

# Cost Management

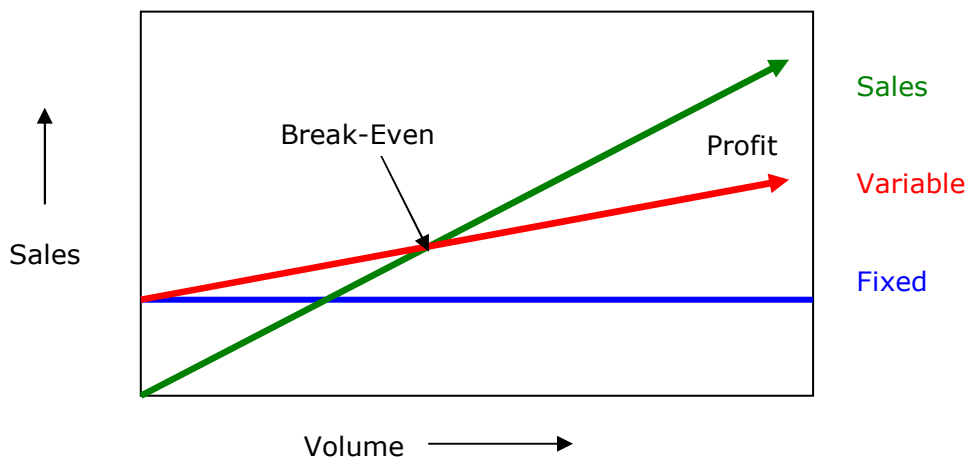
## Principles

Management or organisations need to study the relationship between **S**ales (revenue), **C**osts (expenses) and **P**rofit (income). This will enable them to use the resources of the company most effectively. In any business these relationships are complex but often by splitting them up into sections or operations, they can be made fairly simple.

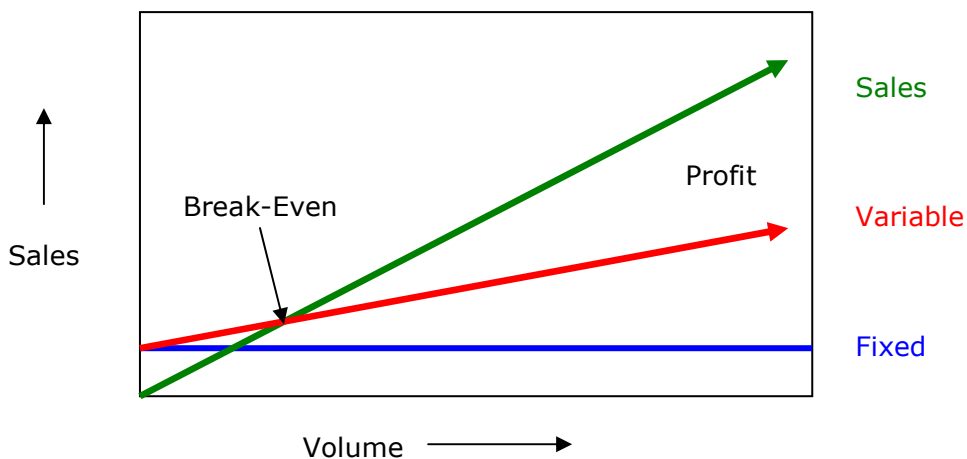
The elements of total costs are usually those allocated as Fixed or Variable, although there can be some overlaps. Companies frequently do not maximise profitability analytically. Fixed costs remain constant over a period of activity called the relevant range. Variable costs increase in direct proportion to activity levels.

Generally one should try to use a simplistic approach but be aware of the shortcomings.

## FIXED and VARIABLE Costs

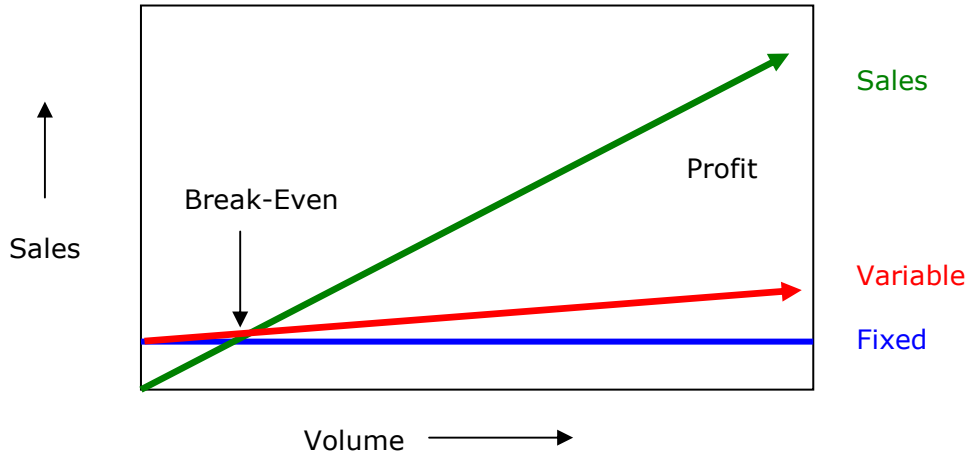


By reducing the Fixed Costs, the break-even volume is lower.



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By reducing the Variable Costs, the break-even point volume again lowers and represents and increase in margin.



1. Reducing Fixed Costs offers immediate 'bottom-line' improvements in indirect overheads
2. Cost : Volume studies often reveal potential for substantial savings.

## Practical Examples

- In a toy and housewears company, their re-pack department had no data on the labour time to carry out each production job. Furthermore, this lack of information meant that planning and scheduling was not possible. Systems and Measurement procedures were established to provide a job cost for each type of work and develop a production plan that permitted accurate scheduling of the work. By analysing the work content of each task, limited investment in automation raised output by a factor of 3 and reduced the variable cost. Identification of products suitable for longer production runs also raised efficiency and further improved the variable cost. **Annual savings: £10,000.**
- A wholesale distribution company tendered for alternative third-party carriers that could provide the same or better service. Through this exercise, savings in rates were achieved by the introduction of a second carrier who offered a delivery schedule that provided an improved service to local areas. **Annual savings £15,000.**

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- Introduction of Least-Cost Routing **reduced annual telephone charges by almost £2,000.**
- A pharmaceutical company identified opportunities to import from EEC countries products of identical specification but at significantly reduced prices. This opened up new markets within the UK and despite the investment in Regulatory Affairs, the company made acquisitions of similar companies to **raise sector sales from £10m to £85m.**
- Following an internal review of external print costs, it was concluded that some investment in Desk-Top publishing and Staff Training would reduce print costs by 20%. **Implemented.**
- A “traditional family-owned company” carried out a comprehensive analysis of operating costs by challenging managers to theoretically assess the implications of a range of cost-centre reductions along with their consequential effects. Alternative courses of action were devised consistent with maintaining the integrity of the business. Structural re-organisations were identified and new work responsibilities were introduced with un-necessary tasks and duplication of effort eliminated. **Annual savings in excess of £50,000.**