STRATEGIC COST MANAGEMENT

Presentation by:

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Uphold public interest
Agenda

• Introduction
• Definitions
• Strategic Cost Management (SCM)
• Traditional Cost Management vs. SCM
• SCM Underlying themes
• Conclusion
Introduction

Theme:
“Seizing opportunities to deliver enhanced insights and improve business performance”
Cost management is the process of effectively planning and controlling the costs involved in a business, usually for purposes of score keeping, problem solving, attention directing.

Strategic management is the continuous planning, monitoring, analysis and assessment of all that is necessary for an organization to meet its goals and objectives.
Just 6 percent of CFOs say that cost management will be their top strategic priority in 2016.

This is the case even though they expect costs to increase year over year from 2015 to 2017. — Accenture Strategy
The application of cost management techniques so that they simultaneously improve the strategic position of a firm and reduce costs.

The managerial use of cost information explicitly directed at one or more of the four stages of the strategic management cycle.
Cost information plays a role in each of these stages.
Offer a radical approach to disrupting enterprise costs from the inside, a structural transformation powered by digital technologies.

Not status-quo cost reduction focused on doing the same things for less.

Makes deliberate and durable changes to the business or operating model for sustained reduction and impacting on growth
## Traditional CM vs. SCM

<table>
<thead>
<tr>
<th>Focus</th>
<th>Traditional Cost Management</th>
<th>Strategic Cost Management</th>
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</thead>
<tbody>
<tr>
<td>Perspective</td>
<td>Internal</td>
<td>External</td>
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<tr>
<td>Value-added</td>
<td>Value chain</td>
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<tr>
<td>Cost analysis</td>
<td>Product, customer,</td>
<td>At various stages of the</td>
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<tr>
<td>process</td>
<td>and function;</td>
<td>value chain.</td>
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<tr>
<td>Cost analysis</td>
<td>Score keeping, attention</td>
<td>Strategic positioning -</td>
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<tr>
<td>objective</td>
<td>directing, and problem</td>
<td>cost leadership,</td>
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<td></td>
<td>solving.</td>
<td>differentiation</td>
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## Traditional CM vs. SCM

<table>
<thead>
<tr>
<th>Cost driver concept</th>
<th>Traditional Cost Management</th>
<th>Strategic Cost Management</th>
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<tbody>
<tr>
<td>Cost is a function of volume.</td>
<td>Scale, scope, experience, technology, complexity</td>
<td></td>
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<td>Cost containment philosophy</td>
<td>Cost reduction via responsibility centers or product cost</td>
<td>Function of the cost driver(s) relating to each value activity.</td>
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<td>Primary concern</td>
<td>Cost impact</td>
<td>Competitive advantage</td>
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<td>Management responsibility</td>
<td>Follower/reactive Risk-averse</td>
<td>Leader/proactive Comfortable with ambiguity</td>
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Emergence of SCM

- Increased prominence of strategy
- Strategic Analysis industry
- Blending cost management with 3 underlying themes, taken from strategic management literature:

1. Value Chain Analysis
2. Strategic Positioning Analysis and
3. Cost Driver Analysis
Effective management of costs require broad focus, external to the firm – the value chain.

The value chain is set of value-creating activities from basic raw material sources through to the ultimate end-user product delivered to the final customer.
Value Chain Analysis

Traditional cost management techniques focus attention from the purchase of raw materials, stopping with sales – Key objective, maximising the difference between purchases and sales (value added).

VCA – looks at the entire supply chain and ends after the sale. Allows opportunities for linkages with suppliers and customers that enhance competitive edge.
Michael Porter identifies two basic strategic choices under which a business can compete:

- Cost leadership
- Product differentiation

The choice determines the cost perspective an organisation will adopt.
## Strategic Positioning

<table>
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<th>Importance of:</th>
<th>Differentiation</th>
<th>Cost Leadership</th>
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<tbody>
<tr>
<td>Standard costs</td>
<td>Not very</td>
<td>Very Important</td>
</tr>
<tr>
<td>Importance flexible budgeting</td>
<td>Moderate to low</td>
<td>High to very high</td>
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<tr>
<td>Marketing cost analysis</td>
<td>Critical to success</td>
<td>Not done on a formally</td>
</tr>
<tr>
<td>Product cost as an input to pricing decisions</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Competitor cost analysis</td>
<td>Low</td>
<td>High</td>
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Cost Drivers

• Cost driven by many interrelated factors

• Cost is a factor of output volume according to traditional cost management, thus the emphasis on CVP analysis, BEP analysis, contribution margin etc.

• In SCM cost divers are categorised into two:
  • Structural cost drivers
  • Executional cost drivers
Cost Drivers

Structural Cost Drivers
- Scale - How big an investment in various functions – manufacturing, R&D etc.
- Scope - Degree of integration.
- Experience - How many times done in the past.
- Technology used at each step of the value chain.
- Complexity - How wide the line of products or services offering.
Cost Drivers

Executional cost drivers

Å Work force involvement ("participation“)
Å Total quality management
Å Capacity utilization
Å Plant layout efficiency
Å Product configuration – design and formulation
Å Exploiting linkages with suppliers and/or customers.
Conclusion

The SCM perspective is much more inclusive than the management accounting perspective.

Full adoption of SCM concepts requires a paradigm shift from the basic attitudes that shape current thinking about management accounting practices. Are we ready?
Interactive Session

Thank You