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# FINANCIAL REVIEW

The Future of Australian Business Trends

# The Cost Conscious Australian Organisation



# The vital signs of corporate cost consciousness

Cost consciousness is built into the DNA of successful organisations. To compete locally and internationally they understand the need to boost productivity; keep a close eye and tight rein on costs to help confirm that spending is aligned with corporate strategy; and develop creative and agile sourcing approaches.

The focus on the corporate hip pocket is sharpened by the persistently high Australian dollar and rising costs which have made Australia among the world's most expensive places to live and run a business.

It costs 40% more to run a business in Australia than in the US.<sup>1</sup> And in the six years between 2006 and 2012, Australia dropped from being the 9th overall easiest place to do business in the world to the 15th.<sup>2</sup>

Not only has the country become more expensive and difficult to work in, it is struggling to keep pace with productivity improvements elsewhere.

Figure 1: Cost consciousness<sup>12, 13</sup>

Australian consumers seek value and spend more cautiously. Australian businesses face a more conscious consumer.

Internet shoppers seek lower prices, convenience and wider range of goods

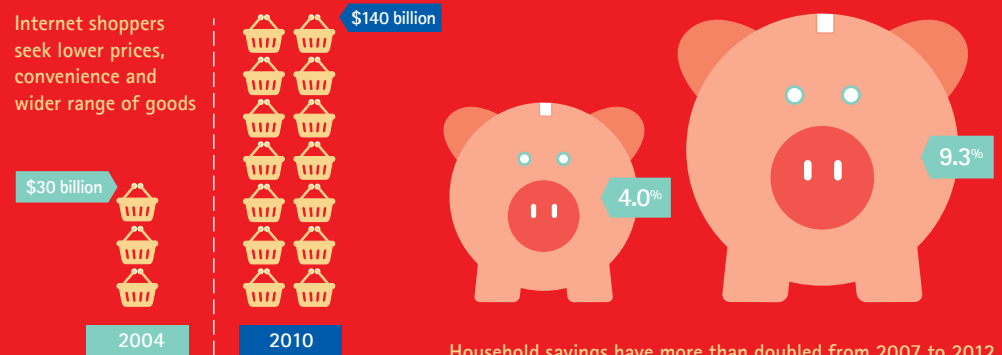
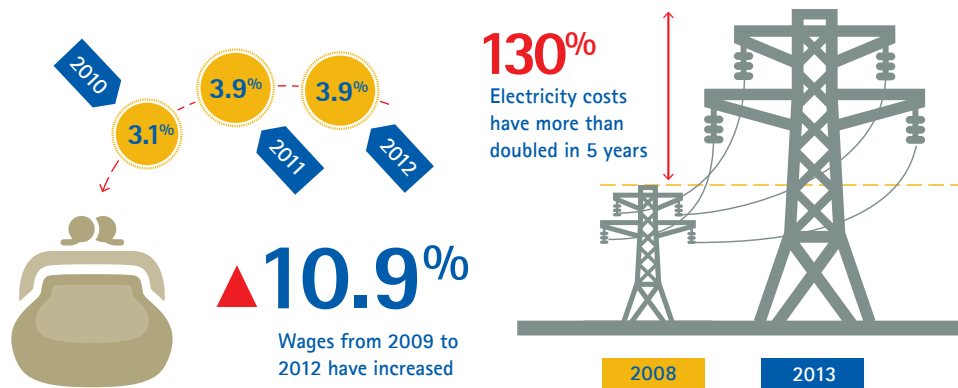


Figure 2A: Cost of doing business<sup>14,15</sup>

The cost of doing business in Australia is high. Key business inputs are becoming more expensive.



The Australian Bureau of Statistics has compared the average annual multifactor productivity growth of key OECD nations between the periods 1985–2006, and the shorter period 2001–2006<sup>3</sup>. It found that Australia was among the worst performers.

While productivity growth averaged 1.12% in Australia between 1985–2006, it declined to 0.81% in the period 2001–2006. By comparison Japan, Sweden, the UK and US all experienced growth in productivity in the five years to 2006 which was ahead of that achieved in the previous 20 years.

While Australia has to an extent been cushioned by the boost in incomes because of the strong dollar, the Reserve Bank has warned that without an uptick in productivity growth there would be a slowdown in real income growth<sup>4</sup>.

However the challenge is not only about the nation's currency, geography or infrastructure. Wages have increased 10% over four years (2009–2012) and are a continuing contributor to costs in a mature economy.<sup>5</sup>

It was against this backdrop that the *Financial Review Cost and Global research study*<sup>6</sup> ("the research") was conducted in February 2013 and found that organisations were united in their determination to keep a lid on costs while enhancing productivity. However further analysis of the research data showed that a much smaller proportion felt they were well positioned to do that.

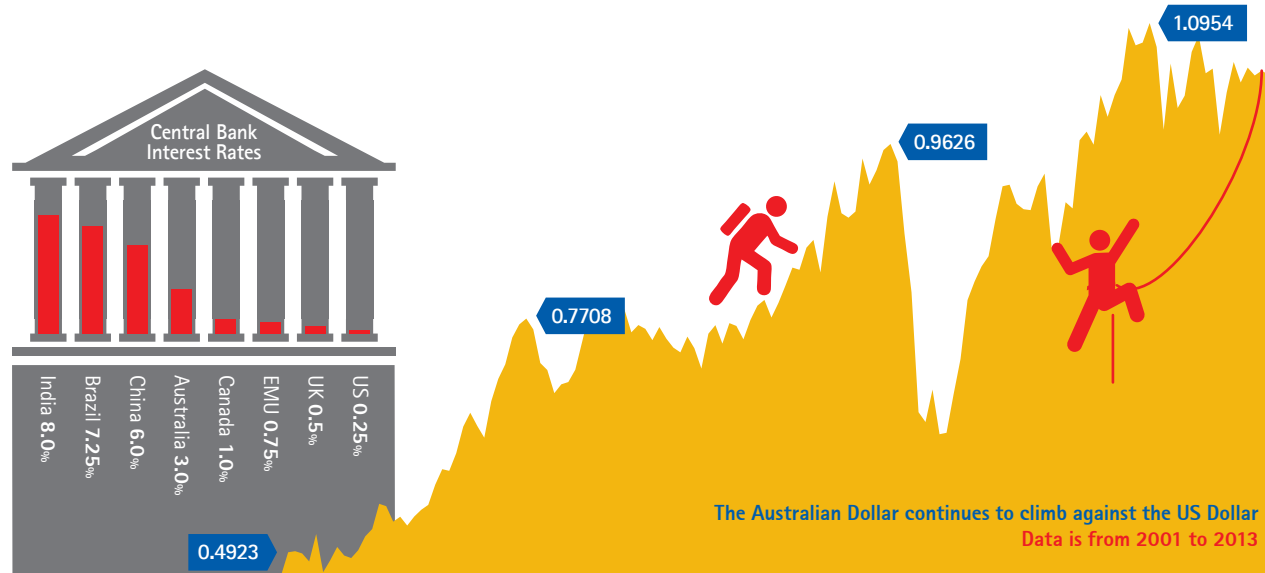
Whether a business operates locally or internationally, cost consciousness is imperative in the battle to remain competitive. Australian executives, however, generally have little confidence in their organisations' capacity to consistently execute cost conscious strategies with less than 10% of respondents to the research rating their company as achieving most of these goals. Just 12% believe their companies are executing cost savings at all levels successfully.

Recommendations about how to achieve a transformation in Australia's competitiveness and productivity in the context of an increasingly high-cost economy has been addressed recently by UTS Business School Dean Roy Green.

He notes three factors in particular; "The terms of trade effect associated with rising commodity prices is beginning to taper off, and other sources of growth must be found with an emphasis on boosting productivity performance. Second, the stalled productivity growth will not recover sufficiently without agile policy intervention to compensate for the decline in the terms of trade. And third, the dollar has now become a "haven" currency and remains stubbornly high, making competitiveness even more demanding."<sup>7</sup>

Figure 2B: Cost of doing business<sup>16, 17</sup>

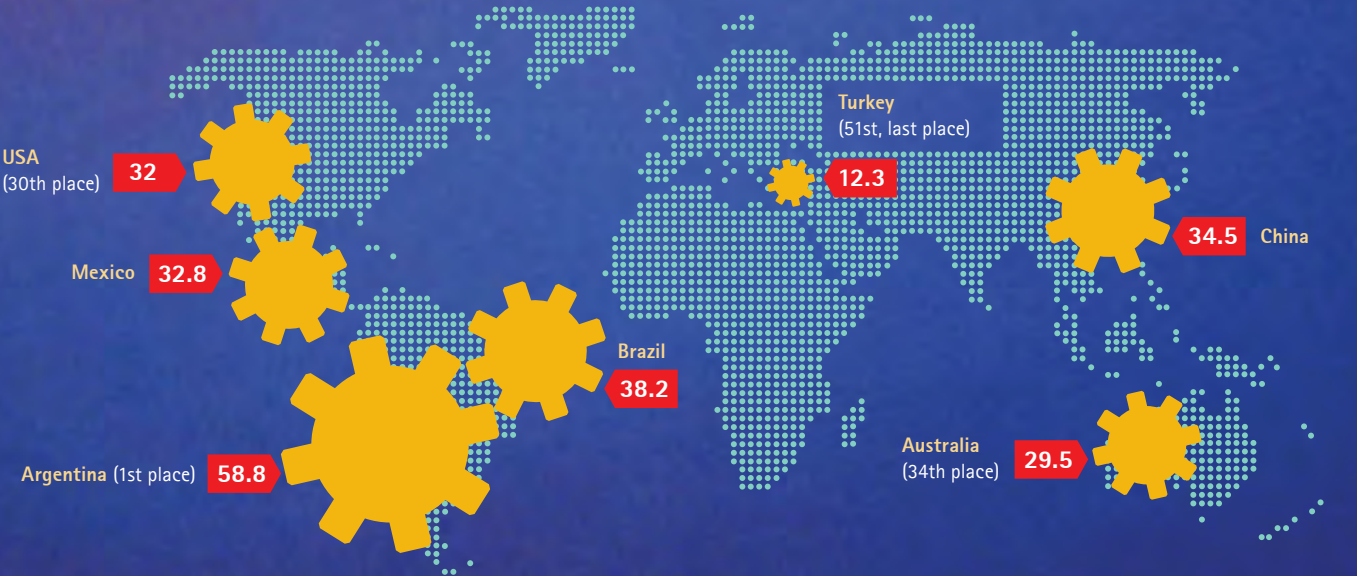
The cost of doing business in Australia is high. Interest rates and exchange rates put pressure on costs.



Not only has Australia become more expensive and difficult to work in, it is struggling to keep pace with productivity improvements elsewhere.

Figure 3: Improving cost and productivity outcomes<sup>18</sup>

Australia needs to improve cost and productivity outcomes. The global index in economic performance comparative rates are seen below.



# The value matrix

Opportunities for cost savings arise through partnerships, insourcing, co-sourcing and outsourcing as well as through breaking down business silos. An inability to maintain a consistent savings profile, instead relying on one-off projects or austerity drives, is a particular cause for concern in many Australian organisations.

Similarly, businesses report in the research that they are challenged to embed cost conscious practices which are both encouraged and rewarded and also reflect the full value of employee suggestions.

The research shows that those organisations where cost savings were seen to be more realistic, used a range of levers, with most getting better outcomes through a cost focus that includes external partnerships and supply chain management. For example, a large education organisation, surveyed in the research reports finding savings; "Through collaboration with other similar organisations, teaming up with them in procurement processes and engaging with vendors, encouraging them to join service provider panels."

Similarly, a large property company participating in the research has created a panel of approved providers for each service required. "Rates are negotiated for all work undertaken, rather than on a transaction by transaction basis. This reduces admin costs for everyone and lets the service provider know that they will receive more work than a single engagement."

There is also evidence of acute pragmatism when it comes to cost consciousness. As one large construction firm noted in the research; "We individually and collectively keep costs down. We stay at cheaper hotels, we look for cheap flights, we only buy assets like computers when essential. We have a virtual office and meet in shared spaces or public spaces and use client locations." Meanwhile a large financial services company noted; "There is minimal differentiation between rules for management and rules for staff. No one is authorised to spend company money on team lunches, meals with colleagues, limos. Everyone gets the same standard laptop, mobile. Hierarchy is limited. Seniority does not attract extra benefits."

But when the last Tim Tam has been cut from the company kitchen, the organisations which are leading the pack in terms of cost control are taking the next steps and implementing structural reform underpinned by technology to further drive costs out of the organisation without sacrificing quality.

Accenture's closed loop methodology establishes a virtuous cycle with regard to overhead cost management. Organisations implement systems to deliver greater visibility regarding costs; category managers become accountable for costs in their line of business; there is a clear priority according to spending which aligns with the overall business strategy; this then informs procurement policies and actions; with the whole cost cycle tightly controlled and monitored, which again provides data to help monitor visibility of all costs across the enterprise.

This laser focus on accountability, analytics and transparency – backed by a cost conscious culture – would help deliver the greatest control over costs.

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### Case Study Lloyds Banking Group

Lloyds Banking Group embarked on a cost reduction strategy in 2011 with a target of stripping £1.9 billion of costs out of the group by 2014.

In its most recent annual report the bank notes that it is well advanced toward that goal. Besides rationalising its international operations, which has reduced overall organisational risk and cost, the bank has established a Group Cost Board chaired by the bank's director of group operations and charged with ensuring a focus on cost efficiency by business line and functional category with 14 individual cost management units operating across the bank.

Costs have also been saved through a bank-wide simplification strategy which has reviewed organisational structures, increased the average spans of control and decreased the average numbers of management layers.<sup>8</sup>

### Case Study Downer EDI

At engineering and infrastructure group Downer EDI, rationalising the number of suppliers from 350 to a panel of 12 has had a dramatic effect on costs, cutting a \$100million bill by 5%.

The executive general manager of human resources and corporate affairs, Bob Fryer, says dealing with a much smaller number of suppliers means Downer can negotiate better agreements and also reduce the risk of dealing with so many entities.<sup>9</sup>

# Breaking down silos

A more granular attention to costs in high performing enterprises is matched by internal measures, particularly through breaking down silos and managing costs within and across business units. A dedicated "central services" team was formed in one financial services firm to specifically focus on managing cost across units.

In another firm the effort started at the top with; "A strong management drive and focus for productivity and innovation, which were then added to all staff KPIs."

This helps anchor an accountable cost culture, where a strong link is made between employee goals and rewards. Those organisations which felt they had a good handle on costs often reported using lean methodologies, partnering with clients, establishing service provider procurement panels and embracing a culture of continuous improvement – encouraged by top management but fostered throughout the organisation.

Worryingly however Accenture's research reveals that only 18% of companies employing 1000 or more staff were confident that they were effectively managing cost savings across business units. Many organisations reported that their business units operated as silos, or were otherwise fractured from the main enterprise. Without reform these silos could create roadblocks against future cost savings by adhering to narrow departmental, rather than enterprise-wide, agendas.

As one large facilities management company lamented in the research; "We work in silos and don't effectively work together towards a common goal. People identify with their contract business unit rather than the company as a whole." A perceived lack of ownership of the cost issue was also regularly cited as a problem in the research.

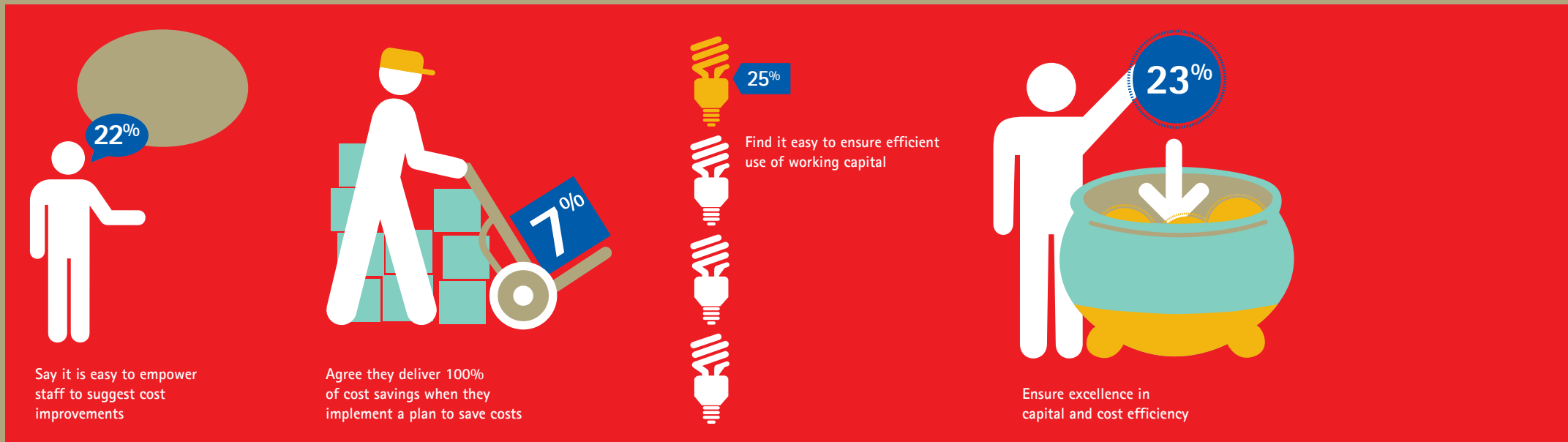
Leading organisations meanwhile typically empowered their staff to take more responsibility for cost management by setting up online portals and wikis – the 21st century equivalent of a staff suggestion box – to tap into innovative ideas and cut costs.



"We work in silos and don't effectively work together towards a common goal."

Figure 4: Cost management<sup>19</sup>

Australian businesses do not excel at cost management. Survey data reports poor delivery of cost conscious imperatives.



# Accountability and culture

The research reveals that in large manufacturing enterprises the barriers to cost cutting are often related to cultural factors which influence behaviour and attitudes, particularly in senior ranks. As one such organisation reports; "Cultural change is required. There is some lack of understanding and desire at senior and management levels to undertake cost management."

Another respondent to the research cites senior management "spending money on their pet projects and then wanting to reduce cost on more critical projects."

There can also be unintended consequences from cultures where a heavy focus on sales and revenue generation targets comes at the expense of cost savings or containment. At a large communications firm, revenue generation is often given the priority over cost savings. "The revenue centres are given a lot more leeway in incurring costs, as long as they generate strong sales growth." In another, the structure is "too silo-based and does not have the intellectual capability within its leadership ranks to deliver real savings."


Meanwhile a large financial services organisation noted it had a; "Strong focus on measuring ROI for all projects and business cases. We are a financial company that must apply its working capital effectively. Budgeting is planned and implemented ruthlessly with little forgiveness for serial offenders."

For financial services organisations, indeed many large Australian companies operating in a knowledge economy, the major cost by far remains employees. A culture which encourages regular monitoring of overheads and acting responsively to payroll bloat is a hallmark in many top performing companies. Forensic attention to staff costs and resulting productivity emerges from the research as a common factor in large services firms.

"Our business as a service provider with 65% of our costs on labour, means we are keenly aware of managing the operations with sometimes weekly analysis to stay on top of costs," says one financial services respondent. In another financial services firm, the utilisation of "micro P&Ls" was successfully implemented to address salary-cost management goals.

Importantly though, as one large healthcare enterprise notes, rampant cost cutting in and of itself can be counter-productive. Cost consciousness needs to be considered in the broader context of sustainable corporate health and talent retention. "Sometimes quality costs money, if you don't spend the money on quality you cannot always achieve 100% of the outcome."

As the closed loop approach illustrates, aligning investment in all areas with corporate strategic goals is imperative for effective cost control.



“Cultural change is required. There is some lack of understanding and desire at senior management levels to undertake cost management.”

### Case Study

#### Boral

Building materials company Boral has been using the process of “lean manufacturing” to cut costs in its blue-collar workforce, harvesting the good ideas of individual workers to find better ways of doing things.

Duplication and waste have been cut and simple factors, such as the installation of shadow boards for tools, have had an effect.

“Boral is a very traditional unionised culture but we are certainly seeing some great buy-in,” says general manager of human resources, cement, Cate Hathaway.<sup>10</sup>

# The new black - flexibility and technology

Structural flexibility is already being delivered across multiple sectors through judicious use of technology, especially in digital economies. The advent of fast broadband networks coupled with increasingly sophisticated collaboration and communication tools would enhance this.

Improved communications would also allow resilient supply networks (rather than potentially more brittle supply chains) to be developed. Respondents to the research who felt they were making headway in terms of cost control often reported the use of loose procurement coalitions in order to drive supply chain efficiency. Service provider panels were also popular among the front-runners, allowing costs and service levels to be negotiated in advance. Again, these loose coalitions require robust technical infrastructure to support them, and also to allow regular reformation in response to changing market conditions.

The rise of the subscription economy – where goods and services such as media, data, telecommunications and computing (cloud) services – can be accessed over the internet and via subscription rather than through an outright purchase would also allow companies to take more of a balance sheet focussed approach to cost control rather than examining it through the rear view window of the profit and loss sheet.

One respondent in the research who felt their organisation had a good handle on cost control had made achieving cost savings a KPI for the chief information officer. The CIO was expected to implement computing solutions to support current activities and drive savings for the future.

Such an approach could prompt wholesale reform in some sectors, particularly mining, agriculture, education, healthcare and aged care where a combination of computing and broadband communications can deliver significant business transformation combined with savings. In the mining sector, for example, the use of autonomous technology and augmented reality would allow remote specialists to control equipment in several distant mines from a single location; the use of telehealth would allow rural and remote patients to be seen by urban specialists using high definition video-conferencing, and have their vital signs constantly monitored without human intervention.

Leaders in every industry sector are also exploring how fast, internet-enabled self-service can deliver cost savings and improve customer satisfaction.

Flexible work practices such as telecommuting, job sharing and reduced hours can also deliver cost savings and higher productivity when well managed and implemented according to the research.

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### Case Study Suncorp

Suncorp's use of the Agile Development Framework has led to it being acknowledged as one of the nation's most technically innovative financial institutions which has allowed it to reform work practices in key areas.

The Brisbane-based business insurance claims section has a team of about 60 to handle claims calls, 70% of whom have some form of flexible work arrangement. The results have been overwhelmingly positive with lower direct costs as a result of a reduction in rented office space and increased productivity. At the same time service levels have improved as Suncorp has been able to tap into seasoned claims officers and reduced its staff churn. Westpac has made similar arrangements for some of its contact centre staff who now telecommute, with an attendant rise in productivity.

Teleworking is still a nascent trend. The Federal Government has only recently set a target that 12 per cent of public sector

workers will be telecommuting by 2020. Even so, there are some early signals of a potential cooling of executive appetite for this approach, with the leaders of both Yahoo! and Google recently suggesting that productivity and culture may be compromised by teleworking.<sup>11</sup>

# Effective execution – bringing cost saving strategies to life

While enterprises can often see where savings can be made – many report being challenged to actually implement programs to deliver those savings.

Less than 10% of respondents in the research rate their companies on the positive end of the scale in terms of achieving the required cost savings. Only 12% report achieving savings in collaboration with partners and executing cost change programs for cost savings at all levels.

One large financial services sector respondent in the research notes; "We don't have full or complete process mapping – therefore some "idealistic" targets are set – but not achieved simply through lack of proper understanding of the process."

Execution of transformational cost strategies to make substantial and positive changes to financial results and the balance sheet require more than "tweaking" around the edges. While efforts within one part of the business,

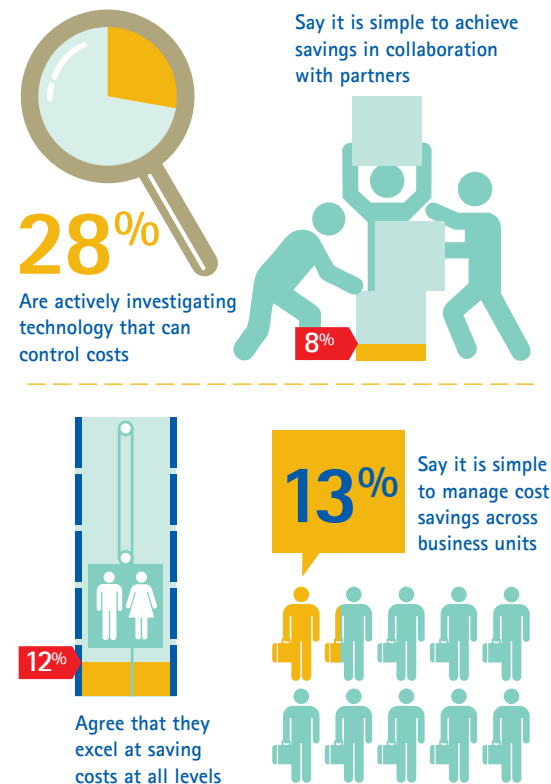
simple revenue improvements (adjustments to prices), or cost savings efforts led by a business unit will have impact – they do not embed successful and continuous cost conscious practices across the organisation.

Organisations setting out to make real and lasting changes to their cost behaviour need to focus their efforts across the whole organisation. Change comes from the top – led by the CEO and the board with ownership of the project given to an individual or a team. All parts of the organisation impacted by the project should be identified and included in the project, the impact of change management requirements should not be underestimated, and must be addressed at the beginning of large transformational project. Ensure your plans anticipate the impact on customers and external partners and identify targets that can be tracked and reported to all involved.

Effective cost conscious strategies are hampered by ineffective execution both within the organisation and through the partner and supply network. There are missed opportunities to improve cost outcomes. But with the right action plan this can be addressed. Are you ready to become a cost conscious Australian organisation?

Figure 5: Cost management initiatives<sup>20</sup>

Australian businesses perform poorly in cost management initiatives. Survey data reports missed opportunities to improve cost outcomes.



# Steps to Success

## Employee focus

Introduce cost consciousness as a KPI and clear goal for employees at all levels and in all business units.

## Pool ideas

Provide opportunities and incentives for staff and partners to share their cost conscious ideas.

## Enforce transparency

Apply data analytics to deliver transparency regarding costs and outcomes.

## Rigorous review

Regularly review culture and structure – actively confront silo mentality.

## Drive change

Is cost consciousness a core tenet of the enterprise? If not, institute reforms and education programs to drive change.

## Agile accountability

Identify managers throughout the business who are accountable for cost innovation and execution. Encourage and reward staff for an agile response to changing market conditions.

## Empower execution

Enable cost saving execution by ensuring leadership and governance, setting appropriate scope and delivery targets, analysing customer service impact, tracking and control, and appropriate management of the internal change associated with executing cost saving strategies.

This research is released in partnership with Accenture Management Consulting and The Financial Review Group, and is the second report in a series looking into key future trends for business in Australia.

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