Strategic Cost Management: Upsizing, Downsizing and RightSizing

A Presentation by, Kennedy Auka

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Credibility . Professionalism . AccountAbility

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outline

- Why Strategic Cost Management
- Concept of SCM
- Definition of SCM
- Components of SCM
- Guiding principles of SCM
- Enablers of SCM
- References

Why SCM

- The law of recurring costs: staff costs and expenses reduced but workload doesn't reduce at the same rate, behaviors don't change, costs elsewhere drift up offsetting cost savings
- Wrong costs eliminated: many employees don't understand the real costs because the standard costing systems and their allocation processes usually "easiest" costs cut first.
- Cost reduction is a true path to sustainable competitive advantage

Why SCM

- Costs cut outside strategy: in response to a crisis, short term needs, weakening the strategic strength of an organization, one time reductions neither followed up nor maintained
- Mistrust because of top down viewed as sensitive, not suited to employee involvement.

Why SCM

- Traditionally companies have been under pressure to cut costs in the short-term without really thinking about sustainable change, impact on the people and integration with the overall business strategy
- It is evident that yesterday's tactical solutions despite consuming considerable resources have failed in many organizations to deliver planned reductions in the cost base.
- Arbitrary cost reduction activities can breed uncertainty, anger and resistance which overtime will eat away the success of programmes (PWC)

Concept of SCM

- It is cost analysis in a broader context where strategic elements become more conscious, explicit and formal
- Cost data is used to develop superior strategies in route gaining sustainable competitive advantage
- SCM give clear understanding of the firm's cost structure in search of sustainable competitive advantage.

Concept of SCM

- Cost analysis in terms of overall value chain of which the firm is part which has a strong external focus
- The design of cost management system changes dramatically depending on the basic strategic position of the firm (Cost leadership, Product differentiation)
- Cost is a function of strategic choices about the structure of how to compete and managerial skills in executing the strategic choices

Concept of SCM

- The adoption of strategic cost management practices by the companies has been the subject of several studies at (Reckziegel, Souza and Diehl, 2007, Marques et al, 2003,Ferreira, Silva and Batalha, 2010; Muniz, 2010, Souza, Collaziol and Damacena, 2010, Guilding, Cravens and Tayler, 2000; Bowhill and Lee, 2002; Dekker and Smidt, 2003, Waweru, Hoque and Uliana, 2005; Cinquini and Tenucci, 2006; Cadez and Guilding, 2007; Zoysia and Herath, 2007; Noordin, Zainuddin and Tayler, 2009; Angelakis, and Thério Floropoulos, 2010).

Concept of SCM

- Based on the findings of these studies, it is observed that the adoption of the strategic cost management practices, when segregated in countries, present higher frequency of use in developed countries like Japan, Italy and United States of North America.

Concept of SCM

- The strategy of leadership in costs is identified as the ability of the company to produce its products and distribute them to the customers at costs that are lower that those of the competing companies.
- Factors that contribute to individual firms producing identical products at different costs are primarily determined by differences in technology, available capacities and existence of restriction of certain resources

Definition of SCM

- Strategic cost management has been studied through the use of various instruments such as target costing (Seidenschwarz 1993 and Ansari et al. 1997b), activity based costing and activity based management (Turney 1996 and Cooper and Kaplan 1998 and 1999), benchmarking (Hoffjan 1997, Götze 2004 and Wage ner 2006), or life cycle costing (Shields and Young 1991, Coenenberg et al. 1997, Hans en and Mowen 2000 and Götze 2004).
- Thus, in the field of strategic cost management, most studies in the literature concentrate on the application of cost management instruments.

Definition of SCM

- Simmonds (1981, p.26), in a seminal article on the subject states: Strategic Management Accounting can be defined as the provision and analysis of management accounting data about a business and its competitors for use in developing and monitoring the business strategy, particularly relative levels and trends in real costs and prices, volume, market share, cash flow and the proportion demanded of a firm’s total resources.

Definition of SCM

- Strategic cost management, on the other hand, focuses on using unit and non-unit-based drivers, tracing-intensive, broad product costing, managing activities, detailed activity information, system-wide performance maximization, using of both financial and non-financial measures of performance, both internal and external orientation and long-term perspective (Wilson and Chua 1993:530, Fischer 1993:129, Shank and Govindarajan 1993:217 and McNair 2000:31).

Definition of SCM

- The SCM approaches by other authors, in general, are in accordance to the proposal of Simmonds (1981).
- Bacic (2009) sustains that management accounting should be considered within a framework that recognizes the impact of competition and strategy, noting the criteria and business's needs.
- Blocher et al (2007) since strategic factors are growing in importance for management, cost management has transformed its traditional role of cost of product and operational control into a broader and strategic focus.

Definition of SCM

- SCM is the managerial use of cost information explicitly directed at one or more of four stages of strategic management. (strategy formulation, communicating strategy, implementing and controlling)
- It is the overall recognition of cost relationship among the activities in the value chain and process of managing those costs relationships to a firm's advantage

Pillars of SCM

- Strategic position analysis
- Cost driver analysis
- Value chain analysis

Strategic Position Analysis

Porter five forces model

- New entrants
- Suppliers force
- Buyers force
- Rivalry among competitors
- Substitute goods

- Low Cost Leadership
- Product Differentiation

Cost driver analysis

- Structural drivers are costs related to size, experience and technology etc
- Executional drivers relate to the share of labour in the production process, the use of the capacity, production configuration, total quality management production etc (Shank and Govindarajan,1993)

Structural drivers

- Favorable location, number of locations
- Number of plants, scale, degree of centralization
- Management style and philosophy
- Number of product lines, number of unique processes, number of unique parts
- Scope, buying power, selling power
- Sales volume in units or Euros, number of different customers
- Types of process technologies, experience
- Debt level, debt capacity, favorable tax status
- Cumulative volume in the activity, time in operation

Executional drivers

- Employee morale level, turnover rates, degree of involvement
- Quality management approach, employee training level, return
- merchandise rates, customer satisfaction ratings
- Plant layout efficiency; throughput time, ability to convert from one product/service to another
- Product configuration
- Capacity utilization, number of production or service facilities
- Lead-time from product concept to production, R&D cost compared to competitor

Value Chain Analysis

- A systematic approach to examining the development of competitive advantage
- The chain consists of activities that create and build value
- They culminate in the total value delivered by an organization
- Helps determine which type competitive advantage to pursue and how to pursue it
- Value is referred to as the price the customer is willing to pay for a certain offering

Value Chain Analysis

Primary Activities

- Inbound logistics
- Operations
- Outbound logistics
- Marketing and Sales
- Service

Support Activities

- Firm infrastructure
- Human Resource Management
- Technology
- Procurement
- Finance

Create competitive cost base

- Keep cost under continued observation through targeted key performance indicators
- Know current best practice and regularly benchmark the cost base against competitors
- Have effective decision-making processes
- Execute periodic, tightly focused tactical cost reduction projects under an effective project management discipline
- Ensure compliance through strict governance and robust supplier management
- Understand net profitability by customer, product, market and channel.

Cost effective strategy execution

- Continually challenge the business model to shape investment choices
- Analyse key cost data to show the cost implications of new opportunities, products and customers
- Ensure poor areas of customer and product profitability are understood and continually addressed
- Ensure that growth is funded through cost efficiency
- Robustly track the execution of strategy against plans and manage performance
- Embed a culture of cost consciousness in the organisation but invest in those areas that will deliver the greatest return

Continuous improvement

- Actively track the customer experience and market place, being able to effectively assess the costs of response
- Review the external environment for different cost effective methods or business models
- Be alert to potential market entrants from any area, recognizing that lower cost competition can arise from different industries
- challenge operational costs to drive investment in critical research and development
- monitor complexity throughout the business, constantly simplify execution whilst enhancing service delivery
- Recognise that employee satisfaction and performance drives financial success and structure rewards accordingly

Guiding Principles of SCM

- Understand what causes the cost and revenue structure of the business
- Identify the firm's activities and select those that can be used to produce (or sustain) a competitive advantage
- Understand and reduce inter-functional complexity
- Increase effectiveness and continuously improve costs.
- Use strategy to manage costs.
- Build skills.
- Involve employees in decisions.

SCM Enablers

- Redefinition of procurement business processes
- Maximize the leverage effect of purchasing
- Sharing of Risks and Rewards
- Supply chain visioning
- Diffusion of best practices in the organization
- Strategic alliances
- Planned change management
- Supply base rationalization
- Existence of shared supplier-customer strategies
- Minimization of transactional activities of
- Shifting of supply chain costs

SCM Enablers

- Top management support and sponsorship
- Information systems
- Identity of total cost drivers
- Cost models
- A strategic cost management plan
- Effective cross-functional teams
- Known Business strategies
- Alignment of supply strategies with business strategies
- Total cost approach to procurement
- Balanced approach to sourcing
- Performance measurements

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