



Cost Management Strategies: Importance of Sustainable Business Model through CMA

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Background

- The management accounting term got popularized and practiced by Anthony (1956), Shillinglaw (1961) and Horngren (1962).
- Since then the transition from cost accounting to managerial cost analysis is a significant accomplishment. It helped management accounting prominent place in industry, commerce, and academe.
- The transition from managerial cost analysis to strategic cost management will help in determining the prominence of cost management in the future.



Background (Contd.)

- In the recent past, the literature on strategic cost management is growing. The journals like “Accounting Organization and Society”, “The Journal of Cost Management” and the “Journal of Management Accounting Research” are publishing articles on the subject.
- Cost analysis helps in assessing the financial impact of alternative managerial decisions. In strategic cost management, understanding of a firm’s cost structure helps in formulating strategies for sustainable competitive advantage.



Background (Contd.)

- Cost information plays a role in continuous cycle of:
 - strategy formulation (financial analysis to evaluate strategic alternatives in terms of financial feasibility and required financial returns)
 - communicating strategies across organization (reports that focus attention on critical factors)
 - execution of strategies financial analysis showing the tactical programs likely to be effective)
 - developing and implementing management controls in meeting the strategic objectives (monitoring performance of business units and their managers).



Key Themes

Hilton, Maher & Selto:

- Cost management supports management's strategic decision making. They consider it a *philosophy*, an *attitude*, and a *set of techniques* to create more value at lower cost.
 - Philosophy: Make the right decisions to create more customer value at a lower cost.
 - Attitude: Costs result from management decisions. Be active partners in making management decisions to develop and improve products/services and reduce costs.
 - Techniques: To support a specific decision or together to support the organization's goals and activities.
 - [Cost Management Support of Management Decisions.docx](#)



Key Themes (Contd.)

Shank & Govindrajan:

- The key themes underlying strategic cost management taken from the strategic management literature are:
 - Value chain analysis
 - Strategic positioning analysis
 - Cost driver analysis



The Value Chain Concept

- The value chain for any firm in any business is the linked set of value-creating activities ranging from sourcing to delivery of goods and services to the consumers.
- In the SCM framework, managing costs effectively requires a focus external to the firm – value chain.
- In contrast, management accounting often adopts a focus that is largely internal to the firm.
- Cost Leadership: Economies of scale of production, experience curve effects, tight cost control, cost minimization in specific areas such as R&D, service, advertising, etc.



Value Chain (Contd.)

- Examples of low-cost strategy: Texas Instruments in consumer electronics, Hyundai in auto, Black & Decker in machine tools, K-Mart in retailing, etc.
- Differentiation: brand loyalty (Coca Cola in soft drinks), superior customer service (IBM in computers), dealer network (Caterpillar), product design and features (HP in electronics)
- The value chain concept highlights four profit improvement areas viz. linkages with suppliers, linkages with customers, process linkages within the value chain of a business unit, and linkages across business unit value chains within the firm.



The Strategic Positioning Concept

- Differentiation and cost leadership involve different managerial mindsets, they also involve different cost analysis perspectives.
- Cost management and control systems for cost leadership strategy have higher focus on: role of engineered product costs in assessing performance, flexible budgeting and manufacturing cost control, importance of product cost as an input to pricing decisions, and importance of competitor cost analysis.



Strategic Positioning (Contd.)

- On the other hand, product differentiation strategy has significant importance of marketing cost analysis but moderate to low emphasis on role of engineered product costs in assessing performance, flexible budgeting and cost control, product cost as an input to pricing decision, and competitor cost analysis.
- The logic for linking controls to strategy is based on the following line of thinking:
 - For effective execution, different strategies require different task priorities; different key success factors; and different skills, perspectives, and behaviors.



Strategic Positioning (Contd.)

- Control systems are measurement systems that influence the behavior of those people whose activities are being measured.
- Thus, the design of control systems should ensure whether the behavior induced by the system is the one that is consistent with the strategy.



The Cost Driver Concept

- Understanding cost behavior implies understanding the complex interplay of the set of cost drivers at work in any given situation.
- In management accounting, cost is a function, primarily, of one cost driver, output volume.
- SCM tends to draw upon the richer models of the economics of industrial organization.
- The first category of cost drivers comprises “structural cost drivers” viz. scale, scope, experience, technology, complexity.



Cost Driver (Contd.)

- Scale – how big an investment to make
 - Scope – Degree of vertical integration (horizontal integration is more related to scale)
 - Experience – how many times in the past the firm has already done what it is doing again
 - Technology – what process technologies are used at each step of value chain
 - Complexity – how wide a line or products/services to offer to customers.
- Each structural cost driver involves choices by the firm that drive product/service cost.



Cost Driver (Contd.)

- The second category of cost drivers are “executional drivers”.
 - Work force involvement (participation)
 - Total quality management
 - Capacity utilization
 - Plant layout efficiency
 - Product configuration
 - Linkages with suppliers and customers



Cost Driver (Contd.)

- Whatever cost drivers are on the list, the key ideas are as follows:
 - For strategic analysis, volume is usually not the most useful way to explain cost behavior.
 - It is more useful to explain cost position in terms of the structural choices and executional skills that shape the firm's competitive position.
 - For each cost driver, there is a particular cost analysis framework that is critical to understanding the positioning for a firm.



Summary

- What is the most useful way to analyze costs?
 - In terms of the various stages of the overall value chain of which the firm is a part
 - With a strongly external focus
- What is the objective of cost analysis?
 - Three objectives viz. score keeping, attention directing and problem solving remain
 - The design of cost management systems changes dramatically depending on the basic strategic positioning of the firm
- How should we try to understand cost behavior?
 - Function of strategic choices about the structure of how to compete
 - In terms of structural cost drivers and executional cost drivers



References

- (1) Shank & Gvoindrajan, *Strategic Cost Management: The New Tool for Competitive Advantage*, The Free Press, 1993.
- (2) Hilton, Maher & Selto, *Cost Management: Strategies for Business Decisions*, McGraw-Hill Irwin, 2003.



Thank You
