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Emerging Strategic Cost Management Trends for Effective Cost Management in the Present Scenario

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Abstract

Despite vast changes in business and technology over the past five decades, the traditional costing practises used by most companies today have failed to evolve. Information provided by traditional costing methods like unit costing, output costing, job costing, process costing, standard costing, marginal costing, etc., does not effectively support critical management decisions. In the present market scenario, mere cost control is not enough and a company needs to concentrate on strategically managing costs. Today, companies are facing competition not only from domestic companies but also from international companies. They need to swim against benign winds, and offering the best quality at the lowest price is a common phenomenon among the top leaders in the market. Market-driven strategies play a vital role, whereby a company should be capable of launching a product that suits the target market. Product differentiation with a view to covering various customer groups is also one of the strategies to grab the market at national and international levels. Sustainable competitive advantage is playing a significant role. The present study throws light on various emerging strategies for cost management techniques that not only help in reducing the cost but also improve the overall performance of the company and simultaneously help to offer the product at a lower price with the best quality. The researcher used secondary data for the analytical study of emerging trends in strategic cost management.

Key words: Cost, Strategic Cost Management, Techniques, and Trends

Introduction

Strategic Cost Management (SCM) plays a significant role in managing the cost of an organization in a systematic and logical manner. It is the application of cost management techniques that simultaneously improve the strategic position and reduce the cost. With this approach, costs, especially overhead costs, are analysed to a broader extent with the help of cost management techniques. It facilitates more accurate accounting data so management can take more realistic decisions. Strategic cost management is the implementation of cost management strategies to boost a company's strategic position as well as control its costs. It also deals with combining cost information with the system for decision-making to support the organizational strategy as a whole. It is not only restricted to controlling costs but also extends its scope to the use of cost information for decision-making purposes by the management.

The methods of cost management should be such that they strengthen an enterprise's strategic position apart from concentrating on cost control. The basic goal of strategic cost management is to help the company achieve a competitive advantage in a sustainable manner through product differentiation and cost leadership. Strategic cost management focuses more on continuous enhancement to provide consumers with superior quality products. Strategic cost management in India needs to be part and parcel of the value chain. This must cover all aspects of production, procurement, design, manufacturing, distribution, and operation. Thus, in the field of strategic cost management, most studies in the literature concentrate on the application of cost management instruments for the overall improvement in the performance of an organisation. Indeed, it is important to include strategic cost management at the early stages of a product development process to reduce high failure costs.

The Objectives of the Study

- To know the emerging trends and techniques in strategic cost management
- To study and provide a basic guideline to those companies who plan to undergo cost analysis as a part of strategic analysis.

Methodology

The present study is descriptive in nature and based on secondary data. The secondary data has been collected from journals, periodicals, and reference books.

Scope of the study

This study will serve as a guideline for those companies who have decided to apply cost management as a part of their strategy. It extends the discussion to cover techniques and trends in SCM that are strategically important to improve strategic positioning by improving the overall cost. This study may be followed by companies and other business or non-business organizations where cost and management accounting is in practice either as a statutory obligation or to support management decision making process.

Strategic Cost Management Concept

Strategic cost management is important to organizations because it focuses more on costs than anything else. In the successful companies of the 21st century, costs will not be the only important factor, but also value and revenue, which are considered critical factors in the success of companies. At this point, the researcher advocates that strategic cost management is a philosophy, an attitude, and a set of techniques to contribute in shaping the future of the company. (See Figure 1).

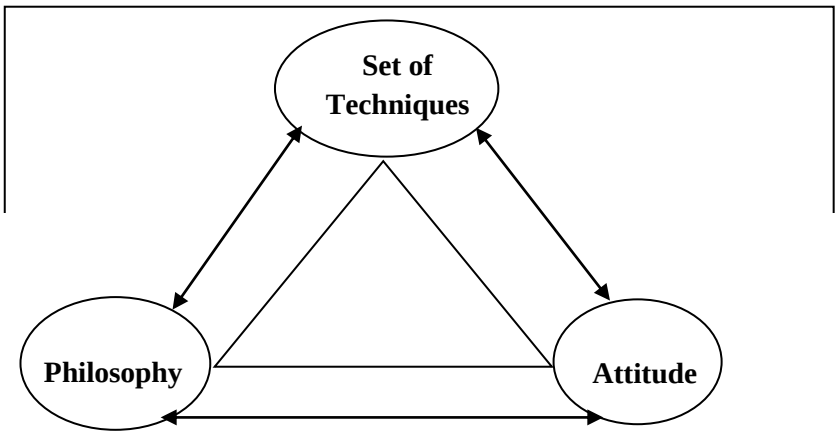


Figure 1: Strategic Cost Management Concept

Philosophy: Strategic cost management is a philosophy of improving cost and revenue; strategic cost management is not only cost management but also revenue management, therefore, it is seeking to improve productivity, maximize profit, and improve customer satisfaction. This philosophy plays a vital role in determining the future of the company because it promotes the idea of continually finding ways to help organizations make the right decisions to create more customer value at lower cost.

Attitude: Strategic cost management represents a proactive attitude that all the costs of the products and services result from management decisions within the company and with customers and suppliers.

Techniques: Strategic cost management is a set of reliable techniques. These techniques or instruments may be used individually to support a specific goal or together to serve the overall needs of the organization. A set of strategic cost-management techniques that function together to support the organization's goals and activities is called a strategic cost-management system

The Defect of Traditional Costing System

- Typically used one rate to allocate overhead to products.
- This rate was often based on direct labour cost or direct labour hours or machine hours worked.
- For job order costing, overheads cost absorption rates are normally based on direct labour cost or direct labour hours.
- For process costing, overheads cost absorption rates are normally based on machine hours worked.
- This results in over-costing or under-

Results of the defect

- Each product appeared to cost the same, as far as overhead cost is concerned.
- Products with high profit margins subsidized products with low profit margins.
- In-accurate cost accumulation led to inaccurate profit planning of products.
- A product cannot compete in the market if its cost is not accurately accumulated and reflected in costing records.

The following table makes a clear demarcation between traditional cost management and strategic cost management.

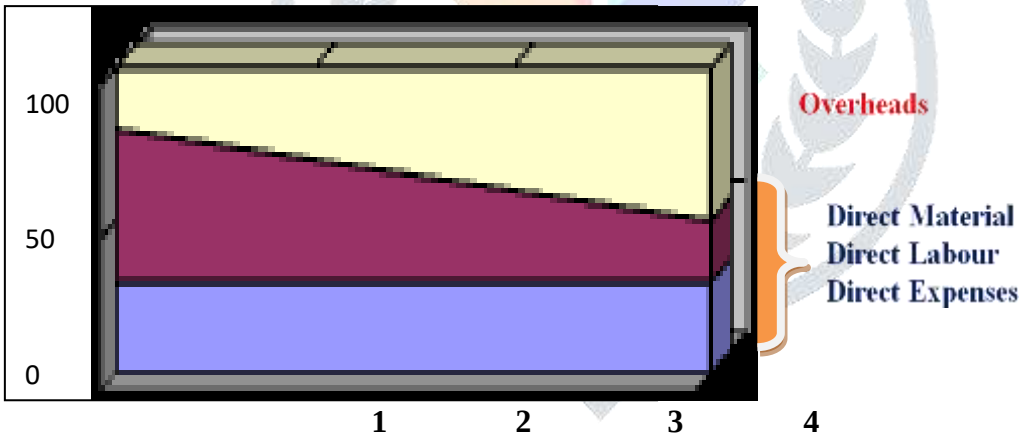
Traditional Cost Management	Strategic Cost Management
1. Cost Control & Cost Reduction	1. Cost Management
2. Reducing direct cost, Advertising cost, Marketing cost etc.	2. Increasing performance - Output increasing - Activities of no use to be stopped.
3. Focus on internal factors	3.Focus on external factors - Suppliers - Competitors strategy
4. Repair of machine when it breaks down	4. Continuous preventive maintenance
5. Focus on achieving Targets	5. Focus on Value Chain Analysis

Trends and Techniques of strategic cost management

The following trends and techniques need to be adopted by the manufacturing and service companies to overall improvement. The important techniques are;

a. **Activity Based Costing (ABC):** ABC is a cost attribution to cost units on the basis of benefit received from indirect activities.It has been developed in order to overcome the inadequacies of conventional method of overhead absorption. It is an accounting methodology that focuses on activities as the fundamental cost of a cost object rather than the products or services. It is based on two premises. Activities consume resources and products use activities.

Need for ABC



As the business grows overhead takes a larger pie in the total cost of the product and hence it is important to charge it accurately and more scientifically.

Tracing Cost to Activities

This step is to identify major activities that cause/drive overhead costs to be incurred. Some of the activities are related to production volume (such as production runs, salary of supervisors and so on) but others are not (such as inspection/handling of materials, setting up equipment and so on). The cost of resources consumed in performing these activities are grouped into cost pools.

Cost Pools & Cost Drivers

Activity Cost Pools	Activity Cost Drivers
a. Production	a) Number of units b) Number of set-ups c) Number of electricity units consumed
b. Marketing	a) Number of sales personnel b) Number of sales orders
c. Research &Development	a) Number of research projects b) Personnel hours spend on projects c) Technical complexities of the projects
d. Customer Service	a) Number of service calls b) Number of products serviced c) Hours spend on servicing products
e. Purchasing	Number of purchase orders
f. Material Handling	Number of material requisitions

When do we use ABC?

- Product lines differ in volume and manufacturing complexity.
- Product lines are numerous and diverse, and they require different degrees of support services.
- Overhead costs constitute a significant portion of total costs.
- The manufacturing process or number of products has changed significantly - for example, from labour intensive to capital intensive automation.

Limitations of ABC

1. Difficult to identify the overall activities that influence costs.
2. Not easy to select the most suitable cost drives.
3. Difficult to evaluate cost on the basis of activities.
4. Not suitable for small manufacturing concerns.

b. Activity Based management: It refers to set of actions that management can take on the basis of information provided by a ABC with a view to improve or increase the profitability.

c. Life Cycle Costing (LCC): Life Cycle Costing tracks and accumulates costs and revenues attributable to each product over the entire product life cycle. It aims at ascertaining all costs associated with the system as applied to the defined life cycle. The total cost of a system could be broken into four categories, (a) design and development cost, (b) production/manufacturing cost, (c) utilization cost, and (d) retirement and disposable cost.

Objectives of LCC

- It aims at ascertaining the total cost of a product over its life cycle.
- It identifies each element of cost of the life cycle and magnitude and timing of each element cost.
- Assists management to smartly manage total cost throughout product's life cycle.
- To identify areas in which cost reduction efforts are likely to be more effective.
- To estimate the cost impact of various designs and support options.

Advantages of LCC

- It results in earlier action to generate revenue or lower costs than otherwise might be considered.
- It provides an overall framework for considering total incremental costs over the entire span of a product.

Disadvantages of LCC

- Time consuming and Costly
- Ever changing technology
- Too many tools
- Lack of expertise and awareness

d. JUST-IN-TIME (JIT): The Just-in-Time or JIT is an inventory management system wherein the material or the products are produced and acquired just a few hours before they are put to use. The Just-in-time system is adopted by the firms, to reduce the unnecessary burden of inventory management, in case the demand is less than the inventory raised. In other words, JIT is an inventory management method whereby labour, material and goods (to be used in manufacturing) are re-filled or scheduled to arrive exactly when needed in the manufacturing process

Objectives of JIT: The philosophy of JIT is to Zero Inventory, Zero Lead Time and Zero Failure.

a. **Reduce all Non-Value-Added activities** –

   - Process steps which are not needed
   - Unnecessary movement of goods within or outside the organization
   - Re-work due to defects found in products
   - Re-checking of inventories
   - Unnecessary storage of raw materials or finished goods
   - Expensive machine or labour lying idle

b. **Elimination of in-plant inventory and in-transit inventory and**
c. **Quality and reliability improvement**.

Types and meaning of Waste under JIT

Waste	Definition
1. Overproduction	Manufacturing an item before it is needed.
2.Inappropriate Processing	Using expensive high precision equipment when simpler machines would suffice.
3. Waiting	Wasteful time incurred when product is not being moved or processed.
4. Transportation	Excessive movement and material handling of product between processes.
5. Motion	Unnecessary effort related to the ergonomics of bending, Stretching, reaching, lifting, and walking.
6. Inventory	Excess inventory hides problems on the shop floor, consumes space, increases lead times, and inhibits communication.
7. Defects	Quality defects result in rework and scrap, and add wasteful costs to the system in the form of lost capacity, rescheduling effort, increased inspection, and loss of customer good will.
8.Underutilization of Employees	Failure of the firm to learn from and capitalize on its employees' knowledge and creativity impedes long term efforts to eliminate waste.

Strategies for minimizing waste by using JIT

- Manufacturing in smaller lot sizes reduces excess inventory.
- Reducing inventory levels allows the problems to be uncovered … thus creating opportunities for manufacturing process improvement

Disadvantages of JIT

- Danger of disrupted production due to non-arrival of supplies.
- Increased ordering costs and Administrative costs.
- High dependence on suppliers.
- Less time for quality control on arrival of materials.
- Price shocks and
- May lose bulk-buying discounts.

e.(i) Cost Control: Cost Control is a process which focuses on controlling the total cost through competitive analysis. It is a practice which works to maintain the actual cost in accordance with the established norms. It ensures that the cost incurred on an operation should not go beyond the pre-determined cost. It regulates of cost of operation of an undertaking by executive action.

Steps in Cost control:

- **Establishing norms:** The first step in cost control is to set norms or standards which may serve as yardsticks for measuring performance. These standards are set on the basis of past performance adjusted for changes in future and on the basis of studies conducted.
- **Comparison with actual:** The actual costs incurred are compared with established standard costs to know the level of achievement. The variations are analysed so as to arrive at the causes which are controllable.
- **Corrective Action:** Remedial measures are taken to avoid the recurrence of variation in future and for revision of standards wherever necessary.

Main Areas of cost control:

- Materials
- Labour
- Overheads
- Sales
- Energy

Disadvantages of cost control:

- Reduces the flexibility and process improvement in a company.
- Restriction on innovation.
- Requirement of skilful personnel to set standards.

e.(ii). Cost Reduction: It aims at lowering the unit cost of a product manufactured or service rendered without affecting its quality by using new and improved methods and techniques. It ascertains substitute ways to reduce the cost of a unit. It ensures savings in per unit cost and maximisation of profits of the organisation. It is the process of identifying and eliminating unnecessary costs to improve the profitability of a business is known as cost reduction.

Key Differences between Cost Control and Cost Reduction:

Basis for Comparison	Cost Control	Cost Reduction
Meaning	A technique used for maintaining the costs as per the set standards is known as Cost Control.	A technique used to economize the unit cost without lowering the quality of the product is known as Cost Reduction.
Savings in	Total Cost	Cost Per Unit
Retention of Quality	Not Guaranteed	Guaranteed
Nature	Temporary	Permanent
Emphasis on	Past and Present Cost	Present and Future Cost
Ends when	The pre-determined target is achieved.	No end
Type of Function	Preventive	Corrective

f. Target Costing (TC): Literally achieving a target cost over the entire life cycle of a product to compete for the best price in a market. It is a customer-centric for a product from its market price. The purpose is to reduce cost of a product as low as possible to arrive at a price that would be either equal to or less than that of competitors' product while delivering the same functionality.

Objectives of TC

- Reducing cost of a product equal to that of competitors' product at design stage to enable the company top stay competitive in the market in terms of price and product features.
- TC is a market-driven costing system for developing a product that is primarily and effectively used for cost planning and controlling at allowable levels throughout the lifecycle of a product.

Features of TC

- TC is contradicts the traditional approach: It focuses on design product, determine cost and set price.
- Intense customer focus;
  – What do they want?
  - How much will they pay for it?
  - Can we make a profit on it?

Want answers to these questions before committing to the project.

- It facilitates to control cost form the beginning at all phases of the product life cycle. i.e., Design, Production, Delivery setup and customer's cost of ownership.
- 70-80% of costs are committed to at the design stage. Focus on product and process design to engineer out costs from the beginning.
- Emphasizes future sales instead of current cost savings – Service and repair and Disposal and recycling.

Applicability of TC: TC is the most effective system for planning, controlling and monitoring of cost for new products at each state of their life cycle. However, it can also be used for existing stream of products. It is very effective for new products, because 70% to 80% cost is planned and committed at design stages. If all focus is placed on cost-cutting at design stages then cost managed according to the plans efficiently and effectively.

How TC works?

- **Market Survey and Research** is conducted about the price and features (functions and characteristics) of a product that is to be benchmarked by a management.
- Preparing feasibility around **Target Price. Target Profit and Target cost.**
- The primary focus is on the product design that could match target cost. Product design is changed time to time and again to reduce cost. This process is repeated till the time target cost is achieved by a design.
    - At this stage the tools used are; Value Analysis, Value Engineering, Functional Analysis etc.
- Working out cost for each stage of a product's lifecycle. This would help in achieving overall target.
- Implementing Kaizen costing for continuous improvement in cost of a product during remaining stages of the life cycle of a product.

Limitations of TC

- It takes more time than usual to achieve a design that meets all market considerations pertaining to cost and allows a price that is acceptable in the market. The iterative process of finding target cost is more time consuming.
- Since team of cross-functional technicians is working together, it may have behavioural issues because of different working background. In traditional methods, only design department supposed to finalized the design.
- Too much cost consciousness may hamper smooth functioning between departments.
- It is relatively difficult to apply in service industries due to paucity of information and high level of specialities.

g. Business Process Reengineering (BPR): Business Process Reengineering, when fully implemented, will reduce a lot of clerical work and maintenance of records. Thus Purchasing, Material Receipts, Accounts Payable procedures and documentation will be virtually eliminated. Instead annual contracts with a few reliable suppliers to whom payments for quantities consumed in production will be made. These improvements are made possible by the rapid strides made in Information Technology. Government support and the attitude of Business Executives at the top level will determine the pace of acceptance of these recent developments.

h. Benchmarking: It is the process of studying and adopting the best practices of competing organizations to improve the firm's own performance. It serves as a corner stone for an efficient and effective operational performance.

i. Total Quality Management: TQM is a philosophy of management. It is a total commitment to continually increasing value for customers, investors, supplier, employees etc. it is commitment to fundamental improvement to work process through knowledge, skill, problem solving ability and team work.

j. Kaizen Costing: Kai means change, Zen means better. Therefore, Kaizen means making changes for the better on a continuous basis. It is a Japanese contribution to cost accounting. It is a technique of costing that focuses on continuous cost reduction to existing products and process.

k. Balanced Score Card: It is strategic tool for measuring and evaluating the performance of an organization. The performance management system is also called balanced score card. It is a comprehensive strategic planning technique. This approach advocates a top-down approach to performance management starting with strategic intent expressed through the organization down to operationally relevant targets.

Conclusion

In the current competitive era, most companies try to sell at more or less similar prices with the least profit. It is one of the market's myopias. So, to effectively live in the business world with a competitive advantage, one has to use strategic cost management. It can be considered as an updated cost analysis programme that improves the overall position of an organisation by clearly and formally placing each strategic element and

analysing cost information to achieve a sustainable competitive advantage by developing various measures. It offers a better understanding of an organization's overall cost structure to gain a competitive advantage in a market. SCM specifically governs the formulation, communication, implementation, and control stages of a strategic management process by using cost information. It also identifies the cost relationship between value chain activities and the process of management. Entrepreneurs in India should try to understand the emerging trends and techniques of SCM at an early stage and imbibe them in their organisations to attain a sustainable competitive advantage and satisfy customer needs and requirements.

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