Controlling Costs

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Here for Business

Introduction

A structured approach to cost control is essential in any well-managed business and can have an immediate and sustainable impact on its profitability.

This factsheet explains how to identify and monitor business costs and how to carry out cost-benefit analysis to assess which costs are justified by the benefits they bring to the business.

The factsheet also outlines good purchasing practice and identifies some useful resources that can help businesses to manage and control their costs.

Identifying costs

In order to control costs, the first step is to identify them clearly. Whether a start-up or an established business, it is important to prepare an annual budget showing expected expenditure in three main categories:

- Variable costs (i.e., costs that will vary in relation to sales), such as the wholesale cost of goods bought for re-sale, components that go into products the business manufactures, or commission paid to sales staff.

- Fixed costs (often referred to as 'overhead' costs), which stay more or less constant, irrespective of changes in sales, such as:

    - Staff salaries.
    - Rent and business rates.
    - Telephone, internet and utilities charges.
    - Business insurance.
    - Finance costs, such as bank charges, loan interest and depreciation on equipment.

- Capital costs, for example the purchase of new machinery or an IT system.

In addition to identifying expected costs in a budget, it is important to record actual expenditure and review it regularly to assess how the actual costs the business is incurring day to day compare with the budgeted costs. Any variations or excessive spending can then be spotted and addressed at the earliest possible stage.

To make it easier to see where money is being spent in the business, all costs should be assigned to 'cost centres'. These are segments of the business where similar costs are grouped together. Typical cost centres are human resources, stock, overheads and finance.

It may also be worthwhile to record each cost as a percentage, either of total cost or of income. This will not only highlight the critical costs and help compare them with others but should also indicate when expenditure on specific items is rising, giving an early warning that there might be a problem.

Cost-benefit analysis

Cost-benefit analysis should be an integral part of every business planning process. This is the process of comparing the cost of a project against the benefits it will bring to the business. It is important to determine whether the benefits outweigh the costs, making the project worthwhile. In meetings and planning sessions the overall impact of any decision should be understood in terms of its cost, its benefits to the business and its impact on profitability.

For each product or service that the business supplies, it is important to determine whether there is any way to reduce its costs without affecting its quality, by asking questions such as:

- Can it be produced or supplied with cheaper materials or resources?
- Can it be produced or supplied more cheaply if some processes are outsourced?
- Can it be produced more quickly than at present?
- Can less material or fewer resources be used?
- Can wastage be reduced?

Purchasing and stock control

Costs can also be controlled by adopting good purchasing practice. When ordering stock, it is advisable to:

- Review the cost of stock regularly by comparing the prices of current suppliers with others in the market.
- Negotiate with or change suppliers in order to achieve a better deal.
- Agree prices in writing in advance of placing an order.
- Control stock levels accurately in order to be able to meet customer demand without incurring unnecessary storage costs or tying too much money up in stock.
- Set up a system to ensure that purchases are authorised before being made, and that no unnecessary goods or services are ordered.
- Allocate a reference number to every purchase order to make it easier to track invoices and monitor spending.

Useful resources

Resources that can help businesses monitor and control their costs include the following:

- **Cost management software**, which allows businesses to centralise their processes for approving, monitoring and paying supplier invoices, employee expenses and other business costs. Examples include Spendesk (www.spendesk.com/en/product) and Expensify(www.expensify.com).

- **Travel management software**, which allows businesses to make early bookings for travel, accommodation and meeting space, set budgets for employees and review travel costs efficiently. Examples include AirBnb for Work (www.airbnbforwork.com) and TravelPerk (www.travelperk.com).

- **Business comparison websites**, which enable businesses to find the most competitive price for energy, loans, insurance, payment services, waste collection and other business-related services. Examples include Business Comparison (www.businesscomparison.com)and Business Cost Comparison (https://businesscostcomparison.co.uk).

- **Professional services**, such as those provided by an accountant, which can include support with identifying and forecasting costs, carrying out cost-benefit analysis, monitoring cashflow and managing budgets.

Further information

BIF038 Choosing and Using an Accountant

BIF054 Costing and Pricing a Product or Service

BIF058 How to Forecast Cash Flow

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