

## **IV. ANNING OF COST REDUCTION PROGRAMMES**

### **1. Cost Consciousness**

1.1. Briefly mention may be made of waste in all forms:

- (i) Waste of materials
- (ii) Waste of supplies
- (iii) Waste of machinery
- (iv) Waste of manpower
- (v) Waste of money
- (vi) Waste of space
- (vii) Waste of customers
- (viii) Waste of ideas

1.2. First and foremost, let us for ever remember that economy and cost consciousness do not sprout from the bottom in an organisation. They must trickle down from the top. The managers and supervisors must show the way to greater efficiency by their own cost conscious attitude, and by daily effective and enthusiastic action.

1.3. We must remember that, when we employ persons, we are buying from them what they have to sell, viz., human effort and ingenuity. If part of the effort is spent on ineffective motions or operations, it is sheer waste; If part of it is spent in using inefficient machines or tools, or if workers are waiting for materials or orders,

it is again sheer waste. If workers, are not trained properly, or if we have the wrong type of workers, it is waste. If workers' ideas are restrained, or if we don't solicit them, the best in man is wasted.

1.4. Therefore, it is management's job-our basic responsibility, if you please-to analyse all work performed, to reduce it to its simple form, to solicit ideas from workers, to teach them the fundamentals of good work, to motivate them to give their level best, to make them the willing and able guardians of their own efficiency, and thus attain maximum utilisation of the efforts purchased from our employees.

1.5. Only a satisfied and contented work force will earnestly and eagerly help us achieve our own desires of lower costs, higher quality, increased productivity, and greater profits. With work simplification, which is a scientific analysis of the men, materials, machines, and methods used in the performance of all operations, the desires of management and the workers can be satisfied in an effective and interesting manner.

1.6. In approaching any given activity in any department, we must be sure that it can-like the airplane, the automobile, or a machine tool-be unendingly improved. We must be really curious; we must open our minds to the necessity of hunting for better and easier ways; we must be dissatisfied to leave things as they are, and we must truly and sincerely welcome suggestions that may disclose improvements.

## **2. A Check List For A Programme**

2.1. Here, briefly outlined, is a programme of cost reduction that can be brought about by creating cost consciousness throughout an organisation:

- (i) Remember that no programme of any kind will work unless you do.
- (ii) Aim to tell your man hours, your materials, your Rupees and your ideas where to go, instead of wondering where they went.
- (iii) Before you can successfully embark upon any programme of cost reduction, ask yourself and find answers to the following questions:
  - (a) Where do we stand today?
    - Where can we go?
    - How are we going to get there?
    - When are we going to get there?
  - (b) What is being produced?
    - How much is being produced?
    - How long does it now take to produce?
    - How much does it cost?

- (c) What is the -
  - Production per hour?
  - Production per man?
  - Production per square meter?
  - Capacity of plant, equipment and men?
  - Percentage of capacity operations?
  - Cost per unit?
  - Cost per hour?
  - Cost and breakdown of overhead?
  
- (d) What are the fixed expenses?
  - What are the controllable expenses?
  - What is the extent of waste at present?
  - Where is it caused?
  - How is it going to be stopped?
  - What will it cost to stop it?
  - How much will the business get out of it?

2.1.1. Unless we prepare ourselves with that kind of programme, we may be embarrassed while trying to prove its worthwhileness or we may lose the enthusiastic cooperation of our work force. We must make a game out of cost reduction; we must have a target to shoot at, not a field to shoot into. As Frederick W. Taylor so aptly put it, "We must first know what is being done before we can do it better, and the art of management is knowing exactly what you want your men to do; then seeing to it that it is done in the one best way."

2.1.2. However, to continue with the various steps in our cost reduction programme:

- (iv) Be sure that your programme is properly introduced into the organisation and that the organisation is ready for it. By that, I mean that the top management must be sold and must enthusiastically support your programme before you can expect your organisation to produce results.
  
- (v) Don't introduce your programme too fast-i.e. faster than your organisation can absorb it-or the resistance to it will be greater than your enthusiasm to get it started.
  
- (vi) Never start a programme in a disturbed atmosphere or during management or labour trouble. When too many new ideas, methods, machines or changes are brought up at the same time, or at the wrong time, your organisation may develop a case of "organisational indigestion," giving your programme little chance to develop or even live.

(vii) Tell your employees why you want to, or have to, reduce costs. Use figures, facts, chart, competitive samples-valid reasons.

(viii) Find out what your employees are thinking of. You can do this by "Town Hall" meetings or by attitude surveys. This is extremely important, because without the proper mental attitude of your workers and the' union behind them you will never get enthusiastic cooperation, and the lip-service may be more against your programme than for it.

2.1.3. If our employees believe that they merely think themselves out of jobs by eliminating waste and reducing costs, we shall have a job on our hands in trying to provide that their opinions are ill founded. Can we do it?

2.1.4. On the one hand, management knows that in the long run the ability to cut down costs results in a better competitive position, more sales, more production, more jobs, and more job security for workers as well as more stability for shareholders. On the other hand, employees and their union fear immediate results, chiefly a reduction in the number of jobs available, through improved efficiency and better methods. But the paramount issue both with management and with the employees is security. It is management's job and obligation to create new demands for its old products, or to develop now products to absorb the manpower released through a cost reduction programme, if it wants the programme to be long-lived and productive.

(ix) Correct unfavorable conditions as soon as possible. Prove by deeds, not by lip-service, your sincerity in providing ideal working conditions first. It is little things that count; if you have conditions that can't be changed immediately, tell your workers the full story, and they'll understand and cooperate with you.

### **3. Planning for Overhead Cost Reduction**

3.1. The steps necessary to a well-planned overall programme of cost reduction and control, and the contributions of the various departments within the master plan, are outlined below: By and large, it has been recognised that with the exception of direct labour and direct material (i.e., manufacturing value added), all costs incurred by a manufacturing organisation can be deemed as overhead. Since material and labour costs can be controlled directly through a system of standard costing, discussed in the next chapter, let us now consider the control of overhead cost relating to the return-on-investment concept.

3.2. Firstly, what are overhead costs? Overhead costs are many things to many people. Some businessmen fear them, and make every effort to keep them at a minimum, particularly during times of economic stringency. Some accountants~ in turn, find overhead costs a nuisance, and merrily divide and distribute them in

various ingenious ways over certain measured activities. Let us make it clear that overheads are all costs other than direct labour and material.

3.3. Secondly, what is overhead control? It embraces cost determination, collection, reporting to management, and action & management to reduce such costs in order to yield the most effective utilisation of all company resources-~ in other words to maximise the return on the total investment.

3.4. Effective overhead control is becoming more and more vital because of the speed of events and the fact that more change is occurring daily. So rapid a planned programme of cost control is a dynamic approach to overhead control. While we must practically take a segmented approach to the collection of costs of any business operation, we must have a unified total concept whereby the various segments can be integrated into one total framework for management purposes. Without this integration, the cost of overhead control becomes excessive, and the results questionable.

3.5. If all costs other than direct labour and materials are viewed as overhead, then surely we must re-examine the vitally accepted approach that overhead costs must always be kept to a minimum. Furthermore, the thought that overhead is "bad" must surely be re-examined. The proper performance of these various functions, defined as overhead, is vital to a business organisation and approach that we hear so much of these days- "we must get rid of some people" -is completely erroneous and badly conceived.

3.6. Here are a few examples: A curtailment of selling and advertising effort in a declining market may be the very thing to put a company out of business in those product lines where this "bad" overhead has been eliminated. A reduction or elimination of some research activities may be far more detrimental to the overall profit position of a company than any possible benefits of short-range savings, if that company is dependent on new products for maintaining its competitive position.

3.6.1. Many accountants and managers who, when sales decline, recommend reducing the advertising budget, weaken the direct selling effort, and fail to spend the money to eliminate a quality control problem. An examination of the facts of the case might show that sales are dropping off because of poor quality and inadequate selling coverage. Surely the approach taken by these managers and endorsed by their accountants, who are looking solely at the immediate Rupee effect, is most inadvisable and ill-conceived. So, in a planned system of cost reduction and control each element of overhead cost must be considered in relation to its individual long-range and short-range contribution to the overall profit activities of the company. This means that the profit contribution of each element of cost must be considered against the backdrop of all the other elements of cost and of revenue. For example, one large whole- saler decided to eliminate the teletype installation at a branch because the cost was

considered unwarranted. This teletype installation was used mainly for quick communication with the main warehouse to fill shorts on orders. These arose because of a much smaller stock carried to necessity at the branch. The result was certainly a reduction in direct cost to the branch, but an analysis showed a decline in the gross margins of the branch, because the manager took action to fill some shorts on orders through local purchase at higher cost. The analysis also showed an indirect, but much more serious, long-range implication-i.e., a rise in shorts on orders at a growing dissatisfaction amongst the trade with the service being provided by this company. The teletype has been put back-shorts are declining, but it remains to be seen if the erosion in sales through dissatisfaction can be recovered.

#### **4. Planning Overhead Cost Control**

4.1. Now let us consider how to plan to secure overhead control? Here are the six basic steps:

- (i) Establish company objectives and targets;
- (ii) Develop detailed programmes;
- (iii) Organise resources to meet the objectives;
- (iv) Establish department standards of performance to match programmes;
- (v) Develop a system of budgets; and
- (vi) Report on performance.

4.2. The first step in any overhead control system is the establishment of company objectives and targets. These firm objectives should be in sufficient detail to provide for the most efficient allocation of resources, both physical and human. This blueprint for action can then be translated into money value and developed into approved budgets-operating, capital and cash, and into preformed financial statements.

4.3. In this process, it must be ensured that the company organisation is so arranged that it is designed to meet the company's long-range and short-range plans. If it is not, changes must be made and, of course, at this point the system of accounts and the system of controls must be changed to meet these new plans and changed objectives. So often a company will make organisational changes, and then not follow through with adjustments in its chart of accounts. If the company has been on a system of responsibility accounting, management has lost its performance measures through the organisation changes. Accountants can play a major role in providing management with this control. They should ensure that these charts of accounts and other systems and procedures are continually revised in the light of changing management requirements.

4.4. Budgets should be established and maintained with a minimum of change. If the company's programme is well conceived, and the information has been properly

developed, then budgets need to be reviewed only infrequently in the light of experience.

4.5. All this suggests that if the company's plans are carefully thought out, and alternative courses are considered, there is an optimum level of operations in terms of revenue and costs which will yield a maximum result for the company and its investment for any level of business activity. Despite this, there is a most serious temptation in periods of business reversal to curtail expenses drastically, even if the effect of this curtailment is more serious in the long run than any aspect of short-range gain. A common attitude is-"let us cut out additional employment". If this means that the recruitment of able young men is cut off, then the company has made a most tragic error. Another error which has been touched upon already is a reduction in advertising and public relations expense. Certainly some of this expense is variable in a normal sense, but to set an arbitrary per cent of net revenue maximum without an examination of the purpose is like setting 80 Kilometer per hour maximum on all inter-urban trunk highways, and on all segments of these roads.

## **5. Specific Areas for Improvement**

5.1. Let us consider some specific areas in which some planning for cost reduction might be undertaken in this general concept of overhead control.

5.2. The ideal cost-cutting situation would be found in an organisation that is efficiently run and in which day-to-day details and overall policies are so efficient that not a single paisa is wasted. Cost-cutting then becomes a philosophy and an attitude directed at assuming that all the latest ideas and equipment are adopted to keep the machine running at peak efficiency. Unfortunately, this situation never arises.

5.3. What can marketing management do to plan for cost control and, in fact, for cost reduction?

5.3.1. One of the first areas to consider is whether or not profit responsibility ought to be passed over to field management. This is most desirable if the company has a field force adequately trained in, and cognizant of, the factors impinging on profits. If not, there is a grave danger since an overzealous field manager can give away profits very quickly through price concessions.

5.3.2. The second thing which should be considered from the marketing management point of view is the elimination of unprofitable customers. This means an examination of the profitability of individual product lines. The first place to look! is at those customers whose individual orders are small or whose overall volume is low. But again, remembering the implication of one element of cost on another when considering the elimination of some of these unprofitably small accounts, the effect of their contribution to Overhead cost on other business must be examined.

5.3.3. From the sales management point of view, there are certain things which can be done. The first of these is an examination of individual sales territories. Perhaps realignment is necessary, or the overall size of certain territories needs to be reduced. This can cut out some high-spotting, and will reduce travel time and travel expense. Such a realignment can mean that certain areas would be left uncovered. The implication of this must be examined, and a decision made between no coverage and the engaging of dealers to cover these low volume areas. Another point which ought to be considered, particularly if profit responsibility is to be passed out by corporate management to sales management, is that no change can be made in the price schedule by salesmen without sales management approval. In a period of retrenchment, opportunities should be taken to eliminate the deadwood in the sales force, and it is also a good time to shift to a sliding commission schedule related to contribution to profit.

5.3.4. From the field management point of view there should be a close watch kept on out-of-pocket expenses, car maintenance and car use. The field manager should be watching time utilisation, and should stress the desirability of the appointment sales call. The control of promotional sales material should be emphasised.

5.3.5. Any planned sales programme should be organised to meet the customers, requirements. The Sales Manager should look at the market potential, and ensure that it has been set up to get the maximum. In other words, it is important to the company to decide whether or not it wants 100 per cent of 25 per cent of the market, or 25 per cent of 100 per cent of the market, since this can be done at a much lower distribution. cost if market conditions permit.

5.4. In the field of administrative expense, it has been stated that "every office manager should be dedicated to the elimination of his functions by combining, eliminating, and substituting until the cost of office management is negligible." This criterion has a good deal of merit. Statisticians and, in fact, economists are comparing the number of office workers with the number. of production workers. Unquestionably every company needs a clerical staff of sufficient size to do the job of getting current information to management, and satisfying customer requirements through adequate service.

5.5. There is a great similarity between the management of an office and the management of a factory when one considers that the concept of an office is really not much different from a manufacturing plant. The reason for an office is the manufacture of an end-product of service to the corporation and of its management. The reason for a factory is the manufacture of a product for sale. The same managerial techniques apply to both. Just as the Plant Manager must do, so the Office Manager must plan, co-ordinate, and control. He must establish the programme, the schedule, and the budgets, both as to Rupees and to the time required

to achieve his objectives. It has been said, "the Office Manager to do a proper job, must be an industrial engineer, a salesman, an administrator, a leader, a cost accountant, and a psychologist"-a large order. To be effective in all these fields requires ability, tact, and understanding. Unless a manager has some benchmarks against which to measure performance, particularly in a period when he is being asked by management to exercise a greater control over operating cost, he is liable to be somewhat at sea.

5.6. This is a difficult area in business in which to secure standards, but it is possible, and a good deal of work has been done in setting up pre-determined motion time values for various operations. Unless you know your costs, you can't secure savings.

5.7. If these values are neither available nor applicable to a specific operation, then standard industrial engineering practices can be employed to secure the most efficient set of systems and procedures.