

ACCOUNTANCY

COST CONTROL AS PART OF THE CORPORATE CULTURE

Maintaining a standard of low overhead costs forms a solid basis for a company's competitiveness. Nevertheless, many cost reduction plans only have a temporary effect, and after a while the cost carousel merrily starts turning again. Do you wonder why? But above all, how can you avoid that yo-yo effect?

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CONTINUITY VS PERIODICITY

According to the Japanese 'Kaizen' philosophy, a company makes progress by making successive small improvements. It is no different for cost management. Systematically improving ongoing processes and reducing costs is much more effective than ad hoc savings.

In practice, however, cost reduction programmes in companies have a limited life span, meaning new cost reduction plans are constantly launched. This is very disruptive, requires much effort and can sap the morale of employees. Often, cost savings are implemented because turnover or margins are under pressure, or synergy benefits can be

realised quickly in a merger and acquisition situation. In this way, cost management becomes a quick solution to a purely short-term problem.

However, those who want to systematically reduce and control their costs could do no better than to opt for a structural cost savings policy and make cost control part of the corporate culture.

A MATTER OF ATTITUDE

Continuity is essential for a structural approach, but so is a broader view of all the processes that determine or even simply affect costs. Look beyond the strict management of purchasing costs, and approach the policy broadly and procedurally. The scope exceeds the direct costs and also covers (i) strategic indirect expenditure (e.g. labour costs), (ii) operational indirect expenses (e.g. business travel) and investment expenditure (e.g. machinery and installations). The structural approach is based on clear objectives, identifies all parties involved in purchasing costs, assigns responsibilities and continuously seeks process improvements. To ensure that the cost structure also provides a competitive advantage, measuring

and benchmarking with other companies is necessary. Not a matter of course, but a number of service companies - including BDO - have relevant comparisons based on their own research or specific assignments.

ROADMAP TO SUSTAINABLE COST MANAGEMENT MODEL

How can you build a structure to achieve sustainable and structural cost savings? Some guidelines.

Know your cost structure - ABC and OVA

Good knowledge and understanding of the factors driving costs are fundamental to a focused analysis of the cost structure.

The 'Activity Based Costing' method (ABC) is ideally suited to indicate the actual cost of a process as it links the costs to the company's products/services. In other words, you are looking for the cause-and-effect relationships between the (indirect) costs and the cost unit. More information about ABC can be found in the article 'Cost accounting as management tool', TothePoint no. 1, 2017 (www.bdo.be > search for 'publications' > 2thepoint 2017/1).

COST REDUCTION PROGRAMMES

There are three common cost reduction programmes:

- Tactical savings** are short-term savings that have little or no impact on the business organisation (e.g. traditional redundancies)
- Operational savings** are the result of the streamlining of processes and business structures
- Strategic savings** result from a renewed business model in which cost reduction is embedded in the corporate culture

As with all major projects, the success of a cost reduction programme depends on the support of the management. Moreover, the success ratio depends strongly on communication to employees and third parties (e.g. shareholders).

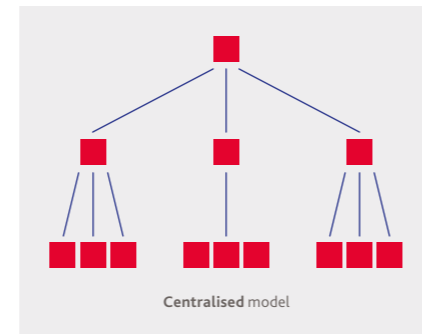
End product or service	Cost-reduction options					
	Eliminate	Postpone	Reduce quality	Reduce volume	Decrease frequency	Replace
Report	✓		✓		✓	
Form			✓	✓	✓	
Analysis	✓		✓			✓
Advice		✓	✓	✓		
Decision	✓	✓				✓

In addition to ABC, there is the 'Overhead Value Analysis' (OVA). This forces a company to look critically at all overhead activities and to determine their added value in relation to the cost price for the (internal) customer. This gives you an overview of the activities with the corresponding options.

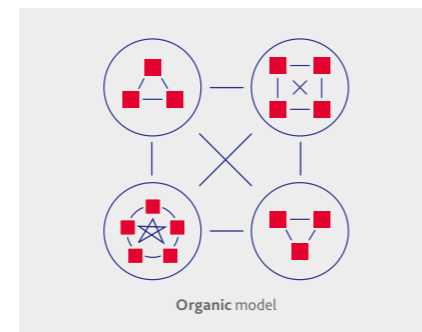
The results of the OVA analysis can be further used to optimise the cost allocation in accordance with the ABC methodology. Those who regularly carry out an OVA analysis can create sustainable strategic cost benefits. Practice shows that sometimes up to 40% of costs can be saved on the indirect overhead.

Choose the right organisational model

The organisational model of a company helps determine how the overhead functions are organised. Four organisational models are usually used.



In the **centralised model**, central management makes all the decisions and the operational units are mainly implementers. Almost all overhead services are centrally organised here.



The **organic model** does not have a central management structure. Rather, it is a family of fairly autonomously operating business units. Each business entity determines its own overhead services.

“Does your cost structure offer a (sufficiently) competitive edge?”

There are two other models between these two extremes. These are the most common in practice:

- ▶ In the **coordinated model**, the central management structure does not make all decisions, but mainly checks compliance with the overall strategy. Overhead services are mainly arranged centrally here.
- ▶ In contrast to the coordinated model, no one in the **holistic model** watches over the whole. The company places the responsibility with the broad management to realise the mission according to the company's values. In this model, the overhead is usually set up decentrally, unless decentralised units request central organisation.

Particularly the centralised model offers the best chance of the most substantial economies of scale. However, the central decision-making and the strong formalism slows down and numbs the decision-making process, which is why many companies opt for the coordinated model. The sound combination of autonomy and effectiveness stimulates innovation and entrepreneurship and leads to synergy effects because most overhead services are centrally arranged.

Eliminate unnecessary work - process optimisation

Certain routine tasks that have little or no value often still remain part of the process. However, those who continue to question all process steps critically can generate surprising savings. The fresh look of an external consultant, such as BDO, can break the risk of routine and offer a different view.

Routine tasks that continue to be indispensable can possibly be performed more efficiently with the help of technology. In particular, repetitive and labour-intensive steps are amenable to automation. Such process optimisation not only saves costs and time, but can also contribute to improving the quality of the product or service.

Focus on controllable costs

In cost-saving projects, companies sometimes pay (too) little attention to the controllable costs, even though these manageable costs sometimes represent a significant proportion of the non-production costs. Controllable costs are those costs that management can influence in the short term (e.g. office supplies, external maintenance or reception services).

Suppose that a department within your company uses a central IT department: these costs are controllable if they are charged on the basis of the measured use. The manager of that department thus has control over the allocated costs. It then seems odd that such quick-win opportunities for rationalisation are sometimes overlooked.

Change management

Sustainable cost management also means that departments must cooperate in those processes that exceed departmental boundaries. Such a radical transformation can only be successful if the new attitude is introduced step by step (change management). Here it is essential that the improvement plan is approved and supported at the highest possible level in the company. Moreover, strong project management plays a key role.

DECISION: FEWER YO-YO EFFECTS IN THE COST PATTERN

'Best in class' companies do not opt for savings surges, but instead succeed in achieving lasting cost savings thanks to sustainable cost management. Success depends on the extent to which the procurement department shares the cost responsibilities with other departments, with the business processes that drive costs being continuously monitored and adjusted.

This strategy leads to a value-driven organisation where you can optimise the 'consumption' required for the output. In doing so, you take into account all cost items, ensure regular benchmarking, continually monitor where unnecessary activities can be eliminated, and ensure a visible commitment from management and a 'change management' culture. ■

QUESTIONS ABOUT AN EFFICIENT COST MANAGEMENT POLICY?
Contact our Accountancy specialists:
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