In today’s competitive and economically challenging times, forward-thinking organizations are revisiting their cost structures. Laden with budgets that include such values as “prior year + 5%”, historical values and industry averages, astute senior executives are challenging managers and employees to dig deeper into line item expenses and determine if there are alternatives to eliminating or reducing expenses. This directive is not only necessary to improve profitability, earnings performance, and shareholder value, but is critical to remain competitive in a global marketplace where product pricing is a vital component to attracting and retaining customers. Unfortunately, there are several challenges to meeting the directive.

According to a survey of CFO’s in mid-size companies by CFO magazine, 50% of respondents report they lack the time and resources they need to secure better vendor pricing. CFO’s also cite a need for best practices, benchmarks and accessibility and visibility of aggregated spend information. These issues are oftentimes the result of:

➢ manual, paper-based systems;
➢ fragmented systems;
➢ limited measure of supplier performance and compliance;
➢ distributed purchasing groups and suppliers;
➢ lack of time and resources to focus on implementing better systems; and
➢ utilization of disparate vendor sources.

While senior executives understand the criticality of expense reduction, running the daily business oftentimes disallows a thorough evaluation. Yet, as earnings performance and shareholder value continue to dominate boardroom discussions, expense management is rapidly rising to the list of strategic goals. But what exactly is expense management?

**Expense Management Defined**

Expense management is a term used to describe the process of managing costs associated with doing business or completing projects. It is an ongoing process of control in which employees take an active role in continually managing expenses instead of just reviewing expenses once a year (or periodically) through a budgeting process. Many budgeting models still refer to expenses as either “controllable” or “non-controllable”. Assumptions are often made that little can be done about “non-controllable” (or direct) expenses and thus the organization focuses only on “controllable” (or indirect) expenses when trying to reduce costs. However, isn’t every expense somehow controllable, and isn’t there an alternative to most, if not all, costs?

While there are certainly expenses that may be easy targets to reduce cost, an effective expense management system should be viewed in a larger context of all organizational expenses. This would lead to a more integrated and holistic strategy whereby all facets of the business operate at maximum cost efficiency. The operative words are “cost efficiency”. An effective expense management system does not consist of cutting costs to an extent where strategic capabilities or customer service are negatively impacted. Rather, the process focuses efforts on ensuring that each dollar spent is somehow generating revenue or creating competitive advantage. Yet, because organizations have limited time, resources and budgets, they need a clear strategy to implement the process in an effective and efficient manner using the tools and software available to expedite the process.
The following outlines some key elements of an expense management strategy:

**Understand Who Initiates the Expenses**
High performance organizations improve profitability and shareholder value through innovation and creating a leading-edge culture that engenders personal responsibility and builds strategic value. The same holds true in expense management. Each individual makes decisions that incur expenses in an organization and thus each individual is personally responsible for creating value. While control procedures, authorization levels and budget variance reports are important, they cannot replace a culture of expense management where individuals are focused on cost efficiency rather than just being under budget. Implementing management reports on employee spend, spending trends and comparisons to performance targets could considerably improve spend visibility and the corporate culture. Employees would have a heightened level of awareness which would enable decision-making and performance accountability to be devolved to employees and create a self-managed working environment and a culture of personal responsibility. This leads to increased motivation to continually focus on managing expenses and value creation—an expense management culture.

**Understand Why the Expenses Are Incurred**
In addition to understanding who initiates expenses, leading organizations also understand precisely why expenses are incurred. This understanding goes beyond reviewing the expense" categories on the income statement and gets at the root cause of the expense. For example, is the marketing expense related to creating a competitive differentiator or is it a result of a mandated internal business process? The answer to the question has significant implications in expense management. If it is to establish a competitive differentiator then the expense generates revenue (in theory) and the focus would be on measuring ROI, vendor selection, etc. However, if the cost is incurred due to an internal business process then the focus would be on eliminating or streamlining the process. One approach to understanding the cause of the expense is to organize expenses into categories that denote the underlying reason for the expense. Categories could include:

- regulation (e.g., government taxes, SOX compliance, etc.),
- customer acquisition (e.g., marketing, sales, etc.),
- organizational strategy (e.g., acquisition costs, strategy development, etc.),
- product/service delivery (e.g., product parts, product shipping costs, etc.),
- back office operation (e.g., accounts payable, billing, etc.),
- business operations (e.g., office phone, postage, etc.), or
- customer service (e.g., call center, web portal, etc.).

When creating the categories it is important not to get too detailed. Rather, categories should be reflective of functional, strategic or operational capabilities that will improve comprehension and provide for value-based analysis. This analysis provides a basis for strategic substitution.
Strategic Substitution
Strategic substitution is the process of identifying strategic alternatives to eliminate or reduce expenses. Tantamount to the success of expense management, employees are continually and actively engaged in creatively thinking about methods, processes and opportunities that are substitutes to improve an expense. Substitutes could include:

➢ redefining a business process to make it more efficient;
➢ negotiating better vendor pricing;
➢ evaluating other equipment, products etc. that improve efficiency or offer better pricing;
➢ outsourcing non value-added activities or processes;
➢ automating business processes or functions; and
➢ eliminating or simplifying systems, procedures, processes, reports, etc. that add little or no value.

Strategic substitution must be a thought process that is ingrained into the corporate culture through specific human capital strategies (discussed below). However, some organizations perceive that such a process would take a vast amount of time and resources, which is not necessarily the case. Organizations can use RDM (rapid deployment methodologies) to quickly assess and implement substitutes on initial implementation and use the human capital strategies for continuously assessing and improving. Of course, rationalization of all the factors (e.g., quality, internal controls, cost-benefit, etc.) involved with the substitute must occur to ensure it is viable. Once a substitute is selected, establish new (lower) expense targets for the expense and implement. Depending upon the alternative and its impact to the organization, a phased-in approach may be a more appropriate risk strategy.

Performance Measurement
As with all processes, an organization must establish key measures of performance, analytics and reporting to monitor the actual results to ensure the substitutes meet the lower expense targets. Assuming the organization already has expense analytical tools and reporting in place, identification and assessment should be straightforward. In some cases the benefit may be better measured using key performance indicators (KPI’s) than specific expense variance analysis (e.g., cost per customer acquisition). Of critical importance is the flexibility and responsiveness of the monitoring process to the changing business environment which will provide the opportunity to make adjustments today, not six months from now.
**Human Performance Integration**

Finally, expense management success relies on actively engaging and rewarding employees to innovate and go beyond day-to-day routines. Consequently, successful organizations create a human performance system of processes and rewards that engenders a focus on expense management. While some organizations may attempt to implement the process surmising that “it’s the employee’s job”, strategic thought leaders understand that a system of goals and rewards will achieve much greater success. How many organizations provide rewards to employees for minimizing costs, creating new cost efficient processes or developing new and efficient techniques? Few, if any. Thus, employees typically live within the budget and enterprise performance suffers. Consider implementing performance-driving, high visibility incentives including financial rewards, personal recognition and achievement awards which will drive an expense management culture and eliminate fear of retribution or job stability. In many cases, it is the employees on the front lines that have a keen understanding of inefficient processes and methods to reduce or eliminate expenses.

**Summary**

Expense management is not just another business philosophy, fad or non value-added endeavor that increases complexity and wastes precious time. Rather, structured correctly from the onset, the process can be accomplished effectively and efficiently and as vast or limited as desired. The important point to remember is that in this time of global competition, increasing costs, and limited resources expense management is not only critical to reduce costs and thus increase shareholder value but is vital to the very long-term sustainability of the organization.

**About AscendCFO**

AscendCFO is a nationwide part-time CFO, part-time Controller and software services company that transforms high-end small, midmarket and government organizations into high-performance enterprises.

We accomplish this by providing leading edge expertise, customized tools, and a comprehensive suite of services that bring significant strategic value, capabilities and operating efficiency in a few critical core disciplines. Leveraging our core strengths, we deliver solutions that create long-term, sustainable value for our clients by:

- growing revenues,
- increasing profitability,
- improving operational performance, and
- enhancing software technology capabilities.

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