# How to Reduce Overhead Costs for Your Business


Every business has costs that come with, well, doing business. And when these costs get out of control—when overhead costs threaten to devour the hard-earned profits generated through operations—it's time to take a serious look at eliminating the thousand "tiny cuts" that can bleed your business dry.

Understanding how to reduce overhead costs is crucial to eliminating needless and wasteful expenses. But it also helps both large and small business owners boost their bottom lines and develop a robust and healthy business with the agility and resilience to thrive when times are good and persevere when the going gets tough.

# Why Knowing How to Reduce Overhead Costs Matters

Curtailing costs to save money is a fundamental part of doing business. But it's especially important to identify and rein in overhead expenses, which have traditionally been difficult to track accurately but can represent a massive drain on your bottom line.

Most business activity generates costs. But not all costs are created equal.

**Operating Costs** (Also called *operating expenses* or *direct costs*) include the expenses accumulated in the course of daily operations. Examples include:

- Raw materials and supplies.
- Costs related to product production, sales, and marketing.
- Labor costs (including piece work).
- Equipment
- Packaging
- Fuel and utilities.

**Overhead Costs** (also called *overhead expenses* or *indirect costs*) are those ongoing expenses related to the support functions of your business; the "business of doing business," as it were.

These include:

- Accounting
- Information Technology Services.
- Insurance
- Salaried labor costs.
- Administrative costs.
- Software

- Office supplies.
- Utilities

These areas of expense can, if properly tracked and analyzed, provide a powerful opportunity for business owners to streamline and optimize business processes while cutting costs, particularly if they're embracing digital transformation after relying on manual, paper-based methodologies in the past.

> *Generally speaking, the lower you can keep your overhead costs, the stronger your bottom line and profitability will be. And once you've identified the expenses generating overhead within your business, you can use a simple formula to calculate their impact.*

# Identifying and Calculating Overhead Costs

Almost all big and small businesses have costs created by in-house processes they could probably be trimming. But before you can slash expenses, you need to understand the different types of overhead costs and how they affect your organization.

## 1. Fixed Overhead Costs

These costs are enduring and unaffected by the passage of time, your company's profits or losses, or business activity in general. You'll incur these fixed costs whether you're tearing up the industry or struggling to survive, so it pays to keep them as low as you can.

Examples include:

- Mortgages and rent.

- Property taxes.
- Loan installments.
- Insurance premiums.
- Asset depreciation.
- Government fees.

## 2. Variable Overhead Costs

Unlike their fixed equivalents, variable costs can and do change, rising and falling with sales.

Some of the most common examples include:

- Office supplies.
- Maintenance (for both office equipment and production-related machinery).
- Some utilities (situational).
- Legal fees.
- Marketing.
- Shipping.

## 3. Semi-Variable Overhead Costs

As their name implies, these expenses are a hybrid of the other two varieties. Semi-variable overhead costs change slightly based on business activity.

Examples include:

- Most major utilities.
- Fuel, repairs, and maintenance for vehicles.
- Sales commissions.
- Hourly wages.

## Calculating Overhead Costs

Generally speaking, the lower you can keep your overhead costs, the stronger your bottom line and profitability will be. And once you've identified the expenses generating overhead within your business, you can use a simple formula to calculate their impact.

Simply divide your monthly sales by your total indirect costs for the same period, multiply by 100, and *voila:*

**(Overhead ÷ Sales) x 100 = % Overhead**

So, if your small business generated $15,000 in sales last month, and had $3,000 in indirect costs:

**(3,000 ÷ 15,000) x 100 = 20% Overhead**

The more you can trim the overhead percentage, the more of your sales can be transformed into a more desirable profit margin.

# Best Practices for Effectively Reducing Overhead Costs

Small business owners have been searching for ways to reduce costs since the first enterprising soul hung out their shingle. Today, you can combine digital tools with the right processes to achieve substantial cost savings along with ancillary benefits such as greater efficiency, more strategic decision-making, and better risk management.

1. **Embrace the Power of Digital Transformation.** Cost-cutting requires visibility into, and control over, all your spend. In the past, that meant combing through forests of paper records and engaging multiple teams,

along with management and the C-suite, to try to get a grip on what was essentially a well-greased moving target.

The target hasn't gotten any less slippery with age; if anything, tracking spend data in a world where buyers have a veritable smorgasbord of purchasing options that may or may not be visible to procurement has made it even more difficult to track indirect costs.

Fortunately, choosing a powerful software solution like PLANERGY can help. With its advanced data management, analysis, and process automation tools, you can collect, organize, and analyze spend data with ease. In addition, you can:

- Go paperless, improving your environmental footprint and eliminating the costs that come with creating, storing, using, and protecting paper documents.
- Create a closed buying environment that automatically matches buyers with the vendor who has the best terms, pricing, and support for the goods and services they need.
- Use that same closed buying environment to eliminate rogue spend and invoice fraud by including credit card purchases and other formerly "invisible" spend in your datastream.
- Automate and streamline your entire procure-to-pay (P2P) process, improving overall efficiency, eliminating human error (and its associated expense), and creating value by freeing your team to pursue strategic tasks rather than data entry and correcting exceptions.
- Give stakeholders on-demand, real-time access to spend data they can use to create accurate and complete forecasts, budgets, and reports.
- Identify and pursue opportunities to tighten up your bookkeeping *and* your internal controls to adjust spend across business units through improved communication and collaboration.
- Support your strategic sourcing strategy through analysis of your entire supply chain to create a lean, agile, and resilient vendor list that's strong

against disruptions and needless risk exposure but still flexible enough to protect business continuity when disruptions like global conflict, pandemics (e.g., COVID-19) or natural disasters strike.

2. **Reconsider Your Brick and Mortar Priorities.** With the global economy dividing its opportunities between cyberspace and the physical world, it's a good time to revisit your needs with regard to physical office space. Indeed, in the wake of the coronavirus pandemic, the new normal has made it both possible and profitable for companies to embrace remote workers as a way to keep doing business during shutdowns and self-isolation, provide greater flexibility to their team, *and* handily reduce their overhead by reducing or eliminating their need for commercial space and its associated rent, utility, insurance, and supply costs.
3. **Optimize Your Hiring and Existing Staff.** Wages represent a significant overhead for most businesses—in the US, for example, they account for 70% of overhead costs and represent a strong opportunity to cut costs. Trimming your rolls through downsizing is of course an option where viable, but you can create value as well as savings by adjusting your hiring procedures to ensure your team has a diverse skill set and the versatility to take on different roles. This can allow you to cover all the necessary functions within your business without having high labor overhead or creating an unduly stressful environment for your teams.You can also outsource tasks that don't require a full-time employee (or their wages). As with any other supplier, it pays in the long run to carefully evaluate labor providers and develop strong, strategic relationships that meet your business needs while keeping risk and expense to a minimum.
4. **Leverage Environmental Responsibility.** Choosing to go paperless with a procurement software solution is just one way to prioritize environmental responsibility while enhancing profitability. Practicing sustainable procurement can radically amplify the savings and value

produced by your supply chain.In addition, investing in green alternatives to common items like light bulbs, power strips, and paper products, as well as developing and adopting responsible energy usage protocols, can directly affect your bottom line in the long-term and provide powerful reputational benefits as well.

5. **Get Social with Brand Ambassadors.** Marketing can cost a pretty penny, especially in a world where the average advert needs to be seen seven times to make a dent in the viewer's mindscape and entire industries have sprung up around parsing the fine differences between impressions and reach. But if your customers use social media (and chances are, they do), you may have an opportunity to create some low-cost (or even free) advertising for your goods and services by transforming customers into *brand ambassadors*. Buck up your social media game, engage with your audience, and offer incentives (e.g. discounts, bonuses, free items, contests, etc.) in exchange for testimonials, shout-outs, and shares.
6. **Practice Proactive Contract Management.** When you're tracking spend data along with vendor performance and compliance, you have a rich supply of information you can bring to the negotiation table. Take the opportunity to revisit your existing contracts and look for ways to renegotiate pricing and terms with your best vendors, eliminate or replace underperforming or overpriced ones, and pursue new opportunities to add resilience to your supply chain as your business needs evolve.

## Trim Overhead Costs and Help Your

# Business Come Out Ahead

Nobody likes wasting money—or missing out on potential profits. Keeping overhead costs low with help from a few best practices and the right digital tools can help your business grow its bottom line, free up cash flow, and achieve the flexibility and resilience it needs to compete, grow, and create lasting value in today's market.

# What's your goal today?

## 1. Use PLANERGY to manage purchasing and accounts payable

We've helped save billions of dollars for our clients through better spend management, process automation in purchasing and finance, and reducing financial risks. To discover how we can help grow your business:

- Read our case studies, client success stories, and testimonials.
- Visit our "Solutions" page to see the areas of your business we can help improve to see if we're a good fit for each other.
- Learn about us, and our long history of helping companies just like yours.

Book a Live Demo

## 2. Download our guide "Preparing Your AP Department For The Future"

Download a free copy of our guide to future proofing your accounts payable department. You'll also be subscribed to our email newsletter and notified about new articles or if have something interesting to share.

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