

Cost and Revenue Control – A Private Sector Approach

A Presentation to CIPFA in Midlands

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This session will cover.....

- What we know about likely financial settlements from April 2011 onwards.
- Private sector approaches.
- Research completed on how local authorities are managing their 2011/12 (and onwards) budget setting.

Public Sector Budgets from April 2011 onwards

- Comprehensive Spending Review 2010 to be announced on the 20th Oct 2010.
- Until then we know from the emergency budget in June 2010 there will be on average a **25% in real terms** cut over the next four years from April 2011 across government departments other than the NHS and overseas aid.
- How will these cuts be spread over the 4 years? - Which services will be protected to some degree?
- Period of engagements throughout summer between Treasury and spending depts to consider options.
- Huge challenge for public services.
- Controlling costs will play a vital part of any strategy.

Initial Pointers – Private Sector Cost and Revenue Control

- Private Sector generally reluctant to reveal their cost and revenue control practices on an identifiable basis.
- These practices are seen as critical to their business success.
- Important element of competitive advantage.
- Generalised and anonymised lessons have been identified in this presentation.
- FAN completed some specific research in March 2010.
- Private sector does not share its good practices like authorities do.
- In terms of cutting costs main focus has been on streamlining back office functions and reducing numbers of staff (headcount).

Cost and Revenue Control Approaches of Firms in the Accountancy Sector

- Partners are asked to retire.
- Partners and operational staff are made redundant – generating a long term cost saving.
- Staff are given a six month sabbatical – at 30% of their previous pay levels.
- Reduction in the working week from 5 to 4 days.
- Improved management of working capital.
- Secondments to departments where there is a greater business need.
- Reduction in travel and increased video-conferencing.
- Increased monitoring of mobile phone usage.
- Agreeing reduced fees with clients if they pay quicker.
- Agreeing reduced fees if they agree to have the work done at a less busy period for the firm.

Principle Generic Approaches to Cost and Revenue control in the Private Sector (1)

- **Freeze non essential expenditure** – expenditure which is discretionary e.g. purchasing new carpets, upgrading computers, travelling first class.
- **Freeze Recruitment of new staff** – re-organise existing workloads to fill any gaps.
- **Postpone new products, services and projects** – These all consume a great deal of resources in terms of start up activity.
- **Delay you payments to your suppliers** – this will improve your cash flow and allow you to earn interest on any cash balances which have not been paid out promptly.
- **Hammer suppliers** – If you dominate a particular market then drive down prices from your suppliers as much as possible.
- **Reduce the payment periods from suppliers** e.g. from 28 days to 7 days.

Principle Generic Approaches to Cost and Revenue control in the Private Sector (2)

- **Freeze wages and perks** – These will directly affect employees and they will not be please by this
- **Lay off employees and close facilities** – If cost reduction approaches do not work then drastic action will need to be taken
- **Improve your contract negotiation skills** – skilful negotiation of purchases and contracts will make a difference to your bottom line – Need to sharpen up procurement approaches
- **Payments to vendors** – Ensure that you are not paying them more than you should contractually
- **Upon receiving a contract price increase proposal** – Threaten to market test immediately unless the proposal is reduced or with drawn
- **Consider all the costs** - associated with a purchasing decision

Cost Cutting in the Private Sector – Based on the Derek Rayner Approach Within M&S – early 1980's

Cost Control – Private Sector Philosophy

- Costs are too high
- They can be controlled
- They need to be reduced
- Cost cuts will make your organisation leaner and fitter
- The process involves
 - Deciding in which operational area you are going to reduce costs and which expenditure head within that area you will need to cut
 - Prepare a plan to make the cuts
 - Conduct the cost reduction exercise
 - Review its success

Cost Control – Focus

Within an operational area you will need to focus upon:

1. Labour Costs
2. Manufacturing production costs
3. Selling costs
4. Development Costs
5. Material and Inventory costs
6. Operating costs

Cost Control – Focus – Identifying Wasteful Practices

- These areas need to be identified **before** conducting a cost reduction exercise so that the exercise can be focused on problem areas.
- Focus on company practices\processes which lead to waste or pointless costs may include the following:
 - Unnecessary forms or over complex paperwork procedures
 - Too much checking or verification of work
 - Too many and/or too large committees
 - Excessive layers of management and supervision
 - Inefficient workflows
 - Poor procurement processes
 - Delays in decision making due to poor delegation
 - Too many paper systems
 - Poor IT systems and processes

Cost Control – Focus – Cost reduction Plans (1)

- Not blind cost cutting but Minimise costs to ensure that cost reduction plans are cost effective
- Cost effective = Achieving a policy goal with the minimum of expenditure
- Augment the cost reduction plans using value analysis – value analysis = reducing the cost of a service without reducing its quality
- Split the service into its component parts and know the costs of those parts – examine each cost component – following questions need to be answered;
 - Does the component contribute to the value of the service?
 - Does the service need all its present features?
 - Can a standard and less costly component be sourced?
 - Will another supplier deliver this component more cost effectively?
 - Can the service be re-designed more cost effectively?

Cost Control – Focus – Cost reduction Plans (2)

- Post value analysis define what costs you can incur and control expenditure against the budget
- The Cost Reduction Exercise – Phases
 - Setting targets for cash cuts
 - Deciding where to cut
 - Deciding how to cut
 - Identifying responsibilities for the cost reduction plans
 - Approaching the exercise
 - **Finance department to take the lead role here?**

Cost Control – Focus – Cost reduction Plans (3)

- **Setting targets:** specific to an area of activity i.e employees, overhead reduction or productivity increases.
- Reduce employees by 10%, ratio of labour costs to sales by 1%, reduce costs per unit of output by 3%.
- Changes in ratios need to translate into a cash figure for savings.
- **Deciding where to cut:** usually , employees, back office functions or identified wasteful practices – take account of value added analysis.
- **Deciding how to cut:** allocating responsibilities – drawing up the programme and delivering it.
- **Responsibilities:** senior manager should direct the cost cutting exercise, supported by a small senior team of not more than 3 senior staff – should have proper authority and adequate terms of reference to deliver savings.

Cost Control – Marks and Spencer Approach – Some Lessons (1)

Value analysis consisted of the following questions:

- What are we doing?
- Why are we doing it?
- Does it need to be done?
- If we need to do it can we simplify it and do it more cheaply?

Some universal principles emerged from the M and S Review

- Top managers must accept a simplification of administration and business processes
- The price of perfection is prohibitive
- Most employees can be trusted
- All staff can bring about change
- Staff can become too specialised
- Never legislate for every eventuality
- There is no substitute for observing what really happens

Cost Control – Marks and Spencer Approach – some lessons (2)

Results of the cost reduction exercise included the following:

- 6 million forms in annual use were eliminated.
- Staff numbers gradually reduced from 27,000 to 20,000.
- Merchandising system was simplified and simpler ways of sending stock to stores were developed.
- Distinction between store room staff and sales staff was abolished which also lead to job enrichment.
- A recruitment freeze was instituted.
- 200,000 forms were abolished by simplifying the control of cash in tills.
- Stock control was also modified as were the systems for returned goods.

COS Group Bradford West Yorkshire – Cost and Revenue Control Practices

COS – Group Carpet Sampling Manufacturers (1)

- Four Group Companies – divided between – presentations, printing design and plastics.
- Focus on presentations where carpet samples are produced and manufactured into display books and swatches.
- Turnover of the presentations company is circa £4m per annum with a net profit of 10% of turnover.
- Standard manufacturing processes which produce standard sample carpet products which can be costed.

COS – Group Carpet Sampling Manufacturers (2)

- Carpet rolls arrive and are slit (5 staff involved).
- Carpet elements are then cut into sample pieces (10 staff involved).
- Each sample piece is labelled (5 staff involved).
- Carpets are sowed into sample pattern books (15 staff involved).
- And they are then packed and distributed (5 Staff involved).
- All staff are interchangeable between each of the above processes.
- Management structure is flat – Most staff are paid the same wage.

COS – Group Carpet Sampling Manufacturers (3)

- Out of the £4m turnover circa 10% = Net profit.
- 50% of turnover = purchases of components for the sample display books and swatches – which will be covers, plastic binders and other materials.
- 20% of turnover = overhead costs of the business e.g. business rates, rents, utilities, maintenance of machines, accountancy and legal fees, depreciation.
- 20% of turnover = direct costs e.g. employees fuel and company cars.
- This is the basic information utilised for both cost and revenue control in the business.

COS – Group Carpet Sampling Manufacturers (4)

- All labour costs are charged to jobs at the rate of (total cost +profit) divided by total labour hours = £20 per hour.
- Non labour costs charged to jobs e.g. palletisation (£10), bagging of sample books (60p) and distribution of carpet sample books (£7.50) at a mark up of 20% on cost.
- Non labour cost elements compared to what was paid a month ago – if significant variance on that then new cost is challenged and threats issued to choose an alternative supplier.
- All invoices received are matched to orders made, to minimise fraud.

COS – Group Carpet Sampling Manufacturers (5)

- Employee costs and productive hours ruthlessly monitored.
- 5 minutes late for work means half hour pay docked.
- Rigorous sickness interviews to minimise productive hours down time.
- Production per staff member is monitored to ensure that it reaches 1000 pattern books a day.
- Productive hours are monitored weekly.

COS – Group Carpet Sampling Manufacturers (6)

Some strategic approaches;

- Company net profit margin is compared to that of previous years and to competitors (as much as possible).
- The contribution of each product\process across the whole group is assessed.
- Suppliers quality and costs are constantly assessed and best value suppliers are identified.
- Internal and external fraud is seen as a very high priority in terms of being tackled.

COS – Group Carpet Sampling Manufacturers (7)

Travel ,Vehicle costs and utilities costs;

- Greener low emission vehicles are being considered for use in the business.
- Fleet fuel cards are used for the vehicles.
- Fixed budgets for sales staff for travel.
- Turning off and turning down electrical and gas appliances.
- Utilising lower levels of lighting.
- Reducing postage and paper costs.
- Fixed cost accounting contract.

Cutting Private Sector Costs in a Crisis –
Sourced from Colin Barrow – Formerly Head of
the Enterprise Group at Cranfield School of
Management

The Paradox of Downsizing (1)

- Study published in 2008 on downsizing in all economic climates (Advancement of Management Journal) concluded the following:
 1. Most firms adopting downsizing strategies alone do not reap significant economic and organisational benefits.
 2. Non-downsized firms usually financially outperform downsized firms in the short, medium and long term.
- Downsizing cannot work in isolation

The Paradox of Downsizing (2)

- Cuts strategies are forever not just for crises.
- Cost cutting strategies maintain competitiveness of the business.
- Cutting headcount is not enough on its own.
- BUT IN REALITY.
- RATIONAL CUTS STRATEGY GIVES WAY TO EXPEDIENCY.
- ECONOMIC CRISIS IS PRESSING.
- ORGANISATIONS NEED TO ACT QUICKLY.
- WE NEED TO RUSH TO THE LIFEBOAT.

Crisis Actions the Private Sector Usually takes – Headcount

- Culling the headcount – which employees can you live without – how many levels of middle management
- Freeze hiring immediately – new employees drive other costs like space equipment cars, computers etc – stop it.
- People on average stay 6 years with an employer therefore you can shed 15% of your workforce per annum? – Realistic?
- Get rid of poor performers - train, motivate and reward good performers.

Crisis Actions the Private Sector Usually takes – Lower Wage bill

- Introduce a shorter working week – COS group introduced a 3 day week for its carpet operatives when demand fell
- Freeze Pay – In 2009 ITV froze the pay of its senior executives earning over £60k per annum in the light of falling advertising revenues. A below inflation pay award was instituted for those earning £25k or more up to £60k
- Cut Pay – In June 2009 BA persuaded 7000 of its 40,000 staff to take unpaid leave or part time work
- Reduced pension benefits – July 2009 M and S

Crisis Actions the Private Sector Usually takes – Unfair Dismissal ?

- Employees can interpret significant changes in their working conditions as unfair dismissal
- 180K claims are filed with tribunals each year with just under half being won by the employee
- Average amount settled at is £5k unless you are bond dealer in the city
- Worth the price of doing it?
- Websites which offer reasons to get rid of people – morality of that?

Crisis Actions the Private Sector Usually takes – Make Assets Savings

- Sell off land and unutilised assets or poorly utilised assets for cash gain BUT – Do you know which assets fit into this definition (quality of the asset management strategy) – Depressed values of capital receipts in the recession.
- Sale and leaseback of assets – Usually a fairly desperate measure – Creates cash flow, reduces operating costs as lease payments can often be charged against revenue as an operating expense
- IBM in 2006 sold and leased back 4 of its 5 UK sites – this helped in cash flow, and operating costs – leasebacks were on short term (operational) basis – remember IFRS leasing considerations
- Tesco recently made a £366m property sale and leaseback of 12 stores and 2 distribution centres

Crisis Actions the Private Sector Usually takes – Assets Savings – Mini Case Study

- British International Helicopters (BIH) Penzance – Dec 2008 – Falling passengers and tourist numbers due to the recession - Fuel and spare parts costs had risen – Profits had fallen – 86 employees at risk of job loss
- Strategy Adopted:
 1. Penzance Heliport was sold off as it was prime development land on the edge of town
 2. Flights were transferred to Lands End airport – where running costs were shared with Skybus operator
 3. Most staff transferred to Lands end airport

Local Authority Approaches to 2011/12 Budget Setting

Inner London Borough (1)

- History of low and no council tax increases (in 2010/11).
- Net budget of £243m.
- Planning the following cuts over the next 3 years in MTFP:-
 - 2011/12 – 8%
 - 2012/13 – 5.8%
 - 2013/14 – 6.2%
- Above were decided upon in March 2010.

Inner London Borough (2)

- No protection – depts told to find savings equalling the 8%, 5.8% and 6.2% over the years. – They signed up to it.
- Depts told to achieve reductions but need to be consistent with the achievement of corporate priorities.
- Will aim to minimise the impact on front line services.
- Members challenge sessions in August on the proposals put forward by depts.
- Also members completing a line by line budget review to scrutinise savings.

Inner London Borough (3)

Transformation projects being undertaken:-

Project	Covering
Systems Review & Streamlining Processes.	Introduction of shared services across common processes across the council.
Service Comparator Project Linked to Key Services.	Service Performance and Cost information used to determine where improvement is needed.
Ideas bank.	Developing a facility allowing staff to comment on how services can become more efficient.
Revenue Income Optimisation	Fees and charges.

Unitary Authority (1)

- Formed an efficiency board several years ago – met monthly since budget 2009/10 to keep focus on efficiency across organisation.
- Since January 2010 been planning 25% cut over 4 years, starting in April 2011.
- Means at least a £24m problem over this period.
- Have efficiency projects to the value of £4m.
- All services given an efficiency target of 1%.
- Leaves a gap of approximately £15m.
- Services been told to comeback with proposals to achieve 20% reductions in their budgets.

Unitary Authority (2)

- Services been told to be mindful of prioritisation results that were established by members.
- Services have to specify year and likelihood of achieving the savings.
- Grouped all services to form 80 groups.
- All members voted to establish a category for these services using; vital, non vital, low priority and discontinue.
- Used electronic voting.
- Prioritisation results will be used when considering the options by services.

Lincoln City Council (1)

- Modelling for ranges in cuts in general grant through ranges of 25%, 35% and 40% over 4 year period.
- Scenario planning around interest rate implications, inflation etc.
- Holding away days in August for members to consider the approach they want to take – will be in the context of the Council's strategic plan.
- Considering options for services, including:-
 - Collaboration
 - LEAN
 - Budget cuts
- After away days will consult with staff, also use SIMALTO to consult with users. Information used for draft budget in November 2010.

Lincoln City Council (2)

Since 2008 been successful introducing a budget prioritisation model. How this worked:

- Members were asked to detail against each service, should the Council:-
 - A – Keep/invest consider for a VfM review.
 - B – Deliver differently.
 - C – Investigate for exit from Council provision.
- This has generated £1.1m of savings so far - target to achieve £2.1m by 2013/14.
- Examples of disinvestment – closed tourist information offices, reduced pest control service, charging for blue badges, closed internal print unit, changed refuse collections etc.

Lincoln City Council (3)

- Required considerable amount of project management through a service review programme. Projects were phased.
- Deferred other projects to free up resources.
- Considered: scale of savings that could be made, existing intelligence about service, timescale for delivering programme, resources required to produce business case, upfront costs, public impact and impact on performance.
- Defined services in analysis as mandatory, discretionary and part.

Conclusions

- Private sector different to the public sector in the control of their costs.
- Still can learn from their approaches.
- Must try a number of techniques - no one method.
- Challenge is long term.
- Top of the organisation's agendas.