Indirect cost savings when outsourcing
By Morten Kamp Andersen (Aspector), Palle Fransen Queck (ISS)
& Peter Ankerstjerne (ISS)

Organisations are increasingly using outsourcing as a strategy to increase profitability, refocus on their core business and improve productivity and competitiveness. Cost reduction remains the most important reason behind outsourcing decisions and the choice of partner. However, one element of cost seems to be almost completely overlooked in outsourcing decisions – indirect costs.
# Table of Contents

- Executive Summary ............................................. 3
- Introduction ..................................................... 4
- Indirect costs ................................................... 5
  - Indirect costs in outsourcing .............................. 7
- Realising the benefits ........................................ 13
- Conclusion ...................................................... 16
- Appendix 1 ...................................................... 17
- References ...................................................... 19
Cost saving is the most important reason behind outsourcing decisions and the choice of partner. However, in most cases only direct cost savings are included in the business case. Indirect cost savings are rarely identified and realised as part of the outsourcing process at all yet they often represent a significant portion of the overall cost savings.

In a case shown in this paper, indirect cost savings were 19% of total cost savings. Indirect cost savings are savings that occur in other support functions when outsourcing Facility Management functions. The majority of the savings appear in the finance department, HR and the procurement department, but significant savings can often also be realised in IT, CRE as well as in the legal department. The source and location of the indirect costs saving may be identified by the service provider, as well as guidance to how to realise some of them. However, the cost can only be realised through solid internal processes and an effective change management programme, which must be aligned with the Mobilisation and Implementation phases of the contract.
Introduction

Organisations are increasingly using outsourcing as a strategy to increase profitability, refocus on their core business and improve productivity and competitiveness.

In the early days of outsourcing, cost savings were the primary driver behind the business decision to outsource and behind most deals. As this trend matured, it became obvious to both customers and service providers that the cost saving element was only one of several benefits of outsourcing. Access to new skill sets, greater innovation, better speed-to-market for new and better products and services as well as best quality services were highlighted as potentially more valuable than the cost savings. Some deals were struck on a cost-neutral basis or even a higher cost but in return for the expected value benefits. (Edgell et al., 2008).

During slower economic times, the focus returns to the cost element of outsourcing and companies are particularly interested in up-front or short-term cost savings. The focus on cost vs. value is in other words cyclical. Despite the varying degree of focus on cost, surveys show that cost reduction remains about twice as important as the next most desired benefit of outsourcing. Cost saving is still very much top of the agenda.

One element of cost seems to be almost completely overlooked in outsourcing – indirect costs. When surveyed, the majority of managers only included direct cost savings when making the business case for outsourcing. The few who consider indirect costs seem to purposely underestimate their size. The customers interviewed in connection with this white paper confirmed that although being somewhat aware of the concept, it did not form any meaningful part of the outsourcing decision or process.

It is very surprising that there is almost no academic or other research done on the size and location of indirect cost savings during outsourcing. This may be as Kremic et al. (2006) conclude, that “the effects of outsourcing on an organisation’s cost are not yet fully understood and perhaps the variables and their relationships are more complex than expected”. This White Paper aims to shed some light and increase understanding on this topic.

This White Paper will answer four questions: 1) what are indirect costs; 2) where do indirect cost savings occur in organisations during outsourcing; 3) how large are indirect costs and; 4) how can indirect costs be realised?
Indirect costs

An indirect cost is defined as a cost that represents the expense of doing business that is not readily identified with a particular project or activity, but is necessary for the general operation of the organisation and the activities it performs.

Indirect costs may be either fixed or variable, and are located in departments other than the one where the activity is performed. Indirect costs often include overhead costs, capital costs and personnel-related costs.

Allocating indirect costs

Allocating indirect costs is important to determine the total cost of a project, a function or a service – such as Facility Management. It is however a difficult thing to do. It requires a method that identifies which resources are used in the company’s other support functions for this service or project.

One such method is Activity Based Costing (ABC). ABC is an accounting method which allows an organisation to gather data about their operating costs and assign them to specific activities or departments. In this way, the ABC method enables an organisation to determine the true costs of individual products and services, and the individual profitability can be determined. ABC attempts to assign overheads based upon the activities that relate to the overhead rather on a pro-rata basis or any other arbitrary method. ABC examines each activity and establishes the cost drivers behind each activity. This gives much more accurate costing and importantly shows what the true total cost of FM in the organisation.

ABC programmes require quite a lot of resources and are sometimes abandoned due to high costs, too many planning requirements and unhappy employees. It can be a tedious exercise. An alternative way to use ABC was proposed by Kaplan & Anderson (2004). Instead of using costly and complex resource estimates, they suggest using a time-driven ABC method. This method is simpler, as it only requires two inputs: 1) what are the costs per time unit to supply resources to this activity (total cost divided by time available) and; 2) how much time each activity takes. This method overcomes many of the difficulties – theoretical as well as practical – inherent in the traditional ABC method.
**False cost savings**

A potential cost saving must be realised and the released resources put to better use before it can be considered a real cost saving. Otherwise, it is a false saving. Put in another way, a false saving is an unrealised potential cost saving.

This is illustrated by the following example: through the ABC method, it is concluded that HR spends 100 hours a week supporting the FM division. These hours are split over a number of sub-departments, such as training, recruitment, payroll and admin, and across a number of people within these sub-departments. A true saving would occur if these 100 hours were used to add value (i.e. earn a return above the cost of capital) in another part of the company or if HR laid off 2.5 people (equivalent to 100 hours). A false saving would occur if the 100 hours just ‘disappeared’ into the existing services with no extra value being added.

The head of the FM department may present the outsourcing business case to the CEO and show that indirect cost savings will be, say, 8% of total costs in support functions. However, the business case will only make sense if the CEO reduces each department’s budgets proportionally to the cost saving.

The topic of false saving is especially relevant to indirect savings in outsourcing. The 100 hours of savings will be released regardless of the use of ABC methods, rationalisation and optimisation programmes. The HR division will simply have less to do post-outsourcing. However, if the savings are identified and the resources released or intelligently re-allocated, then the organisation can safely argue that the cost savings have been achieved.
Indirect costs in outsourcing

Empirical work concludes that outsourcing on average reduces direct costs by 20% per year (Domberger et al., 2002). This average varies between countries and sectors. In a survey of 7500 public organisations in Australia, it was reported that the outsourcing of cleaning services saved an average of 46% compared with in-house service delivery (Kremic et al., 2006).

However, most surveys and internal calculations are made by making a simple comparison of costs before and after outsourcing in order to calculate the size of the cost saving. There are several reasons why such calculations should be treated carefully.

1. Most organisations do not know their own true costs before outsourcing, thus making a before-and-after calculation near impossible.
2. Such a simple calculation does not take into account the fact that the service quality may change.
3. Costs associated with the process of outsourcing – such as the tender process, monitoring the contract and streamlining processes – are often not included in these calculations.

The unclear assumptions behind cost estimations may be the reason why cost savings estimates are often overestimated, and many find their cost post-outsourcing to be greater than they expected (Kremic et al., 2006).

Research, which includes a thorough analysis of all direct and indirect costs pre-outsourcing, and which includes the costs of outsourcing as well as changes in services levels, conclude that the total cost saving is between 17%-26% - a wide range (Domberger et al, 2002).

There exist almost no in-depth studies on indirect costs where a proper before-and-after analysis has been conducted. In fact, very little research exists on the topic of indirect costs in outsourcing. Some estimates suggest that between 5%-10% of all indirect costs can be saved by outsourcing the FM division. The details of these estimates are not however provided.

Direct cost savings come in two stages: the initial cost saving comes from restructuring the workforce, processes and introducing new systems; the second stage is represented by ongoing cost savings from the implementation of best practice, ongoing innovation and the reduction of liability costs. Indirect costs savings follow the pattern of direct costs in that they can be immediately realised. Case studies suggest that about 80%-90% of all indirect cost savings fall within the first year.
Categories of indirect costs
When examining the indirect costs connected with running an average FM department, one must look at all other departments to capture all relevant costs. Table 1 shows an overview of common indirect cost categories in different departments when outsourcing an FM division.

Table 1: Indirect cost of FM split by department

<table>
<thead>
<tr>
<th>Department</th>
<th>Saving potential</th>
<th>Cost</th>
<th>Cost description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance</td>
<td>****</td>
<td>Invoicing</td>
<td>Contract invoices, payment of invoices, reconciliation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Payrolls</td>
<td>Payroll processing</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Budget &amp; Cost</td>
<td>Budget Management, Cost monitoring</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Depreciation</td>
<td>Depreciation of sold assets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Capital binding</td>
<td>Cost of capital on sold assets</td>
</tr>
<tr>
<td>HR</td>
<td>***</td>
<td>Recruitment</td>
<td>Job descriptions, advertisement, interviews</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Retention</td>
<td>Annual reviews, Performance Management, People Management, Handling of Unions etc.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Development</td>
<td>Training, Talent Management</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Festivities</td>
<td>Anniversaries, birthdays, Christmas party, gifts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Other personnel costs</td>
<td>Canteen contribution, mobile phone, gym membership, magazines a.o.</td>
</tr>
<tr>
<td>Procurement</td>
<td>***</td>
<td>Purchasing</td>
<td>Process development, bidding, selection, evaluation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Supply Chain Mng</td>
<td>Management of warranties, management of 3rd party sub-contractors</td>
</tr>
<tr>
<td>IT</td>
<td>**</td>
<td>Support</td>
<td>Help desk, support</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Hardware &amp; Software</td>
<td>PCs, Laptops, PDAs, software licenses</td>
</tr>
<tr>
<td>Corporate</td>
<td>**</td>
<td>Space consumption</td>
<td>Rent/lease cost</td>
</tr>
<tr>
<td>Real Estate</td>
<td></td>
<td>Internal Service</td>
<td>Post service, reception, canteen, switchboard</td>
</tr>
<tr>
<td>Legal</td>
<td>*</td>
<td>Contract Management</td>
<td>Legal framework, contract development, contract negotiation</td>
</tr>
<tr>
<td>Management</td>
<td>*</td>
<td>Time &amp; focus</td>
<td>Freeing up of management time</td>
</tr>
<tr>
<td>Business</td>
<td>*</td>
<td>Business Continuity</td>
<td>Less fire fighting, better use of capacity, less service degradation, contingency planning, fewer accidents</td>
</tr>
<tr>
<td>Continuity</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For most companies, 75% of the savings are likely to come from HR, Finance and Procurement.

Finance department
Some of the largest savings will often be found in the finance department. As part of the outsourcing contract, the service provider may purchase various assets such as machines, tools and even buildings from the customer. The customer will thus save the depreciation charges on these assets, as well as the cost of capital tied up in these assets. Other cost savings include payroll processing costs for the outsourced workers as well as budget management and cost control resources.
A final source of savings lies in lower invoicing costs. These cost savings will usually arise for two reasons: firstly, because there will be fewer contracts to manage and thus pay; secondly, the service provider will often take over a significant number of invoices, which in turn will save customer transaction costs. In one of our interviews, the customer told us that their service provider had taken over more than 250 invoice transactions per month.

**HR department**
The HR department will free up the resources previously used to manage personnel issues for the FM division. These include resources typically within staff recruitment, development and retention as well as various administrative tasks. During the recruitment stage, the HR department will often help to draw up job descriptions, advertise the job, do the application screening and in some cases also carry out some initial interviews. The HR department may also be in charge of celebrating employees’ significant birthdays, arranging the Christmas party and team building events, as well as managing fringe benefits such as gym memberships and magazine subscriptions.

**Procurement**
The procurement department develops and carries out the organisations’ acquisition of assets and purchase of out-tasked services. While the new contract with the Integrated Facility Service provider is likely to be more complex and comprehensive than any of the previous contracts, the customer will still save significant money overall. First of all, the fact that there will be only one contract with a single point of contact and communication for contract management activities releases resources. Secondly, there will be many acquisitions and services, which will no longer be needed.

**IT department**
The IT department will save money from three sources: hardware, software & licenses and IT support. The service provider will often supply its own computers, laptops, PDAs etc. and pay for the software installed upon the various devices. In the case where the provider needs to operate or access a particular piece of software, a fee agreement may be reached. The service provider will often bring its own proprietary FM software and operate its own central IT support desk. This in turn will save the customer's IT department the resources previously used to support the systems.

**Corporate Real Estate**
The Corporate Real Estate (CRE) department will save money from two sources: space consumption and internal services. Space consumption will be reduced for two reasons. Firstly, the outsourcing exercise will in most cases lead to a reduction in on-site FM employees. This is because the service provider may change some on-site services to route-based services, because some management functions can be carried out centrally and because the service provider can do the job more efficiently.
The reduction of personnel will only to some extent affect space consumption. If the outsourcing leads to a reduction from 20 to 16 cleaners, then this is unlikely to have any effect on space consumption. If however two managers who occupy two desks are to be moved off-site, then this can result in a saving. A second source of personnel reduction is to be found outside FM i.e. in support functions where released resources are no longer required. This could be the HR business manager for FM.

Internal services, which include postal services, reception service and maintenance services, will be saved for the people no longer employed as a result of the outsourcing process. As with space consumption, this saving only applies to the employees where actual space is saved.

**Legal department**
The legal department will save money from the opportunity to reduce the total number of FM-related contacts. The cost associated with the creation and ongoing maintenance of a legal contract framework is often lengthy and expensive, and may involve external assistance.

**Management time & focus**
Senior management spends time developing strategies, overseeing and reviewing strategic and investment decisions, and is also involved in the review of top-level operations of the FM division. The FM division is one of many divisions that senior management focuses upon, and as many regard it as adding little strategic value to the core of their organisation, they may not spend the expected amount of time on it. Other senior managers – such as Head of CRE, Head of Shared Services etc – also spend a significant amount of time focusing on the division. The saving is the time spent x the total compensation of the management involved.

**Business Continuity**
Business continuity activities are often spread among a number of departments, so the savings are often activity-based. Most costs associated with FM continuity projects can be saved post-outsourcing, and will no longer form part of the overall business continuity programme. This will free up time for the people involved. Research shows that service providers perform FM with better quality and care, which will lead to fewer accidents, fires and service degradations for the customer. The savings may be difficult to quantify, but estimates can be made using benchmark data.

**Case: a Scandinavian industrial manufacturing company**
The following case will illustrate the location and potential size of indirect cost savings. The company is a large Scandinavian industrial manufacturing company and the outsourcing process began a year ago. The company will remain anonymous, but the data is inspired by a real life example.

*A Scandinavian industrial manufacturing company (InduPro) decided to outsource its entire FM operation. The direct cost of its FM operation on these sites was $32m before outsourcing.*
*InduPro has a turnover of $1.35 billion with earnings before tax of $150 million. The headcount is 5,400, with 4,500 FTE (Full-Time Equivalent) employees, of which 2/3 are blue-collar workers and 1/3 white-collar.*

*Pre-outsourcing, the headcount of the FM division was 80 people with 72 FTE employees. As a result of the outsourcing process, 14 FTE positions were eliminated, and a further two back office and two procurement positions were reduced.*

*The direct cost savings as a result of outsourcing the FM division will be $5.8 million annually. In addition, the service provider will take over assets worth $1 million.*

Table 2 below shows the indirect cost savings divided into each department and activity. Bear in mind that this company operates in Scandinavia and all of the cost items will vary from organisation to organisation and country to country. Differences in unit labour costs, real estate costs, IT costs and total employment costs are just examples of where costs will vary significantly from country to country.

**Table 2: Indirect cost savings at InduPro**

<table>
<thead>
<tr>
<th>Department</th>
<th>Cost description</th>
<th>Calculation</th>
<th>Amount ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance</td>
<td>Financial controlling &amp; reporting 1% of FM turnover</td>
<td></td>
<td>240,000</td>
</tr>
<tr>
<td></td>
<td>Payroll</td>
<td>$40 per month per employee</td>
<td>40,320</td>
</tr>
<tr>
<td></td>
<td>Capital binding on assets</td>
<td>10% of asset value</td>
<td>100,000</td>
</tr>
<tr>
<td>HR</td>
<td>Recruitment, Development &amp; Retention 0.5% of turnover</td>
<td></td>
<td>105,000</td>
</tr>
<tr>
<td></td>
<td>Fringe employee benefits</td>
<td>$850 per year per employee</td>
<td>71,400</td>
</tr>
<tr>
<td></td>
<td>Festivities</td>
<td>$125 per year per employee</td>
<td>10,500</td>
</tr>
<tr>
<td>Procurement</td>
<td>Procurement of services</td>
<td>2 FTE, cost per FTE = $110,000</td>
<td>220,000</td>
</tr>
<tr>
<td>Legal</td>
<td>Contract management</td>
<td>0.75 FTE, cost per FTE = $110,000</td>
<td>82,500</td>
</tr>
<tr>
<td>IT</td>
<td>Software licences</td>
<td>$250 per person</td>
<td>21,000</td>
</tr>
<tr>
<td>CRE</td>
<td>Space consumption</td>
<td>$250 per m2, 25 m2 per person</td>
<td>25,000</td>
</tr>
<tr>
<td></td>
<td>Internal services</td>
<td>$350 per employee</td>
<td>29,400</td>
</tr>
<tr>
<td>Management</td>
<td>Freeing up management time</td>
<td>Time spent x salary (x 25%)</td>
<td>45,185</td>
</tr>
<tr>
<td>Other</td>
<td>Admin</td>
<td>2 FTE, cost per back office= $70,000</td>
<td>140,000</td>
</tr>
<tr>
<td></td>
<td>Canteen contribution</td>
<td>$180 per month per employee</td>
<td>181,440</td>
</tr>
<tr>
<td></td>
<td>Other personnel related costs</td>
<td>0.05% of turnover</td>
<td>10,500</td>
</tr>
<tr>
<td></td>
<td>Communication a.m.</td>
<td>$600 per employee per year</td>
<td>50,400</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>1,372,645</strong></td>
</tr>
</tbody>
</table>

Detailed assumptions behind the calculations of each cost line are clearly shown in appendix 1.
Indirect savings are located in a variety of different support functions at InduPro. However, the majority (71%) are located in the HR, finance and procurement departments.

When the contract was evaluated and the total cost of FM was compared before and after the outsourcing took place, it was concluded that a net 21% of total costs were saved as a result. Had InduPro only included direct cost savings, the saving would have been 18.1% - and from a smaller base. This is illustrated in figure 1 below.

Figure 1: Total cost savings at InduPro

In InduPro’s case, 65% of indirect costs were saved ($1.37m/$2.1m). There is no benchmark data to measure this against, but our interviews suggest that this is at the high end of a wide range. While in theory, it should be possible to realise 100% of the potential indirect savings, this is often practically not possible. However, a robust process should make a 50% realisation rate possible.
Realising the benefits

The cost of realising indirect savings
The financial benefits discussed so far are ‘only’ gross benefits to the client organisation. An investment is required to realise these benefits. Costs essentially come from two sources: the use of external help to identify the location and size of the indirect costs, and the time spent internally to realise the costs.

External help may be needed to identify and realise the size of the costs for practical reasons. It is often easier for external parties to work across departments and measure these costs objectively. Our interviewees confirmed that motives relating to politics and power may represent an obstacle in this process, which an outsider may find easier to overcome with a mandate from the top level. External help may also be needed to help with best practice in finding these costs – many organisations have little or no experience in this process. Some service providers offer this service, which is often the most cost efficient for the customer as the service can be bundled together with the service contract. The few service providers interviewed for this White Paper explained how they start this process as soon as the letter of intent has been signed.

Once the indirect spend has been mapped out, then the hard part of realising it begins. The next section will show which steps are necessary, however it is sufficient to say that the primary cost is the time spent. Some cost items will be realised with little or no effort - examples such as Capital Binding and Invoicing spring to mind. Others require some effort, but are fairly easy such as IT Software Licenses, Legal contractors, Payroll Processing and Other Personnel Costs. Some costs can however take quite some time to realise, as they require a change to internal processes, changes to jobs or the reassignment of some staff. Examples of more complex costs include most HR and Procurement related costs, Budget and Costs, Internal Service a.m.

The analysis stage should include an estimation of the total cost of realising the indirect cost, to see what the overall net benefit of initiating the project of realising indirect costs during outsourcing would be.
Change Management issues

It is one thing to identify potential indirect cost savings, but another and often more challenging aspect is to realise this potential. Indirect costs will often be spread across the organisation and therefore impact a variety of stakeholders and budgets. The decision to outsource is often complex and associated with different internal compromises to gain full commitment from key influencers in the organisation. It is only natural that the outsourcing decision-maker will try to minimise the changes impacting the organisation to ensure success. The realisation of indirect costs however requires a holistic view that includes the outsourcing provider’s setup and the outsourcee’s setup.

According to Kotter’s empirical studies (1995), there are specific areas that should be addressed to successfully implement changes. It is essential to create a sense of urgency within the organisation to facilitate change, in other words, the change must be reasoned by a potential crisis or opportunity that is rooted in the company’s survival. Hence, competitive advantage could be based on cost leadership, providing an argument as to why indirect costs must be realised.

Another key to successful change is that it is rooted in senior management, not just the CEO but the entire senior management team. Leading change is a team effort, and as indirect costs are typically spread across the organisation, it is even more important here.

The sense of urgency should be argued via a description of the situation as it will look after the change, so that a consistent and well-argued case can be communicated to all stakeholders.

For changes to happen and thereby indirect costs to be realised, the appropriate people in the organisation must be empowered, obstacles removed and the new behaviour encouraged. This should be supported by short-term wins, like realising indirect cost savings one department at a time to demonstrate that it can be done, and thereby motivate others.

Finally, it is important for the change to be sustainable, ensuring that the changes are institutionalised. New behaviour should be linked with success and rewarded. Systems, processes and procedures should be aligned, so that the new and ‘leaner’ way of working becomes the future norm.
The realisation of indirect cost savings should be carefully aligned with the transition of the outsourcing contract. The Pre-Analysis and Business Case should be created and approved during mobilisation of the transition project to ensure alignment in planning and approach of the two projects. The implementation of the changes that will ensure the realisation of savings are typically divided between the transfer of responsibility to the outsourcer and the transformation of the contract as illustrated below.

Figure 2: Realisation of savings

### Contract Transition

<table>
<thead>
<tr>
<th>Mobilisation</th>
<th>Implementation</th>
<th>Handover</th>
<th>Transformation</th>
</tr>
</thead>
</table>

### Indirect Cost Realisation

<table>
<thead>
<tr>
<th>Pre-Analysis</th>
<th>Business Case</th>
<th>Design Change Approach</th>
<th>Implement</th>
<th>Verify Results</th>
</tr>
</thead>
</table>
| - Understand current situation (AS-IS)  
- Analyse potential future scenario (To-BE)  
- Identify indirect cost saving potential  
- List barriers of realisation | - Reason for change  
- Savings potential per initiative  
- Prioritisation of cost saving initiatives  
- Understand realisation cost  
- Milestone plan  
- Stakeholder analysis  
- Project Team  
- Steering Group | - Design the most efficient way to execute the changes  
- Define a stakeholder communication plan  
- Define governance structure | - Execute change plan and realise cost savings  
- Monitor progress to plan, cost saving potential  
- Communicate progress and success stories | - Verify that the results are realised in accordance with plan  
- Adjust if required  
- Close project |
Conclusion

Organisations are increasingly using outsourcing as a strategy to increase profitability, refocus on their core business and improve productivity and competitiveness. Cost reduction remains the most important reason behind outsourcing decisions and the choice of partner. However, one element of cost seems to be almost completely overlooked in outsourcing decisions – indirect costs. They are rarely identified and realised as part of the outsourcing process at all, yet they often represent a significant portion of overall cost savings. In a case shown in this paper, indirect cost savings were 19% of total cost savings.

Indirect costs are defined as costs which represent the expense of doing FM that are not readily identified, but are necessary for the general operation function. They are primarily located in other support functions within the company.

Allocating indirect costs is important but also difficult. A popular and robust method is Activity Based Costing (ABC), which allows an organisation to gather data about its operating costs and assign them to each activity. ABC can be used in different ways and the simpler time-driven ABC method may be the best as it only requires two inputs: 1) costs per time unit to supply resources to this activity and; 2) how much time each activity takes.

There exists almost no in-depth research on the topic of indirect costs in outsourcing. Some estimates suggest that between 5%-10% of all indirect costs can be saved by outsourcing the FM division. The majority of the savings however appear in the Finance department, HR and the Procurement department, but significant savings can often be realised in IT, CRE as well as the legal department.

It is one thing to identify potential indirect cost savings, but another and often more challenging aspect is to realise this potential. Indirect costs will often be spread across the organisation and therefore impact a variety of stakeholders and budgets. The realisation of indirect costs requires a holistic view that includes the outsourcing provider’s setup and the outsourcer’s setup and the effecting of changes related to the areas where the benefits are to be realised.

There are specific areas that should be addressed to successfully implement changes: 1) it is essential to create a sense of urgency within the organisation to facilitate change; 2) the change must be rooted in the entire senior management; 3) it must be communicated to all stakeholders consistently and finally; 4) it is important for the change to be sustainable, ensuring that the changes are institutionalised.

The realisation of indirect cost savings should be carefully aligned with the transition of the outsourcing contract. The Pre-Analysis and Business Case should be created and approved during mobilisation of the transition project to ensure alignment in planning and approach of the two projects. The implementation of the changes that will ensure the realisation of savings are typically divided between the transfer of responsibility to the outsourcer and the transformation of the contract.
Appendix 1

Assumptions behind the figures in table 2

1. Finance department
   - InduPro spends 0.75% of its turnover in FM on financial controlling & reporting. FM turnover is assumed to be equal to the value of the contract. This gives $32m x 0.075 = $240,000
   - Payroll processing costs $40 per employee per month to process. This gives $40 x 84 x 12 = $40,320
   - The capital previously tied up in assets and released due to the asset sale will generate a return equal to the cost of capital. This gives $1m x 10% = $100,000

2. HR department
   - InduPro spends 0.5% of its turnover on Recruitment, Development & Retention. As the composition of white collar vs. blue collar is similar in the organisation as a whole compared with the FM division, a similar spend is assumed in the FM division. This gives $1.35bn x 0.005 x 84/5,400 = $105,000
   - Fringe employee benefits include club memberships, gym, subscriptions to newspapers and magazines, art clubs etc. These are valued at $850 per employee per year. This gives $850 x 84 = $71,400
   - Festivities include anniversaries, birthdays, Christmas Parties, gifts and other events, and average $125 per employee per year. This gives $125 x 84 = 10,500

3. Procurement department will save two employees. The total cost of employment is $110,000 p.a. This gives 2 x $110,000 = $220,000

4. Legal department will save 0.75 FTE, with a total cost of employment per FTE of $110,000 p.a. This gives 0.75 x $110,000 = $82,500

5. IT department. The cost of software licences is $250 per employee. This gives $250 x 84 = $21,000

6. Corporate Real Estate department
   - Space consumption: four desks/offices will be saved as part of the process (two in procurement and two in the back office). They each consume 25m² space and each m² costs $250 per year. This gives 4 x 25 x $250 = $25,000
   - Internal services: for all positions, which will be reduced, internal services such as post, concierge, office maintenance services etc will no longer be required. This costs $350 per year per employee. This gives 84 x $350 = $29,400
7. Management time. The total compensation for senior management in this company is $5m. It is assumed that the senior management has spent a proportional amount of time on the FM department compared to its number of employees. The combined affected middle management's total compensation is $2m, and it is assumed that they have spent a proportional amount of time on the FM department compared to its number of employees. The margin of error is however great for this item and a factor of 25% is added. This gives ($5m x 80/5400 x 25%) + ($2m x 80/5400) = $45,185

8. Other

- Back office/admin will save two employees. The total cost of employment is $70,000 p.a. This gives 2 x $700,000 = $140,000
- InduPro subsidises the food in the canteen by $180 per month per employee. This gives 84 x 12 x $180 = $181,440
- Other personnel-related costs amount to 0.05% of turnover. This gives $1.35bn x 0.005 x 84/5,400 = $10,500
- Spend on communication includes the spend on phones and mobile phones, stamps, taxi, trains etc. These costs amount to $600 per employee per year. This gives $600 x 84 = $50,400

In this case, the assets sold to the service provider were priced at cost + depreciation. The client does not therefore save the depreciation charges.
References


Aspector A/S
Aspector is an HR consultancy company. We offer services within HR strategy, organisational culture, change management and HR value impact analysis. Our aim is to enable our customers to meet strategic goals in a sustainable and profitable way by aligning HR activities with their business strategy.

Aspector is based in Aarhus, Denmark, and helps clients across the world. We combine the hardcore disciplines of strategy and finance with the soft areas of psychology and human relations. This combination provides the best platform for effective HR management. We believe that all organisations have unique employees in unique situations, and our methodology, approach and tools are always tailored to each special context.

For more information on Aspector, please visit www.aspector.dk

ISS A/S
The ISS Group is one of the world’s leading facility services companies, providing integrated service solutions based on the core business areas of cleaning, catering, property, security and support services. The ISS Group generated revenue of more than EUR 9 billion in 2009 and employs more than 500,000 people in more than 50 countries across Europe, Asia, North America, Latin America and the Pacific region.

Every day, ISS employees create value by working as integrated members of our clients’ organisations. A key part of the ISS HR strategy is therefore to develop capable employees in all functions. Team spirit and self-governance are encouraged, as is voluntary participation in additional training and multidisciplinary workflows. Besides developing its employees, ISS ensures compliance with health, safety and environment (HSE) regulations. We demonstrate our social and ethical commitment through the ISS Code of Conduct, through our membership of the UN Global Compact and by honouring the principles stated in the Union Network International (UNI) agreement.

For more information on the ISS Group, visit www.issworld.com