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Cost Control for Small and Medium-sized Enterprises (SMEs)

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ABSTRACT

Cost control is the key competition factors for enterprises to succeed, and is also among the significant difficulties facing many SMEs. This paper, starting from analysis of the problems of cost control facing SMEs, divides cost of SMEs into four parts and then analyzes them in details; by using break-even model, it finds the four factors affecting business costs: productivity, staff control, personnel consumption and material consumption, which are also four important strategies for corporate cost control.

Key words: SMEs; Cost Control; Finance

INTRODUCTION

Although the individual strength of SMEs is small, their huge amount has a pivotal influence on China's economy. Governments at all levels have attached great importance to the development of SMEs, but due to increasing labor costs, rising prices, China's SMEs face growing competitive pressures, and sink into the mire of high costs. For example, a research conducted by Zhu Changhui (2008) on the cost of Wenzhou SMEs found most of SMEs have problems of cost management [1].When Yu Junqiu (2012) Investigated the management of SMEs in Wuhai, he found cost management was the key business issues to most enterprises. [2]Therefore, to win in a competitive marketplace, SMEs must rely on innovative and improved cost control and management, explore in-depth potentials to reduce business costs, and establish cost control system. Cost control has been the focus of academic research, and related researches for SMEs are large in quantity. Zhang Shuying (2012) believes, regarding cost management, SMEs should focus on two issues: first, to identify the concepts of cost management, which determines the position of cost management throughout the enterprise management; second, to establish cost management methods, which decides the role of cost management in the enterprise. [3]Jiang Yinhua (2009) considers SMEs should center upon the establishment of cost-effectiveness thinking and cost control system. [4]This paper, starting from the analysis of the problems of cost control facing SMEs, analyzes the reasons for the high cost, builds a break-even model suitable for SMEs and proposes appropriate countermeasures based on the problems and model.

PROBLEM ANALYSIS OF SMES' COST CONTROL

2.1 Obsolete Methods and Concepts, Poor Cost Control Results

Founders of many SMEs are with low-education level, so they are limited in knowledge and generally start the enterprise relying on past experience, previous customers and technology. Their limited enterprise management capabilities, and poor self-learning confined by knowledge, together with the continuous development of enterprises, and the changing social environment have turned their past experiences and methods into outdated ones. There are some other factors or reasons, which account for the phenomena that enterprise management methods cannot be upgraded at any time and management philosophy is unable to meet the real needs of the enterprise. There are also cases that the business is built in the phase of development, but with constantly changing economic environment, their problems get exposed once the economic environment is tough. This is a problem faced by many companies, which shows that many SMEs are not prepared for danger in times of stability.

2.2. Overemphasizing Results, and Ignoring the Process of Cost Control

Although some companies are concerned about cost issues, and have repeatedly stressed the issues, they're only concerned about the cost rise or down in a particular period; they fail to investigate the sources of cost change and analyze them in details, namely, they ignore the process of cost control. In fact, cost control is through all processes of business operation, and is embodied in all aspects of production and management. Purchasing, administration and production and so on are the beginning as well as the end of the costs. For small enterprises, it is impossible to pay high fees to specialized managers as it is a waste, but it doesn't mean that costs for SMEs cannot be controlled; for them, the key is to strengthen the concept of cost minimization, reduce waste, cut back on unnecessary costs and expenses, and control costs outflow. Managers need to analyze and ponder over these details, and then keep cost control in the process of business management.

2.3 Lacking Cost Control Processes and Systems Suitable to the Enterprise

It is wrong for many SMEs to hold the concept that big business should have cost control processes and systems, and SMEs, due to limited strength, needn't invest limited manpower, material resources and money into these illusory things. Some SMEs also recognize that cost control processes and systems are important, but they only indiscriminately imitate, and fail to develop cost management processes in accordance with their own practical situation, which is also a wrong practice. For SMEs, although they cannot have as standardized cost control processes and systems as big companies, it's necessary for them to set up a simplified and suitable control flow. In the face of fierce competition, SMEs are clearly at a disadvantage, so cost control is critical to win the competition. Many managers believe that they only need to pay attention to the cost issue, and do not have to spend time specifically formulating cost control processes. But in fact, general attention is temporary, and only procedural and systematic things can be executed for a long time by corporate managers at all levels. And the cost control flow is to be carried out for a long term instead of a short one, which is also very necessary for simplifying the management.

2.4 Leaders Lack Consistent Cost management

This is a common problem with managers. Many companies, only when they are caught in problems, dilemmas, or serious cost issues, will care about their cost management; otherwise, they will only concern the company's marketing and production. Although each business manager knows the importance of cost control, but they fail to pass on this idea to the entire enterprise; instead of consistently implementing the important initiative, they just carry out intermittently and give attention occasionally. It not only mirrors the lack of cost control processes and systems, but also the many managers' maladies, which is a lack of continuity in implementation.

2.5 Serious Decision Failure, Exorbitant Marketing Expense

This is also an important aspect of cost control. Many SMEs make immature decisions, resulting in a high cost when they fail. This depends on whether SMEs on mature in decision-making and cost management. Decision failures, including failures in product development and market selection, improper use of funds or loss of opportunities caused by decision delays, will indirectly enhance corporate expenses. Essentially, any decisions failures made by managers will ultimately be absorbed by the company. Marketing costs are also a problem facing many companies. For SMEs, corporate orders and sales are their life, and are vulnerable to environmental changes; so many companies attach great importance to marketing channels. In order to promote the marketing, SMEs are used to spend high cost participating various marketing activities, such as promotion events, but due to their neglect of product quality and development, they sometimes get into an awkward position where marketing is overemphasized but quality is neglected, so their products cannot satisfy market needs, and finally they have to cut prices, profit margins to a degree of losses.

CONSTRUCTION AND ANALYSIS OF SHORT-TERM BREAK-EVEN MODEL FOR COST CONTROL OF SMES

3.1 Construction of Short-term Break-even Model

SMEs' cost control cannot be too complicated, otherwise the process itself will imposed high costs on them. In order to simplify SMEs' cost control, this article divides it into the following sections: administrative costs, production costs and marketing costs and stability cost. Production costs include wages, benefits and other costs of workshop staff, costs of raw materials and variable costs changing in proportion to production. Stability cost refers to the cost of the workshop and machinery and so on, and it will not change in proportion to production. Marketing costs are the costs incurred by sales department. Management costs means all costs except the three costs introduced above.

Assuming that we observe sales volume Q, management costs G (Q), production costs S (Q), marketing costs Y (Q), stability costs A. Figure 1 shows the trend of costs fluctuations in one month, namely an accounting period .For SMEs, in the short run, the stability cost will not change, that's to say it will not change with the production as we can see from the figure the cost trend is a horizontal line. Assuming no unexpected situations, the wages and welfares of workshop staff will not change much in the short term, and what can change is the number of personnel. Therefore, production cost depends on the material costs. Marketing cost varies in direct proportion to production, which means the higher the yield, the more it costs. Management cost also varies with yield; at the very start the costs rise faster, but the changing space will be slower, and will increase rapidly when the yield arrives at a certain amount. Figure 1 only represents a potential trend, which reflects the possible relation of the model. Therefore, the total cost of corporate production is equal to: C*=G（Q）+S（Q）+Y（Q）+A. Unit product cost is equal to: C*=【G（Q）+S（Q）+Y（Q）+A】/Q. So the short-term break-even model is:

M=PQ-【G（Q）+S（Q）+Y（Q）+A】 (1)
M/Q=Q-【G（Q）+S（Q）+Y（Q）+A】/Q (2)

The four costs mentioned above indicate that companies can't control stability costs, but can manage administrative cost, production costs and marketing costs. Production cost is in fact related to productivity and production efficiency. Administrative cost is related to management efficiency and management effects, and its existence is for the purpose of production. Marketing cost is the cost to guarantee implementation, and also an important controllable cost.

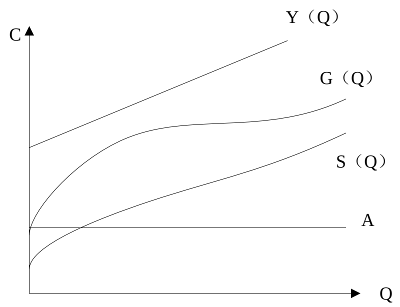

图1 成本趋势图

Fig. 1: The cost trend

3.2 Model Analysis

Though it is a theoretical model, it can reflect main points of SMEs' cost control. The following aspects can be seen from the model. First, production cost is related to productivity and material utilization, so companies can start with the two aspects since production cost is an important part of the product cost. Second, although stability cost is fixed costs, cost of each individual product is reduced with the rising production, which is one of the advantages of large-scale production. Third, management costs are variable and its efficiency and quality plays a key role in costs; it consists of two parts: personnel cost and personnel consumption cost (each employee will consume certain things, such as computers, electricity, and paper and so on).Personnel cost is firstly affected by efficiency, for example, a 200-person company can have 20 managers, or 21, whose difference is one more personnel cost. This is the cost of management efficiency. That is to say, for an enterprise, it's not that the more the management staff the better or the less the better and the optimum is that they keep personnel costs to the extent when management efficiency is the highest. Personnel costs also include the cost of management quality, which means that companies more or less will come across issues of management quality; management quality affects operational efficiency, that's to say, when three-worker's workload is appointed to two, three or four people, quality issues are likely to arise. To control management cost, SMEs need to choose the most appropriate people and number. Meanwhile, management costs also involve costs consumed by managers, namely, other expenses of their work, including travelling and living expenses of procurement staff and so on. Fourth, marketing cost is an important variable cost, and can also be divided into personnel costs and personnel consumption costs. In fact, it is similar to management cost.

COST CONTROL STRATEGY FOR SMES

Based on the above analysis, we can see that, besides strengthening cost control concept and establishing cost control processes and systems, SMEs should pay attention to continuity and consistency of cost controls, the correctness and effectiveness of decision-making, and should also be concerned about the four factors: productivity, control of staff number, personnel consumption and material utilization, which are also the four factors that affect costs. At the same time, to strengthen cost control, SMEs can also start from the following aspects:

First, to increase productivity and reduce production costs is the first cost control strategy. Productivity reflects the important aspect of production costs. When productivity is high and labor cost is definite, the labor cost of product per unit is low. In general, many companies are concerned about this issue, and are regard it as a core part of production management.

Second, increase efficiency. The second way to control cost is to limit the number of workers. Actually, productivity is one aspect to control workers. That is to say, in order to produce a certain yield, an enterprise of high productivity need fewer workers, vice versa. It also applied to management and sales costs. An important strategy to control enterprise cost is to improve management efficiency and sales quality at a given production and productivity, with the same workers numbers and management and sales requirement. For the same management affair, the personnel cost will be reduced if the management efficiency is improved. For the same production, the required personnel cost will be lower if the sales quality, the performance of each salesman, is improved.

Third, to control personnel spending is the third strategy. Any corporate employees will consume a certain substances, and companies need to control the quantity of consumed materials, which is an important aspect of cost control. To control personnel consumption, such as office supplies, needs to reduce personnel expenditures. For example, if companies control expenses of sales staff, their cost will be reduced.

Fourth, to conserve and improve material utilization efficiency is the fourth strategy. To control personnel spending calls for improving material utilization. As personnel consume material, their high consumption relates to low material utilization. Take raw materials for example, if we make efficient use of raw materials, we can get one more product with those materials. Take personnel's pen for another example, they can be used for several months or years if an efficient use is made, but might be missing or broken in a few weeks if not.

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