

The Art of Control

Manage Overhead for Maximum Profits

IN A GROWING BUSINESS, OVERHEAD CAN become a monster. All too often, a tidal wave of rent, salaries, and administrative costs washes away the start-up company.

To begin controlling overhead, learn to define it clearly, insists Brian Forst, a Virginia-based consultant and author of *Power in Numbers: How to Manage for Profit*. He compares your income statement — where the components of overhead are clearly detailed — to an airplane's instrument panel. Not only must the instruments be functioning, they must measure the right thing. Knowing what counts as overhead gives you the power to manage costs.

Overhead is defined as a business's *fixed costs* — it includes the expenses you incur whether you sell anything or not. They are usually listed under the "general and administrative costs" category of the income statement. Small businesses often combine such items as advertising and selling

costs, rent, executive salaries, utilities, accounting and legal fees, and depreciation.

To make sure you're monitoring overhead adequately, apply the following test to your monthly or quarterly income statement, Forst recommends. First, make sure the chart of accounts listing fixed expenses is detailed enough to give you a true picture of company spending. Most industry associations have developed a standard chart of accounts, which will help you make sure you're on track. Forst's rule of thumb: Any account that contains more than 5 percent of costs ought to be broken out on its own line. Next, determine whether expenses allocated to overhead really belong elsewhere.

Salaries for corporate positions are fixed. You'll pay that bookkeeper whether you crank out one or one million units. Workers on your production line, on the other hand, are a variable

expense. Often, though, growing firms don't make the distinction.

The warning signs of runaway overhead: Watch your income statement for operating expenses that grow faster than gross profit. For businesses that are downsizing, the danger zone occurs when cost-reduction measures reduce sales, consequently pinching profits.

Rx FOR EXPENSES

Here are a variety of remedies that work even for America's largest corporations. But for small firms, these are words to live by.

■ *Make your commitments short term.* Kal Wenig, a partner in Arthur Andersen & Co.'s Enterprise Group, Chicago, tells a story of a client — an infant in the software business. The founder got a five-year lease on some excellent office space, which included a year's free rent. It was too good to refuse. The start-up ran behind schedule, but they had to honor the lease. "They went out of business," Wenig says.

■ *Build your strengths in all-important marketing; avoid manufacturing, at least in the beginning.* It's easy for entrepreneurs to convince themselves that in order to control quality and quantity, they need to make their own products. But think again. "There's a lot of excess manufacturing capacity," Wenig says. "Let the other guy make the profit on manufacturing. Concentrate on establishing your products and marketplaces."

■ *Cut staff.* Nobody likes firing staff, but laying off nonproduction personnel is perhaps the best move you can make. Those include people in personnel and accounting, corporate officers, and directors — any employee you can eliminate without sacrificing production or sales. Consider hiring part-time or temporary employees. Investigate staff-leasing possibilities.

■ *Defer executive compensation.* This tactic allows you to motivate key executives while postponing the payout, says Gary Keefe, national director of middle market practice for KPMG Peat Marwick, a Big Eight accounting firm.

Finally, Forst cautions, concentrate on the biggest problems. If you're paying too much for your corporate computer system, you will only antagonize your employees by haranguing them about personal use of the copier. Communicate the problems clearly to staff. Enlist their suggestions, so they can help you grow more profitably. ■



OVERHEAD
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AS A BUSINESS'S
FIXED COSTS —
THOSE NOT TIED
TO PRODUCTION.

Senior editor Sarah Stiansen writes about entrepreneurial management, marketing, and financial topics.



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