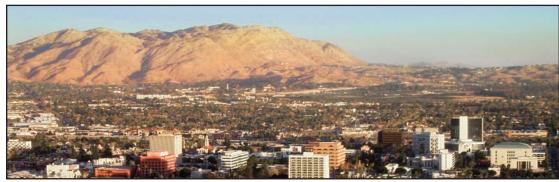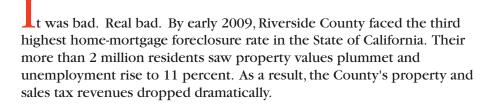# Cost Transparency Enables Strategic Cost Cutting

Photo courtesy of Qwerty510 at the English Wikipedia project.

Riverside County IT cut costs without risking the whole business

BY DEBBIE HILL ZELLNER AND N. DEAN MEYER

It was bad. Real bad. By early 2009, Riverside County faced the third highest home-mortgage foreclosure rate in the State of California. Their more than 2 million residents saw property values plummet and unemployment rise to 11 percent. As a result, the County's property and sales tax revenues dropped dramatically.

Hiring was frozen. Early retirements were encouraged. Voluntary furloughs turned into mandatory time off without pay. Layoffs and pay cuts, unheard of in government, were on the horizon.

For the County's 200-person IT department (RCIT), this meant deep cuts in their $39 million budget. County CIO Matt Frymire was tasked with a 25 percent cut over three years, 10 percentage points of which had to occur right away.

"It wasn't a matter of trimming down to just keeping the lights on," said Debbie Zellner, RCIT's fiscal manager. "We had to turn some lights off."

Escaping the Rock and Hard Place

For many, deep budget cuts trap an organization between the proverbial rock and a hard place.

It's not as simple as cutting waste. Most organizations have been aggressively cutting costs for many years, and pressures to reduce budgets don't

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magically reveal new ways to improve efficiency. Zellner put it simply and directly, "We're not wasteful!"

RCIT knew that deferring internal support costs like infrastructure investments and innovation, another tradi-

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tional response to budget cuts, would be unwise. "That wouldn't be sustainable," Zellner said emphatically.

Nor could RCIT expect staff to work any harder. "We had some staff that worked 18 hours in a day already," Zellner reported.

In organizations like RCIT that have been well managed in the past, there's no "low hanging fruit" and no way to "do more with less." For them, budget cuts mean they'll do less with less.

That's reality—the rock. But meanwhile, clients (in this case, County agencies as well as local police and fire departments) need IT to operate, and they continue to expect all the services they received in the past—the hard place.

Between this rock and hard place, many internal service providers fail to meet clients' expectations, and as a result, find their relations with clients strained and their reputations suffering. Worse, across-the-board cuts leave it to individual managers to decide what that "less" will be, so things fail in an unplanned manner and critical business operations are put in jeopardy. And soon, cuts in training, innova-tion, and infrastructure result in a deteriorating ability to deliver anything.

Fortunately for RCIT, Frymire not only viewed his shared-services organization as a business within a business. He'd put that vision into practice in a very pragmatic way.

In 2005, RCIT had implemented NDMA's FullCost, a business and budget planning process and software that

produces a transparent cost model which calculates the full cost of all an organization's products and services.

RCIT has used FullCost since then to prepare its budgets, set its rates, and manage its business. The results were excellent.

RCIT funding comes from the agencies through chargebacks, and the transparent cost model settled debates about the equity of their charges. "I'll stand up to any member of our Board and tell them that our rates represent the true cost of each service," Zellner said with confidence. "With FullCost, I can drill down and explain exactly what costs, direct and indirect, are in each rate. We can justify every rate."

"As an accountant with professional standards," Zellner continued, "if we didn't have FullCost, there's no way I could vouch for the numbers the way I do now."

Furthermore, relationships with clients improved as the agencies came to understand the value RCIT delivered for a given level of funding. Beyond this, clients were in control of what they bought from RCIT, and no longer expected more than they could afford.

By getting indirect costs in the right place, some rates went up and others went down. For example, the base rate for telephone service was reduced when costs associated with call volumes were absorbed in the per-

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call charge, not the monthly maintenance of the phone. RCIT then negotiated the per-call charge with their telecommunications vendor such that the per-call rate stayed flat.

Frymire's business-within-a-business philosophy and RCIT's investment in FullCost paid off again in 2009 by providing the data for a strategic approach to cost cutting—a deliberate, business-driven process of decid-ing the "less."

Unprofitable Product Lines

First, Frymire went looking for marginal IT product lines. RCIT understood the difference between revenues and costs, and FullCost gave them the ability to analyze profits and losses by product line. In this analysis, they found a cost-savings opportunity.

Matt Frymire, CIO of Riverside County.

RCIT had implemented a speech portal that provided telephone voice-recognition access to applications.

FullCost revealed the true cost of the system. Beyond just the obvious direct costs such as the vendor license and engineering staff, the speech portal drew on resources throughout the IT department.

However, only one client used the service, so revenues were well below plan and RCIT had to make up the difference (the loss) from its reserves.

"It was a nice service, but it wasn't cost-effective," Frymire said. "It was a luxury that the County just couldn't afford. We had to shut it down and find a more cost-effective system to meet our customer's needs."

This decision saved the County hundreds of thousands of dollars in annual operating costs.

Marginal Internal Investments

Frymire understood that this was a time to make only the highest payoff investments in IT process improvements and infrastructure. So next he went looking for internal investments where the ROI was not sufficient to justify spending the money during a bad economy. He gave two examples.

RCIT had approved a project to add a "DMZ" (network security zone) at an alternate site for enhanced extranet reliability. While the value was real, FullCost showed that the investment wasn't justified. Postponing this project saved over $17,000 in labor costs alone.

A second example was a project to install video cameras to remotely monitor dispersed communications facilities—part of the County's radio communications network. This would save technical staff trips up the mountain to check on site operations and reduce vandalism problems.

However, when the full cost of the project was examined, the savings didn't warrant the investment. Frymire cancelled the project.

These two examples were both cases where a superficial look at just the direct costs indicated a good investment. But when the full cost was known, it became clear that the investments were not justified.

What Are You Going to Not Buy?

The third opportunity for cost savings is by delivering less to the business—either eliminating entire projects and services, or opting for a lower level of service.

Strategic cost cutting — a deliberate, business-driven process of deciding the "less."

"A budget cut means that clients can no longer afford all the things they'd like to buy from you," explained Dean Meyer, inventor of FullCost and one of the original proponents of the business-within-a-business paradigm. "Clients have to make the tough decisions about what they'll not buy."

After implementing FullCost, RCIT's account representatives met each year with all the agencies, presented them with a list of products and services they'd bought in the past, and gained agreement on what would go into the RCIT budget and business plan.

They repeated this process mid-year to accomplish their urgent cost-cutting objectives. And clients made tough decisions.

For example, when times were good, RCIT offered Microsoft Premium Services as part of the desktop and infrastructure support bundle provided to all county departments. After an analysis of the usage patterns, it became clear that only a small number of departments were using these services.

Adjusting their cost model and rates, RCIT unbundled these extras and offered clients the option of buying the premium level of service if they wished. Clients are now deciding whether or not the value warrants the additional cost; and whenever an agency drops the service, the County saves money.

"We were able to cut cost fairly dramatically without jeopardizing our ability to keep the enterprise running."

Removing the Costs

A key lesson in RCIT's successful approach to cost cutting is this: Instead of the traditional approach which eliminates costs such as travel, training, and positions, RCIT focused on reducing deliverables.

This is an important distinction. Cutting inputs like training may undermine an organization's ability to produce even the important deliverables.

In all the above examples, RCIT first identified projects and services that it would no longer produce. Then, it used the cost model to identify and remove all the costs associated with just those specific deliverables.

Once the identified deliverables were taken out of the cost model, Zellner was able to identify groups with surplus resources. She supplied the data to Frymire who redeployed the resources to areas that needed them. "We eliminated resources that worked on the projects and services we dropped," Zellner explained, "and assigned them to work on approved deliverables."

Similarly, she managed vendor contracts based on the cost model, reducing spending where it was related to projects and services that were eliminated.

"We dropped some marginal projects and services," Frymire explained, " but we need to fully fund all the rest of the things that we still need to deliver." The transparent product/service cost model allowed RCIT to do exactly that.

Bottom Line Results

The business-within-a-business philosophy and a budget that calculated the full cost of their products and services was the key to an effective cost-cutting campaign at RCIT.

"We were able to cut cost fairly dramatically without jeopardizing our ability to keep the enterprise running," Frymire reported." And it will enable us to further scrutinize our products and services as the budget situation continues to change."

Clients reacted well despite a reduction in IT services. "They understand that RCIT is doing everything it can to ensure they continue to receive the critical services during these tough budget times," Zellner reported.

"I don't know if we were far-sighted or just lucky to have implemented FullCost when we did," Frymire reflected, "but it sure paid off for us during this budget crisis." ❑

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