AdamsonPVFSupply

BY JOAN ADAMS

Quick Budget Cuts

> *A cost reduction program is great, but takes time. Here are some things you can do right away.*

Costs go up. It's an immutable law of nature, a certainty like death and taxes and the house always wins. In finance, this theory is called the "value of money."

Simply put, a dollar today is worth more than a dollar tomorrow. Translated into goods and services, this means something that costs you a dollar today will cost you something more than a dollar tomorrow. Except in rare times of deflation, the value of money theory is in action every day. When costs go up, they go up incrementally, little by little almost every day. There's no fanfare, no announcements, and the daily increase is so small that we hardly notice. Yet, when all these increases are tallied at the end of the year, it's a big number.

It's not just the cost of your pipe, valves and fittings that is going up. It's everything — utilities, insurance, maintenance, payroll, benefits, etc. And this relentless climb in costs is eating right into profits. Rising costs are picking your pocket every day.

The only way to keep that money from leaking out of your company is to actively do something about it. I have written about cost reduction programs in the past, and these focused initiatives are still a good idea, but can take time. Today, let's look at quick hits — those costs you can cut right now without a lot of planning and study.

COST CUTTING ARITHMETIC

Companies tend to focus on sales and growing customers. And with good reason — without sales and customers, where would the business be? Increasing sales is always good; getting new customers is even better. But sometimes a little cost cutting can be the best way to get a quick positive cash hit.

Cost cutting doesn't have the glamour of sales and marketing. It's downright mundane, something akin to coupon clipping, but cutting costs can be very profitable, and these savings show up as profits very quickly. Not only do you start saving immediately, but you save that amount again next month and the month after that.

The Case Of Wonderful PVF Inc.

Wonderful PVF Co. is stagnating. Sales aren't growing as fast as costs – management knows something has to change or they are going to be in big trouble real soon. Let's compare two different possible approaches to increasing profits: cost cutting and increasing sales to see which one has the biggest impact on the bottom line.

The Cost Cutting Approach

In this case, the Wonderful PVF Co. looks at overtime as a place to cut some costs. Sure enough, when the CEO orders managers to cut overtime, they manage to cut OT by 10 hours per week. Let's do the math.

- The overtime rate is $20/hour.
- The company will save about $800/month in payroll. (10 hours x 4 weeks = 40 hours. 40 x $20 = $800.)
- The managers are vigilant and do not let overtime creep back up to previous levels.
- The company saves $800/month for the whole year = $9,600 in savings.
- These savings go straight to the bottom line.

The Increased Sales Approach

In this case, Wonderful PVF Co. decides that by increasing sales, they will be able to get a nice bump to their bottom line. The sales guys go out there and sell an additional $10,000/month of material. Let's do the math.

- On average, Wonderful PVF generates net income before taxes of 4% of sales.
- An increase in sales of $10,000/month will bring $400 profit/month.
- These new customers order consistently, and in one year the increased sales deliver $4,800 to the bottom line.
- Wonderful PVF needs consistent sales of $20,000 a month to match cutting 10 hours of overtime a month.

Keep in mind there was an assumption made that Wonderful PVF made profit of 4% of sales. Take a look at what happens at another company – The Average PVF Co. They earn something like 2% of sales net profit. This translates into increasing sales almost a half a million dollars ($480,000) to match the dollars brought to the bottom line by cutting 10 hours of overtime.

Ask yourself: which do you think will be easier to do?

Eliminating 10 hours of overtime a week?

Or increasing sales by a quarter to a half million dollars every year?

Unless your staff is made of sales superstars, I suspect you, like most PVF distributors, would opt for the cost cutting strategy.

MORE QUICK HITS

Let's look at a supply house's biggest fixed and variable costs to see where and how you can start cutting some costs.

✔ **Overtime:** Overtime, overtime, overtime. Track it and cut it. Enough said.

✔ **Contract Services:** Once distributors set up their insurance policies, their cell phone contracts and their copy machine contracts, they just tend to renew every year. However, things change. Your business, your needs and the services offered may not justify the automatic renewals. Don't just accept contract increases each year. Make those vendors earn your loyalty. Shop around every year. Renegotiate your contracts every year. I guarantee you will save money and probably get more service for your hard-earned dollars.

✔ **Trucks:** Trucks are expensive. Insurance and maintenance costs, and in case you haven't noticed, gas prices, are always on the rise. You want to get the full bang for your trucking buck. Start by monitoring truck usage. Which trucks are on the road delivering PVF most of the time and which are mostly idle?

Look at truck efficiency. Are the big trucks delivering small (low weight) packages? You must know that is costing you big money. Create some rules about material size. Start with something like, all packages under 10 pounds are sent by UPS. Instantly you will reduce the amount of gas guzzled and employee time spent delivering little packages. Ultimately you will use your trucks more efficiently, or you may discover you have more trucks than you need. Eliminating a truck will save you a bundle.

✔ **Warehouse:** If nature abhors a vacuum, the supply house hates empty shelves. It's the PVF equivalent of "Field of Dreams" — if you build it, it will be filled. A spacious warehouse can be a good thing, but don't fill it up simply because the space is there. The space is costing you: lights, heat, real estate taxes, and the general inefficiency of having your stuff all over the place. Clean up the warehouse. Who knows, you may find yourself with a bunch of square feet of excess space. Block it off, cut the heat and the lights. Better yet, rent it out, thereby turning a cost into a source of income.

✔ **Inventory:** Excess inventory comes with an incredible cost. You pay in advance for things you may or may not eventually sell. Keep lower amounts of inventory in stock, set lower quantity reorder points, and order more frequently. Reduce the cycle time, by which I mean, shorten the time from when you pay for an item and you get paid for it. (Think "Value of Money" – you want that high value dollar today, rather than a lower value dollar tomorrow.)

Cutting costs is not the exciting part of business. It doesn't get the competitive juices flowing like landing a big job does. But stopping rising costs from their inevitable trend upward will put money right back on your bottom line. You can do these quick hits without a lot of effort. You work hard for your money — it is time to start keeping more of it. <<

Joan S. Adams has consulted for industrial clients for more than 15 years. She headed DITT, the consultancy arm of the French National Utility, Electricité de France, and was a managing consultant at A.T. Kearney. Later, she started Pierian, a consultancy that brings sustained and measurable success through operational excellence, customer focus, and competitive market strategy. Joan Adams speaks French and Spanish. She has worked on projects in Europe, Central America, Africa, Asia as well as North America. She has engineering degrees from the University of Wisconsin-Madison and MIT. She also has an MBA from the Wharton School. She can be reached at adams@pierian.net.