Protecting profit in a higher cost economy

A practical guide for business owners facing rising employment costs, inflation and increasing commercial pressures.

Prepared by :

building better together.

200 group

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Introduction

Many business owners feel as though they are working harder than ever whilst seeing less reward for their efforts. Turnover may still be growing. Order books may still be healthy. Yet profitability is under pressure, cash reserves are tighter and decisions feel much harder.

The challenge facing UK businesses today is not a lack of demand, it's the cumulative impact of rising costs.

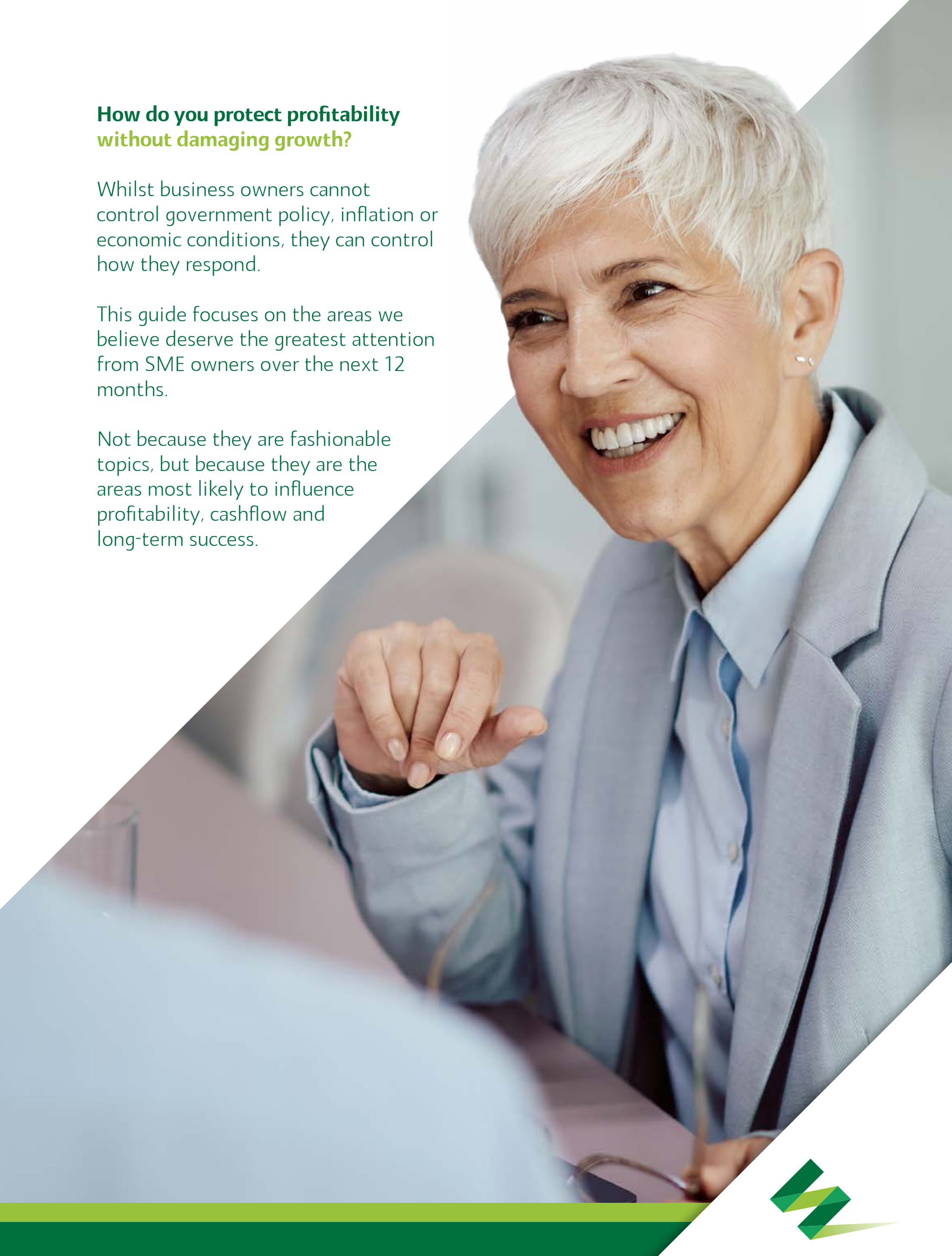
Employer National Insurance increases, National Living Wage rises, higher energy costs, supplier price increases, inflation and ongoing recruitment pressures are all placing additional strain on businesses of every size. These pressures affect different sectors in different ways, but they all raise the same question.

How do you protect profitability without damaging growth?

Whilst business owners cannot control government policy, inflation or economic conditions, they can control how they respond.

This guide focuses on the areas we believe deserve the greatest attention from SME owners over the next 12 months.

Not because they are fashionable topics, but because they are the areas most likely to influence profitability, cashflow and long-term success.



Understanding the true cost of employment

For many businesses, people are both the greatest asset and the largest cost.

Recent increases to Employer National Insurance and National Living Wage rates have increased the cost of employing people across the board. For some businesses, these changes have added tens of thousands of pounds to annual operating costs without generating a single pound of additional revenue.

The natural reaction is often to focus on headcount. In reality, the better question is whether your workforce structure remains fit for purpose.

Many businesses have evolved organically over time. Roles have expanded, responsibilities have shifted and processes have become more complex.

Periods of rising employment costs provide an opportunity to step back and ask some important questions.

- Do you know the true cost of every employee?
- Are highly skilled team members spending time on low-value activities?
- Could technology remove repetitive administration?
- Are managers spending enough time leading people and improving performance?

The businesses that respond best to rising employment costs are rarely those that cut deepest. They are often those that improve productivity, remove inefficiencies and ensure people are focused on the activities that generate the greatest value.

Points to consider

- Review the full cost of employment, not just salaries.
- Assess productivity across departments.
- Identify repetitive tasks
- Review workforce planning for the next 12 months.
- Consider succession planning for key roles.

Profit matters more than turnover

Many businesses continue to judge success by revenue growth.

Unfortunately, revenue alone pays very few bills. A business can increase sales every year and still become less profitable. Rising costs expose this problem quickly.

Businesses often discover that some customers are highly profitable whilst others consume significant amounts of time and resource for relatively little return.

Equally, some products and services may have remained unchanged for years despite substantial increases in delivery costs.

This is where business owners need to be willing to challenge long-held assumptions.

- Not every customer relationship is equally valuable.
- Not every service remains commercially viable.
- Not every pricing structure still works.

Businesses that regularly review profitability at a detailed level are generally better equipped to make informed decisions about pricing, resource allocation and future investment.

Points to consider

- Review customer profitability.
- Review service and product profitability.
- Assess whether pricing reflects current costs.
- Identify low-margin activities.
- Evaluate where time is being spent within the business.

Cash remains king

Many profitable businesses fail because they run out of cash. This is in fact, one of the most common challenges facing growing SMEs. As costs increase, cash requirements increase with them. Larger payrolls, higher tax liabilities and increased supplier costs all create additional pressure on working capital. The issue is often made worse when customers take longer to pay.

Business owners should therefore place greater emphasis on cashflow forecasting than ever before. The purpose of forecasting is not to predict the future perfectly but to provide visibility. Good forecasts allow business owners to identify challenges early and make decisions whilst options remain available. Poor forecasts result in reactive decision-making and unnecessary pressure.

Points to consider

- Maintain a rolling cashflow forecast.
- Monitor debtor days regularly.
- Review stock levels and working capital.
- Assess future funding requirements before they become urgent.
- Review tax liabilities well in advance of payment deadlines.

Making tax working harder

In difficult economic conditions, tax planning should not be viewed as an annual exercise. It should form part of ongoing business planning. Many business owners are focused on reducing costs whilst overlooking legitimate reliefs and planning opportunities that could improve cashflow and support future growth.

The tax system continues to provide incentives for investment, innovation and long-term planning. However, these opportunities are only valuable if they are understood and utilised. The right approach will vary depending on the business, ownership structure and future objectives. Take a look at the areas worth reviewing ...

Areas worth reviewing

- **Capital investment**
  If investment in equipment, machinery or technology is already planned, review available capital allowance opportunities.

- **Pension planning**
  Employer pension contributions remain an effective way of extracting value from a business whilst planning for the future.

- **Research and development reliefs**
  Many innovative businesses continue to overlook qualifying activity.

- **Business structure**
  Ownership structures should be reviewed periodically to ensure they remain appropriate for growth, succession and tax efficiency. The objective should never be to make decisions solely for tax reasons. The objective should be to ensure commercial decisions are supported by effective tax planning.

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Preparing for making tax digital

Many business owners continue to view Making Tax Digital as a future problem. The reality is that businesses preparing early are likely to gain benefits beyond compliance.

The move towards more frequent reporting requires better record keeping, improved visibility and stronger financial processes.

Businesses that embrace digital systems often gain access to more timely management information, better forecasting and improved decision-making. The question is no longer whether businesses will need to adapt, it is whether they choose to do so proactively or under pressure.

Points to consider

- Review bookkeeping processes.
- Ensure records are maintained regularly.
- Assess whether software remains fit for purpose.
- Separate business and personal finances where appropriate.
- Improve management reporting.

Reviewing commercial agreements

Many businesses are operating under agreements drafted in a very different economic environment.

Terms that appeared reasonable several years ago may now create unnecessary risk.

Supplier contracts, customer agreements, employment contracts and shareholder arrangements should all be reviewed periodically. In particular, businesses should understand whether agreements provide sufficient flexibility to respond to rising costs.

- Can prices be reviewed?
- Are payment terms appropriate?
- Do contracts adequately protect the business?
- Do employment contracts reflect current working practices?

The answer is often unknown until a problem arises. That is usually too late.

Points to consider

- Review customer contracts.
- Review supplier agreements.
- Assess pricing and variation clauses.
- Review employment contracts.
- Review shareholder and partnership arrangements.

Investing in productivity

Many business owners hear the word investment and immediately think of expenditure. The two are not always the same thing.

The right investment should create capacity, improve efficiency or increase profitability.

Technology continues to provide opportunities for SMEs to improve productivity without increasing headcount. The challenge is ensuring investment is targeted at genuine business needs rather than the latest trend.

The most successful businesses are not necessarily spending more, they are often spending more effectively.

Points to consider

- Identify repetitive processes.
- Review opportunities for automation.
- Improve management information.
- Reduce unnecessary administration.
- Focus investment on measurable outcomes.

Final thoughts

Economic conditions will continue to change, costs will continue to rise and fall and markets will evolve. What remains consistent however, is the importance of understanding the fundamentals of a business.

Profit | cash | people | customers

The businesses that perform strongest over time are rarely those chasing every opportunity or reacting to every headline. They are usually the businesses that understand their numbers, make informed decisions and remain focused on the areas they can control.

The coming years will undoubtedly present challenges and opportunities. Those opportunities are most likely to be found by businesses that review, refine and strengthen their operations before pressure forces them to do so.

wakesmith
solicitors

No1 Velocity
2 Tenter Street
Sheffield, S1 4BY

T: 0114 266 6660
F: 0114 267 1253

www.wake-smith.co.uk