

Intelligent Cost Reduction

Reduce costs, increase profits with minimum pain

Have you beaten all your suppliers down to the lowest possible price but still need to reduce costs? Do you feel you are working too hard for the amount of money you are making? Do you feel you are fighting the cost reduction battle on too many fronts at the same time? Have you reached the point where any further cost reduction seems to threaten revenues?

If this is where you're at, this white paper will give some tried and tested techniques for getting beyond the obvious. They're not painless. They're not like waving a magic wand – some in fact take a lot of hard work and hard thought. They are however tried and tested. They will give a return on investment with the greatest gain for the least pain and leave your company stronger, not weaker, when you have done.

SHOULD I FIRE SOME CUSTOMERS ?

This may seem like a strange thing to do when you are trying to improve profits, but if you are not careful some customers can cause you real financial pain. The pain is not just financial, although that's bad enough. They will be demoralising your staff, disrupting your schedules and dragging resources away from other better, more profitable and more appreciative customers.

Case study: I did a profitability analysis on the portfolio of a marketing services company. I found a tail end of projects which accounted for 33% of the work and only 12% of the profit. Simply by saying no to any more projects of the same type, we raised average profitability by 25% over 6 months.

Another case study: a glassmaker had two products, one of which cost, according to their standard costing system, 20% more than the other. When they really looked at it, the differential was 5,000%. The cheaper product practically made itself while the more expensive one was so complicated that it needed skilled engineers hovering over it all through the production process.

The fact is, if you don't keep a very close eye on things, problem customers can creep in and start doing you real damage. The problem is that conventional accounting systems don't give you much of a clue as to who the delinquents are. A proper customer and product profitability analysis will bring the problems to light. Once you have a list of the problem cases it is not hard to work out what they have in common that makes them so awful. Then you can take action. You can stop accepting any new customers like these. Some of the problem cases can be put right with some firmness 'over pricing or service levels – you can be as firm as you like since if they don't fall into line you'd actually be better off without them. Most will probably respond, but you may actually have to let a few of them go. Imagine the relief:

- more time with your good customers
- more money for less work
- fewer stupid deadlines and unreasonable requests

DO YOU HAVE THE RIGHT MARKET CHANNELS ?

As an example, consider the legal publisher who sold a popular tax guide, annual sales in the tens of thousands with a price of around £30. This seemed like good business, but when they looked at the numbers they found they were losing money. The problem was not the product at all, but the market channel. It sold through bookshops, and was the only bookshop product this publisher had. All their other products were sold direct using their mailing lists. Bookshops need a lot of looking after, both before and after the sale, and it simply wasn't economic to do all this for just one book. The solution in this case was to hand over sales and marketing to a sister company who handled lots of bookshop business. The title became a success.

It is worth thinking hard about whether you have the best channel for all of your different products. If you are selling to retailers, how much time are you spending looking after them and meeting their particular requirements ? Are you moving enough through this channel to make it worthwhile ? If you are using intermediaries, are they doing enough to justify their commission ? If you have your own sales force making personal calls, is the average size of sale enough to make them economic in all the different market segments ?

IS THE BUSINESS THE RIGHT SIZE ?

This is an absolutely crucial question. If the answer is no there is probably not a lot else you can do until you've put it right. There are all sorts of reasons why a business, or part of a business, needs to reach a minimum size:

- if you have a field sales force, you need a certain minimum product range or they can't sell enough on each call to be economic

- if you have a service business and need a range of skills to provide the service, that implies a minimum number of people and hence a minimum level of revenues
- if you need a certain marketing budget to make enough noise in the market to get noticed, then you need enough products and people to deliver the revenues to pay for this.

The question of the right size is fundamental. I once worked for a £150m group which was systematically broken up and sold because most of its parts were just not big enough relative to its competitors.

One conclusion, the most obvious, is to say that we must grow. This may be the right thing to do, but there are risks. It needs investment, it probably means taking market share from established competitors, and if you are doing it because your profitability is below par, that's not the best place to start. There are alternatives:

- identify what it is that's forcing you towards being bigger, and see if you can change it. If you have a field sales force that needs a minimum volume to be economic, consider whether a direct sales approach would work better. You may lose some sales, but make it up with reduced costs
- look for a niche strategy. Within the existing business you have a highly profitable core of businesses which dominate their section of the market. What would happen if you concentrated all your resources on developing this ? This is where you really need the information on profitability by customer, product and market channel we discussed earlier.

SUFFERING COSTS OF COMPLEXITY ?

All activities tend to accumulate complexity over time. They respond to individual customers' special requests, different people add their own special twist to the work.

Over time, this adds up to substantial extra costs.

As an example, a publisher of scientific journals had 26 titles. Now one scientific journal is pretty much like another, just in a different subject area, but there were about 25 different workflows for the 26 journals. This was a lot of extra cost, which only came to light when the processes were automated. Periodically you need to stand back and assess which of all the complexities actually add value. Most don't.

I'M FIGHTING ON TOO MANY FRONTS AT ONCE !

A simple piece of advice: don't. There are always, once you start looking, so many problems to attack. Attacking them always turns out to be harder than first expected. This means you have to concentrate. The 80/20 rule is on your side – you could solve just a few of the problems and get most of the benefits. As an example:

most companies are awash with data, on just about anything. Yet by focussing on just two indicators I was able to raise profits by 46% in 9 months with the same staff. Focusing on just two issues made it possible to concentrate so that everyone heard "profit per hour" and "utilization" several times each week, and soon understood what they meant.

Finding the right spots to concentrate your forces does not necessarily need a huge analysis project. Often some approximate information, back of the envelope calculations and intuition will show the best place to start. You don't need to prove beyond reasonable doubt that your approach is absolutely the best. You just need to be sure on a balance of probabilities that the areas you plan to attack are among the most important ones and offer a good prospect of benefit.

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