

# Cost Management for Better & Effective Financial Management.

Presentation by  
CMA Sirish Vasant Mohite

# Cost Management for Better & Effective Financial Management.

C	Continuous			
O	<i>Observation &amp;</i>			
S	Strategically			L
T	Thinking			

# Cost Management for a better & Efficient Financial Management

Remember the Childhood 3 W's

**for igniting the Thought Process in You**

- What happened to the cost?
- When did it happen ?
- Why it happened ?

# Meaning of Cost & Change in Thought Process Required

## 1. COST -

- A Static View -Value of amount spent and accounted / recorded.
- A dynamic View - Continuous **Observation & Strategic Thinking** on it.
- Role is not determination of Cost which the Proprietor knows but managing it to improve profits.
- it is about Critical Observation on its Movement both downward and upward.

# Cost Management for Efficient Financial Management

- Understanding Organisation Management Style

(The devil is in the details)

- Manage What You Measure
  - Understanding Dashboards and Metrics
  - Reading vs. Truly Understanding Reports vs. Taking Corrective Action
- Getting the Right Advice
  - Professional Advisors
  - Board of Advisors
  - Coaches and Mentors
  - Outsourcing Services Providers

# Cost Management for Efficient Financial Management

- How do we do it –
  1. Understanding Business Process -
  2. Identifying Key factors & Control Checks for Material & Time
  3. By Interaction with the Technical & Marketing Team.
  4. Take Note of Process Norms , Business Situations , Waste Norms
  5. Refer if possible Industry Norms
  6. Methods Applying the Costing Techniques & Tools

# Cost Management for Better & Effective Financial Management.

Combination of All Techniques may be also done

:

- Marginal Costing.
- Standard Costing
- Budgeting
- Differential / Incremental Costing.

# Cost Management for Efficient Financial Management

- ROCE Tool -- for Reduction in Profit Margin & thereby Reducing Contract / Pur Price
- Differential Costing- Negotiation Tool on Contract Prices for Various Volumes.
- Reporting on Payback in terms of Return on Investment to make it catchier.
- What are the Cost Drivers – ie driving the Cost. Focus on it.



# Cost Management for Efficient Financial Management

- Cost Management should be done across all Functions depending on the quantum of cost.
- Immediate action on Cost which one can see is not worth spending / incurring and framing policies to avoid such costs.
- Sensitising Cost Awareness among all Departments by asking them to submit a note on the Thought process taken up by them for reduction in Cost .- Cost Reduction is not an area of Costing Dept. but all Departments.
- Remember you have to cut the fat and not the muscles

# Cost Management for Efficient Financial Management

- Penny-wise vs. pound foolish  
(Act with integrity and don't be short-sighted or cut corners ... it will come back to haunt you)
- Communication is critical (most vendors, lenders, etc. will work with you if you communicate early and often)
- Understanding your “pain points” and inefficiencies
- Company capitalization (debt-to-equity ratio and borrowing costs)
- Conducting “want vs. need” analysis on your current expenses

# Cost Management for Efficient Financial Management

- Today's businesses are under constant pressure to reduce costs yet many find it hard to do so in a sustainable fashion. 9 out of 10 cost reduction programs fail to achieve their targets, and the gains that are achieved appear to be short lived.
- The increasing interdependencies faced by companies - internally between functions and externally with suppliers, customers and other stakeholders - help to make the management of cost a highly complex issue that can only be addressed at a strategic level.
- Creating a cost-aware culture is the goal of most if not all of the companies the EIU surveyed, as they strive to respond to downward pressure on prices, intensifying competition, pressure from shareholders and the need to find cash to fund growth

# Cost Management for Efficient Financial Management

- **Cost strategies are failing**

1. Four out of five survey participants see an efficient cost structure as a source of long-term competitive advantage. But in practice, cost initiatives often disappoint.
2. On average companies are achieving only 59 percent of expected savings, and just eight percent of businesses reach or exceed their targets for cost saving initiatives.
3. One of the single biggest barriers to achieving these targets is the lack of adequate processes to drive cost reduction.
4. Respondents gave their companies roughly a 'C+' rating overall in cost reduction, and until business raises its game, the saving will not flow.

# Cost Management for Efficient Financial Management

- **Cost drivers are not clear or transparent**
  1. Companies need more insight into what drives cost in their business.
  2. This knowledge is vital in helping to ensure that cost cutting is targeted in the right places, and that the success of cost management initiatives is properly measured.
  3. Unfortunately, many companies do not have a clear view of what drives costs: indeed, less than half of businesses surveyed make costs and profitability of individual units transparent across their enterprise.
  4. In addition to improving efficiencies, IT has a major role to play in providing better quality information to support this goal.

# Cost Management for Efficient Financial Management

- Fixed vs. Variable Costs
- Debt-service costs
- Infrastructure and Systems Costs
- Human Capital Costs
  - Salaries
  - Benefits
  - Healthcare costs
- Advertising and Promotional Costs
- Overhead and Administrative Costs
- Research and Development Costs

\*\*\*

The type of cost you are trying to manage will dictate the strategy

# Cost Management for Efficient Financial Management

- **Revenue growth has eroded cost discipline**
- 42 percent of respondents admitted that revenue growth had led their businesses to take the eye off the ball on cost, even though two-thirds of respondents say
- that cost reduction requires extraordinary focus. One result is that companies are setting themselves low targets: the average business in the survey currently aims to reduce costs by only about two percent per annum. This research helps to show that companies must retain cost discipline during periods of growth or, in the words of one executive interviewed for this report, “it will come back to bite you
-

# Cost Management for Efficient Financial Management

- **Cost strategies are too cautious**
- Companies can too often pick the easy option for cost initiatives, rather than the one which will yield most savings.
- Improving process efficiency, by far the most popular approach to finding savings, can yield significant benefits but only if it is conducted rigorously.
- Survey respondents indicated that offshoring provided the greatest savings of a range of techniques, but this remains one of the least popular strategies.
- Of course offshoring can be painful and politically sensitive, but companies must be prepared to adopt major changes to their business model - including offshoring where applicable - in order to remain competitive.



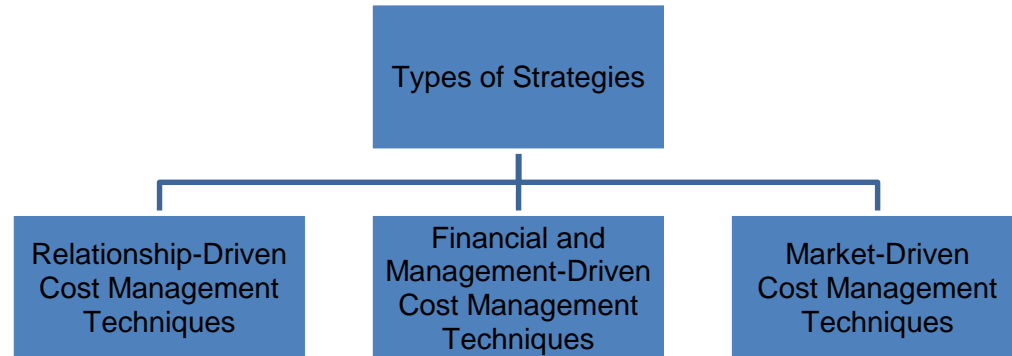
# Cost Management for Efficient Financial Management

- **Cost discipline is not embedded in the culture**
  1. It is hard to get people excited about cost management initiatives.
  2. Nevertheless, companies that achieve a sustainable competitive advantage are often those that embed cost discipline into the culture.
  3. A clear strategy and careful communication is vital to the success of any corporate project, but becomes even more so in cost cutting initiatives where employees may (quite understandably) feel threatened by change.

# Human Capital Costs

1. Employees vs. Independent Contractors  
(IRS 19 point control test)
2. Hiring the right first time and rewarding loyalty  
(significantly reduces turnover/replacement costs)
3. Outsourcing payroll processing, benefits, taxes, etc. (ex. ADP)
4. Free agent nation and part-time/special project/temporary workers
5. Telecommuting and virtual offices
6. Professional Employer Organizations (PEO's) (ex. Administaff, Oasis) can handle everything from payrolls to 401(K) account administration to hiring and firing functions (PEO's now oversee over 2.5 million workers in the U.S.)

# Cost-Management Techniques



- Managing Vendor and Customer Relationships
- Outsourcing IT applications (ex. Network Alliance), benefits, sales financial management, etc.
- Cooperatives for purchasing, advertising, etc. (including trade associations)
- Joint Ventures and strategic alliances
- Employee incentives and rewards for cost-cutting initiatives
- Bootstrapping
- Cash flow management
- Managing employee retention and turnover costs
- Budgeting, planning, forecasting
- Estimates and price quotes
- Corporate restructuring, recapitalization and reorganization
- Competitive bidding and RFP's for vendor needs
- Grassroots and guerilla sales and marketing techniques
- PR vs. Advertising Costs
- Customer referral, retention and loyalty systems (80/20 rule of costs of getting new customers)
- Barter networks

# Cost Management for Better & Effective Financial Management.

	Marginal Costing	Standard Costing & Budgeting	Identify Cost Drivers	80 20 rule / ABC Analysis	Action Points				Cost Volume Profit Relationship	Leverage Analysis
					Quantity	Price	Mix	Yield		
	Variable Cost				Material					
		Variances Analysis			Energy				Operating	
Cost Identification					Packing					
					Others				Financial	
Allocation					Sales				Combined	
Apportionment	Fixed Cost	Study Each Head								
		Salary								
		Rent								
		Insurance								
		Travelling								

# Standard Costs

**Standards are benchmarks or “norms” for measuring performance. In managerial accounting, two types of standards are commonly used.**

## **Quantity standards**

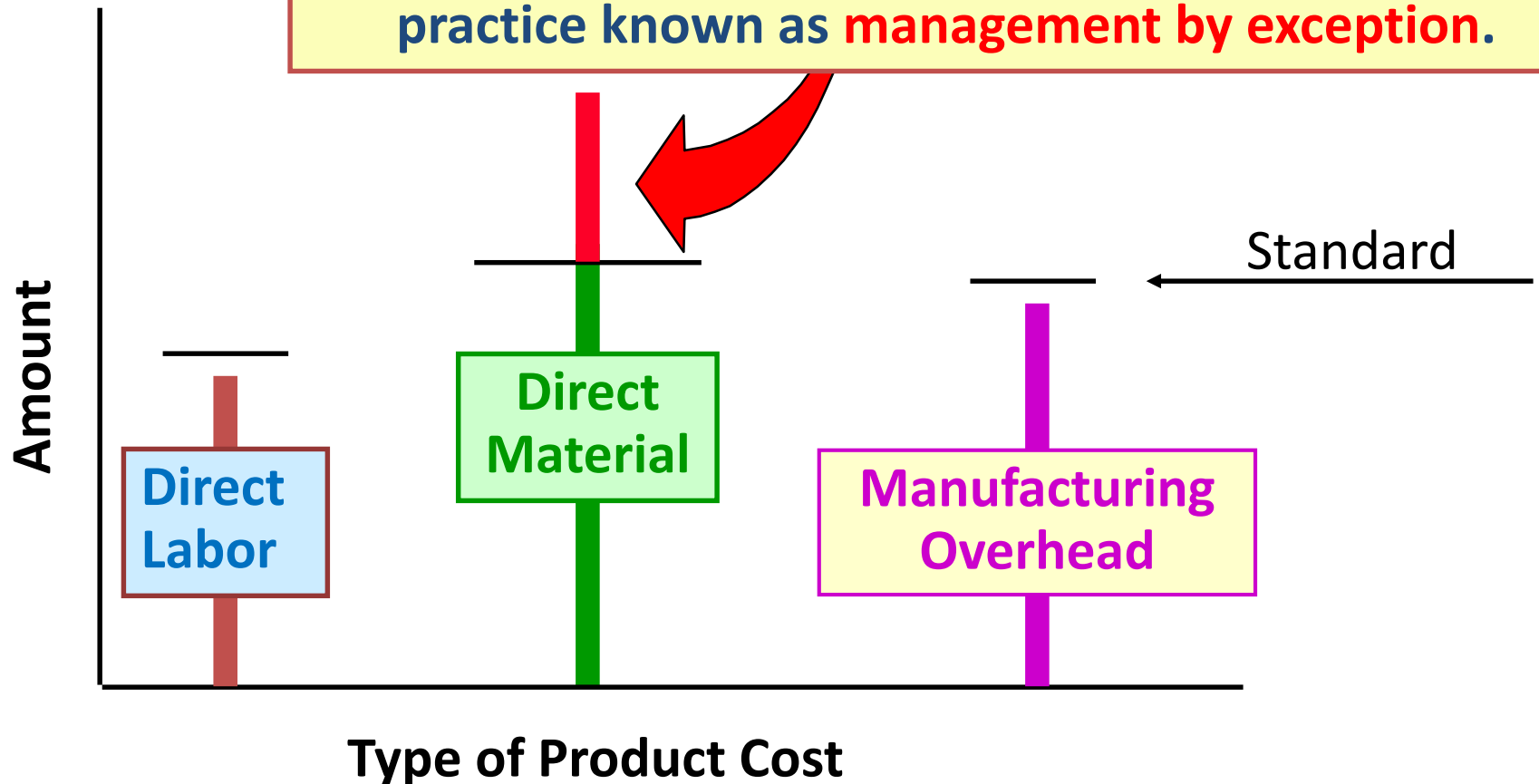
specify how much of an input should be used to make a product or provide a service.

## **Price standards**

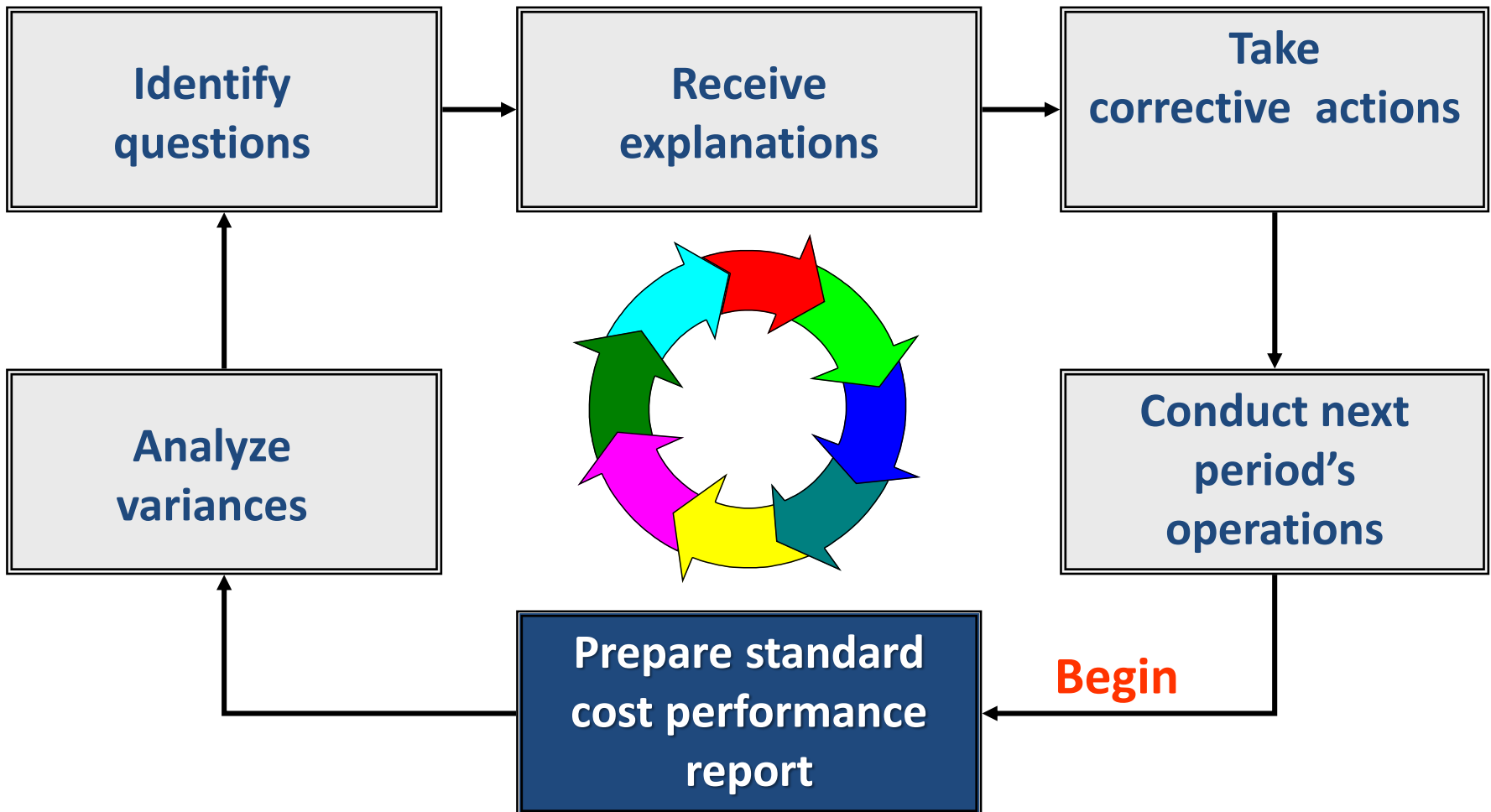
specify how much should be paid for each unit of the input.

# Standard Costs

Deviations from standards deemed significant are brought to the attention of management, a practice known as **management by exception**.



# Variance Analysis Cycle



# Setting Standard Costs

Should we use **ideal standards** that require employees to work at 100 percent peak efficiency?

I recommend using **practical standards** that are currently attainable with reasonable and efficient effort.



**Engineer**

**Managerial Accountant**





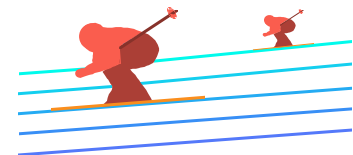
# Setting Standard Costs

Accountants, engineers, purchasing agents, and production managers combine efforts to set standards that encourage efficient future operations.



# Material Variances Summary

Actual Quantity × <u>Actual Price</u>	Actual Quantity × <u>Standard Price</u>	Standard Quantity × <u>Standard Price</u>
210 kgs. × Rs 4.90 per kg.	210 kgs. × Rs 5.00 per kg.	200 kgs. × Rs 5.00 per kg.
<b>= Rs 1,029</b>	<b>= Rs 1,050</b>	<b>= Rs 1,000</b>
		
<b>Price variance</b> <b>Rs 21 favorable</b>		<b>Quantity variance</b> <b>Rs 50 unfavorable</b>



# Cost Management for Better & Effective Financial Management.

Need of the Hour is a

VUCA Professional Who will be the

PUCCA Professional

To handle

Volatility of Data

Uncertainty of Data

Complexity of Data

Ambiguity of Data

# Cost Management for Efficient Financial Management

- Thank You All for the Patient Hearing