



STRATEGIC COST MANAGEMENT

UNDER PERFORMING BUSINESS?

Many shareholders and managers are becoming increasingly frustrated because their businesses are not performing at their true potential.

Some of the indicators of a business performing below its potential are:

- * Decreasing asset turnover ratios
- * Diminishing return on investment or negative economic profits
- * Deteriorating debt:equity ratio
- * Decreasing margins
- * Low growth relative to the industry or economy
- * Falling behind international competitors on many scores

Some of the reasons for this lack of performance are:

- * Once the obvious areas to cut costs have been identified, you are not able to identify further areas which will be successful. The anticipated savings from closing plants or regional offices do not materialise. But, you know that you have to cut costs further, if not to cope with difficult economic circumstances, then to compete internationally.
- * You are not able to align the employees with the strategic direction that you have set for your business. Employees are not concentrating on what is important. Even though you are trying to change direction, it is business as usual.
- * You cannot set prices to achieve the margins you want without creating time consuming and energy sapping arguments. Customers resist price increases. Transfer prices cause in-house fights. Overhead cost allocations are disputed or are mere recovery routing's. Cost have little credibility.
- * You are not able to justify decisions which do not have immediate bottom-line benefits. The investments which build the competitive capability of the business only have intangible and/or future benefits. Issues which are important to the future such as quality, customer satisfaction, throughput or cycle time, and flexibility do not have visibility. Short-term profits are more important than the long term viability.
- * Outdated processes or technologies are being used and competitors seem to be racing ahead in applying advanced and more efficient technologies. Decisions to acquire the best available technologies seem to be put off forever, or does not seem to make economic sense.
- * Competition at times appears to "dumping" products on the market, yet they may simply know the real cost of their products and business methods and are able to compete more effectively.
- * The organisation becomes acutely aware that it has become introverted and does not compare itself with the best in its class. It mostly does not even know at what cost other organisations perform business functions. Benchmarking is not a way of life.



IMPACT OF UNDER PERFORMANCE

The impact of these problems is a business which is not living up to its potential.

- * Profits are not as high as they should be. Profits may be down or losses incurred. Profits are not high enough to fund investments which are important for the future competitiveness of the business.
- * Cost cuts are not reducing the workload - they are increasing the pressure on everyone. Cost cuts are falling on the wrong places. Activities which do not really add value still exist because staff appear busy. Loss making products, customers, and business units are hidden by cross-subsidies from more profitable areas.
- * Faced with a decision whether to spend or to improve customer relations or to save costs, the customer invariably loses out. Staff pay lip service to key strategic decisions - they know that short-term profit considerations win every debate. What gets measured and reported, gets attention.
- * Owners wish they could get rid of the business or find something more profitable to do. Often fatal diversification strategies are followed because of this. Doing business seems to have lost its spark.

Everyone in business is affected. Many businesses can be described as organisations in stress as they seek to meet ever decreasing cost targets. Decisions taken to solve short-term problems are threatening the long-term ability of the business to survive and prosper.

WHAT ARE THE SOLUTIONS?

What needs to be done to solve these problems?

What if you were able to:

- redesign company processes to permanently eliminate work which does not add value to your customer (re-engineer your business)
- set benchmarks for and monitor efforts at continuous improvement in performance and cost reduction
- link accounting systems with quality management systems that clearly identify where waste is occurring and put a price to it (cost of non-conformance)
- understand how cost drivers impact on product and customer profitability as costs vary with changes in the level of activity (activity-based costing)

- come to grips with a disproportionate increase in business support costs and outsource where feasible
- build costs optimisation models to evaluate alternative business scenarios
- change performance measures to match changes in strategies and the business. Utilising, for example, economic value added concepts to align employee objectives with shareholder objectives
- develop an integrated management approach to costs, performance, quality and time
- continually monitor progress in the implementation of strategies

CONDITIONS FOR CHANGE

What conditions are necessary to enable the business to change to meet these challenges?

Top management commitment

Changing the way performance is measured and rewarded, changing the way the business works, and changing the information available to manage the business will change the organisation fundamentally. To succeed, fundamental change needs top management commitment.

Skills

The skills needed to implement the type of changes mentioned here are:

- * in-depth knowledge of the business, its markets, customers and its culture. This requires the commitment and involvement of senior personnel in each area of the business that is effected
- * innovative, creative and lateral thinking to lead and facilitate the development and implementation of the new vision of the organisation. Often this needs ruthless, impartial questioning "of the way things are done" and broad experience of alternatives
- * the technical skills necessary to analyse and implement the issues illustrated in the figure below

Technology

To use the best available technologies such as activity-based costing systems, multi-dimensional database tools (OLAP), forecasting and budgeting systems and other decision support products.



Building Blocks of a Strategic Cost Management System

STRATEGIC COST MANAGEMENT

Improved strategies through careful financial analysis

ECONOMIC VALUE ADDED

Optimise performance utilising our real time performance model

PERFORMANCE MEASUREMENT

Integrated management of contradictory quality, cost, time and service issues

WORKING CAPITAL MANAGEMENT

Assuring optimal use of all capital resources and optimise return on investment

QUALITY MANAGEMENT

Measuring and identifying waste, determine price of non conformance to customer requirements

BENCHMARKING

Comparisons with best-in-class to achieve world-class competitiveness

PRODUCTIVITY

Economic empowerment of employees to ensure lowest labour cost per unit of output

CUSTOMER PROFITABILITY

Identify unprofitable customers or market segments. Understand impact of service levels and customer satisfaction

ACTIVITY-BASED COSTING

Accurately determine product and services costing. Measuring impact of support costs

COST MODELING

Simulate options re capacities and alternative business scenarios

BUSINESS PROCESS RE-ENGINEERING

Critically evaluating business and finding dramatically improved working and business methods

IMPLEMENTATION APPROACH

The following approaches can be followed to guide the implementation of your Strategic Cost Management system:

- * **Top-Down** - A top down approach is used to analyse the value chain of the business to ensure an early implementation into the areas that can benefit most. The aim is to achieve tangible results within six months. This approach is recommended for organisations requiring drastic reconstruction of where the short term survival is questionable.
- * **Integrated** - Isolated cost cutting exercises do not achieve sustainable results. Strategic cost management has to become a way of life and permanent capabilities must be developed to ensure long term success. A comprehensive analysis of the business is required to develop an integrated solution to cost management, using the building blocks illustrated above as appropriate.

CORTELL'S ROLE

Our role is to act as the impartial catalyst to enable you to change the attitudes and practices of your organisation. To the extent that assistance is required, this involves:

- Assistance in the development of innovative alternative ways of doing business
- In-depth financial evaluation of your business and recommended changes in strategies
- Applying modern costing and forecasting techniques to help you make the right business decisions
- Setting up performance management systems that seek to improve well-being of all stakeholders
- Assistance in the specification and development of new systems
- Assistance in the development and presentation of change management programs to implement solutions

Our approach is based on a skills transfer process - providing line staff with the knowledge and skills to take ownership of the solutions. The approach is based on the belief that the days of static systems are over. To remain competitive, processes and organisations have to change continuously. This requires that staff develop the abilities to maintain and enhance the processes and work methods. Businesses have to become learning organisations.

Contact Cortell today for assistance in implementing Strategic Cost Management in your organisation



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