



## **Reduce costs and boost profits**

By H. Frank Sauls Jr. CPA

One of the secrets of high profile companies, such as Wal-Mart, has been their constant effort to become or remain the lowest cost producer in their field. As we all know, the low costs result in more bottom line profits. What small companies do not realize, is that this technique can also work for them.

You may remember from your college Management 101 class, that there are four basic types of businesses. These can be represented in a square box divided into four compartments. In this matrix, you have only two pricing choices - high or low, and two service choices –superior service or little or no service. Therefore, you have a total of four strategic directions – high price and superior service, low price and little or no service, high price and little or no service, or low price and superior service. Only the first two choices will create long term profits for the company. The last two will never produce long term results because of customer dissatisfaction.

So, if your strategy for profits is to sell low and sell in quantity, your aim must center on being more efficient. You must widen the gap between the cost and the selling price of the goods or services you are providing, which will translate to an increase in the profit margin. For small businesses, the stumbling block is often knowing how and where to “work smarter” to achieve their goal. Knowledge is a key component to company success, regardless of the industry in which you operate.

A low cost producer must be able to create a “price differentiation” in the market place. To price competitively, you must examine your cost drivers and pricing strategies regularly. Just look at the old service station. Forty years ago, all service stations were full service, gas margins were high and gas prices did not change often. Today, most stations are self service, margins are low, and prices are changing daily as they seek to match the competition in order to sell more. In order to stay in business with low gas margins, the retail sellers have had to reduce costs, which they have done by reducing labor costs through reducing the level of service. (Just for fun, look back at the second paragraph on the only two successful models. Gas stations are an example of classic management principles at work before our eyes.) The lesson here is that you must examine your product cost on a daily basis, and be willing to change the way that the product or service is provided in order to be competitive.

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**ALLEN PRITCHETT & BASSETT, LLP**  
POST OFFICE BOX 349, TIFTON, GEORGIA 31793  
229.382.6960 FAX: 229.382.6992  
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A business owner needs to know the breakeven point – the point where all costs are recovered and the business begins to make money. In order to know this, you must know overhead costs, the cost of raw materials and components, and labor costs. The application of basic methods or technology can be effective in analyzing your costs. For example, a simple computerized spreadsheet could enable you to develop a financial model in which you can track costs, identify changes, and calculate the effect on profits.

To lower the product cost, it pays to shop-around. Business owners are urged to obtain new quotes regularly, whether it be for raw materials, office supplies, or basic services such as telephone services and electricity. Owners and managers must constantly negotiate for better prices and terms and be on the lookout for alternative suppliers. This sometimes can be accomplished through collective buying with other companies in order to negotiate lower prices. As one client that deals in high-price items once explained to me, “My customers are smart and they know the market. If I am to be able to compete and still make money, I must buy right.” He was right. Sam Walton knew how to buy right - just ask any salesman that ever tried to sell anything to Wal-Mart.

I had the opportunity to talk to a cost accountant that worked for a supplier of Wal-Mart. Guess what - Sam carried my friend to lunch to find out how his company did things. My friend indicated that he did not get a chance to ask Sam a single question because Sam was too busy picking his brain, asking questions and learning. What can we learn from this? If one of the richest men in America was interested in always improving, shouldn't we be doing it, too?

In addition to holding costs down, focus your efforts in the right places. Core products and services and target markets must be identified. Remember the old 80:20 rule, i.e. 80 percent of profit comes from 20 percent of customers or products. Who are the business's top twenty customers or products? Should the other 80 percent of customers or products be dropped? Unless you know your breakeven and have correctly identified those key customers, you could make a big mistake.

To manage, you must continue to learn. Learn from existing knowledge bases, like books and classes; learn from your consultants; learn from your employees; and learn from your peers.

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