Business Cost Management

Ireland has been through, and is still in the throes of, the greatest economic boom yet experienced in the history of the State. Of course this has been tremendous for business at all levels but this success also attracts competition. This is seen in many sectors including the high street retail invasion by UK multiples, the growth of US originated franchises and the continuing erosion of the manufacturing base by low cost economies in Asia and South America.

Faced with such competition companies cannot survive as they are currently structured and with resulting margin reduction, businesses have at a very simplistic level two choices to maintain market share, viability and profitability:

1. Increase sales revenue by price increases or volume increases.
2. Reduce the cost base through lower unit costs, shedding of staff or reduction of purchases.

Many books indeed could be written about either of these two options (neither of which by the way are necessarily mutually exclusive) but this article will concentrate on the latter i.e. management of the cost base and in particular will provide many practical tips on how you might reduce costs in your business.

Furthermore, while for many businesses, the trend may well be to move their business offshore to lower cost economies, this article is primarily written for businesses who do not wish to move their operations to a country 3,000 miles away or who do not want, or have no scope, to make substantial portions of their staff redundant. Ireland needs to keep the industries we already have if we want to continue to excel in the international marketplace – business cost management is an essential tool to ensure this objective is met.

What Costs?

Most chief executives or financial controllers will instantly know how much money is spent in their business on labour and, in the case of manufacturing industries, raw materials. These are the obvious costs and tend to receive high profile attention at all senior management meetings and cost reviews.

Many articles, books, business process theories, software tools and more have been thrown at these two major cost issues of labour and raw materials. Suffice to say, this author will not add to the mountain of information already available on the topic.

However, there is another layer of costs buried within organisations and each business would be well advised to direct its gaze to these other business costs – for example who ever thinks about the amount of money spent, and frequently wasted, on stationery? What about the telephone bill, the ever escalating mobile phone telephone bill, the electricity market may have been deregulated but do you know any business that now pays less for electricity? Is the cost of waste disposal ever even going to stabilise let alone fall? I could go on and on!

In the experience of the author, these areas get quite insufficient attention in most businesses and therefore the cost base for these categories inexorably creeps higher and higher with each passing year.

If therefore you are the owner of a business or a senior executive in business, perhaps you should turn your attention to these somewhat less glamorous but nonetheless very fruitful cost categories wherein lurk substantial savings of quite often 20% to 50%.

Why Reduce Costs?

- Increasing sales can be problematic in a tight market and make take a long time and substantial investment to ensure the sales growth takes place. Unlike like trying to increase sales, you have much more control over your cost base and therefore it is much easier to prune, or indeed slash, your costs.
- Any savings you make on your cost base flows straight to the bottom line effectively at 100% margin. If your business has a 5% net margin, a reduction in your cost base of €100K per annum is the equivalent of having to increase your sales by €2m per annum! Typically the effort required to this is significantly less than actually have to increase your sales by the equivalent amount.
- You owe it to your shareholders, your employees and your customers not to waste money. It is easy to be profligate in times of plenty but tighter times will hit all businesses sooner or later. It is therefore prudent that even in good business times like now in Ireland, that your business develops good habits and manages all costs very well.
- Good habits are easy to keep; bad habits are notoriously hard to get rid of!

How Do Costs Get Out of Line?

The cost base of any business can slowly but surely creep upwards and upwards. In plumbing parlance, this is known in the business cost management industry as 'profit leaks'. Quite frequently these go unnoticed by the business as often the categories in question are those categories which are not priority areas. How many management meetings have you attended where the cost of stationery was discussed? Not many I bet!

There are many reasons for this slow but steady increase in costs depending on the business but some of the more common ones include:

- Poor approval processes on purchasing decisions.
- No 'shopping around', negotiations with suppliers, first price submitted accepted etc.
- No review as to why the purchase is necessary in the first place – the 'we always do it this way' syndrome.
- Lack of awareness of new processes and methodologies in the marketplace.
- Low priority given to low spend areas but quite often these are the areas where the most overcharging occurs.

So How Do I know My Business Has A Problem?

Obviously, poor profit margins are the first indicator that your business may need its costs pruned. While this of course will be blatantly clear even with the most rudimentary accounting system, the real worry is that even with good profit margins, you are still wasting money through overcharges and unnecessary purchases in the first instance.

Comparison with industry indices can give very good indicators as to whether your business is overspending however getting access to such indices that have real meaning for your business can often be very difficult. Furthermore, you must also ensure that the indices in question are reliable and are put together in a proper fashion to give dependable information for your industry.

The simple answer is that one must always assume that costs need to be managed proactively rather than simply reacting when a major problem occurs. The author would therefore recommend that costs are continuously monitored on a rolling 12 month basis and compared to the annual budgeted figure for that cost category.

Critically, every company should have either an in-house or external resource who take a cost category at a time and review all aspects of same e.g. price, requirement, design, etc. In this way, sooner or later, all cost categories will receive a specific analysis which will yield savings for your business.

To Outsourcing or Not Outsource

This is very much a trend nowadays whereby it is common and easy to say outsource, outsource, outsource! However, each business must look at this decision very carefully as assuming outsourcing is the panacea for all ills is more often than not a recipe for disaster.

The benefits of outsourcing are obvious. Many businesses for example may be too small to justify an in-house IT expertise – this is why there is a multiplicity of service IT companies in Ireland and they service a very much in demand requirement.

Many companies outsource such that they can concentrate their management time on the core product that the company produces e.g. freight and logistic companies take away from manufacturing companies the day to day management of trucks, destinations, lorry maintenance, in-house shipping staff and so on. This allows the manufacturing company to focus on the product they manufacture and sell rather than how to physically get it to its destination.

Other factors to be considered however are the loss of in-house expertise, the exposure to future higher costs and the potential loss of control when a business outsources a key function to an external body.

In summary therefore, probably the only certainty here is that smaller companies generally do not have the in-house expertise or cannot justify the cost of having in-house capability for specialised functions that are not core to their own production or service process.

Other than this, there is no simplistic answer to this question and therefore each business must look at its own needs and requirements.

Use of Consultants:

When deciding to undertake business cost management projects, each business should consider the viability of using external consultants for this task. Some consultants have been famously described as 'using your watch to tell you the time!' However, use of an external expert resource can be extremely useful but only if one of the following conditions applies:

- Your business does not have the in-house expertise to undertake these projects itself.
- Regardless of expertise, your business does not the people resources in any case to undertake these projects.

If either of these conditions applies to your business, then the use of external expertise is recommended. Before choosing a consultant do consider the following:

1. Fee structure – these can be structured as a fixed fee or more commonly nowadays, a % of the savings. The former is sometimes the lower out of pocket cost but the latter does guarantee that the consultant will deliver or otherwise does not get paid!
2. Experience – does the consultant have real experience and can they demonstrate this in the form of a track record?
3. Tax Compliance – ensure the consultant is tax compliant and can produce a tax clearance certificate.
4. Ideally, ensure the consultant is not a 'one man band'. Larger consultancy practices will have more in-house expertise, more industry knowledge and more people consulting resources.

Case Studies:

Many businesses out there have successfully tackled their cost base – some of the following examples occur in the manufacturing industry, hotel industry, insurance, hospitals, retail industry, educational institutions and other industry sectors.

- ☺ One hospital having engaged a specialist firm of business cost management experts, discovered after an analysis of its usage of medical gases e.g. oxygen, medical carbon dioxide etc, that they continued to pay a monthly rental on the gas cylinders even after the patient had been discharged from the hospital with cylinder provided by the hospital.

- ☺ A well known high profile retail company reduced its printing costs by 52% through a combination of analysing its print requirement over a 12 month forecast window and reducing its supplier base from eight suppliers down to two suppliers.

- ☺ Local Authorities have become very sophisticated in recent years in managing their costs and have proactively managed their telephone and mobile phone costs. For one Local Authority, savings of €100,000 were identified by consolidating all their mobile phone users on a single corporate tariff structure and the implementation of a consolidated billing structure with the supplier.

- ☺ A meat processing company reduced its packaging costs by €50,000 by renegotiating prices and by a slight redesign of the corrugated box used for the shipping of the meat product.

- ☺ A building supplies company reduced the cost of pallets used in shipping by 27% following a redesign of the pallet that reduced the number of components used in the underside of the pallet from 9 component parts to 3 component parts.

- ☺ A well known, high profile hotel reduced its commission on credit card transactions by 40% providing substantial savings.

- ☺ Numerous businesses have great difficulty understanding their electricity bill and do not understand terms like kwh, kvarh, maximum import capacity, maximum demand etc. Once these are understood, savings can be made on most electricity bills which can amount to considerable sums for many businesses.

- ☺ One well known business used external cost management consultants to investigate electricity, pallets, packaging (timber usage) and freight. Savings of €300,000 quickly ensued.

Summary:

Business Cost Management is essential for all businesses large, medium and small. For many businesses, the major costs are in raw materials and labour and generally speaking, most businesses have these costs well under control. If a business has a scarce in-house cost control resource, then raw materials and labour may well have received prio rity.

However, if your business can discover savings in other cost categories, then these can quickly add up to substantial amounts flowing straight to the bottom line. A few categories yielding savings €10k, €50k and €100k can really start to make a difference to your cashflow.

Start with a systematic analysis of where the money is being spent. Break down this high level review to detailed components and then summarise the annual consu mption for each item. Now you are in a position to go after some of the more obscure costs that frequently get neglected in the bigger picture but where substantial hidden savings are to be found.

Good hunting!

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