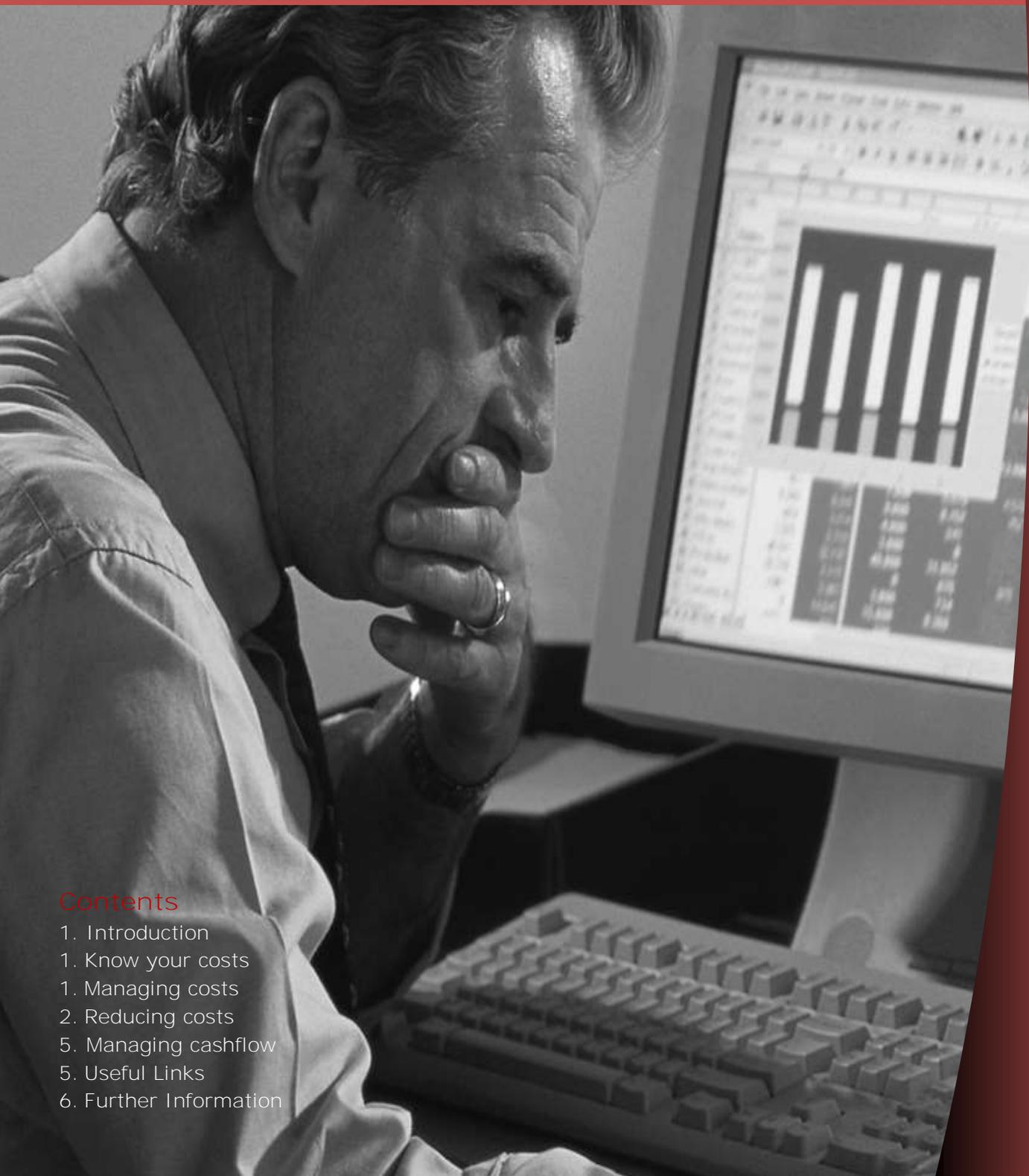


Managing Costs

Expert knowledge means success



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Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

Introduction

There is a well-known business saying: “Sales are vanity, profits are sanity, cash is reality”. In essence, it is foolish to pride yourself on increasing sales, if your margins are low and your cashflow is poor.

If a business is to maintain a healthy balance sheet, it needs to know its sales, its costs and its margins on all its products and services and to use that information to determine the operations, policies and targets of the business. It needs to monitor performance against both its business plan and its budget for realising that plan. It needs to have financial controls in place to manage costs and it needs to monitor its cashflow and warning signs of additional cash pressure.

Know your costs

You need to know where and how your money is being spent. Accurate and detailed bookkeeping and management accounts will help with this. A computerised book-keeping system will be able to produce many useful reports including a Trial Balance, Profit & Loss statement and Balance Sheet.

Use your financial information to check the following for each cost category:

- Change in cost category compared to other cost categories over a period;
- Change in cost category compared to change in sales over a period;
- Change in cost category compared to the same cost category in previous periods;
- Change in cost category against your budget;

Monitoring this information will help you to determine where a particular cost category is moving out of line with other cost categories. Once exceptions are accounted for, it will also help you spot expenditure trends.

Identify costs per product or service provided. This will help you determine the margin on these items and hence their financial viability.

It can be useful to compare your costs with similar businesses. Ask your bank manager, accountant or trade association to help you with this. Business Link provides very useful information on this – details are at:

www.businesslink.gov.uk/bdotg/action/detail?r.lc=en&type=RESOURCES&itemId=1079681323&r.s=sc



Managing costs

Some businesses ignore cost management until a potential crisis looms, and then freeze all “unnecessary” costs. Procedures will help you to manage your costs and keep them under control. In a small business, the owner will usually be spending without question. In a large business, there may be several people authorised to spend, but again, this may be unquestioned.

All sizes of businesses will benefit from a procedure that requires the purchaser to justify the expenditure. At its extreme, the expenditure should be justified against the contents of the current business plan.

Involve employees

Business costs are relevant to all employees. Explain to your employees why managing costs is important to them. If the business is profitable, employees feel secure, and rewards and incentives are possible. If the business is struggling, jobs could be at risk, and morale will be low.

Employees will often have their own cost-saving suggestions and can help identify where waste occurs. Any measures they suggest will by their nature come with the employee’s backing. Enforced measures imposed by management can be harder to implement.

Give employees cost responsibility where appropriate. Consider offering bonuses to employees to incentivise them in ways that help reduce costs and wastage, improve stock control or improve cashflow.

Purchasing procedures

Any purchasing procedures implemented should not be obstructive or time consuming. Routine expenses could be identified and pre-authorised. Management could also be authorised to spend to an overall budget, with restrictions on the maximum spend per item.

Purchases outside these guidelines could be subject to more rigorous purchasing procedures that include the following:

- Which department/personnel requested the expenditure?
- Has the expenditure been authorised by the budget holder?
- What is the expenditure for?
- Could the requirement be satisfied without expenditure?
- When is the product or service required?
- Is there a preferred supplier?
- Have alternative prices been obtained?

Such procedures will make employees think before incurring or authorising expenditure. They will also provide records that the business can examine if costs do increase abnormally in a particular cost category.

Reducing costs

Reducing costs has the same impact as increasing sales – both increase profits: but reducing costs can be easier to achieve. Put simply, reducing costs changes your breakeven point after which the company makes profit.

Your financial information will typically show that the largest expense comes from only a small number of cost categories. These are the areas you should focus on first; reductions made in these categories will have the greatest impact on your overall costs.

Employees

Your employees are your biggest asset, but typically your most expensive one. Their time needs to be used efficiently.

Recruitment

Cost monitoring should begin with recruitment. Your local Job Centre will advertise your vacancy free of charge. You can also advertise your vacancy free of charge on the Internet using Reed's e-recruitment service:
www.freerecruitment.co.uk

Negotiate agency commission fees and refunds. Advertise jobs internally and offer a fee for successful employee introductions.

Temporary employees

Properly managed, temporary employees can be a cost-effective solution to managing peak times or supplementing specialist skills without an ongoing commitment.

When someone leaves, consider whether internal, part-time or temporary employees could fulfill their job.

Consultants

External consultants should work to a specified agreed contract that includes a statement of work, the budget, timescales, acceptance criteria, ownership and payment terms.

Review the fees and services you get from your accountants, lawyers and other professional services that your business uses.

Flexible working

Offering flexible working could allow you to keep experienced employees rather than losing them through redundancy. Parents may prefer to work fewer hours during school holidays. Some employees may be happy to take periods of unpaid leave to fulfil other interests. Employees could be encouraged to work fewer hours in slack periods and more in busy periods, reducing the need for overtime payments.

Training

Effectively trained employees can be more productive and happier. On-site training is generally cheaper than off-site training, and local colleges often offer business and IT training. Your local council's Business Support team may offer free IT training.

Procedures

Having clear written procedures helps induct new employees, helps existing employees cover absence and ensures that employees know what is expected of them. Having a clear process to follow also means that lower skilled employees may be able to complete the procedure, only involving more qualified employees where there is a problem.

The actual creation of the procedures may identify wasted effort and resources in the way a process is currently executed.

Promotional costs

Customers

It is generally easier to get an order from an existing customer than from a new one. Make sure your customer base is aware of your full product and service offerings.

Marketing Collateral

Brochures can be expensive to produce and to post. Instead of sending a full set of marketing collateral for each enquiry, make sure you only provide the material relevant to a specific requirement. You could include a simple A4 letter outlining your full range of products and services with the relevant brochure. Information that changes regularly – for example prices – could also be provided on a separate sheet.

If you have a website, use it to allow visitors to download marketing materials direct to their computer.

Advertising

Not all advertising is cost-effective. Try to determine which advertising campaign is working for you. Consider using unique codes to identify sales promotions so you can track the response and the resulting sales from a particular campaign. Don't automatically renew existing advertising campaigns: try to determine if they have been effective first.

Publishers often reduce the price of publication adverts if they have slots to fill. Contact your chosen publications just before they close their sales campaign to see if you can get a reduced price advert.

Exhibitions

Speakers at trade exhibitions can often negotiate discounts on company stands.

Sales

Ensure sales targets are responsive to market changes and match your production capacity. Commission structures should ensure that the right products are sold and that over generous discounting is discouraged. Money and effort should be focussed on the most likely and most profitable opportunities.

Utilities

Consider the services of a utilities broker. Consultation is usually free, and could save you money on energy, water and phone bills.

Consumption

Consider thermostatic controls for your heating system, time or motion-sensor lighting and energy saving bulbs. All these measures will ensure that energy is only used where required, but implementation costs must be balanced against potential savings. Turn off equipment when not in use. There is no point in leaving a personal computer switched on for two weeks if the user is on holiday.

Telephones

Telephone operators offer a variety of tariffs. Ensure that the tariffs you are paying for both mobile and landline phones reflect your usage volume and pattern. Itemise calls, particularly those from mobile phones. Where appropriate use SMS messages rather than speaking or leaving voicemail.

Publish a policy on company and mobile phone usage so that employees know what you will and won't pay for. Advise employees that records of itemised calls are kept.

Travel

Cars

In the United Kingdom, cars are a common benefit for senior employees. Cars are expensive items, and the costs associated with their purchase, repair, insurance and maintenance can be both significant and unpredictable.

You could choose to downgrade car models when they are due for renewal or keep cars for longer periods between renewals.

Alternatively, you may decide to keep your car costs at a predictable level; either through leasing or through replacing cars with a car allowance. HM Revenue & Customs has penalised company car owners through taxation in recent years, and some employees may prefer to receive a car allowance.

Alternatives

Use the phone system to set up conference calls and save both time and travelling costs. Most modern phone systems will allow you to set up conference calls yourself. If there are a large number of participants in different locations, you may need to use an external supplier.

You could also hold Internet based “conference calls” and use a Web camera to add a visual presence. Professional video conferencing equipment can be hired for a more professional meeting.

Office Expenses

Postage

Use second-class mail as standard, with first class mail reserved for customer responses, sales leads and other urgent information. Make sure that multiple items for the same customer go in the same envelope. If possible, send e-mails rather than post letters.

Printing

Consumable costs make volume office printing expensive. Professional printers can produce volume stationery at lower costs: they can also advise on how to design your stationery for cheaper printing cost.

Photocopying is even more expensive than office printing, again due to the high costs of consumables in addition to the rental and maintenance costs. For small volume print runs, use your office printer, for large volume; again consider a professional printer in preference to photocopying.

Install a fax interface on your computer. Instead of printing out a document, faxing it to a third party and disposing of the piece of paper, you can send the document directly from your computer as a fax.

Stationery

Your local stationery store may be convenient, but it won't offer the best prices. Compare mail order and Internet suppliers. Delivery is usually free over a specified value.

Premises

If you have more space than you need, consider moving to a smaller, cheaper location or renting some office or storage space. Make sure your insurance covers any arrangements you make. If you have many empty desks during the day consider hot-desking, where employees can use any computer at any desk - or connect their laptop at any desk – and redirect their phone so their number rings at the desk they are occupying.

If you downsize your company in any way, check that your insurance does not cover space, equipment and stock that you no longer use.

Plant and Stock

If you manufacture goods, look at whether it may be cheaper to buy components elsewhere for assembly, or subcontract production to allow you to focus on selling. The reduction in stock, tools and machinery costs could pay for the additional cost of outsourcing. Alternatively, look at rationalising your product line.

Only keep as much stock as you need, it is an easy way to tie up money. If you have equipment lying idle, see if it can be hired out. Sell off old stock, tools and equipment when it is no longer required.

Money costs

Banking

Review your bank account and make sure you are getting the best deal and cost-effective services. Check your “per item” costs such as cheques and paying-in slips and group items where possible to reduce your number of transactions. Replace cheque payments with cheaper automated payments such as BACS, Direct Debits and Standing Orders.

Investigate on-line banking: it's faster and usually cheaper. It will also allow you to view your bank statement to the end of the previous working day instead of waiting for your bank statement to come in the post. Don't forget to consider uncleared cheques when using your bank balance to determine your cash position.

Credit

There is a lot of competition between credit card providers. Ensure you are getting the best deal. Where possible, set up trade accounts with your suppliers rather than use a credit card for payment.

Re-mortgaging

If you own your business premises, consider releasing some of its equity through a mortgage. If you already have a mortgage, see if you can reduce your repayment or switch to a better deal with another mortgage provider.

Leasing

Consider leasing your assets, such as new plant or vehicles. Spreading the cost will spread the financial burden and help your cashflow.

Managing cashflow

A cashflow crisis can kill a business. You may have your costs under control, but unless you also manage your cashflow, your business could run short of operational funds. Monitor and estimate your cashflow: this will help you predict any shortfall in available cash and determine the level of sales required to cover your costs.

Debtors

Keep a tight grip on credit control to ensure that you are paid according to the terms of a sale. If your customers know that they will be chased if they do not pay on time, they are more likely to keep to your payment terms. If you have many late payers it may be worth considering third party invoice discounting or factoring.

Where possible, get a customer to pay a percentage of the bill up front, with the remainder on completion. If you have a large or long-term contract, negotiate stage payments. This will also help protect you should your customer go bust.

Creditors

Pay your creditors according to their terms, but as late as possible. If they offer a discount for early payment, calculate the saving to see whether it is financially beneficial.

Cashflow shortage

Under normal circumstances, a cashflow shortage can be predicted. Prudent financial management when business is good can make the difference to survival for a company when business is bad. Keeping a close watch on market trends, expenditure and customers' payment history will help to identify any financial threats to your business.

The following warning signs should be noted:

- Revenue is down as sales are less than expected over a given period;
- Revenue is down as sales are growing less than anticipated;
- Revenue is up, but sales are rising faster than anticipated, and there is not sufficient working capital to meet sales;
- Increased competition in your marketplace threatening margins and profits;

- Unplanned or poorly managed spending, perhaps as a result of increased revenue;
- Unexpected large expenditure;
- Unexpected bad debts and
- Unexpected sales growth or "over-trading".

A significant customer going bust or an external catastrophe, such as war, could also cause a cashflow crisis. The former can be insured against, the latter can't.

Over-selling

All sales require financial investment; too many sales over a period can cause too much cash pressure as monies are paid out to employees and suppliers before monies are received from customers. If your business reaches the limit of its production capacity, it may also have increased costs through overtime and temporary staff. This situation needs to be monitored carefully. It may be prudent to delay taking orders or put up prices rather than increase your production costs at a time when cashflow is threatened.

Resolving a cashflow shortage

If a shortage of cash is recognised in time and managed appropriately, the business can remain viable. Look at how you can increase sales, cut costs and raise margins from each sale. All expenses should be looked at carefully, and where possible consider putting on hold expenses that do not directly impact sales OR service. Negotiate hard on all business expenses: it is in your suppliers' interests that you stay in business. Maintain employee and customer satisfaction as far as possible during any cost cutting.

If these measures are not sufficient, talk to your bank manager about raising a loan, or seek new capital or venture finance.

Useful Links

The Business Link website can be accessed at www.businesslink.gov.uk Business Link provides practical advice for businesses including a free company healthcheck and the benchmarking service mentioned in this publication. They can be contacted on 0845 600 9006.

Further Information

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

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