

## Are your cost benefit reviews effective enough to maximise short term profitability?

Generating profits in the current economic environment is extremely challenging for many businesses. Mark Perrin explains how important it is to combine a number of different methods such as regular cost reviews to help improve short term profitability.

When the UK economy entered the recession, businesses started to focus on reducing costs as one method of maintaining short term profitability. These were relatively easy commercial cost cutting decisions taken by businesses which arguably should have been taken during the good times to further enhance profitability.

However, as many businesses have experienced, cost cutting decisions should be undertaken with caution. There is a danger that they can streamline the business to such a degree that it has insufficient capacity to trade at a profitable level and reduces the ability to respond to positive trading opportunities. Unfortunately, we have all seen that some of these businesses have failed in the current economy.

So what can be done to maximise profitability in the short term, whilst at the same time take the long term view into consideration?

The focus of a business should be on maximising performance at all times. Many business owners and owner managers fail to implement regular cost reviews to help their business maximise profitability, regardless of economic conditions. What owner managed businesses most fail to understand is that there are subtle differences between undertaking cost cutting reviews and an effective review of costs.

Business owners should review direct costs and overheads in their Profit and Loss Account line by line and consider the cost/benefit of what they are spending. The costs/benefit analysis is critical

in making decisions and may be appropriate to increase costs if the enhanced benefits make it worthwhile. It should not be automatically assumed that reducing costs is a good thing. Undertaking a thorough cost/benefit analysis is the key to best practice when reviewing costs and making commercial decisions.

### Supply chain and direct costs

Have you recently reviewed your supplier's costs against alternative suppliers to assess if you are getting the best quote? Identify if any cost savings can be made to increase gross profit margins by negotiating with existing suppliers to achieve their best prices.

### “Undertaking a thorough cost/benefit analysis is the key to best practice”

Ensure the quality of service and products from alternative suppliers will be at least equal to existing suppliers and undertake credit searches to ensure continuity of supply. Consider entering into service level agreements to ensure ongoing timeliness and the quality of supply.

### Staff costs

Usually one of the largest costs within a business, money spent on staffing your business should be continually monitored. Are your staffing levels lean? Are staff performing to the best of their ability? Do individual staff members know what is expected of them on a daily basis? Is there clear

management and reporting structure to review performance regularly?

Small and medium-sized enterprises (SMEs) can be reluctant to address and manage under performance and often do not actively manage staff in a way to maximise their performance. Changes in management style and the introduction of monitoring processes can be very effective in improving the cost/benefit from staff costs. Investing in independent coaching and advice for management to help generate better performance from staff frequently provides a healthy cost/benefit result of its own.

### Property costs

Third party organisations may undertake rate reviews and utility pricing reviews on a contingent basis. Utilising space in the most efficient manner so that the business is generating the best profit it can should be a key focus. Can simple but effective changes be made in how your business uses the space it occupies?

### Sales and marketing

Benchmarking the value a business receives from investment in sales and marketing activity is where SMEs can make significant improvement. Resource should include money directly spent on advertising, PR and the sales teams cost and the cost of other staff involved in sales including management. The total cost can be alarming, particularly where they have no effective method of assessing what benefit the business is deriving from the total cost.

When was the last time you did a cost review of your sales

and marketing? What return on investment do you get? How can this be improved?

### Taxation

As a business cost, tax planning can play a key part in increasing your short term profitability. Regular reviews with business advisors help mitigate taxation costs.

### Capital expenditure

Decisions on the timing of acquiring new fixed assets in the current climate are challenging for any business.

Business owners face the dilemma of either spending valuable cash flow and/or incurring financing costs by acquiring new fixed assets or, delay purchasing and, use existing fixed assets for longer. Using existing fixed assets for longer could incur high repair bills which reduce profitability. However, using fully depreciated fixed assets for longer, as long as they don't break down, may generate higher profits.

It is important to consider the tax implications on the timing and method of acquiring new fixed assets to ensure maximum benefit is obtained. Can you put any orders for machinery etc on hold and save tax by using your old assets for longer?<sup>1</sup>

Owner managers are tasked with implementing various business support functions within their business, such as marketing, HR and finance, leaving little or no time to focus on cost reviews. The options and decisions can be complex so seek professional advice to help you make the right choices. Reviewing costs should not just be undertaken during an economic downturn and it may not always be appropriate to reduce costs, it may be

beneficial to increase costs where there is a positive cost/benefit.

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<sup>1</sup> It is recommended that you discuss the cost/benefit analysis of capital expenditure with your advisors.