

momentum >>>



LOOK AT THINGS DIFFERENTLY



➤ **HOW TO:**

**REDUCE YOUR
FLEET COSTS**



HOW TO: REDUCE YOUR FLEET COSTS

This is a short guide aimed at companies with small to medium sized fleets. It is intended to provide easy to understand and practical advice to managers and directors who have a stake in their company vehicle fleet.





SIGNIFICANT COSTS

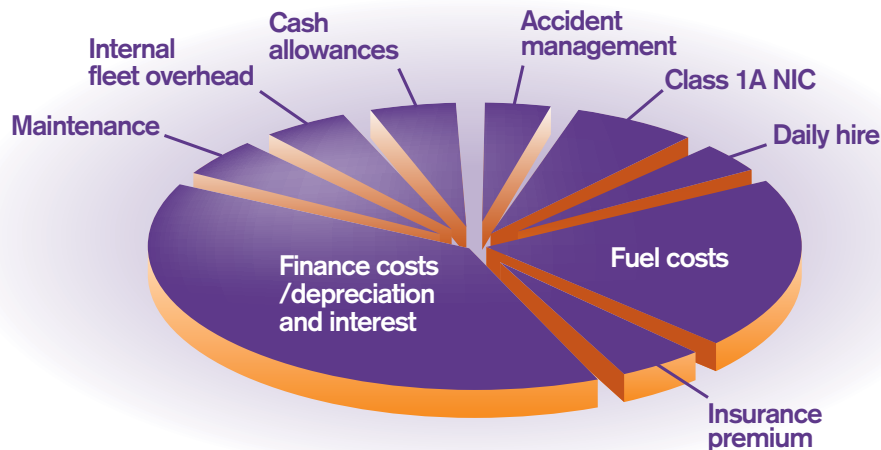
Company car and van fleets are often non-core areas of organisational activity. They support the business and therefore reducing fleet costs may not necessarily be a key focus for directors and senior management.

However, the costs associated with fleet can often be a significant part of the company profit and loss statement, especially in organisations within support services, construction, telecommunications and technology.

An example of the components which make up fleet costs is shown in the chart below. (Note: the relative cost percentage is likely to vary between different organisations – for example, some may have a higher proportion of cash takers, or provide employees with private fuel, which will correspondingly increase these segments relative to other cost categories.)

Typically, annual fleet costs represent £5,000 – £10,000 per vehicle (pre-tax) when all these elements are taken into account. The actual cost will also be significantly impacted by car policy, for example, whether private fuel is paid, and whether there is a generous level of car or cash allowance offered to senior employees.

There are six main areas to focus on when looking to reduce fleet costs, reviewed overleaf.





SIX MAIN AREAS FOR REDUCING FLEET COSTS

1. Fleet funding

You should initially focus on whether you are funding your fleet by the most cost efficient method.

If your internal rate of return (IRR) for investment decision making is around 6% or greater then it would make financial sense to run some discounted cashflows to assess the most appropriate approach, taking into account your VAT recovery and effective corporation tax rates. Most of the time, spreading the cash flows over the vehicle term can be financially beneficial, allowing more efficient use of capital for core investment projects. Funding products such as contract hire or contract purchase provide an even spread of monthly repayments, whereas outright purchase can require a high initial capital outlay.

The choice of funding product can also result in further savings – for example, if you have a van fleet, it may be worthwhile, depending upon your VAT recovery position, to acquire these vehicles via contract purchase, as you can recover input VAT up front on the acquisition cost.

If you have expensive cars (with a tax list price greater than £12,000) funded via contract hire, there are currently potential corporation tax savings depending upon how you calculate Expensive Car Leasing Disallowance (ECLD). Most organisations will use the tax list price, whereas it is permissible to use the actual purchase price – which can be a significantly lower value – and result in a smaller proportion of the finance lease rental being disallowed for tax purposes. However, the rules are due to change – from April 2009, the calculation of ECLD will be based on an emissions orientated approach, with a 15% tax restriction applicable to cars with CO₂ emissions greater than 160g/km, but the restriction will not apply to cars with emissions of 160g/km or less.

Organisations should consider reviewing their fleet mix and car policy to make sure they are aligned to the new tax rules.

You may also wish to think about your short-term versus medium-term funding needs. If your business is seasonal, it might be appropriate to fund your core fleet by contract hire or contract purchase, whilst funding the seasonal element via a shorter term product, such as Minilease, or Daily Rental (for ad hoc requirements).

› **Selecting the most appropriate funding method for your business can achieve cashflow benefits and reduce your finance costs. Lex can support you in this financial evaluation.**

2. Manufacturer discounts

Savings can be made by reducing car and van vehicle choices down to either dual or sole badge.

Manufacturers will often offer extra discounts on vehicles purchased if you choose to limit your selection to their vehicles alone. The leasing company can apply these discounts to the purchase of the vehicles which may have a significant impact on reducing your lease costs. If your company cars are funded via contract hire, any reduction in the lease rental will also result in a reduction in the amount of disallowed VAT you incur, and may potentially reduce the amount of Expensive Car Leasing Disallowance applied to your corporation tax computation.

However, care needs to be taken not to apply a restrictive vehicle choice policy across your entire company car fleet, without considering the impact on driver morale. Reducing choice to a small number of manufacturers can have a negative impact as flexibility of vehicle choice is commonly ranked by employees as one of the most important elements



a company car policy should have. You may wish to think through the reasons why you have a company car fleet and whether the purpose is the same for the whole driver population – restrictive choice may work well for job need employees, but not for status or perk users.

› **A first step would be to enter into dialogue with vehicle manufacturers about the level of discount they are willing to provide, dependent upon the level of exclusivity you want to give them. You should then link this back to your review of policy, thinking about the impact of vehicle choice restriction on the perceived value of the car scheme by your driver population.**

3. Car policy

Reviewing your current car policy can lead to a number of opportunities for potential cost saving.

However, the impact of proposed policy changes on the perception of the value of the car scheme to drivers needs to be carefully thought through. Notwithstanding this, a potential area for cost saving is to consider extending the contract period to take advantage of potentially lower average annual contract rentals from a longer period of hire – the saving in lower depreciation charges is likely to outweigh increases in maintenance charges. Many organisations run their vehicle fleets over a 3 or 4 year period of hire – if you renew your vehicles every 2 or 3 years, you may want to extend this by 12 months, and drive out cost savings as a result.

Also, companies may have a stated replacement cycle of 3 or 4 years, but in practice they may allow higher mileage drivers to replace vehicles before the end of the contracted term – if they reach a mileage threshold first. This can lead to unnecessary depreciation costs. Companies should ensure that vehicles are driven to the end of the contract period, wherever possible, and mileage parameters are set at the outset based on mileage projections on a case by case basis.

A second key area of car policy, which can provide saving opportunities, is the level at which cash allowances are set. This may be driven by a percentage of average pay per employee grade, without regard to the cost to your business of an equivalent company car – sometimes this can result in the level of cash allowance being set too generously.

A sensible approach to take is to ensure that the cash allowance level is set so that it is cost neutral to the employer – i.e. whether the employee takes a company car or cash allowance, the whole life cost to the business (allowing for any variation in fuel reimbursement rates) is the same.

Companies should also look to encourage employees to trade down wherever possible to a vehicle with lower CO₂ and fuel consumption – providing an incentive via a partial cash payment of the whole life cost difference between the benchmark vehicle and the chosen vehicle can be beneficial for both employee and employer. It is important that this is properly communicated via the policy, so that employees are aware of this option.

› **Reviewing your current car policy may lead to options for change which can result in cost savings, although you should be mindful of the effect this may have on attracting and retaining employees, if the car scheme is seen as a key part of the total reward package.**

See our 'How To Review Your Car Policy' guide for more information.





4. Fuel and NIC savings

Fuel is often a significant component of fleet costs.

You may currently provide fuel cards to your drivers and provide fuel for private use. If this is the case, there is often a significant opportunity to reduce costs by removing the provision of free fuel – typically the private fuel element will cost an employer between £1,000 and £2,000 per driver per annum. Also, providing free fuel can encourage employees to drive more miles, leading to additional depreciation costs.

In many cases, the benefit in kind cost of free fuel provision to the driver will exceed the value received, even more so, given the increase in taxable benefit since April 2008. Ways to remove free fuel include:

- › A well communicated education programme to your drivers, which will encourage a significant number to opt out, creating a win/win situation for employer and employee
- › Ensuring free fuel is not offered to new starters
- › Buying out existing employees via a one-off, non-pensionable lump sum payment
- › Set a future date after which free fuel will no longer be paid

In each case, you will need to assess the motivational impact on your employees, relative to the projected savings.

Whether you offer private fuel or not, effective management of fleet CO₂ emissions can also assist you in managing fleet related cost and achieving your environmental objectives due to the improved fuel economy of lower CO₂ emitting vehicles. Additionally, lower CO₂ emissions will result in lower employer's National Insurance Contributions, due to the way the employer's NIC charge is calculated.

Fleet costs can also be dramatically reduced by the introduction of video conferencing for meetings between business sites. This simply reduces the amount of time the vehicles are actually on the road, cutting down on the number of journeys undertaken, with a favourable impact on fuel costs, and provides a good opportunity to generate favourable public relations feedback.

- › Reviewing your current fuel provision policy may lead to cost saving opportunities. Likewise, a focus on CO₂ emissions, by establishing the current fleet average and setting targets for future reduction may also result in Class 1A NIC savings.

5. Operational fleet model

Outsourcing elements of the fleet can achieve cost savings for the organisation, including better purchasing power capability, cheaper maintenance rates and better residual value performance when remarketing.

A key factor is that you can remove risk from your organisation, whether this relates to future unforeseen maintenance costs, or operational risk, resulting from the need to hire more staff if your fleet expands over time.

You should also think about your ad hoc fleet needs – whether it is worth retaining a handful of pool cars for potential business journeys – which can be expensive if they are not properly utilised – or whether utilising daily hire vehicles gives greater flexibility, as you are effectively only paying on use.

Where the fleet is associated with core activities, such as delivery vans or maintenance engineers, telematics can be used to monitor and improve utilisation. Speed limiters can also be fitted to ensure the vehicles are not driven beyond a maximum speed enabling better fuel efficiency and lower maintenance costs.

- › **The key issue to think about is what is the most appropriate operational fleet model for your business. You need to consider whether you can effectively manage the risks and costs of running a fleet internally, whilst meeting the service needs of the organisation, or whether it is more effective to outsource your fleet, and redeploy your staff in core business activities.**



6. Risk management

Minimising fleet risk can have a significant impact on costs.

Such risks might include:

- › Disposal risk
- › Accidents
- › End of contract damage
- › Downtime

Disposal risk relates to the actual value achieved on vehicle disposal – this risk can be significant for your business if you outright purchase your vehicle fleet – effectively you will be basing your budgets and forecasts on your predicted resale values, which may or may not be realised, and which could leave you exposed to unforeseen cost. The alternative is to outsource the risk by leasing your fleet through one or more of the leasing products described earlier.

Minimising the cost of accidents, end of contract damage and downtime means focusing on identifying and managing the occupational road risk which your organisation and its drivers face. Undertaking a comprehensive risk assessment to identify where the greatest risks lie in terms of individual drivers, vehicles, and journeys undertaken is not only good practice, and will ultimately lead to cost saving, (if action is taken to mitigate such risks e.g. through selective driver training), but is also a key focus of recent duty of care legislation:

- › Under the Management of Health and Safety at Work Regulations 1999, every employer is required to carry out and record a risk assessment with regard to the Health and Safety of their employees and examine how risks can be reduced. This applies to those driving on company business whether in a company car or not. Employers should consider the risks to employees on the road in the same manner as those in a workplace.

- › The Corporate Manslaughter and Homicide Act gained Royal Assent in July 2007 and became law from April 2008. The Act outlines companies' duty of care responsibilities to all employees (whether company car or private car users) when driving on company business; particularly as private cars being used for business purposes, including cash takers, have been acknowledged as high risk.

Effective and detailed risk assessments demonstrate that your organisation takes employee safety seriously and cost savings may be achieved by improving driver awareness and lowering insurance costs by demonstrating a safer fleet.

- › **The first step is to evaluate the risk environment, identifying who are your 'at risk' drivers, what risks are associated with the vehicles they drive, and the types of journey undertaken. Lex can offer advice and support in this area.**





For more information on any issues covered in this HOW TO: guide, please contact your Account Manager.

About Lex Momentum

Lex Momentum is a strategic consulting team that works with board directors and senior managers to identify how fleet can better impact key business objectives. Our consultancy covers cost reduction, policy, tax, the environment, duty of care and fleet delivery strategy. In addition to core fleet issues, we consult on related areas such as fuel and cash schemes.

Since the team was created in early 2004 we have advised over 250 companies – both clients and non-clients of Lex.

Our consultants have depth and breadth of knowledge in a range of technical areas and have prior experience in major advisory firms or industry. We combine leading edge thinking with the operational experiences that come from being part of Lex, the UK's largest fleet provider.

www.lexmomentum.co.uk

Copyright © 2008 Lex Momentum. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means or stored in any retrieval system without the prior written permission of Lex Momentum.

Whilst every effort has been made by Lex Momentum to ensure that the information given is not misleading, this material is provided only as an overview of the subject (at the time of publication) and is not a substitute for specific professional advice. No responsibility can be accepted by Lex Momentum for any loss or liability occasioned by any person acting or refraining from action as a result of the contents of this publication.

Lex
Latimer House
Anglo Office Park
White Lion Road
Amersham
HP7 9JQ

Tel 0844 335 2300
Fax 0844 335 2660

Lex
Heathside Park
Heathside Park Road
Stockport
SK3 0RB

Tel 0844 335 4000
Fax 0844 335 4400

Lex
Unit 8
Bremner House
Castle Business Park
Stirling
FK9 4TF

Tel 0844 335 8500
Fax 0844 335 8595

Lex
Charterhall House
Charterhall Drive
Chester
CH88 3AN

Tel 0845 769 7311
Fax 0845 712 3823



LOOK AT THINGS DIFFERENTLY