



Golden Rules of Cost Reduction

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In challenging times, getting the basics of business right is particularly important. Cost reduction can be vital.

1. Consider the interaction between the business's financial strategy and its commercial strategy. If the two are pulling in different directions, cost reduction can backfire. Random cost reduction is dangerous: it can damage customer relations, harm employee morale, create conflict and inhibit the achievement of strategic goals.

Cost reduction exercises should be led from the very top of the business.

2. Cost reductions must be sustainable, and not 'window dressing'. Do not blindly slash budget headings such as training or marketing, nor carry out cost cutting based on budget variances, without considering what the underlying activity actually represents. If increased marketing spend will deliver more profitable sales, then an overspend on marketing in comparison to the original budget is sensible. Underspending on health and safety may look good on paper, until there's an accident.

3. Use reporting and management tools to make sure that target cost reductions actually happen. Almost all financial software packages have an 'actual vs. budget' reporting capability.

4. Bear in mind behavioural aspects of cost reduction. Guard against those who regard the budget as both the minimum and maximum spend, rather than authority to spend up to a certain limit if circumstances warrant it. Do not move budgets around simply to produce a 'we've met our budgets' feel good factor. It hides over- and underspends. Similarly, comparing actual figures to the previous year may give a warm glow but comparison to an anticipated budget figure is usually more meaningful.

5. Good budgeting helps businesses understand the link between activity and cost. Know what the budget represents: x people at y gross salary plus employer's national insurance contributions, plus employer's pension contributions of z. If the outcome is different from the budget, it is possible to identify why.

6. Manage your risks - be very careful when investing in fixed assets or extending credit. You may have an opportunity to secure a very profitable bit of work but what would it mean for your business if you didn't get paid?

7. In harsh times it is more important than usual to focus on cash. How can you reduce your investment in debtors, stock or work-in-progress? Can you extend credit periods offered by your suppliers? Identify surplus assets and convert them to cash. Try to lower your break-even point. Nobody ever went out of business because they had too much cash.

Cost reduction is never easy, but with positive management you will benefit your organisation.

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