CURRENT APPROACH OF THE ENTERPRISE COST MANAGEMENT

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Abstract

In the current economic context, any enterprise that wants to achieve sustainability market, should be concerned also by the means of control and reducing costs. The enterprise's sustainable competitive advantage depends on the ability to minimize costs relative to its direct competitors, in order to obtain higher profit margins. So, a realistic cost management strategy becomes a necessity. It should not overlook that the success of a based-cost strategy requires the existence of some opportunity conditions defined and delimited on three levels: at the enterprise level, at the specific market and in the industry. Through this study we intend, using predominantly theoretical approach, a consistent and as complete as possible presentation of the role that cost management may have across the enterprise, in the Romania's current economic context.

Key words: cost, decision, management, cost strategy

JEL classification: M21, M41

1. Introduction

Generally, it can say that the evolution of the costs system building and interpretation, accompanies the global economy mutation. With an economy where the resources are rare and lower than the demand, the cost systems have to distribute optimally all these resources. When the resources are higher than the demand, the main concern is not saving the materials and the labor, but identifying the sources of value. In this case, the economic information systems that include also the costs system should be orientated on the produced value and not the consumed resources.

The definition of the costs management must be linked to its capacity of developing and maintaining those functional models allowing managers to consider the cost and the value in the same time.

The actual demand is that a new product, starting with its conception, has to respond at the market needs, especially those related to the price. So, it's necessary to find all the information linked to the affordable price for the customers starting with the product conception. That information can be helpful for the managers to make the right cost systems.

Also, for the costs strategies, in order to ensure the competitiveness of the company, the expenses which have the most impact on the final result, should be optimized. For this, it's necessary to know the specific structure of the cost on each activity area.

Regardless the activity fields, the efficient management of the most important cost elements ensures a crucial competitive advantage to the company (Niculescu, 2003), of course with the condition to have the necessary resources.

2. The role of the cost in the company's management

The role of the costs in the company's management starts from the idea that the cost represents an important tool for the administration of a company, having the role to inform managers about the company's activity and identifying some strategic directions for the next activities (Niculescu, 2003).

Also, costs provide an estimated measure of the resources that the organization uses in providing a product or service. By understanding their costs, managers can make trade-off decisions to use their resources more effectively (Oliver, 2000).

In Table 1, are defined several types of management decisions based on cost information.

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Table 1. Based-cost management decisions

Cost information	Management decisions
Complete cost information	Decisions on unit selling price fixing Decisions on planning and optimizing production Decisions of "make or buy" Decisions related to the product portfolio management
Partial cost information	Decisions on sizing and optimizing production Decisions on sizing and optimizing volume sales Decisions related to the management of product portfolio Decisions on how to increase enterprise performance
Margin cost information	Decisions on production capacity Decisions on launching new products Decisions of acceptance to the new orders

Managerial speaking, to be able to satisfy the actual market demand, the company has to prove the resources availability and also the ability to combine and use all these resources in terms of efficiency and effectiveness.

The use of cost accounting systems and methods to guide current and future operations toward specified objectives; the analysis and interpretation of cost data is critical to the decision-making process (Lenhard and Colton, 2000).

A business professional must understand the organization's cost accounting practice to competently manage a specified area and understand how personal accountabilities are calculated and tracked (Stenzel and Stenzel, 2003).

In this context, it can be introduced the concept of strategic cost management which propose a new vision of the costs calculation and analysis. This consists in taking into account necessary the aspects and strategic priorities of the company (Drury, 2008).

3. Actions of strategic cost management

To ensure the success of a strategic cost management, it should be done three main actions (Ionescu, 2008): analysis of value chain; analysis of strategic positioning; analysis of cost sources.

Analysis of the value chain consists in detailing and analyzing all stages of conception and sale of a product corresponding to an activity area, starting with the raw materials and finishing with the sale of products or if it's the case, with the after-sales services. The method of analyzing the value chain is considered to be the most appropriate method of effective routing and / or cutting costs, which means:

- identification of the sector's value chain and attaching the costs to those activities that create value;
- identification of the factors that influence the specific costs of each activities;
- obtaining a durable competitive advantage managing the factors with influence on the costs better than the competitors and reconfiguring the value chain.

The value internationalization of the cost system becomes the pivot competition game between firms. The value support being correctly judged, the competitors impose the calculation of resources consumption necessary for obtaining it, in the most appropriate way. Finding the pertinence is replaced by the exactness as the customers can understand more clear the value chain. On the other hand, knowing the value that an activity brings to the customers, it is aimed to ensure this value with limited resources. As far as this is possible, the company can hope to maximize the added value internally, and to obtain additional competitive advantage externally.

In M. Porter (2004) opinion, the competitive advantage can depend on the way a company can manage its value chain: the company can offer superior quality for an equivalent price or equivalent quality for a lower price.

The analysis of strategic positioning starts from the idea that the companies can have two types of competitive advantages: cost advantage and advantage derived from offering superior products, differentiated. Combining those two advantages, it can result a third advantage.

The strategic position represents the second key of the cost management, after the value chain. Inside a company that applies a strategy based on reducing costs, on a consumer goods market that reached the maturity, the rigorously determined costs can be a solid instrument to control the management activity. In the other case, when a company uses a strategy based on differentiation, on a market with a significant growth rate, the manufacturing costs management is less important.

When the costs systems are made, it has been taken into account the strategic context where the company operates and the firm's mission, which can be influenced by: increasing the share market; maintaining the share market or maximizing short-term benefits.

The third key of the strategic management, analysis of the cost sources*,* starts from the idea that the identification and the analysis of the real cost factors can explain and quantify the best their behavior. So, the analysis of the cost sources can help to choose the best strategic options.

Professionals tried to separate the cost sources in two parts: structural sources and operational sources.

The structural sources depend on the economic structure of the company, being influenced by: internal organization, company size, the range of coverage, experience, technology and production complexity. Every structural factor requires from the managers decisional and strategic choices which will determine the positive or negative changes in costs. The operational sources include: use of enterprise labor force, use of production capacity, the efficient use of the company space, quality system, manufacturing of products, exploiting links with suppliers and customers.

4. Opportunity conditions for cost strategies

The materialization of the cost-based management is to develop and implement cost strategies. The cost strategy or volume strategy means that set of decisions with strategic feature, which are meant to guide primarily the company's efforts to minimize its cost of production. This includes production and design costs, engineering, distribution, advertising and promotion costs. This strategy is based on the idea that the strong competitive advantage is closely linked to the company ability to reduce its costs at minimum, compared to the direct competitors. This will provide a superior profit margin. For the successful of a cost strategy, the opportunity conditions should have three levels: the sector of the company's activity; the specific market; the enterprise itself.

Figure 1 shows the delimitation of conditions of opportunity for cost strategy on three levels cited above.

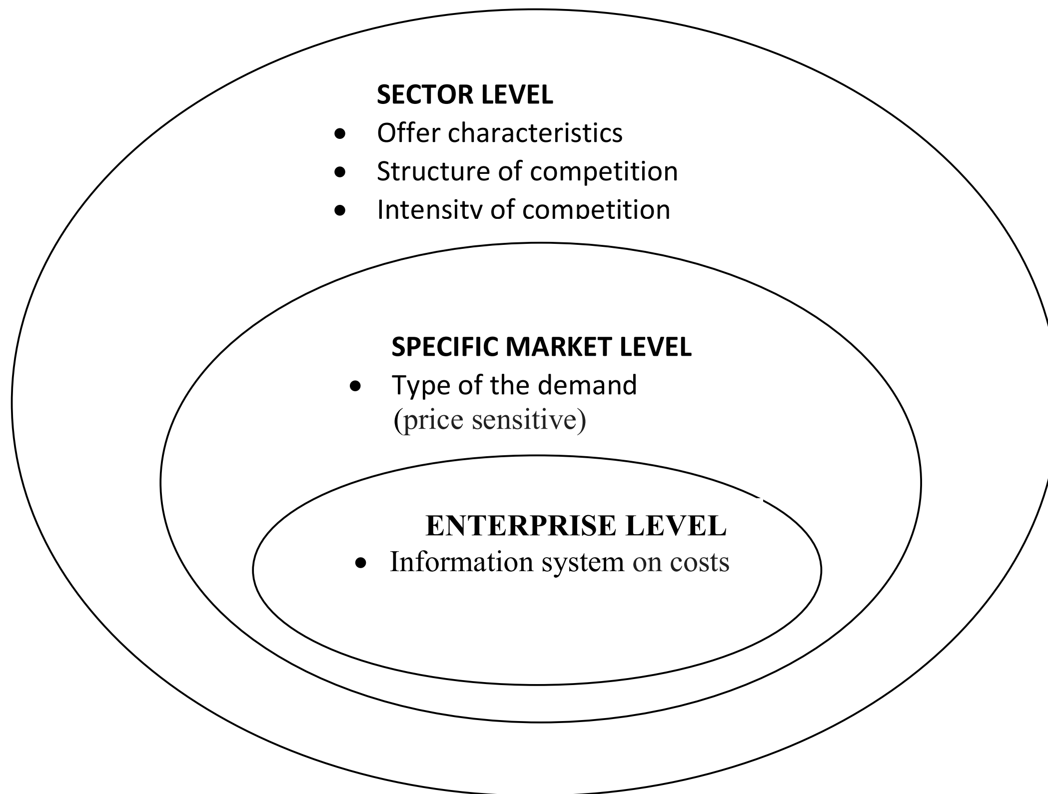

Figure 1. Delimitation of conditions of opportunity for cost strategy

At the sector level, the offer characteristics, the structure and intensity of competition are factors that can determine the costs to become a crucial strategic variable. In what may concern the pertinence of this variable, the studies made by Boston Consulting Group showed that the cost-based strategies are relevant in those sectors where can be exploited a limited number of key success factors, while the cost is a permanent factor and last used. It's the case of the industries based on volume and in some extend, of the deadlock industries.

At the specific market level, the type of the demand is taken into account because it can have direct influence in choosing the cost variable. Generally, this choice is considered to be good and economically justified when the demand is very price sensitive.

At the enterprise level, the choice of this strategy means that it is possible to implement an information system focused on careful observation of the costs. The cost system should allow: identification of causality links in costs, identifying opportunities for sharing-impairment, identifying responsibility centers and value perception. The final assessment of the cost system is primarily, according to its contribution to value creation and secondary, depending on the accuracy of the allocation of resources consumed. In practice, minimizing costs means to have savings of resources engaged to manufacture a unit of product. This is based on the optimal combination of three costs effects: volume effect, scale effect and experience effect.

The volume effect - corresponds to the scale economy and results directly from the production volume (activities volume). The economy of scale results on one hand, from the allocation of fixed costs over a greater volume of goods produced, and on other hand, from the reduction of investment per unit of capacity, when the total production capacity is increased. The increases of the production volume imply an optimal utilization of production capacity and a good organization of labor. Once obtained, the growth of a business activity,

therefore of its size, allows it to obtain a privileged place in dealing with the social partners (e.g. with suppliers), having favorable conditions in relation to competitors.

Theoretical and practical implications of the volume effect are concentrated in determining the Break-Even point (critical level of activity, in Figure 2) and the optimal level of activity (Petrescu, 2003).

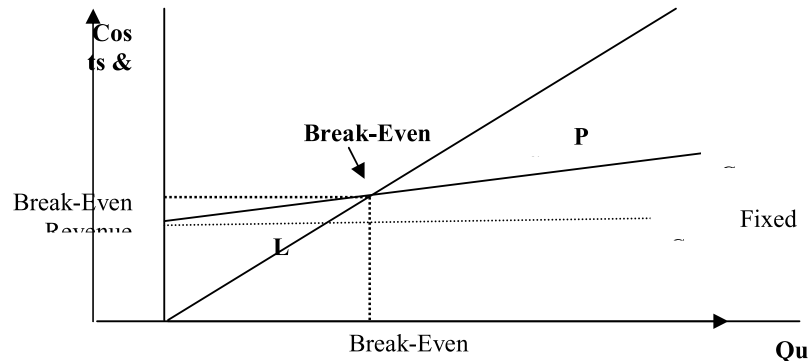

Figure 2. Break-Even Point chart

Effect of scale - called the range effect refers to the effect obtained by performing several different products within the same enterprise, compared to their production in several specialized companies.

When, within a single firm, there is several different production processes, their implementation will require both specific costs and significant common costs and the savings will be obtained mainly from the second category.

Economies of scale apply to a variety of organizational and business situations and at various levels. For example, a large manufacturing facility would be expected to have a lower cost per unit of output than a smaller facility, all other factors being equal, while a company with many facilities should have a cost advantage over a competitor with fewer. The economic concept dates back to Adam Smith and the idea of obtaining larger production returns through the use of division of labor.

In Figure 3 observed as quantity of production increases from Q to Q_1, the average cost of each unit decreases from C to C_1 (Sullivan and Sheffrin, 2003).

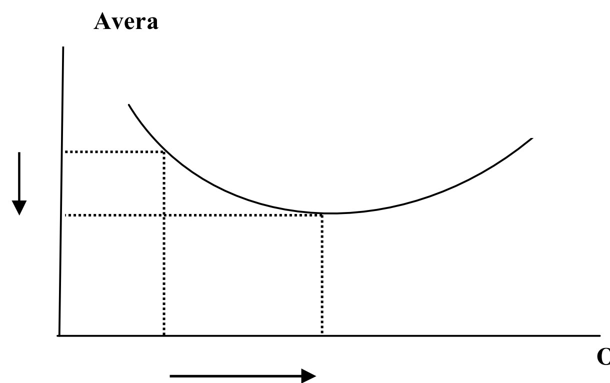

Figure 3. Economies of scale

The experience effect - is the best known in strategic analysis, being first observed in the 30s in the U.S. aviation industry and resumed in 1971 by the Boston Consulting Group. Later on, many management theories have turned to the use of this concept and highlighted the strategic implications that determine in practice.

According to the theory of the experience effect, the total unit cost of a product decreases by a constant percentage each time when the cumulative production company for the product doubles, specifying that the cost unit is measured in constant monetary units. It is noted that this theory links in a determining relationship, two coordinates of the activity: cumulative production and the unit cost of the product.

The cost reduction, determined with doubling cumulative production, varies depending on the sector, ranging between 10% - 30%, which means that allow under a sustained growth of the quantitatively factor, to obtain a decreasing curve of the unitary cost. This curve is called in economic theory the experience curve cost. This curve, also known in the cost theory as the average cost curve on long-term (Niculescu, 1997), it's not proper only for one company, but the whole activity area can be described based on its specific returns. The extents to which the existing firms in the sector benefit from the experience curve effects depend, however, on how manage their own resources. When the management resource proves to be ineffective, despite the accumulation of experience, unit costs departs from the experience curve, registering a cost derive.

The experience curve is a graphical representation in Figure 4.

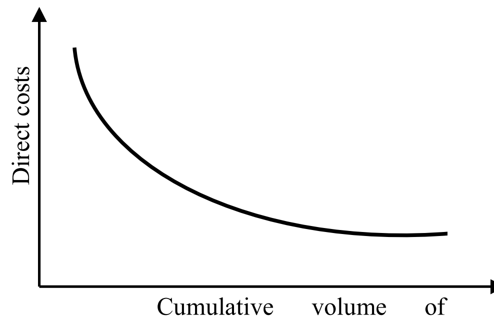

Figure 4. The experience curve

Therefore, the experience curve will be convex and have a downward slope, as shown in the adjacent diagram. It refers to the effect that firms learn from doing, which means that the higher the cumulative volume of production (X), the lower the direct cost per new unit produced (C).

There is a simple rationalization behind all this: there is a reduction in the average cost of production of a particular product, as a consequence of an increase in the firm's experience.

The experience curve is defined by the following function:

$C_n = C_1 X^{-a}$

where: C_1 = direct cost of first unit of production

C_n = direct cost of nth unit of production

X = cumulative volume of production

a = experience rate (%)

The experience rate corresponds to the elasticity of cost with regard to output.

The strategic implications of the experience effect can be traced primarily, but not exclusively, in those sectors or areas of mass activity where to fulfill the objective of accumulating experience, the companies try to maximize their production volume. When the market allows it, maximizing the output implies a proper increase in turnover and winning an important share of the market, to the detriment of competitors. The companies continuous fight to gain and maintain market position, generally results in a decrease in the average price to a level very close to the cost of the most important competitor (in terms of workload). As a result, competitors whose activity volume is low (implying a reduced size of these companies)

are unable to obtain an effect of experience comparable to the industry average, which leads to holding a marginal position in the market or even to their elimination.

We note that the cost advantage can be different depending on production volume (scale of the produce) and on type of production. Figure 5 shows how to obtain comparative cost advantage for two types of firms: one with small scale production (production on orders specializes in small batches) and other with mass production (high volume).

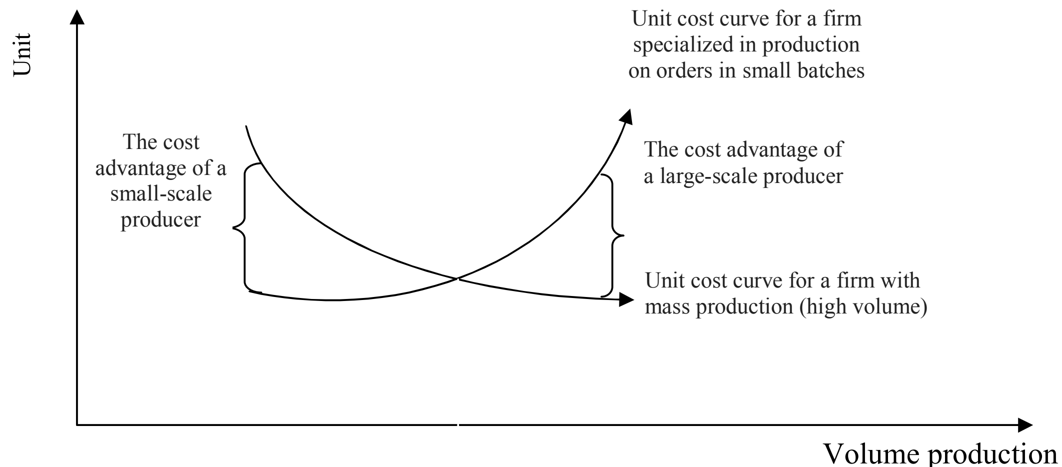

Figure 5. The cost advantage based on the volume and type of production

5. Cost strategies limits

Even though the cost strategy advantages are obviously, we think it's necessary to present also the limits of this strategy, for a better understanding. So, following the concept of experience curve in practice is not always easy, especially because of the difficulty to standardize the sectors development in the form of relevant experience curves. It's the case of those sectors where the big, medium and small size enterprises are together. The medium and the small ones are not forced to close their activities because can't reach the dimension that allows them to have the experience effect advantage. Also, in the sectors where most companies are medium to large size, and the effect of experience can feel in the cost, the pressure on firms directly involved is very high and the risk of making mistakes is high. It is well-known that a forced increase in the activity volume, without regarding the quality and production value perceived by customers, lead along with the market "saturation" at an excessive increases in stocks and inevitably at the cancellation of the advantage offered by reduced costs due to effect of experience. A past of this limit can be given by the cost strategy along with another/other consistent/compatible strategy/strategies. Uncontrolled expansion of production capacity in order to obtain rapid experience effect can generate losses with exponentially growing, many times greater than the economy realized by increasing labor productivity (Vâlceanu et al., 2004). This is explained by the influence of fixed costs arising from production capacity, regardless of its use degree. Since the international economic environment tends to turn from complicated into complex, the risks are more obvious: reducing costs being directly linked to increased workload should be noted that any significant increase in production capacity including research capacity, design and/or distribution, involves immobilization of financial resources and working capital necessary to ensure continuity of mining process. The problem is even bigger as the enterprises don't have these resources and are forced to contract significant bank loans. But, because the firms are not trustful anymore for the banks, it was established

excessive guarantees and a high level of interest, leading to an unacceptable cost of debt (which partially cancels the company's profitability).

Also, any financial blockages in the economy affect the enterprises activity through non-collecting the receivables-customers on time and failure to pay term debts. The cost strategy may turn against the company that implemented it through a boomerang effect on short and medium term. So, the balance proves to be hardly maintained in favor of positive effects and for this reason it is advisable that the cost strategy to be well founded and maintained in accordance with the characteristics of the economic environment (business environment)to avoid waste of resources in activities that do not purchase a real and sustainable competitive advantage.

The entry of a new competitor on the market may represent another risk, the effect of experience may be reduced or canceled if he succeed (by various means) to incorporate improvements of old competitors similar products to his products, to learn from an experience that is not his own, without spending the same amount as his competitors and, in the same time, manages to convince a financial institution to provide the resources necessary to obtain a significant amount of work in a relatively short time.

Cost strategies applied rigidly can negatively guide the enterprise's synergy to a reduced range of products, even unique, making it vulnerable to environment external threats. The danger of triggering a "fight" of market prices is another risk of applying this strategy, given that many competitors applies it, temporarily sacrificing their profit margins to sell at prices as low as possible, desiring more favorable market positioning. The consequence may be a degradation of the sector profitability and maintaining approximately the same market distribution between competitors.

Conclusions

The sustainable competitive advantage of a company depends on its ability to minimize costs in relation to direct competitors, which will enable them to obtain higher profit margins. For this purpose, the cost is a priority tool and therefore, a realistic optical cost management and strategy becomes a necessity of the current management.

However, the success of a cost strategy requires the existence of opportunity conditions defined at three levels: enterprise sector; specific market and the company itself.

At the sector level, offering features, the structure and intensity of competition are factors that may cause costs to become a crucial strategic variable.

At the specific market level, taking into account the nature of the demand, it can directly influence the strategic choice of the variable cost. Generally this choice is considered good and economically justified when demand is very price sensitive.

At the enterprise level, the choice of this strategy requires that it will be possible to implement an information system focused on careful observation of the costs. The cost system should allow: identification of causality costs, identifying opportunities for sharing-impaired, identifying centers of responsibility and value perception. The final assessment of the cost system is a priority, according to its contribution to value creation and secondary, depending on the accuracy of the consumed resources allocation.

For proper understanding of the utility of a cost strategy in the management company, it is necessary that, besides the obvious advantages, to be considered and taken into account the limits and risks inherent in implementing this type of strategy.

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