

# Overheads and Cost Reduction

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# What are we going to discuss?

- **Classification and understanding of overheads and costs**
- **Methods of reviewing overheads and costs**
- **Key factors in overhead evaluation**
- **Identifying the responsibility of overheads and costs to management**
- **Control and measurement of overhead and cost expenditure**
- **Methods of overhead and cost reduction**
- **Alternatives, substitution and outsourcing**
- **Assessing value for money**
- **Regular reviews of procedures**

# What are Overheads ?

- **Anything not linked to the core activity of the business**
- **A drain on the company**
- **Things that have to be paid for**
- **You and me!**
- **The company infrastructure**
- **The biggest challenge any human has ever faced**
- **Costs that are out of control**

# The Nature of Overheads and Costs

- **How do they link to activity?**
- **Can they be controlled?**
- **What are the true costs and how do you measure and apportion them?**
- **What feeds into and influences overheads and cost structures?**
- **How do you identify if a cost is an overhead in the first place?**
- **Overheads are not outside the control of managers but are often generated by the way a business carries out its business.**

# Strategy

- **Must be linked to the three key levels**
  - Corporate Strategy
    - The overall purpose and scope of the review
  - Business strategy
    - The market and its requirements
  - Functional Strategy
    - How things are done
- **Must have one!**

# Manufacturing and Service Industries

- **The key differences with overheads**
  - Service industry often very employee intensive
  - Manufacturing premises costs
- **The crossovers are obvious**
- **Service overheads can be easy to identify but there is often an overhead or cost “creep” where they escalate if not monitored**
  - Contractors
  - Department power bases
- **Manufacturing have identifiable product costs but often major overheads are neglected or remain unchallenged**

# The Impact of Technology

- **Possible cost reductions – that's often the aim but not always achieved (HMRC computers)**
- **What is going to be achieved and what is the cost of achieving it?**
- **Don't be blinded by the techno babble, KISS**
- **Look beyond the here and now, and make sure it is sustainable into the future (McV preSAPP system)**
- **The difficulties of assessing value for money**
- **Impact of the word processor!**

# Assess Overheads and Costs Correctly

- **Look at the impact of that overhead**
  - What if you removed it completely ?
    - Get rid of the staff Christmas party!
      - Loss of moral
      - Loss of staff – especially the good ones that can leave
  - What if the overhead budget was actually increased ?
    - Increase the party budget
      - Improve moral
      - Show that staff they are valued
- **Understand what causes a cost**
- **Don't be too simplistic – things are never as they seem**

# Reviewing the Overheads and Costs

- **Make sure that the business recognises its overheads and is aware of the costs structures it has.**
- **Try and understand what is the Key Performance Indicator that affects each overhead and cost.**
  - Does it have to be fresh coffee and sandwiches for the meeting or can it be tea and biscuits
    - What impression does that make?
    - Does it matter?
  - You have to have somewhere to work!
    - Do you need a desk?
    - Can an employee work from home (are they trusted)?
  - You must be able to communicate with customers
    - Is a desk top essential, or can they e mail from a blackberry?

# Reviewing the Overheads and Costs

- **Choose the right approach to the review**
  - Top down edicts (generally large organisations – very formal)
    - “The US say we have to cut overheads by 10%”
  - Bottom up staff involvement
    - “Finally they are involving us and asking what we think”
    - “I wish they’d leave us alone to get on with our jobs”
  - Radical, quick and sweeping
    - “that was done with no thought for the people involved”
  - Gradual and subtle
    - Can the company afford to wait?
  - Continuous improvements
    - Depends on the company culture.....

# The Structure of an Overhead and Cost Review

- **Establish the objectives**
- **Establish the scope**
- **Identify the method which is going to be used**
- **Identify the roles of the people directly and indirectly involved**
- **Appoint a Team Leader and establish their authority and boundaries**
- **Set up the lines of reporting and the methods of communication through the business**
- **Set a time scale**
- **Make sure the timescale is adhered to and especially where jobs may be lost that employees are kept informed.**

# The Overhead Review Team Leader

- **Needs to be someone who knows the business well and understand the challenges of the business from the bottom up.**
- **Must be involved with the future aims of a business**
- **Must be a good communicator – a listener**
- **Must be able to focus**
- **Should be able to delegate, but also able to make tough decisions**
- **Must not be seen as a confrontational**
- **Must be seen to have been fair**

# Identify the Key Business Critical Success Factors

- **Has an overhead level been set that can be agreed and worked towards?**
  - Where did that come from?
- **Does the overhead review fit in with other strategic reviews and budgets?**
  - Make sure there are no clashes – sales are planning large push into a new sector whilst distribution are closing channels. Beware of local optimisation.
- **Look at the impact on customers**
  - External
  - Internal
- **How is the business going to manage the changes required (US and post Saddam Iraq)**

# The Benefits of a Strategy

- **Avoids short term affect**
- **Proactive – helps identify strategic issues**
- **Allows for Goal Congruence**
- **Improves the stakeholder perception of a business**
- **Ensures that the projects are controlled**
  - Someone is responsible
  - Gives targets for success
- **Development management potential**

# Practical Ways to Reduce Overheads and Costs

- **Improve processes**

- Study them first

- Time management
- What makes a process speed up or slow down?

- Look for double handling

- HMRC 64-8
- The pencil

- Ask the people that do the process

- They often can readily identify where process is going wrong they just have never been asked
  - Redundant components
  - Filling silos
  - Answering phones

# Practical Ways to Reduce Overheads and Costs

- **Reduce internal negative activity**
  - Stop in fighting
    - Intra departmental
    - Inter departmental
    - Business Units
  - Often the biggest cause of waste
    - Staff wasting time or resources
    - Staff obstructing other processes which could improve efficiencies
  - Hard to identify initially as many are reluctant to discuss
  - One of the key tasks of the overhead review team, especially when a team is sent into a section/unit in free fall
  - Stop the NIMBY

# Practical Ways to Reduce Overheads and Costs

- **Reduce the externally negative activity**
  - Customer requirements
  - Customer Account Profitability (CAP)
    - McVities and M&S
    - Identify projects that are likely to fail from the start not near completion (French Chocolate %)
  - Supplier Requirements
    - Minimum order quantities
  - Local Government
  - Trade Unions
  - Health and safety
  - Other Government agencies

# Practical Ways to Reduce Overheads and Costs

- **Change the structure**

- Sounds very easy
- Often the hardest task
- Must have the buy in of the business from the boardroom down
- Sometimes the hardest people to convince are the bottom of the heap and they can make or break a structure change
- Pyramid
- Matrix
- Business units
  - Sectors
  - Products
  - Geographic

# Practical Ways to Reduce Overheads and Costs

- **Understand and Measure the Internal Service levels**
  - Establish a marker
  - Measure the service given
  - Talk to the service users
  - Talk to the service givers
  - Look at zero budgets (ZBB), is a personnel department needed?!
  - Is a desk a requirement?
  - Does the employee need a desk phone?

# Practical Ways to Reduce Overheads

- **External Service Levels**

- Understand the customer requirements
  - Split the customers into types
  - Identify their key requirements with regards to the business
- Talk to the customer
  - Identify their key requirements withy regards to their business
- Understand the current service levels
  - Does the company need a reception?
- Look at where resources are concentrated
- Follow processes through
- Ask the service providers
- Benchmarking against the competition

# Analyse Activity

- **Effective in both sectors**
  - Service
  - Manufacturing
- **Collect data**
  - Essential to know where you are starting from to be able to aim in a direction
- **Understand the processes**
  - Watch and Learn
  - Ask and query
- **Overhead activity cost drivers**
- **The cost of people/employees**
- **Non employee costs**

# Zero Based Budgets and Costs

- **Assume nothing is sacred**
- **Challenge everything**
- **Start with the assumption that nothing is required**
- **Question every cost and ask departmental managers to justify each one**
- **Excellent for service based businesses**
- **Can be very time consuming for a larger business**
- **Liable to a lot of argument and discussion**
- **Very Effective where costs and overheads have been historically rising without any reviews**

# Product Costing

- **Look at the largest costs first**
  - Check the product cost is correct
- **McDonalds versus Antiques**
- **Challenge all the costs – Jaffa**
- **Will the end user notice? – Kit Kat**
- **Quality**
  - Alpha Romeo
  - Ford
  - Lexus
- **Quantities**

# Product Costing

- **Look at the impact of cost on each component, can it be replaced with**
  - The same from another supplier (i.e. generic Vegetable Oil)
  - A new product that does the job of multiple components.
  - A similar product that won't be noticed by 99% of end consumers.
- **Don't over engineer a product in the first place.**
  - Light bulbs in fridges
- **All new products should be cost challenged before launching, its often easier at this stage to correct mistakes before the end consumer is allowed to compare.**
- **With Service products expect others to critique the product as internal review is far less costly than loss of external customers**

# Limited Resources

- **Start with the forecast**
- **Work the forecast into a budget**
- **Assess what resources will be needed to achieve the budget**
  - People
  - Money
  - Time
- **Relate limited resources back to the budget and try and maximise to fulfil the budget**
- **Outsource either whole or part of a service or product**

# Limited Resources

- **Change part of the product (Smarties tube)**
- **Change methods (Smarties tube)**
- **Change process (Smarties tube)**
- **Change service levels by devising new work methods and/or services available (Not Smarties!)**

# Small Businesses

- **Often a formal approach can be unsuitable but control is still required**
  - Differences in Goals
    - Not always the same reasons for running a business (they don't need the money)
  - Limited Scope
    - The activities of the business are very narrow
  - Limited Resources
    - There are no excess to trim
  - Small Organisational Structure

# Waste

- **Look at the entire process, as is it never only at the end that waste is generated**
- **Is your waste another product ? (Whey)**
- **Aim for waste free processes**
- **Time wasted – me!**
- **One person's waste is another person's resource (Al cans)**
- **The less a business throws away the cheaper its bills will be**
- **Don't let the pursuit of waste cost the business though (thinning syrups)**

# Product Rationalisation and Optimisation

- **The pencil**
- **Diaries**
- **Have one service product with wider scope**
- **Generic products – own label (all biscuits are made equal)**
- **One form**
- **The cardboard box**
- **Beware the multipurpose remote control**

# Review Teams

- **Works best when they are multidiscipline**
- **Ensure that all levels of the business are asked and consulted**
- **IF there are many levels of management it may work better to have an initial suggestions session, which can be filtered by a team.**
- **Can be used for product/service specific reviews, but must have targets clearly defined**
- **Also good when a business operates a continuous improvement process as they is a recognised point of contact for employees**
- **Must be rewarded for their efforts as it can be a thankless task**

# The Rational Process

- **Set the objectives**
  - Specifies and quantifies
- **Corporate Appraisal**
  - Can the business do this without substantial effect on core activity
- **Generate strategic options**
  - Look at the alternatives, never assume that there is one solution
- **Evaluate and choose**
  - Short list
- **Implement**
  - The “how too” and the action
- **Review and Control**

# The Rational Process

- **The drawback of the rational approach**
  - Conflict of objectives
  - There is often a gap between the people dictating and those that implement
  - There is often a political element that cannot be planned for
  - Actual events unfold and emerge (emergent strategies and adaptive strategies – Mintzberg 1987)
  - Management should focus on the positives as the process is never rational (Brunsson 1985)

# The Value Chain

- **Porter (1985)**
- **Ignores departments and looks at activities and processes instead**
- **Developed to demonstrate how management can analyse their business in terms of how it generates value for its customers and overheads**
  - “ a sequence of business activities, by which, in the perspective of the end user, value is added to the product/services by the organisation”
  - The firm becomes a sequence of value creating activities
  - A good basis for developing performance measures
    - “Porter’s Value chain is only a way of “seeing” things

# The Value Chain

- **The Value system**
- **Describes the position of a firm relative to the companies up and down stream**
- **The entire system generates costs**
- **Each part of the chain generates value and your business wants to have the biggest slice**
  - Inhabit the highest value segment
  - Strike good deals (supplier low/Customer high)
  - Collaborate with other in the system
    - Work together with customers and suppliers to reduce the cost of the system
      - Supply chain partners

# Business Process Re-engineering

- **Radical redesign with a view to creating and delivering better customer value**
- **A Root and branch redesign of the way a business operates**
  - Organise around the outcomes and not the tasks
  - Have those that use the output perform the process and drive the system down to the end user – i.e. Sales do the Credit checks
  - Subsume information processing into the real work that produces an outcome (i.e. online analytical processes from sales data)
  - Treat disperse functions as centralised i.e. use a central database
  - Link parallel activities (Insurance clerks and managers)
  - Make decisions at the point where the work is performed and build control into the system
  - Capture information once and at source

# Continuous Review Process

- **Never relax**
- **Ask staff – often the best use of a review team**
- **Reward for innovation**
- **Always respond, any idea is better than none**

# Outsourcing

- **Very popular method of reducing overhead costs starting in 1990s with the rapid outsourcing of IT functions, HR, Van Sales etc**
- **Should not be driven by cost alone**
- **Many advantages**
  - Often an instant result for the bottom line
  - Allows a company to focus on core activities
- **Some key disadvantages**
  - Potentially less control over IT functions, at the mercy of others
  - Continuity guarantees
  - Control procedures
  - Compatibility of culture and personal

# Outsourcing going forwards

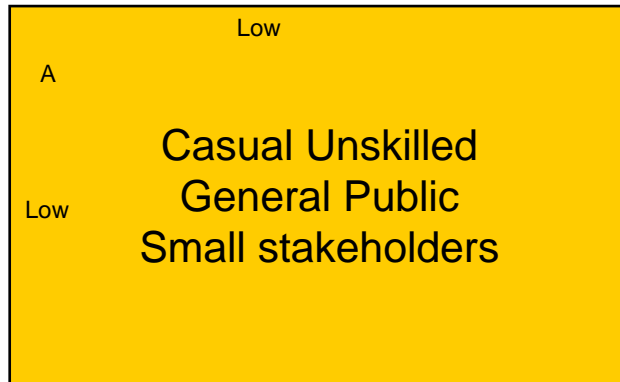
- **“stick to the knitting”**
- **But don't weaken a company by risking customer service levels or the perception of quality**
- **Key relationships with out source companies**
- **Many businesses are bringing IT back into the business as ERP becomes essential**

# People

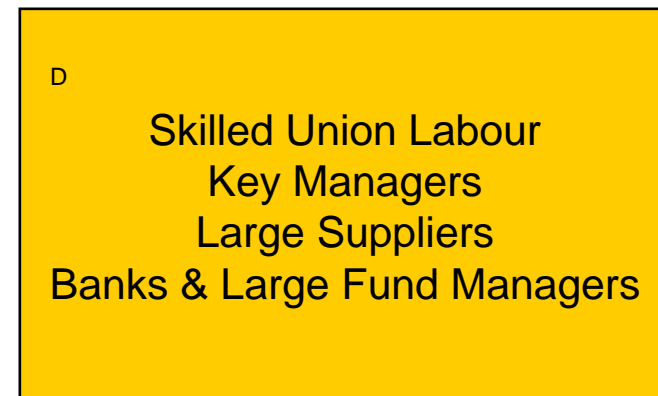
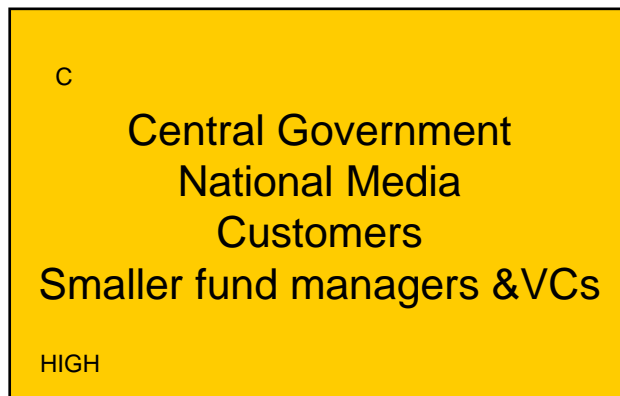
- **Outsourcing again!**
- **The most emotive area**
  - Recognise the extra loss
- **Management structures – less of a pyramid**
  - Matrix
- **Central processes**
  - HR
- **Complete organisational restructuring**
- **Project management**
- **Process management**
- **Functional management**

# The Stakeholders

Importance



Power



Dyson Factory Closure

# The Stakeholders

- **Box A**
  - Direction – they maybe the most malleable
- **Box B**
  - Educate and Communicate to reduce the impact
- **Box C**
  - Intervene and keep satisfied
- **Box D**
  - Make then key drivers for change

# Reviewing the Changes

- **Make sure that reviews are regularly scheduled otherwise those doing the actual overhead reduction never get to know how well (or not) they are doing**
- **The reviews must be recognised at the highest level**
- **No review is worth anything without the original to benchmark**
- **After the results are shared, ask “could we do better?”**
- **Make sure if mistakes have been made that they are not ignored but studied and the key findings shared to ensure that it does not happen again**
- **Don't find scapegoats – reward for success, otherwise no one will ever want to do it again.**

# Reviewing the Changes

- **Ask how the changes fitted in with the company culture?**
- **Can this process become continuous?**
- **Have the senior managers got the commitment to make it part of normal day to day business**
- **Make sure that the costs of reducing the overheads doesn't exceed the savings made!**
- **Ensure that the costs do not creep back in to the business by another route**
  - Rehiring staff as contractors

## At the end of the day .....

- **Overhead and cost reduction is the natural result of good forecasting and budgeting**
- **All companies owe it to their stakeholders to review and challenge the costs**
- **Make sure that all actions taken can be backed up by solid data and are not made at an emotional level.**