what needs to be done in this economic climate, as compared to past downturns.

"Businesses have strong balance sheets that are buttressed by plenty of cash. Most

have kept their workforces lean and productive. They're positioned to withstand current economic headwinds."

(Source: Towers Perrin)

Likelihood of Taking the Following Business Actions in 2008

| | Highly Likely | Neither Unlikely Nor Likely | Highly Unlikely |
|---|---------------|-----------------------------|-----------------|
| Significant expense reduction effort | 56% | 22% | 22% |
| Expansion into new product or service lines | 56 | 20 | 24 |
| Small-scale/targeted reduction in workforce | 41 | 20 | 39 |
| Expansion into new global markets | 40 | 11 | 49 |
| Medium or small-scale merger or acquisition | 36 | 16 | 48 |
| Significant change in organizational structure | 30 | 25 | 45 |
| Significant outsourcing or offshoring of operations | 18 | 21 | 61 |
| Major shift in business strategy | 16 | 25 | 59 |
| Large-scale merger or acquisition | 14 | 18 | 68 |
| Large-scale reduction in workforce | 11 | 19 | 70 |

(Source: Towers Perrin)

THE CONTROLLER'S CALENDAR

THE CONTROLLERS WORKSHOP: Oct. 6, Indianapolis; Oct. 7, Orlando, Fla.; Oct. 8, Albuquerque, N.M.; Oct. 9, Fort Lauderdale, Fla.; Oct. 20, Manchester, N.H.; Oct. 22, Cincinnati. Contact: www.skillpath.com

THE THIRD ANNUAL CFO RISING WEST CONFERENCE AND EXHIBITION: Oct. 14-17, Las Vegas. Contact: www.cfoenterprises.com

7th ANNUAL ACCOUNTS PAYABLE CONFERENCE & EXPO: Oct. 15, Las Vegas. Contact: www.accountspayable360.com/conferences/916.html

PROFIT IMPROVEMENT: 10 TIPS FOR A BETTER BOTTOM LINE: Oct. 16, Iselin, N.J. Contact: www.njscpa.org

DRIVING ORGANIC GROWTH: HOW TO MAXIMIZE ALL OF YOUR COMPANY'S ASSETS: Oct. 16-17, New York City; Nov. 17-18, Atlanta. Contact: www.amanet.org

AFP ANNUAL CONFERENCE: Oct. 19-22, Los Angeles. Contact: www.afponline.org

ADVANCED STRATEGIES FOR CONTROLLERS: Oct. 20-21, Chicago. Contact: www.amanet.org

THE CONTROLLER'S JOB IN TODAY'S ENVIRONMENT: Oct. 27-29, Arlington, Va.; Nov. 3-5, San Francisco. Contact: www.amanet.org

FAS 109—INCOME TAX REPORTING: Nov. 5-6, Kissimmee, Fla.; Nov. 20-21, Chicago. Contact: www.eeiconferences.com

Costs in 136 Industries

CONTINUED FROM PAGE 1

three-month period ending in July "did not counter the effects of inflation and weak sales." At the same time, the components in this survey measuring future expectations fell to their lowest level since April 1980.

In the associated table, CR provides background information that controllers can use as they track current sales and costs trends at their employers. Developed

by Schonfeld & Associates and published in its current edition of *Workforce Ratios & Forecasts (WRF)*, our table shows:

- *Sales per employee.* This ratio is self-explanatory, showing average sales per employee in each featured industry.
- *Gross margin per employee.* According to Schonfeld, this ratio provides an income-statement measure of average per-employee "resources" in an industry, after the cost of goods sold has been excluded from sales.

Sales, Gross Margin Per Employee in 136 Industries

| | SIC | 2008 Sales per emp (\$000) | 2008 Margin per emp (\$000) | | SIC | 2008 Sales per emp (\$000) | 2008 Margin per emp (\$000) |
|-----------------------------------|------|-------------------------------------|--------------------------------------|------------------------------------|------|-------------------------------------|--------------------------------------|
| Advertising | 7310 | 306.9 | 135.3 | Cutlery, hand tools, gen. hrdwr | 3420 | 245.8 | 105.4 |
| Agricultural chemicals | 2870 | 715.1 | 263.7 | Deep sea frn transfreight | 4412 | 503.8 | 213.1 |
| Agricultural production | 100 | 140.8 | 40.1 | Drilling oil and gas wells | 1381 | 331.0 | 177.1 |
| Air transport, scheduled | 4512 | 304.2 | 65.4 | Drug & proprietary stores | 5912 | 364.5 | 80.7 |
| Apparel & other finished prods | 2300 | 174.1 | 79.8 | Drugs & proprietary—whsl | 5122 | 2,296.7 | 146.9 |
| Apparel & accessory stores | 5600 | 87.8 | 38.3 | Eating places | 5812 | 48.4 | 13.1 |
| Arrange trans-freight, cargo | 4731 | 439.8 | 85.6 | Educational services | 8200 | 146.4 | 75.5 |
| Auto dealers, gas stations | 5500 | 575.1 | 76.3 | Elec. meas. & test instruments | 3825 | 299.3 | 163.5 |
| Biological pds, ex. diagnostics | 2836 | 372.3 | 254.4 | Elec. & other svc comb. | 4931 | 1,088.8 | 230.2 |
| Bituminous coal mining | 1220 | 220.4 | 55.3 | Electric lighting, wiring equip. | 3640 | 209.7 | 74.1 |
| Btld & can soft drinks, water | 2086 | 203.1 | 94.5 | Electrical services | 4911 | 827.7 | 220.7 |
| Business services, NEC | 7839 | 80.0 | 33.1 | Electric ind'l apparatus | 3620 | 249.2 | 106.0 |
| Cable and other pay TV svcs | 4841 | 459.0 | 247.9 | Electromedical apparatus | 3845 | 281.8 | 187.3 |
| Calculate, acc't mach., ex. comp. | 3578 | 215.6 | 53.3 | Electronic comp., accessories | 3670 | 112.6 | 29.1 |
| Catalog, mail-order houses | 5961 | 510.6 | 144.5 | Electronic components, NEC | 3679 | 187.5 | 53.4 |
| Chemical & allied products | 2800 | 499.4 | 192.6 | Electronic computers | 3571 | 418.7 | 139.7 |
| Cmp integrated sys. design | 7373 | 158.6 | 55.4 | Electronic parts, equip.—whsl, NEC | 5065 | 1,288.2 | 171.8 |
| Cmp processing, data prep svc | 7374 | 109.0 | 35.6 | Engineering services | 8711 | 148.9 | 20.7 |
| Cmp prgrmg, data process | 7370 | 209.7 | 96.3 | Equip. rental & leasing, NEC | 7359 | 413.0 | 289.4 |
| Cogeneratn-sm power producer | 4991 | 716.2 | 303.7 | Family clothing stores | 5651 | 111.7 | 41.4 |
| Coml physical, biological resh | 8731 | 160.7 | 47.4 | Fire, marine, casualty ins. | 6331 | 948.5 | 242.9 |
| Commercial banks | 6020 | 599.7 | 288.6 | Footwear, except rubber | 3140 | 250.6 | 108.3 |
| Commercial printing | 2750 | 196.6 | 39.3 | General med. & surgical hospitals | 8062 | 132.2 | 19.3 |
| Communications equip., NEC | 3669 | 177.6 | 73.0 | General industrial mach. & equip. | 3560 | 244.7 | 83.9 |
| Communications services, NEC | 4899 | 438.6 | 208.7 | Grocery stores | 5411 | 204.3 | 55.0 |
| Computer communications eq | 3576 | 502.1 | 320.2 | Hazardous waste management | 4955 | 187.0 | 55.7 |
| Computer peripheral eq, NEC | 3577 | 303.9 | 156.5 | Heavy constr.—not bldg constr. | 1600 | 312.7 | 39.1 |
| Computer programming svc | 7371 | 55.2 | 21.9 | Help supply services | 7363 | 31.2 | 7.3 |
| Computer storage devices | 3572 | 291.7 | 117.2 | Home health care services | 8082 | 66.2 | 32.7 |
| Computer & software, whsl | 5045 | 1,584.4 | 124.3 | Hospital & medical svc plans | 6324 | 1,108.7 | 247.1 |
| Concrete, gypsum, plaster pds | 3270 | 309.4 | 88.6 | Hotels & motels | 7011 | 62.8 | 14.4 |
| Construction-special trade | 1700 | 238.8 | 30.6 | Household audio & visual | 3651 | 419.9 | 52.7 |
| Convrt papr, paprbrd, ex boxes | 2670 | 268.5 | 103.7 | Household furniture | 2510 | 196.9 | 64.3 |
| Crude petroleum & nat. gas | 1311 | 2,454.2 | 1,319.4 | In vitro, in vivo diagnostics | 2835 | 223.9 | 100.5 |

(Source: Schonfeld & Associates)

Altogether, our table provides norms for businesses in 136 standard industrial categories (SICs). Obviously, these norms for sales and costs per employee are a useful backdrop for controllers in these industries as they work to align cost structures with sales expectations.

We emphasize that Schonfeld develops these norms through forecasting. In particular, its benchmarks for 2008 are based on a stream of IRS data that begins with information from 2002. Then, Schonfeld processes

this data through proprietary time-trend, constant-ratio, and industry models. *Key point:* These norms are forecasted values, not actual current performance figures.

Further, these industry norms are weighted averages and are biased upward toward larger companies. *Reason:* In general, these are businesses that consistently report employment figures in their financial statements.

Additional details: For manufacturers, these measures reflect sales after returns,

| | | 2008 Sales per emp (\$000) | 2008 Margin per emp (\$000) | | SIC | 2008 Sales per emp (\$000) | 2008 Margin per emp (\$000) |
|------------------------------------|------|-------------------------------------|--------------------------------------|-------------------------------------|------|-------------------------------------|--------------------------------------|
| Ind'l inorganic chemicals | 2810 | 432.1 | 122.8 | Personal services | 7200 | 42.7 | 13.3 |
| Industrial measurement instr. | 3823 | 227.5 | 106.5 | Petroleum refining | 2911 | 1,184.5 | 279.0 |
| Industrial organic chemicals | 2860 | 1,298.3 | 245.6 | Pharmaceutical preparations | 2834 | 448.7 | 343.2 |
| Ins. agents, brokers & service | 6411 | 306.6 | 51.3 | Phone comm. ex. radiotelephone | 4813 | 359.5 | 178.0 |
| Investment advice | 6282 | 1,410.2 | 931.8 | Photographic equip. & supply | 3861 | 259.3 | 116.3 |
| Lab analytical instruments | 3826 | 281.2 | 146.7 | Plastics products, NEC | 3089 | 262.7 | 83.7 |
| Life insurance | 6311 | 1,178.6 | 159.9 | Plastics, resins, elastomers | 2821 | 854.8 | 153.6 |
| Management consulting svcs | 8742 | 154.4 | 43.7 | Prepackaged software | 7372 | 317.2 | 222.5 |
| Meas. & controlling dev., NEC | 3829 | 252.1 | 117.1 | Printed circuit boards | 3672 | 204.6 | 13.3 |
| Medical laboratories | 8071 | 164.0 | 73.4 | Radio broadcasting stations | 4832 | 293.4 | 153.6 |
| Medicinal chems, botan. pds | 2833 | 324.1 | 128.5 | Radio TV br'dcast, comm. eq. | 3663 | 487.6 | 169.1 |
| Metal mining | 1000 | 422.0 | 370.5 | Radiotelephone comm. | 4812 | 531.5 | 299.0 |
| Misc. amusement & rec. service | 7990 | 117.2 | 49.5 | Railroads, line-haul operating | 4011 | 323.4 | 112.9 |
| Misc. elec. mach'y, equip. spls | 3690 | 204.0 | 63.1 | Refrig. & service ind. machine | 3580 | 280.3 | 104.9 |
| Misc. fabricated metal prods | 3490 | 222.1 | 77.4 | Refuse systems | 4953 | 270.7 | 104.2 |
| Misc. health & allied svc, NEC | 8090 | 174.6 | 61.6 | Retail stores, NEC | 5990 | 128.6 | 52.4 |
| Misc. manufacturing industries | 3990 | 271.2 | 149.9 | Rolling & draw nonfer. metals | 3350 | 369.0 | 74.7 |
| Misc. shopping goods stores | 5940 | 200.2 | 61.7 | Savings inst'n, not fed. chartered | 6036 | 627.3 | 144.1 |
| Miscellaneous retail | 5900 | 401.7 | 104.1 | Savings inst'n, fed chartered | 6035 | 441.5 | 157.9 |
| Mng, quarry nonmtl minerals | 1400 | 367.0 | 103.4 | Semiconductor, related device | 3674 | 272.3 | 127.8 |
| Motion pic., videotape prodtn | 7812 | 525.0 | 286.7 | Special outpatient facility, NEC | 8093 | 86.1 | 22.3 |
| Motor vehicle parts, accessory | 3714 | 211.1 | 32.2 | Special industry mach'y, NEC | 3559 | 379.0 | 172.3 |
| Motor vehicles & car bodies | 3711 | 625.2 | 145.7 | Sporting & athletic gds, NEC | 3949 | 268.4 | 112.6 |
| Motors & generators | 3621 | 78.0 | 22.2 | Sch., det., nav., guid., aero. sys. | 3812 | 279.4 | 64.8 |
| Natural gas distribution | 4924 | 1,065.9 | 161.4 | Steel works & blast furnaces | 3312 | 355.7 | 77.5 |
| Natural gas transmission | 4922 | 3,044.9 | 991.7 | Surgical, med. instr., apparatus | 3841 | 231.5 | 147.3 |
| Newspapers: pub'g & printing | 2711 | 172.8 | 81.0 | Telephone & telegraph apparatus | 3661 | 307.8 | 123.5 |
| Oil & gas field mach'y, equip. | 3533 | 287.9 | 101.7 | TV broadcast station | 4833 | 354.4 | 129.0 |
| Oil & gas field services, NEC | 1389 | 303.9 | 119.1 | Trucking, except local | 4213 | 192.8 | 19.6 |
| Operator nonres. buildings | 6512 | 435.7 | 208.2 | Variety stores | 5331 | 172.3 | 47.0 |
| Optical instruments & lenses | 3827 | 354.7 | 194.9 | Water supply | 4941 | 164.9 | 17.3 |
| Ortho, prosth., surg. appl. supply | 3842 | 300.6 | 195.4 | Water transportation | 4400 | 203.5 | 77.2 |
| Paper mills | 2621 | 399.7 | 79.3 | Women's clothing stores | 5621 | 110.9 | 44.2 |
| Perfume, cosmetic, toilet prep. | 2844 | 310.4 | 236.9 | Wmns, miss, chld, jrs outerwear | 2330 | 317.4 | 191.6 |

allowances, and discounts. For nonmanufacturers, sales are the top line of the income statement, where they may be deemed net revenue or gross income, depending on an industry's accounting convention. The gross-margin-per-employee ratio is also a weighted average.

CR points out that WRF, besides offering pages of industry-based forecasts, also provides revealing data on the productivity and cost structure of specific companies. For example, it provides company-specific information on per-employee revenue and costs at 73 public companies that are in cable television and other pay television services (SIC 4841). Near the top of this alphabet-

ized company list is British Sky Broadcasting Group (14,819 employees). Near the bottom is XM Satellite Radio (1,215 employees). Thirty-first on the list is iDNA Inc. *Key point:* For controllers in this industry, WRF is a useful tool for learning about workforce productivity throughout their industries, both at leaders and at specific rivals.

Altogether, WRF provides norms for sales and gross margin per employee at more than 400 industries and 6,000 companies. Controllers can get a copy of this unique book reference by contacting Schonfeld & Associates at 1931 Lynn Circle, Libertyville, IL 60048 (800-205-0300) or visiting www.saiBooks.com. Price: \$395. □

Lower Administrative Costs

CONTINUED FROM PAGE 1

Interestingly, Booz Allen Hamilton (BAH) has articulated an approach to cost reduction that addresses these two problems. Branded "administrative cost transformation" (ACT), this approach addresses what BAH calls the fundamental challenge of cost cutting: "getting it off and keeping it off."

In the associated exhibit, CR provides an overview of this approach to cost reduction. Titled "Seven Principles That Achieve Permanent Change in Administrative Costs," our exhibit describes what BAH deems a holistic approach to cost cutting.

"An administrative cost transformation," BAH says, "reviews all the cost levers at once. This is an important advantage, since the most frequent mistake organizations make during a cost-containment campaign is to look at costs in a near-sighted, ad hoc way, with executives scattering their efforts across the enterprise, cutting costs temporarily but failing to address the root drivers of those costs."

CR points out that BAH developed this ACT approach primarily to reduce structural costs in service organizations, such as health plans. Nonetheless, ACT is a useful conceptual tool that will help controllers and their colleagues maintain focus and commitment as they reduce what BAH calls inherent, structural, and systemic costs.

"In our experience," observes BAH, "a campaign to reduce costs is best framed by asking three simple questions: What are our costs? Where are our costs? How well do we manage processes that generate costs?"

According to BAH, controllers that ask and answer these three questions—while applying the seven principles in our exhibit to their organizations—will develop a comprehensive and coordinated approach to cost reduction that ensures administrative cost transformation takes hold. □

Seven Principles That Achieve Permanent Change in Administrative Costs

1. *Ensure that senior management is aligned.* Many organizations have launched cost-saving programs only to find that when the moment of truth arrives to execute the plan, leadership is conflicted. The organization senses confusion, and dissent against the plan gains strength.

How the leadership handles this expected resistance often determines the outcome of the initiative. Indeed, leaders' actions need to consistently reinforce objectives, demonstrating conviction and resolve in decisionmaking and priority setting that support cost-reduction efforts. Maintaining this resolve is essential.

One company succeeded in cutting 7 percent in the first year of a three-year plan to reduce costs by 15 percent but reached only 2 percent the second year. The reason for the shortfall was that the company's leaders began to confuse the organization by pushing other priorities forward, such as new products, along with cost reduction.

This challenge is even tougher at organizations without an ingrained sense of cost consciousness. When that's the case, organizations often make cost reductions only when they are convinced survival depends on making some hard choices.

2. *Simplify the product portfolio.* At a time when manufacturers were faced with growing product complexity, the response was to simplify portfolios. Today, we believe health plans face a similar challenge. In many, offerings have evolved from simple contracts to broker-customized plans that incorporate an increasing number of features that give employers and consumers more choice. But fulfilling such orders typically leads to the ongoing retrofitting of back-office functions. This drives up per-member-per-month costs.

A forward-thinking business addresses complexity by creating modular service plans. In much the same way as a buyer of a Dell computer can customize certain features but not every one, this approach lets members and benefits executives select certain groups of features but only among modules where processes are clearly configured and the cost structures are clearly understood. Then the complexity that remains is isolated and confined mostly to strategically important high-value areas.

3. *Think wisely about IT.* When health plans begin to look for cost saving and a means for controlling complexity, they often act as if IT is an easy lever to pull. But turning too quickly to IT does not maximize cost reduction. More important, leaning heavily on IT may serve only to optimize process problems. *Key point:* In the course of drawing up the business case for an IT solution, the cost savings in the forecast are often mostly process improvements that are independent of the new application.

Certainly IT solutions can lead to significant productivity gains and workplace improvements. But in the end, their success depends largely on the degree of process optimization that took place before.

4. *Attack sacred cows.* What is only a line item on paper often translates into a cherished part of the corporate self-image, an

important part of someone's career, or the livelihood of hundreds of colleagues. Executing such changes is disruptive and uncomfortable at best. Serious cost-reduction programs address the entire scope of the business, thereby sending the message that this is a new era. But how often have we been in situations where everything is in play except "the executive canteen"? Taking on sacred cows often unlocks a scale of savings far beyond what the organization thought possible.

5. *Build in the right control philosophy.* Businesses must incorporate cost savings as a cultural element in day-to-day operations, systematically questioning and examining sources of defects, waste, and variance. Traditionally, companies address variances and optimized processes only to find that, over time, processes become inefficient again, due to newly added complexity, long refresh and upgrade cycles, unplanned growth, and lack of a control philosophy to drive continuous improvement and sustain gains.

Key point: When plans undertake an administrative cost transformation, whether across the enterprise or in a specific process, the end result must include an embedded control philosophy to ensure sustainability and ongoing cost improvement.

But how do businesses embed such philosophy? Initially, cost-reduction programs need to carefully examine processes to identify waste and unnecessary cost variances, utilizing tools such as lean or Six Sigma to address root causes. Then they set up centers of excellence with practice champions to make converts to these control philosophies. Finally, the competency grows as the capabilities work into the mainstream of the organization.

6. *Clean up the physical footprint.* As businesses grow, the operational footprint typically expands as well. In a cost-conscious environment, companies need to regularly assess whether their current footprint is efficient. Often the natural course of evolution encumbers companies with units that once served a clear function but that are now there only because they have always been there. A clear study of current footprint costs and opportunities for optimization can reveal opportunities for cost savings, often through consolidation or relocation.

7. *Manage the effort as a program.* Cost-reduction efforts demand the same level of energy and focus as launching a new product. This means the effort requires dedicated teams, clear milestones, work plans, and a governance structure that focuses on outcomes. Further, reporting lines should cascade down through the organization clearly and in a way that creates a high degree of internal transparency.

At the same time, managers must focus on more than monitoring metrics. Frequently, they must play the role of coaches and educate employees on subjects such as lean, Six Sigma, root cause analysis, and continuous improvement. This emphasis on educating the staff pays off, since it helps companies manage cost reduction directly and avoid the common trap of managing those efforts through templates.

(Source: Booz Allen Hamilton)