

**A.L.BEAN & Company**  
**Business Insights**

**Managing Your Cost Structure**

**Small Business Edition**

*Strategic and Business Planning*

## **Overview**

Business owners wear several hats, and all are important to running a successful enterprise. The Finance hat should be given a considerable amount of time, considering that cash flow kills businesses more than any other reason. For many small business owners, managing costs is arguably at the very top of the priority list. There are various ways to manage your costs, and we highlight some in this article.

## **Managing Costs**

When managing costs, there are two primary types of costs that should be given attention: Fixed Costs and Variable Costs.

### **Variable Costs**

Variable costs are the expenses that go into making a product or providing services. For example, variable costs for a restaurant are food items purchased for resale. Variable costs include inventory items, hourly direct labor, shipping expenses and others. These costs will go up when sales are high and down when sales are low. Business owners should take a lot of care in managing variable costs, because they directly impact the quality of your product or service. Aggressively finding the lowest cost may not be the best strategy though. For example, a high-end retailer like Saks Fifth Avenue can't sell low quality items and expect to stay in business. The items may cost less, but will have an inferior quality, which is against Saks Fifth Avenue's business strategy. Therefore, a higher cost can be justified. Wal-Mart can sell low cost items, because its business strategy is to offer low priced items. We don't go to Wal-Mart to purchase an Armani shirt. We generally don't expect Armani quality at Wal-Mart. Companies put a lot of effort into managing their supply chains to balance cost and quality.

### **Fixed Costs**

Fixed costs are expenses that are stable over time. These costs are generally the same or very close every month. Examples include rent, lease, interest, certain utilities (e.g. local phone service), internet, etc. Business owners should keep these expenses as low as possible. High fixed costs can destroy a business quickly. These costs do not fluctuate with your level of sales, so your business has to cover these expenses regardless of how well business is going. Keeping these costs at the lowest possible level will allow you to weather a storm such as the current recession. Many companies with high fixed costs are really struggling right now, as they have very high expenses and few sales. Some businesses have high fixed costs, as this is the nature of the business. Businesses that require large and expensive equipment to make a product would be an example. Businesses in this category should still attempt to keep fixed costs as low as possible, though they may be higher than many other businesses.

### **Gross Margin**

Of course, sales pay for all expenses. As long as variable costs are lower than the sales price of items, a business has cash left over to pay for fixed costs. Will a business have enough though? This is why managing fixed costs as low as possible is extremely important. Many companies have cost variabilization strategies for their cost structure. In essence, the idea is to increase the percentage of costs that are variable versus fixed. This will allow them to weather a long period of low sales.

Our next article will discuss some of the variabilization strategies that are being used.

There are various approaches to managing your cost structure and we encourage you to call A. L. Bean & Company for the many ideas we have in assisting our clients.

**If you would like assistance, please contact A.L.BEAN & Company at 214-387-8525 or visit our website at [www.albeanco.com](http://www.albeanco.com).**

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## **ABOUT A.L.BEAN & COMPANY**

**A.L.BEAN & Company** is a consulting and accounting firm that specializes in serving small-to-medium sized businesses. We help businesses by offering the following primary services:

- Accounting Services
- Tax Services
- Business Plans
- Budgeting and Financial Planning
- Business Process Improvement
- Project Management