

# COVID-19: How to Reduce Operating Expenses in Business



## How to Reduce Operating Expenses in Business

When you look at documents such as the balance sheet and income statement, it's possible you may come across some terms you're not familiar with. However, coming to understand these terms is essential, as they will help you better understand your company's financial statements to make improvements in your organization's fiscal health during good times and bad. In fact, as the economic devastation that accompanies the COVID-19 pandemic continues to spread, understanding how to optimize your company's financial health is more important than ever.

Small businesses in particular should be focused on terms like *operating costs*. Also known as *operational expenses*, *operating expenses*, operating expenditures, or simply *OPEX*, operating costs are those that are necessary for the day-to-day maintenance and administration of your company.

Before you can reduce your operating costs, in a pandemic or otherwise, it's crucial to gain an understanding of what these costs are, how they influence business, and the best ways to keep them low while preserving your company's productivity and profits.

## Common Operating Costs

One of the biggest parts of a company's operating cost is the *cost of goods sold* (COGS). These direct costs are associated with producing your business's goods or services. Other operating expenses include:

- Office space
- Labor costs, including payroll
- Employee benefits such as health insurance, pensions, disability insurance, life insurance, and any other benefits offered
- Depreciation
- Amortization
- Sales commissions
- Maintenance costs

Understanding how to measure operational costs is more important than ever before in the age of COVID-19. With suppliers shuttered, staff working remotely or sheltering in place at home, and governments scrambling to balance economic recovery against the public health, companies need to keep expenses as low as possible in addition to seeking a healthy bottom line. If you operate as a for-profit organization during a massive economic disruptor like the coronavirus pandemic, reducing your operating costs has a direct impact on not just your profitability,

but your ability to keep operating, paying your staff and suppliers, and survive long enough to compete once the crisis is over.

## Operating Cost Ratios

Once you have a solid understanding of your operating costs, you can use that information to get a number of other relevant business ratios and figures. The two most important data points you can get through operating costs include your operating income and your operating expense ratio.

### Operating Income

Your operating income refers to the total amount of profit associated with your company's operations. To calculate this number you subtract your operating expenses from your total revenues.

Operating income = Total revenues - operating expenses

That means if your company earned \$3,600,000 in revenue last year but has \$1,000,000 in operating expenses, your operating income for the year would be \$2,600,000.

### Operating Expense Ratio (OER)

Your operating expense ratio is a direct comparison of your expenses to your income so you can track your company's efficiency.

To continue with our fictional company, we determined that the company's operating income is \$2,600,000. If you were a Fortune 500 company, you are likely disappointed by this amount but if you're an entrepreneur who just opened your company last year, you are incredibly excited. A good operating income is relative and does not always provide a strong indication of financial health,

whereas the OER does provide a better picture of overall financial health. Operating expense ratios vary by industry.

Calculate OER with this formula:

**Operating Expense Ratio = Operating Costs ÷ Revenues**

Keeping with our above example, we get:

$\$1,000,000 / 3,600,000 = .277778 * 100 = 27.7\%$  That means that more than  $\frac{1}{4}$  of the revenue we earned this year went to operational costs for the business.

*Banks traditionally have low operating expense ratios sometimes as little as 0%. Other industries however, such as the building materials industry, have OERs as high as 73%. Because of this, you need to be more concerned with how you rank within your industry. If you find ways to either meet or beat the industry average, your business can be successful.*

## Ways to Slash OPEX

### Invest in Technology

With software-as-a-service (SaaS) platforms for everything from marketing to procurement and inventory, there's no reason to avoid technology. These systems can automate and streamline nearly every function of your business, reducing costs and improving efficiency. PLANERGY for instance, is accessible from anywhere with an internet connection, can be automated to meet your specific workflow needs, and addresses the entire procure to pay process. The automation also helps to reduce labor costs and creates cost savings in the form of overall increased accuracy and reduced human error.

## **Telecommute**

One of the biggest cost savings you'll find is allowing your team to work remotely. By using a remote team, there is no need to lease office space, manager physical office, or pay for utilities. Because of how easy it is to stay connected today, the difference between an employee sitting in an office and sitting at home is negligible. Employees often find this to be a good thing, too because they can reduce their own expenses and eliminate commute time.

Thanks to tools like Skype, you can communicate with your team as needed throughout the day, without paying the overhead costs associated with an office. You can provide your team with an allowance for office supplies, and still save money overall.

Telecommuting and remote collaboration are critical for companies working to accommodate the "new normal" created by COVID-19. For many managers and teams, the transition to remote work can be daunting, so it makes sense to invest not just in remote access and office supplies, but training for those who find themselves transitioning in this fashion. Ensuring your team can work together effectively while working separately in multiple locations can help keep your operating expenses much lower than if those same workers are scattered, confused, and working without a shared purpose or understanding of the task at hand.

## **Shop Around**

No matter what you're looking for - be it goods for your break room or a service provider - you should shop around for the best deal. You may not always get the cheapest cost, but in areas where the value add makes sense, it is often worth it to pay a bit more. It can help you save in the long run.

Talk to your existing vendors and see if you can get a better rate than what you're

getting now. If you work with certain vendors on a regular basis, send a request for proposal to each of them, with as much information as possible so you get the most accurate quote. This allows you to get the best possible price, while also planning for anticipated operating expenses.

For those dealing with closed suppliers or limited access to essential materials during the pandemic, it's a good time to revisit your supply chain structure. Finding local suppliers who can get you what you need fast, as well as more distant (but reliable) vendors willing to work with you on pricing and terms, will help you build a healthy and resilient supply chain that can more effectively weather disaster without raising operating expenses to prohibitive levels.

## **Cancel Unused Services**

Keep an eye on your variable costs. Periodically go through everything to make sure you're not still paying for something you don't use. If you haven't used a product or a service in a couple months, consider downgrading to a cheaper (or free) plan, or completely canceling the service. If you're not using it, it's doing nothing to improve your operating income. Suspending accounts is a good cost-reduction strategy if your office is closed and everyone's working remotely (or not working). The office doesn't need cable, for example, if no one's there to watch it.

It's easy to lose track of unused services, especially if you've got the setup to automatically pay on your credit card. If you come across services you want to keep, shop around for a cheaper alternative.

## **Pay Your Invoices on Time**

Most vendors out there will offer you a discount if you pay your invoice early - and a late fee if you don't. By paying early and getting a savings of even 2 to 3% can add up over the course of a year. If you pay \$100,000 a year in invoices, but earn a 2% savings on each one because of early payment discounts, that's \$2,000

a year in savings.

If you can't afford to pay early, make an effort to pay on time because those late fees and penalties will add up, too.

If you're struggling to make ends meet due to the pandemic, don't be afraid to reach out to your vendors to work out a temporary arrangement. Chances are they're struggling as well, and working together to preserve your relationship now will go a long way toward good relations when restrictions are lifted and everyone's back to work.

## **Improve Efficiency**

Remain on the lookout for ways to improve your business efficiency. Tightening up your procedures and processes reduces waste in terms of time and materials. Investing in process automation can help immensely, as it frees human staff to focus their time and talents on high-value strategic and analytical work while removing human error and delay from high-volume, repetitive, and rules-based tasks.

Encourage employees to look for inefficiencies and suggest potential solutions. If you provide an incentive for this, making a small investment in an employee reward keeps them motivated to help, and has the potential to save you thousands of dollars over time.

For remote teams and skeleton crews working through the coronavirus, look for ways to maximize communication and collaboration without increasing expense or resource usage. Meetings can easily become emails or teleconferences, and teams spread across time zones can collaborate to accomplish essential tasks on staggered shifts to keep the wheels of production, sales, and other essential functions turning regardless of who's at home, across the country, or on the other side of the planet.

## Outsource

If you use digital marketing campaigns to draw in new leads and convert them to paying customers, it may benefit you to outsource your web design, social media, and search engine optimization (SEO) tasks to another agency. Trying to handle this yourself when you are not an expert or paying someone full-time to remain on staff in house isn't the most cost-effective way to address that task. Freelancers are available for nearly any task you can imagine, so you can get the services you need without the expense of adding an employee to the payroll.

While you won't be able to eliminate all your business operations costs, even allowing for part-time remote work will help you reduce your business costs while boosting employee morale because of the increased flexibility it offers. With both social distancing and stay-at-home isolation changing the rules, remote work is rapidly becoming a necessity. Freelancers can help fill the gaps in your teams as you adjust to the new normal, or even form the foundation of a new paradigm for your business. You can also call on remote-work veterans who are already on your team to lead new teams of freelancers, or bring other existing workers up to speed, helping to reduce culture shock and keep everyone healthy, employed, and productive—and your business alive.

Reducing your business expenses does not mean you have to eliminate business functions—even when a pandemic threatens global economic stability. With the right investments, you can improve your cash flow, insulate your business against economic downturns, disease, and disaster, and increase your profit margin without sacrificing quality or your offerings to your customers or employees.

## What's your goal today?



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