

reduce costs without cutting corners

MIKE SPEED

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If you have survived the past 12 months, at least have the decency to give yourself a pat on the back. It has not been easy and the mere fact that you have survived means that you are doing some things correctly. It is in these times when we find ourselves vulnerable and subject to bad debt, bank pressure, declining business, smaller margins, that one has to really sit down and clear your head. To do this one needs to understand what exactly the situation is in general and within your own company. We always hear the famous recession sayings “Cash is King”, “reduce debt”, “invest and check for the best interest rates”, “check for tax implications” and so on. Ironically, if we had money, we would not find ourselves in a stressed situation so now how do we do this balancing act of reduced turnovers, lower margins and in a lot of times, increasing costs?

DISCOUNT

Do we discount? NO! Discounting, although it may seem to be a short term option to boost and inflate sales, but is a long-term nightmare. Try to explain to a regular client why he paid R3000 a night last year, R1000 a night now and that you would expect him to pay R3500 a night next year. Once you have reduced rates or tariffs, your clients and supplier customers are going to keep you to those rates for as long as possible, so what do we do? There are a number of options... Add value! Add maybe a dinner and an afternoon tea to the rate. Therefore not dropping the rate but giving the client more for his money, which in fact is the most cost advantageous to yourself because a dinner valued at R150 and a tea valued at R50 that you are offering the client, is a R200 added value, but has only cost you maybe R60 to produce, so the nett effect of that is that you are still receiving R2 940 per night as against if you had discounted the room by R200, you would only have received R2 700. The alternative is to run a special for a limited period only, reduce your rate for an off-season or a winter period by 20% if required, but this is an incentive special and is marketed and sold as such and in no way does this reflect a reduction in your base rate. Even a Hybrid mixture of the 2 can be a very successful way of adding value and running a special and NOT costing you anywhere near the value of a discount and nor are you creating the impression of cutting rates and having the uphill climb of getting customers to accept the higher rate at a later stage. We all see it every day in the supermarkets, end of range sales. A jacket that was R2000 is now on sale, i.e. special for R800. If you buy one now, your perceived value is

immediately a saving of R1200. Although its price now is only R800 now, it was R2000.

If you had bought one 3 months ago and paid R2000 for it, then your perceived value was R2000 and you paid R2000 and therefore you felt you had got what you paid for. You would look very foolish going back to a supermarket 3 months after buying your jacket for R2000 and now demanding a R1200 refund because it was now on a sale. It is just simply not done, nor would you receive any assistance from the enterprise concerned, so value and cost are therefore linked to perception and if you value-add as I have illustrated, is not only limited to the items mentioned, but you can create the perception of very good value for money without affecting the bottom line too drastically. This illustration can obviously be adapted to many types of business and is certainly not restricted to room rates at lodges and hotels.

Often we look at lodges, country venues who offer a boma or braai type meal in the outdoors and charge an extra or a set-up fee for the perceived extra work that they have to do moving equipment, food etc to the outsides, yet at the end of the day, this is basically only a utilisation of staff that is normally there and already being paid so once again we are working harder but retaining our value by offering that type of incentive in a packaged form. Consider 2 day tour operators: Both running 10 seater vehicles with one or two people in them for their tour, leaving both of them with a break-even at best. If the two companies got together and worked together, cross sold the product, condensed the 2 day tours into one, had 4 people on the vehicle, we would now have break-even and a profit. Two companies would now share a profit, although small and there would only be one cost of operating the vehicle, fuel, maintenance etc.

It's a pretty simple arrangement to alternate days and weeks and you really don't need a mathematician to work out how many pax there were and what the split should be.

OVERHEADS

If we move on to overheads, what are the first expenses normally to be cut?

Always the non-tangibles: Maintenance, insurance. Because one doesn't see the benefit until the bomb bursts, people tend to convince themselves that these are not really critical items. Nice to have but not critical. However, suffer a vehicle accident, clients injured or a burglary or armed robbery in a lodge and then one suddenly one realises that the non-tangible expense was critical to the success and survival of the company. Same with maintenance – A simple thing like a faulty contactor can end up causing a fire, and if you have cancelled your insurance you

are really in deep #%@*! So one needs to ensure that you keep that type of requirement on the “To Pay” list.

OVERHEADS

In our businesses we have fixed overheads and variable overheads. Fixed overheads for example bonds, leases etc are not normally short-term and therefore difficult to cut or change, but our variable expenses is a somewhat different picture, for example most rural properties, lodges etc. are billed on maximum demand with regards to electricity. I think we all know that the maximum demand of anything is normally in start-up or full load, for example walking into a kitchen in the morning and turning on all the appliances simultaneously and the most expensive operating expenses of appliances are those that generate heat, so if one had 6 kitchen appliances, baking hobs etc and one turns them on simultaneously one could have a draw of between 60 – 80 kilowatt for 20 minutes, but you will be billed on all the units used for the whole month on that maximum draw.

If you had turned the appliances on 2 at a time at 15 minute intervals, your draw would possibly be less than half, which if you take all your monthly units at half of your kilowatt demand, would make a considerable adjustment to your electricity bill. Ensuring that lights are switched off and not left on unnecessarily all plays a part in cutting your variable cost. Use the internet and the landline and less cellphone, you also generate a saving. Don't be so quick to say I will call you back, rather say “Just a minute and I will sort the problem out for you” or give the answer right now, which also makes the client feel more important and of course, he's paying the bill. Other small examples, boil a kettle and not a 20 litre urn, add all these things up and you can make a saving of a couple of thousand Rand a month in a normal tourist venue and you will be surprised the difference this will make in your total overhead.

R500 per month per item doesn't sound like much, but have 10 items and a year later, in anyone's book

R60 000 plus interest on the bottom line means that you have achieved the same bottom line with a turnover of R400 000 to R500 000 less per annum. This is based on a bottom line return on turnover of between 10% – 15%.

Salaries & Wages: Normally the highest overhead factor in conventional business. How often have we complained where do we get good staff, how hard it is to get trained people, yet after insurance and maintenance, this is the first item people look at and normally the lower end of the earning scale suffer first. All this does, any sort of retrenchment, is create uncertainty in the company and uncertainty leads to rumour, rumour leads to stories going out to the balance of your staff, and your customers and suppliers, so now we have total uncertainty.

Staff who are more worried about whether they are going to have a job tomorrow than concentrating on doing the best job for the company, customers who aren't sure to place business with you because they aren't sure if you are going to be in business tomorrow, suppliers who are uncertain whether to supply you goods and services because they may not get paid. So what's the answer to this? The answer is to be open and honest with your staff, to keep them informed of the situation, if things are tight, motivate them to be more cost conscious than ever, explain to them that if we cannot increase sales and profit, we have to cut costs to survive and that cutting costs, once all the small cost savings have been done, only means cutting jobs to reduce costs. Give them an undertaking that you are not going to cut jobs and that if necessary the whole company including yourself will share the load. How do we share this load?

By agreeing on a percentage of short time, for example 25% less work in a month, is 25% off the wage and salary bill. Now motivated correctly, the majority of people in times like this would rather have 75% of their job than 100% of no job! This way, we make everybody part of the solution and not part of the problem. Have weekly or daily meetings, keep everybody informed, lay the carrot and stick. The harder we work and achieve, the less we are all going to suffer. Have brain-storming or think tanks. What can we do to get more business? How do we close the deal? Keep it positive!

Stock: Always remember that stock on the shelf is dead money! It's a delicate balance to ensure that you have enough stock for your commitments, bookings etc. and often one makes the mistake of ordering in excess, so that someone doesn't have to continually control.

Bearing in mind that the average cost of sales in food and beverage is between 32%-36%, in other words an item that you are selling for R100 should only cost you R32 – R36, so if you can reduce stock from a normal stock level in money value of R100 000 to say R60 000, you would increase cash flow by approx. R110 000 – R120 000 on the basis of a 32%-36% cost of sales. If times are this slow and business that quiet, then there should be ample time to base things on the American principle of things arriving JIT (Just In Time!)

Cashflow: The dreaded words "Cash flow". How do we balance our income against our expenses and be assured that if cashflow is tight and business is slow, every month that you operate with a negative cashflow, increases the problem. Managers or owners should have the bank balance and trust deposits on their desk in the morning upon arrival.

If you do not have control, you cannot manage. If you can't measure your progress or lack of it, you can't manage. If you do not work with the facts, you cannot manage. It's a simple matter to use an Excel spreadsheet to allocate money to the months that it has been deposited for. A prime example – if we are receiving deposit money now for 2010 and we are not putting a large percentage of that money away, when the time comes for 2010, we will not have the cash to operate and provide the services that we were paid for 6-8 months ago. So to take the pooled allocation of money for each month that you have deposits on hold for, and to lump them together and the total being the minimum bank balance that you should have at any one time, obviously one deletes the current month at the beginning of that month. One can feel confident that if you can still pay the rent and overheads and maintain the bank balance, you are in survival mode. If you cannot do this, you are in pending disaster mode.

This creates two things: it creates a positive bank balance which you can invest for interest, it eases your bank's mind about your business and any facility you might have in your business. Do a simple cash in, cash out on a monthly basis and make a graph of the results. If the trend on average is cash positive, you should be OK. If the trend is cash negative, you have not reduced the overhead costs enough to survive. Budget for provisions. If you have fixed expenses at different times of the year, you need to allocate those expenses and amortize them over 12 months to ensure that the money will be there when it is required.

WHEN DO BUSINESSES FAIL?

It is not unusual that the answer to this question is normally on the down side of a recession. No businesses fail as the market picks up and capital is required to increase stock, vehicles or commodities or whatever you operate with to allow yourself to be in a position to take advantage of the up turn.

How to treat the supplier, your creditor and the bank: Always return calls! If you make a commitment to go back to someone regarding a payment, do so! If you make a promise on a payment date, make sure that it is achievable and that you stick to that promise and if something goes wrong, pick up the phone immediately and speak to the creditor. Remember they also have cash flows to balance and they will make provision and commitment in their cash flow, based on your promise. I think that you will agree that we would always prefer to work with a debtor who is open and honest, sticks to his promises and makes us feel secure. We have to do what we have to do to survive and to run a profitable business. It's YOUR choice!