

MEETING THE CHALLENGE: SAVING TAXPAYER DOLLARS BY ADOPTING BEST BUSINESS PRACTICES



presented by



Board Council on Responsible Government Spending

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INTRODUCTION

The New Jersey State government is vast, complex and responsible for a wide variety of activities. In recent years, the State government budget has been difficult to balance, and policymakers have adopted a range of financial management strategies to do so. We at the Chamber of Commerce Southern New Jersey have been consistent in urging policymakers to look to the private sector for ideas on how to economize while still fulfilling public needs in a responsible fashion. Certainly, the public and taxpayers benefit when government can work smarter and spend smarter.

With this report, the Chamber provides some specific suggestions of private sector cost control approaches that could be implemented in the State government to cut costs. In some respects, certain State government activities have no private sector analog, but, in other cases, there are some significant commonalities. We have called attention to some of those areas of state government operations where private sector examples could be helpful in finding a better way - and a more economical way - to manage.

This report is the product of the efforts and expertise of our Board level committee - the Board Council on Responsible Government Spending. The members of five subcommittees worked over a period of four months to examine and identify private sector best practices in five distinct areas that bore commonality with State government operations: property management & space utilization, fleet management, procurement, information technology compatibility, and public employee benefits. Our focus was on efficiency, not on cutting or eliminating operating programs.

In the following pages we discuss best practices in five operational areas and offer 43 recommendations. Virtually every business has to manage all of these expenditure areas, and many businesses have worked to develop ways of economizing in a responsible way in all or most of them. We believe that the strategies undertaken by our members to reduce or control these costs will work in State government.

The spirit in which we present these ideas is one of cooperation. We believe that it is the responsibility of the Chamber to help in solving public problems when a private sector perspective may lead to a better result. We plan to discuss the recommendations contained in the following pages with those in the Legislature and Administration who have responsibility for balancing the budget, as well as those in the various state departments who administer the operations that are the focus of this report. We will explain why and how these ideas work in the private sector, and offer our resources and expertise to assist in implementation.

We recognize that it will be difficult, if not impossible, to implement all of these ideas in one budget year. Therefore, we offer the recommendations as a multi-year plan for State government. In the future, we will explore other areas of State government operations that are analogous to the private sector and that offer further opportunities to save money.

We look forward to a productive dialogue with our State government representatives over the next few years to implement recommendations of our Board Council on Responsible Government Spending. In every respect, the Chamber intends to assist in a responsible resolution of the State government's continuing budget woes.

PUBLIC EMPLOYEE BENEFITS



BACKGROUND

State employees perform a vital role in delivering services to the taxpayers of New Jersey. They are hard-working individuals, many of whom work in programs that make a real difference in the lives of New Jersey residents.

Currently, 750,000 people are enrolled in the State Health Benefits Plan (SHBP), representing \$2.1 billion of the FY 06 budget. Employees from the State and its affiliate colleges and universities, as well as local public employees, receive benefits through SHBP.

Recent trends in the cost of providing health insurance should compel the State to review the pricing structure of health benefits for employees enrolled in the SHBP. The State has been experiencing the same double-digit increases in health insurance costs as the private sector. The average cost of providing health benefits in the private sector has risen by more than a third over the last three years. Yet, the copay and deductible structure for public employees has only changed modestly since 1996. By 2010, health care and pension costs for public employees will represent 20 percent of all state spending.

A review of information on the financial condition of the SHBP fund finds that there are some concerns that need to be addressed. First, the current benefit packages are extremely rich when compared to other public employers both in the northeast region and nationally. Few standard industry practices are in place to assist in moderating the escalating costs of health care. Second, nearly 25 percent of those enrolled in SHBP are retirees, all of whom receive their health benefits for free. Third, the

enrollment distribution includes close to one-third of enrollees in the Traditional Plan, which is completely "unmanaged", with provider reimbursements based on reasonable and customary charges. Fourth, the plan designs are out of date, particularly with regard to prescription drug copays.

Recently, the State retained Mercer Human Resource Consulting to conduct a comprehensive review of the State Health Benefits Program. Some key findings of the study entitled, "State of New Jersey: State Health Benefits Program and Consultant Review," include:

- ◆ SHBP's annual per employee medical and dental costs were the highest among peer states and among the richest plan design due to lower deductibles, copayments and out of pocket maximums. Further, New Jersey's plan represented the highest average total health benefit cost as a percentage of payroll (14.6 percent).
- ◆ SHBP's two-tiered drug program requires copays of \$3 for generic and \$10 for brand drugs, well below the national benchmark of \$8 and \$18.
- ◆ NJ requires no contribution for POS plans, five percent contribution for HMO and 25 percent contribution for indemnity plan. The State has no PPO plan, which remains the most prevalent plan for other states and the private sector.
- ◆ Medical coverage for employees under SHBP is free to retirees, which is out of synch with other states. Retirees represent approximately 25 percent of the total cost of health benefits.

**BY 2010, HEALTH CARE
AND PENSION COSTS
FOR PUBLIC EMPLOYEES
WILL REPRESENT
20 PERCENT OF ALL
STATE SPENDING.**

RECOMMENDATIONS

1. Create a five year strategic plan for SHBP.

The SHBP employs actuaries, but does not retain strategy or design consultants. Consultants would prove valuable in identifying cost saving strategies, including better case management. One area that should be examined is how the state administers its plans, and the cost per head for administration. Recognizing that improvements in this area will be an ongoing and multi-year effort, the State should develop a detailed plan which recognizes upcoming demographic shifts (e.g. more retirees). The Plan should be used as a template as the State makes benefit decisions and conducts contract negotiations. Best practices from other states should also be explored and implemented.

2. Review and update employee contribution strategies. Any review of plan design or plan offerings should include a review of employee contributions. Benchmarks from other states and public employers would be useful to developing strategies.

3. Adopt cost control techniques. The state has implemented few strategies adopted by private employers to control health care cost increases. The State should explore and implement strategies used by private employers to control costs, including requiring employees to pay increased deductibles, co-payments or paying a larger share of premiums.

4. Offer a PPO benefit plan and eliminate the indemnity option. The SHBP does not offer a PPO, which close to half of state peers offer. The State should offer a PPO, while considering an overall evaluation of its mix of plan offerings. Many private employers have consolidated the number of HMOs offered in order to leverage larger volume, reduce administrative complexities and mitigate adverse selection. Implementing efficient provider networks can lead to savings as much as 10 percent. Further, the State should drive new employees to more efficient plans, including HSAs (once legislation is passed to enable them to be offered in New Jersey) and HMOs.

5. Utilize population based care management techniques to manage costs. The SHBP should conduct a detailed analysis of utilization patterns across the entire program to identify trends and areas of opportunity for the management of care of enrollees. The current approach of multiple vendors each managing their own populations does not provide for the efficiencies which a broader review of overall utilization would provide.

6. Implement a three tier drug option. The SHBP should implement a three tiered drug benefit for all programs such as those used in Pennsylvania and New York, including drug formularies. The current options are not current with industry best practices.

7. Implement consumer driven health plan (CDHP) options. The State should implement consumer-driven health plans (CDHPs) in order to reduce plan costs and provide efficient options to employees.

8. Maximize new medicare drug program for eligible retirees. The State should take advantage of the new federal Medicare prescription drug benefits for its retirees. A variety of options are becoming available and the State should review and maximize its options.

9. Create new options for new employees and new retirees. Recognizing that the State has obligations to current employees and retirees which limit some changes, the State should mandate specific health benefit options for new employees and retirees. New Jersey should adopt a plan similar to Pennsylvania's for active and retiree medical benefits. Under Pennsylvania's plan, new employees are required to contribute 1.0

percent of their biweekly gross salary toward their health benefits. For the first six months of employment, the State covers only the employee in the least expensive plan with no supplemental benefits, allowing the employee to purchase dependent coverage. After six months, the employee and

dependents are covered in the least expensive plan with supplemental benefits. Pennsylvania requires dependent spouses of employees hired after August '03 who have medical benefits through their own employer to take such coverage.

Pennsylvania also requires employees who retire after July '05 to contribute 1.0 percent of their final gross salary at the time of retirement toward their post retirement medical benefits.

A MODEST SAVINGS OF
JUST TWO PERCENT
WOULD DECREASE
COSTS BY \$42 MILLION.

POTENTIAL SAVINGS

There are many variables contained in the nine recommendations that could result in significant savings in the cost of providing health insurance to public employees. A modest savings of just two percent would decrease costs by \$42 million, and a five percent decrease would save \$105 million annually.

FLEET MANAGEMENT



BACKGROUND

Many businesses employ fleets of vehicles, including sedans, SUVs, pick-ups, vans and special-use vehicles. Business recognizes the enormous expense that fleets represent to their companies. Vehicles are an asset used to service customers. As an asset, vehicles must be managed just as computers, furniture, and office equipment are.

In a competitive business climate, companies constantly seek solutions that cut costs without sacrificing service. Consequently, business frequently reevaluates vehicle use policies in response to changes in the business environment. Organizations have dramatically cut back the size of their fleets, recognizing that they could continue to provide a high level of service to customers with

fewer company-owned vehicles on the road. Fleet management teams and field managers work together to maintain the proper balance of vehicle types, and age of the fleet, as well as identifying possible manufacture defects. As employment levels change, vehicles with several years of life left are redeployed, instead of purchasing new ones. Vehicles with a long maintenance history, high mileage, or more than ten years old are sent to auction.

In many organizations, close to 90 percent of fleet vehicles are assigned to employees who directly interface with internal and external customers in special-use vehicles. The supervisors of these employees have an assigned vehicle to allow them to be in the field.

RECOMMENDATIONS

1. Analyze the job functions that require a state supplied vehicle.

- ◆ Identify state employees who interface in communities across the state on a daily basis with clients and require 24/7 access to a state owned vehicle in order to do their jobs (e.g., State Troopers, DYFS workers).
- ◆ Work groups who are in the field frequently and do not need to have individually assigned cars should convert to a vehicle pool. The ratio of vehicles to these employees should be based upon the group's historical mileage.
- ◆ All other employees, including management, should use their personal vehicle and submit a voucher for reimbursement at the IRS mileage rate for business related travel.

These changes in policy saved one company millions of dollars annually in maintenance, insurance, gas and storage costs.

2. Bring the “customer facing employee” to vehicle ratio in line with average daily attendance.

VEHICLES ARE AN ASSET THAT MUST BE MANAGED.

One-hundred percent attendance daily is a rarity for most organizations. On an average day, at least 10 percent of an employee base is not at work because of vacation, short or long-term illness, or they are not scheduled. A ratio of .8 or .9 special-use vehicle to employee ratio is fairly typical for business.

3. Approach the issue of employees who commute to work in their assigned vehicle as a benefit.

Any employee who travels to and from home in a state-owned vehicle should have their commutation treated as imputed income for salary and taxation purposes. Further, policies should ensure that employees may use their state assigned vehicle only in the course of carrying out their assigned duties. Non-employees may not drive or ride in company vehicles. Severe penalties should be imposed for violations of policy.

POTENTIAL SAVINGS

The cost of purchasing, insuring, maintaining and putting fuel into a single vehicle represents at least \$3,000 per year. This represents the potential for significant savings for the State for every vehicle that is eliminated.

STATE GOVERNMENT PROCUREMENT PRACTICES



BACKGROUND

Recently, the State retained a consultant to assist in the implementation of strategic sourcing, an approach that has reduced costs in many U.S. and global companies.

Creating a strategic sourcing process, that incorporates consolidating purchasing power, is a proven method to drive down costs in a supply chain. However, there are several challenges to overcome, including:

- ♦ The need for a full understanding of the existing supply chains;
- ♦ Cultural issues surrounding control of supply chains;
- ♦ The need for an understanding of the different market forces for specific goods and services to determine if consolidation is the right path;

- ♦ Clear proof that the changes associated with strategic sourcing will produce real results, including savings.

Over the years, businesses have utilized several tactics that have proven effective in controlling costs associated with purchasing goods:

- ♦ Cost plus contracts for commodity items;
- ♦ Aggregate purchasing to obtain volume discounts;
- ♦ Contract terms, including extending the length of contracts and discounts for prompt payment (already in place in the State);
- ♦ Signing bonuses from key partners;
- ♦ Reverse auctions.

RECOMMENDATIONS

1. Strategic sourcing is the right answer, but should be executed in a phased approach that focuses first on an area where leadership can ensure successful implementation and real results.

2. The strategic sourcing mindset must grow from within an organization. A consultant is recommended to assist with the orchestration and leadership of the initial implementation and culture change to win employee buy-in.

3. The culture change must address redeploying employees from “clerical supply tasks” to “managing the supply chain.”

4. The State should routinely practice price negotiation with vendors following the submission of sealed bids, to ensure that the state government gets the best value that it can. Further, the State should provide training to the purchasing staff in negotiation skills.

5. Identify strategic sourcing targets, i.e., goods and services, that have produced significant savings in the private sector.

6. Use proven process improvement tools, such as Lean Six Sigma, to build the new mindset.

PROJECTED SAVINGS

The State spends approximately \$1.5 billion every year on the purchase of myriad goods. One large commercial acquisition structure supporting 14 business locations in the Northeast used these strategies to reduce procurement costs by 50 percent, lead times on commodities procured by 67 percent, and the average unit cost of material by 6.4 percent. A very conservative estimate of potential savings for the State is 10 percent, or \$150 million.

**CREATING A STRATEGIC
SOURCING PROCESS IS A
PROVEN METHOD TO
REDUCE COSTS IN THE
SUPPLY CHAIN.**

PROPERTY MANAGEMENT & SPACE UTILIZATION



BACKGROUND

The management of the state's real estate assets provides many opportunities for saving. Private sector best practices in the real estate function generally surround five disciplines:

1. Planning for future real estate requirements and obligations.
2. Establishing consistent space standards for operating organizations.
3. Monitoring and tracking critical milestones.
4. Monitoring and tracking rent and operating expense charges.
5. Maintaining current market information to utilize in the leasing and decision-making processes.

Other states and municipal entities, working with commercial real estate professionals and other outside

consultants, have achieved significant cost effective occupancy solutions, with consistent results in the following areas:

1. Reduction in procurement time per transaction.
2. Space savings achieved through utilization of space standards and improved efficiency in selected facilities.
3. Cost savings achieved by: (i) leveraging inherent value of existing leases; (ii) long range strategic planning for both growth and contraction; (iii) managing market conditions; (iv) consolidation of multiple users into a single facility and (v) elimination of month to month leases.
4. Independence from politically motivated real estate decision making by utilizing an objective, independent third party.

OPPORTUNITIES FOR SAVINGS

A thorough review of the following areas, and implementing changes where needed, will insure efficient use and management of the State's portfolio of owned and leased space.

1. Review Property Database System to insure accuracy and integrity of data, and that renewal and option dates are not missed.
2. Evaluate and recommend consolidation and co-location opportunities.
3. Investigate early renewal opportunities, including lease renegotiations and sale-leaseback opportunities.
4. Review disposition and acquisition practices.
5. Review, revise and create, as needed, space standards.

6. Audit leases to evaluate opex charges by landlords, recover overcharges, etc.
7. Conduct property management review to insure efficient and economic use of owned properties.
8. Evaluate personnel training needs to determine skill level and expertise of existing staff, recommend training agendas, and changes in organizational structure and practices.
9. Utilize benchmarks established in the Building Owners and Managers Association (BOMA) Experience Exchange Report. This report provides data on area occupancy costs, including rent, operating expenses and space utilization.

RECOMMENDATIONS

The following specific steps should be undertaken in order to assess current practices and implement changes in order to achieve potential savings as quickly as possible.

1. Review prior year's actual costs versus budget - overall and by department - to identify and understand deviations from budget to control costs and manage recurring space and operating overruns.

2. Review existing internal real estate policies - statewide vs. departmental - to create consistent policies and space standards that will save departmental and Treasury staff time and prevent negotiating space requirements on a case by case basis. Consistent standards will enable different departments and divisions to occupy existing leased or owned spaces without incurring significant modification costs.

3. Reach out for “Best Practices” to leverage the experience gained by other states and government entities. Significant occupancy cost savings and reduced transaction delivery time realized by other states can be achieved by New Jersey.

4. Review and update standards based on standards employed by private sector for specific uses and functions. Reduced overall space requirements will result in occupancy cost savings. More uniform office types reduce time, cost and impact of moves, adds and changes.

5. Assess legislative and political restrictions, including existing statutes that prolong the process of selling state property. This will increase the State's ability to maximize market opportunities resulting in occupancy cost savings and improved turn-around of occupancy requirements.

6. Develop a strategic plan based on current and projected requirements for leased and owned facilities. Establish priorities for real estate requirements including geography and location, space standards, ownership, term, building quality, quality of improvements, operating standards and most importantly, occupancy cost. A good plan will create savings and reduce staff time required for addressing short term and problematic leases or deteriorating owned property.

7. Identify opportunities for consolidation, disposition or restructuring leased and owned real estate. This will improve the quality of the State's real estate portfolio while creating measurable occupancy cost savings.

8. Utilize the services of qualified consultants with demonstrated experience. This will introduce proven processes developed from prior private sector and government practices that reduce transaction time, structure and negotiate cost savings, eliminate portfolio inefficiencies and improve per employee real estate cost metrics.

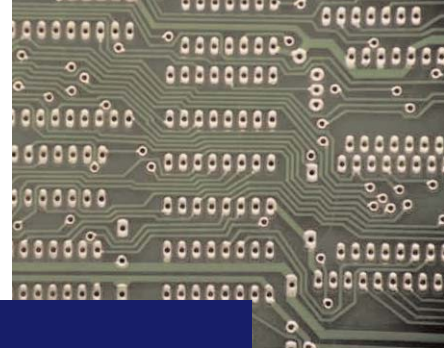
9. Leverage the size and value of the State's ongoing real estate requirement. Longer term, larger deals with the State's low risk profile will provide reduced costs and operating flexibility.

OTHER STATES &
MUNICIPALITIES HAVE
ACHIEVED SIGNIFICANT
COST REDUCTIONS BY
WORKING WITH
COMMERCIAL REAL
ESTATE PROFESSIONALS
& CONSULTANTS.

PROJECTED SAVINGS

Without access to consolidated historical information for the State's real estate expenditures, specific savings are difficult to project. However, the following case studies are enlightening. 1) A Southeastern state that secured the services of an independent real estate provider reduced occupancy costs by \$82 million. 2) Through the efforts of a third party real estate consultant, a Northeastern state reduced delivery time of new space by 20 percent while saving between 15 percent and 20 percent on their annual real estate expenditure of \$100 million.

INFORMATION TECHNOLOGY COMPATIBILITY



BACKGROUND

Communication and sharing data are critical success factors in both business and government. Today, State government supports 16 different agency budgets with five overlapping networks, four different desktop operating systems, six e-mail/GroupWare tools, 21 call centers, and many server operations with vastly different capabilities. The challenge is to make these systems compatible.

When integrating systems, priority must be given to the network's infrastructure, including security. Consolidating service contracts and utilizing Custom Off The Shelf

Software (COTS), versus the costly custom development approach, can save significant dollars.

Many businesses employ a skilled lead executive to set policy and strategy, as well as propose, review, and prioritize technology investments and initiatives. Businesses also have a long range IT strategic plan in place to ensure performance and control costs. Right now, more than half the State's IT expenditures and personnel are not under the control of the office of Information Technology.

RECOMMENDATIONS

Infrastructure

1. Centrally manage and contract for infrastructure components such as network, security & e-mail; and network operating systems, helpdesk, server administration and virtual storage (SAN) within a long-term strategic plan.
2. Inventory the infrastructure of all business units to assess their needs, identify opportunities for consolidation, and gain consensus for required changes.
3. Establish standards for infrastructure components with the flexibility to address unique needs.

Service contracts

1. Inventory the contracts of all business units to assess needs and identify opportunities for consolidation.
2. Centrally manage and contract telephony components such as mobile services, switching, call routing, and scripting, as well as Disaster Recovery services.
3. Consolidate service (maintenance) contracts by minimizing vendors, platforms and infrastructure components.

Software

1. Inventory the software of all business units to identify opportunities for consolidation.
2. Implement a standard methodology for all stages of project delivery including evaluation, requirements, implementation, testing and recurring upgrades/maintenance.
3. Avoid custom development and use Custom Off the

Shelf Software (COTS) application packages.

4. Use a portfolio management approach to applications to prioritize resources.
5. Evaluate new applications for security, scalability, and the ability to web-enable.

Governance

1. Centralize IT policy in the Office of Information Technology and strengthen the authority of the Central Information Officer (CIO).
2. Create support structure to assist CIO in removing barriers and accomplishing change.

Strategy

1. Establish a consistent long-term technology strategic plan.
2. Attempt to segregate daily support from project delivery teams.
3. Identify outsourced opportunities to allow focus on vital projects.

**CONSOLIDATING SERVICE
CONTRACTS AND USING
COTS SOFTWARE SIGNIFICANTLY
REDUCES COSTS.**

PROJECTED SAVINGS

Industry experience suggests that implementation of best practices as outlined above can realize returns of 10 - 20 percent in a given budget year. Assuming a \$300,000,000 State IT budget, realized savings would be \$30 - \$60 million per year, with additional savings resulting from increased productivity.



The Chamber of Commerce Southern New Jersey's mission is to provide its members with: opportunities to meet each other and do business; resources to enhance their position in the marketplace; and a collective voice on public policy issues impacting operations and profitability.

Named the Best Chamber in New Jersey by NJBIZ, the Chamber of Commerce Southern New Jersey is the region's largest business organization, representing a diverse group of member companies in the region. The Chamber consists of a 13-member professional staff; a strong volunteer Board of Directors comprised of 68 of the region's top business executives; and an ideal membership mix of small, medium and large businesses.



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