Strategic cost management – suggested framework for 21st Century

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Abstract
The term strategic cost management has a broad focus, it is not confined to the continuous reduction of costs and controlling of costs and it is far more concerned with management's use of cost information for decision-making. Strategic cost management is important to organizations because it is more than focusing on costs; in the successful companies of the 21st century costs will not be the only most important factor, but also value and revenue consider 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. Authors suggested a framework which has far more impacts on any organization compare to traditional cost management.

Introduction
During the past two decades, organizations have had to respond to the trends and changes in the business environment with newer and better approaches to managing their businesses (Manoochehri 1999:7). These new approaches are being implemented in organizations under names such as: total quality management, employee involvement and empowerment, business process reengineering, continuous improvement, and other approaches. These philosophies require organizations to be responsive, agile, and flexible in profitably providing value-added products and services to customers at competitive prices. Thus organizations are now discovering that they must be able to manage a complex and rapidly changing environment without the significant costs that traditionally have attended these characteristics. Within this changing environment, organizations have witnessed a significant rebirth of new accounting approach; strategic cost management. Accounting terminology is often misinterpreted, and the term "cost management" is no exception. This is perhaps inevitable, given that "cost management" combines two terms ("cost accounting" and "management accounting") that are themselves subject to frequent misinterpretation (Hansen and Mowen 2000:2).

While these terms are sometimes considered synonymous, they are at other times used to mean quite different things (Maher 2000: 336).

In any case, cost management builds on the both cost accounting and management accounting and assumes knowledge of both. Nonetheless, cost management is not cost accounting; cost management is much more than just cost accounting - cost accounting is the field of accounting that records, measures, and reports information about how much things cost (Maher and Deakin 1994:3), cost management is more comprehensive than cost accounting (Berliner and Brimson 1988:3). Similarly, cost management is not the same as management (or managerial) accounting, if by management accounting what we mainly have in mind is breakeven analysis, economic order quantities, and - above all - calculation of variances between actual and standard costs (Cooper 1997:46). Cost management is far more concerned with management's use of cost information for decision-making. Although, cost management is not cost accounting and management accounting, they at least help set cost management in context.

Review of Study

In the contemporary business environment, cost management has become a critical survival skill for many organizations. But it is not sufficient to simply reduce costs; instead, costs must be managed strategically (Cooper and Slagmulder 1998a:14). Many authors stressed that the strategic importance of cost management has drastically increased in the recent years due to intense competition. According to Cooper and Slagmulder (1997a:108) customers in highly competitive markets expect that each generation of products presents improvements. These improvements may include: improved quality, improved functionality or reduced prices. Any of these improvements alone or any combination of them urges a firm to manage its costs to stay profitable.

Furthermore, Cooper and Slagmulder (1997a:168) pointed out that highly competitive markets are characterized by low profit margins, low customer loyalty and low first move-advantages. Cooper (1995a:10) argued that in competitive markets where competitors are frequently technologically equivalent, it becomes increasingly difficult to maintain a sustainable competitive advantage.

Similarly, Kato (1993:37) argued that while successful Japanese companies are all cost conscious companies, they also pursue differentiation strategies. This means that successful Japanese companies are both cost leaders and product differentiators. Also, Monden and Hamada (1991:16) contend that in highly competitive markets - that are characterized by a shortening of product life cycles, diversification of demand and keen competition – cost management is indispensable to introduce new products that meet customers' demands at the lowest cost, and to reduce costs of existing products by eliminating wastes.

Conceptual Framework

Strategic cost management is understood in different ways in literature. Cooper and Slagmulder (1998a:14) argued that strategic cost management is "the application of cost management techniques so that they simultaneously improve the strategic position of a firm and reduce costs". They suggest three sorts of cost management initiative, based on whether the impact on the organization's competitive position is positive, negative or neutral. An example of a cost management initiative that strengthens an organization's position is illustrated as follows. A hospital redesigns its patient admission procedure so it becomes more efficient and easier for patients. The hospital will become known for its easy admission procedure so more people will come to that hospital if the patient has a choice. The strategic position of the hospital has just been increased over its competitors. The second example of a cost management initiative that has no impact on the organization's competitive position is explained as follows. An insurance company decides to reevaluate its accounts payable system to make it more efficient. The evaluation has no positive benefits to the insurance company in the external market. The objective of the change is to make the organization more profitable. The third example of a cost management initiative that will weaken the organization's competitive position is illustrated as follows. A large airline company only has two desks for administering and selling tickets. This set-up induces long lines for the airline customer which can ultimately result in high dissatisfaction and a bad reputation for the airline. This may reduce the amount of ticket sales when compared with the airline's competitors. Even though having only two desks available for customers may initially be cost effective, in the long run, it harms the company. As a general rule, an organization should never undertake any practices that are predicted to weaken the position of the organization.

Furthermore, Cooper (1995a:89) argued that strategic cost management needs to include all aspects of production and delivering the product; the supply of purchased parts, the design of products and the manufacturing of these products. So, strategic cost management should be inherent to each stage of a product's life cycle, i.e. during the development, manufacturing, distribution and during the service lifetime of a product. According to Welfie and Keltyka (2000:33) strategic cost management is an area that holds exciting possibilities for accountants. They also emphasized that strategic cost management attempts to improve the strategic position of an organization and reduces costs at the same time and it is important because global competition means that firms must be constantly aware of their strategic position. An organization must compete in the areas of cost, quality, customer service, and flexibility with any cost reduction efforts contributing to an improved strategic position (Seal 1989:117). A sophisticated understanding of an organization's cost structure can go a long way in the search for sustainable competitive advantage, this point is emphasized by Shank and Govindarajan (1993:6ff.) who define strategic cost management as "the managerial use of cost information explicitly directed at one or more of the four stages of strategic management:

(1) Formulating strategies, (2) communicating those strategies throughout the organization, (3) developing and carrying out tactics to implement the strategies, and (4) developing and implementing controls to monitor the success of objectives".

According to Horvath and Brokemper (1998:585), strategic cost management has emerged as a key element to attain and sustain a strategic competitive advantage through long-term anticipation and formation of costs level, costs structure, and costs behavior pattern for products, processes, and recourses. For this purpose, strategic cost management must provide managers with different information. Strategic cost management sees products, processes, and resources themselves as creative objects for attaining a strategic competitive advantage. This goal may not be achieved based on traditional cost management. They also argue that strategic cost management must determine and analyze long-term cost determinants (economics of scale, experience, etc.) and their influence on costs level, costs structure, and costs behavior pattern. Finally, strategic cost management should begin with participation during R&D and design stages of the product in order to avoid the costs early in the product life cycle.

Another contribution to the development of strategic cost management was that of Porter (1998a). Porter suggested that a firm has a choice of three generic strategies in order to achieve sustainable competitive advantage. They are cost leadership, differentiation, and focus. Where cost leadership is selected Porter advocates the use of strategic cost analysis.

Hinterhuber (1997:11-13) argued in his study that cost management is "a necessary course of action which acquires strategic significance the more it increases the number of options for discovering new opportunities or inventing new markets. Strategic cost management tends to be an integrated, proactive part of strategic management aimed at satisfying all key stakeholders." Further, Hinterhuber has interviewed executive of European companies about strategic cost management and has come to the conclusion that strategic cost management should be a part of the strategy of businesses in order to achieve a radical and long-term increase in the value of the company. Strategic cost management needs the support of employees, top management as well as information technology because effective and timely communication is a prerequisite for implementing it. Finally, strategic cost management has to consider the value systems, beliefs, and projections of employees; changes in business processes and in the ways activities are carried out have to be supported by incentive and other non monetary systems - strategic cost management has to create win/win situations and to communicate effectively the benefits for all involved.

The term strategic cost management has a broad focus, it is not confined to the continuous reduction of costs and controlling of costs and it is far more concerned with management's use of cost information for decision-making. Strategic cost management is also not confined to use cost management techniques that reduce costs and improve the strategic position of a firm at the same time. When most authors talk about strategic cost management, they are really thinking about cost reduction. However, it is often difficult to demean the importance of cost factor for the success of company, but the challenge is to increase revenue, which can be facilitated by strategic cost management. Cost-management knowledge and information is critical to their organization's success. Strategic cost management is important to organizations because it is more than focusing on costs; in the successful companies of the 21st century costs will not be the only most important factor, but also value and revenue consider 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 (Hilton et al. 2001:8) (see Figure 1).

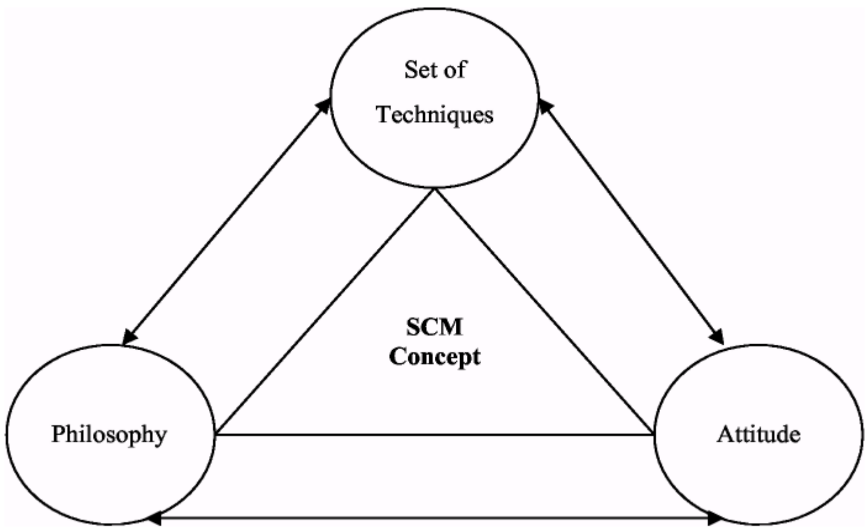


Figure 1 *Strategic cost management-Concept*

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 (Hilton et al. 2001:8).

Traditional Cost Management and Strategic Cost Management

Change is an imprint of contemporary business environment that cannot be avoided. In the 21st century, strategic cost management is facing just such a challenge. Strategic cost management has both the opportunity - and difficult task - of defining and shaping its own future as well as the future of companies. Trends and changes in the business environment such as: increase of global competition, increasingly demanding customers and shareholders, and rapid advances in information and manufacturing technology - traditional cost management may be not adaptable to these events (McNair 2000:28). In fact, there are many cost management systems, have been offered many solutions for companies, but their primary concern was cost reduction (see figure 2), as result, the late 20th century found organizations anxiously to, not deciding, their future.

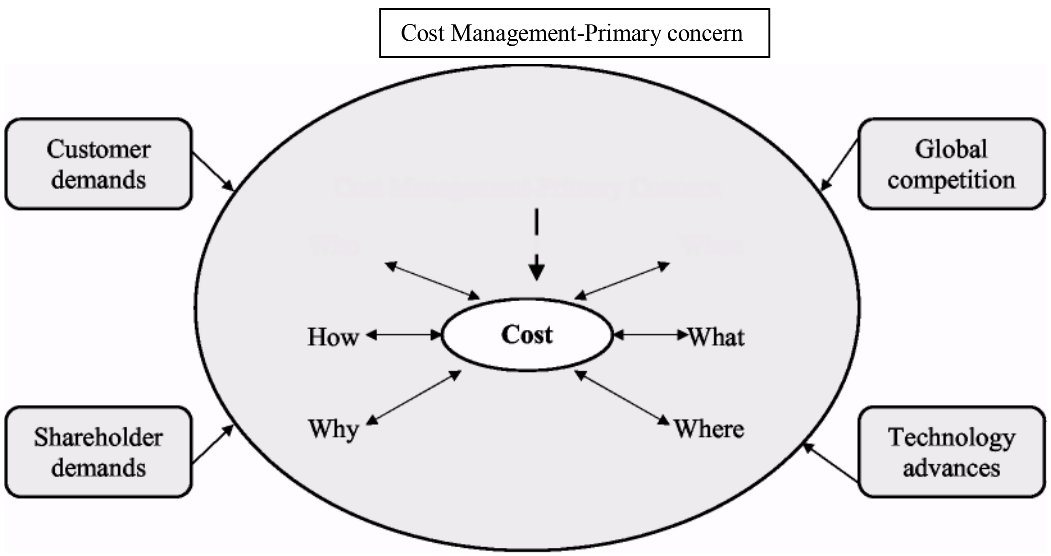


Figure 2 *Forces of change and cost management-primary concern in the 20* century (McNair 2000:28)*

Cost and revenue management is the present role of strategic cost management; In the 21st century, strategic cost management primary concern will not only be cost management but also increase revenues, improve productivity and customer satisfaction, and the same time improve the strategic position of the company (see figure3).

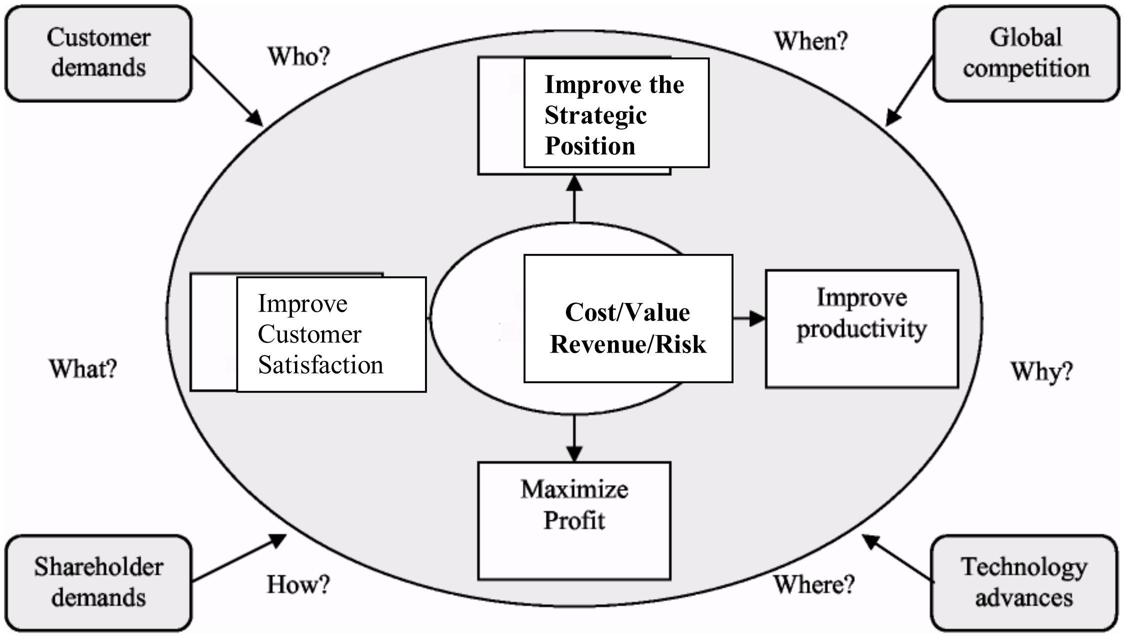


Figure 3 *Forces of change and strategic cost management-primary Concern in 21st century*

The key is that costs must be viewed by looking simultaneously at the value they provide. Strategic cost management must recognize that cost/value and revenue are complementary, not competing terms - both must be understood if an organization is to intelligently choose its customers and markets (McNair 2000:28). Strategic cost management must bridge the gap between cost and value as well as between the language of the market and the language of the business. Traditional cost management during the 20th century faced many criticisms which are explained above; however, strategic cost management during 21st century faces a future that will be unique and rewarding compared to its current realities. The key features and shifts that define this transition are detailed in the table 1.

	Traditional Cost Management	Strategic Cost Management
Focus	Internal	External
Perspective	Value-added	Value chain
Cost analysis-way	In term of: product, customer, and function With a strongly internal focus Value added is a key concept	In terms of the various stages of the overall value chain of which the firm is apart With a strongly external focus Value-added is seen as a dangerously narrow concept

Cost analysis-objective	Three objectives all apply, without regard to the strategic context: Score keeping, attention directing, and problem solving.	Although the three objectives are always present, the design of cost management system changes dramatically depending on the basic strategic positioning of the firm: either under a cost leadership strategy, or under a product differentiation strategy.
Cost driver concept	A single fundamental cost driver pervades literature - cost is a function of volume. Applied too often only at the overall firm level.	Multiple cost drivers such as: Structural drivers (e.g. scale, scope, experience, technology, complexity) Executional drivers (e.g. participative management, total quality management) Each
Cost containment philosophy	Cost reduction approached via responsibility centers or product cost issues	Cost containment is a function of the cost driver(s) regulating each value activity.
Primary concern	Cost impact	Cost/Value/Revenue
Key disciplines	Finance/Accounting	Marketing/Economies
Primary role	Scorekeeper	Analyst and consultant
Management responsibility	Follower/reactive Risk-averse	Leader/proactive Comfortable with ambiguity

Table1 *Comparison of traditional cost management and strategic cost management (Fischer 1993:129, Shank and Govindarajan 1993:217 and McNair 2000:31)*

Suggested Framework for Strategic Cost Management

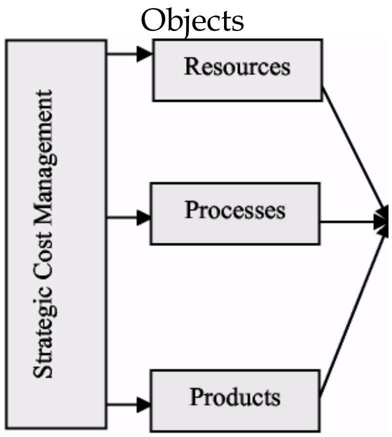
Strategic cost management is not limited to cost but is inclusive to all resources used and deployed across the value chain (Cooper and Slagmulder 1998d:18). Therefore, strategic cost management should not confine its concerns and objectives only to cost, but should also consider revenue, productivity, customer value, and at the same time the strategic position of the company. The need to understand costs is a clear one. Organizations need to know what their costs are in order to decide and manage their profitability. To aid in determining their profitability, organizations need to understand what their total costs were, are, or are going to be over a given period of time. The difference between the revenue for that period and the costs incurred during the same period determines the profitability for the period. Ultimately, decisions are made in for-profit organizations to drive profitability. While other salient factors help to determine the long-term viability of an organization, without profitable performance, long-term viability is not an option. In order to survive for the long run, an organization ultimately must be able to show that it can make more money from a product or service than it cost to make that product or service (Yu-Lee 2001:2). Successful strategic cost management should focus not only on cost improvement, but also on revenue enhancement. Cross (1997:4) argued that a company should sell the right product to the right customer at the right time for the right price (cost), thereby maximizing revenue from its products. The figure 4 shows the objects and means by which strategic cost management can contribute to the process of cost improvement and revenue enhancement.

Objects Means

Strategic Cost Management	Resources	By identifying cost drivers that link resources, activities and cost objects and using resources efficiently Focusing resources on the customers By measuring the cost and performance of resources By improve the purchasing process Managing procurement costs	Cost improvemen t Revenue enhancemen
	Processes	Reduce operational costs by optimizing value-added activities and eliminating non-value-added activities Explore customer expectations and define value from the customer's perspective Identify which steps add value for the process customer.. .and those that don't Determine which investments in process improvement will maximize the value produced Utilize activity/process analysis to assign costs Use activity costing to improve processes Manage company costs in terms of what you do (processes).	
	Products	Cost management should be inherent to each stage of a product's life cycle Identify and analyze cost drivers Provide accurate product cost information	
	Customers	Managing customer service costs	
	Competitors	Competitor cost analysis	

Figure 4 *Strategic cost management - cost improvement and revenue enhancement*

Strategic cost management understands costs and the causes of costs as well as how to drive the greatest possible productivity through the firm. Many studies generally focus on the equation that productivity is defined as the quantity of output produced divided by the quantity of input. Improvement is measured in terms of change in the ratio from one period to another. For example, Horngren et al. (2000:485) argued that productivity measures the relationship between actual inputs (quantities and costs) and actual outputs produced. The lower the inputs for a given quantity of outputs or the higher the outputs for a given quantity of inputs, the higher the level of productivity. Other authors have a broader view of productivity and understand it as three (E's): Effectiveness, Efficiency and Economy. This is more simply stated as, "Do the right job, do it right and do it cost-effectively" (Bryce 1992:70 and Sharman 1991:8). In strategic cost management, reducing costs alone is not productivity improvement. Many times, reducing cost in one activity can shift costs to another activity. But lead time decrease, product quality improve, revenue increase, overhead and operation expenses decrease, customer satisfaction, continuous improvement are examples for productivity improvement. Strategic cost management can play an important role here as shown in the figure 5.



Productive Improvement

Do the right things	Do things right	Cost effectiveness
Effectiveness	Efficiency	Economy
Characteristics • integrated • continuous improvement • value added • break through	Characteristics • cost • quality • cycle time • customer satisfaction	Unless the results increase revenues and reduce costs by more than the cost of the things implementation, do not do them.

Figure 5 *Strategic cost management and productivity improvement*

Furthermore, successful strategic cost management must help a company to develop and identify superior strategies that will produce a sustainable competitive advantage. Competitive advantage is creating better customer value for the same or lower cost than offered by competitors or creating equivalent value for lower cost than offered by competitors. Customer value is the difference between what a customer receives and what the customer gives up (Ansari et al. 1997b:67). What customer receives includes such things as product functionality (features), product quality, reliability of delivery, delivery response time, image, and reputation. What customer gives up or sacrifice includes product price, time required to learn to use the product, operation cost, maintenance cost, and disposal cost. The figure 6 shows the two dimensions of customer value and the potential role of strategic cost management.

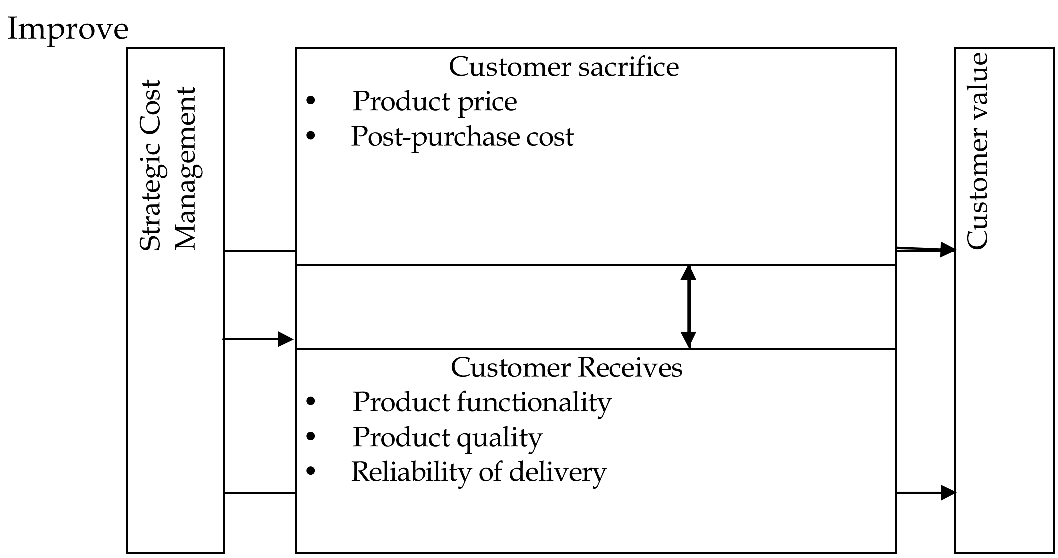


Figure 6 *Strategic cost management and the dimensions of customer value (Based on Ansari et al. 1997b:67).*

Strategic cost management should influence the attributes associated with the dimensions of customer value (decrease the customer sacrifice and improve the customer receives) in order to help a company increase customer value and therefore improve the strategic positioning.

Conclusion

Although cost management has moved from a traditional role to a strategic role, strategic cost management is understood in different ways in the paper. In addition, strategic cost management has been discussed from many aspects in the paper. The existing conceptual approaches only consider certain individual contributions and therefore focus on specific aspects of strategic cost management. The paper explained that the term strategic cost management has a broad focus. It is not confined to the continuous reduction of costs and controlling of costs and it is far more concerned with management's use of cost information for decision-making.

Strategic cost management is also not confined to use cost management techniques that reduce costs and improve the strategic position of a firm at the same time. The paper concluded that strategic cost management is a philosophy, an attitude, and a set of techniques to contribute in shaping the future of the company. In addition, strategic cost management should not confine its concerns and objectives only to cost, but should also consider revenue, productivity, customer value, and at the same time the strategic position of the company.

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