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Competing Globally with Cost Accounting

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Introduction

In a competitive market, where executives are scrutinized over every single decision, businesses need to gain a competitive advantage to maintain continued success in the industry. Of the numerous options that are available for executives, an effective accounting information system may be the key to creating a successful business. Within the accounting information system, the cost management system exists to provide reliable information to users inside the company. As the business world continues to spread globally, it is vital for a company to achieve an edge over its competitors. An organized cost management system allows a company to excel in functional areas that were lacking before within the business.

The paper will first define the concept of cost accounting and the three objectives that cost accounting deals with for managers. Afterward, it will explain the concept of globalization and tie the two ideas together. The paper will then explain problems with traditional cost systems, but then detail more effective tools from a cost management system. The paper concludes with three case studies that depict a company's success through the use of a cost management system. This paper seeks to explain that the utilization of an efficient cost management system will allow a company to make an impact globally.

What is Cost Accounting?

A person needs to understand what cost accounting encompasses to comprehend why it is beneficial for a business to implement an effective cost management system. Cost accounting seeks to provide cost information to cost objects. The term *cost* is defined as "the cash or noncash assets sacrificed for goods and services that are expected to bring a current or future benefit to the organization" (Hansen 24). For most companies, the benefits represent the revenues in an organization. Whenever costs are used to provide revenue, the costs expire and are called expenses. Ultimately, expenses are deducted from the revenue of a company to provide insight into the profit of the business. The costs that do not expire represent the assets of the company. Examples of these costs are land, building, and supplies of an organization. The difference between expenses and assets depends solely on the timing of the costs. *Cost objects* are "any item, such as products, customers, departments, projects, and so on, for which costs are measured and assigned" (24). In a shoe factory, the cost object is the shoe that is being produced. A cost object can extend to entire departments within a factory. If one wants to determine the cost of maintaining the utilities department inside the factory, the utilities department is the cost object. By identifying the cost objects within an organization, executives can get a sense of the costs involved in developing a certain product or maintaining a particular department. Thus, executives can use cost accounting to complete three primary objectives: product costing, planning and control, and decision making.

For a cost management system to be successful, it needs to help with these three specific objectives. First of all, the cost management system must be reliable in providing accurate "costing of products, services, and other objects of interest to management" (Hansen 5). Varying circumstances may call for executives to utilize different aspects of the cost management system to obtain the appropriate data. For example, whenever management calculates inventories for the balance sheet, they must use product costs determined by the generally accepted accounting principles. Product costs include all the cost of materials, labor, and overhead that are used for a cost object. If management desires further information beyond mere product costs for profitability and strategic reasons, they may use the cost management system to find additional costs associated with a product. These additional costs may include the costs used during product design, the development process, and even during marketing and distribution. By evaluating the entire costs associated with a particular product, management can decide whether to continue with the product or not. The accuracy of costs associated with a cost management system helps businesses to become more profitable, and immediately gives the company an advantage over other businesses with disorganized data. Accurate information is crucial in deciding the future direction that an organization takes. Management needs to invest in a reliable cost management system so that costs calculated for a cost object are as true as possible. Inaccurate cost assignments "can produce erroneous decisions and poor evaluations" (24). For many companies, the option of using outsourced employees may be determined by a cost management system. If the system is not up-to-date, executives may receive results that say producing internally costs less when, in fact, the outsourcing option will be more beneficial for the company in the long-run. Accurate costing measures are a key in a business environment that is fast-paced and always changing.

Secondly, a cost management system helps companies with planning and control purposes. It should "help managers decide what should be done, why it should be done, and how well it is being done" (Hansen 5). For example, cost measures help in planning various budgets within the organization: the production budget, the purchases budget, the marketing and administrative budget, the budgeted income statement and balance sheet, etc. With reliable cost measures, executives can be certain that their assumptions are on track with how they expect the company to perform in the coming years. Cost accounting also helps in determining the profitability of new product lines. Cost information can be used to figure out the expected revenues and costs for new products. Executives use forecasting to determine the revenue of the new product, and then calculate the costs involved in the entire process of developing and selling the product. Management would decide to produce the project by weighing the expected revenue against the associated costs. The cost management system aids in controlling the operations of the company and planning for the future. (Hansen 5)

Furthermore, the use of "cost information is a critical input for many managerial decisions" (Hansen 5). As stated previously, in deciding whether to outsource production or handle the operations internally, management needs to identify the costs of the materials, labor, and overhead involved in production. If management decides to outsource production, they need to know if the internal costs will be minimized. Cost accounting can be used to measure the fixed costs (costs that will be associated with the product whether made internally or externally) and variable costs (costs that will change when deciding to move production overseas). A cost management system can identify all the costs associated with the decisions that management needs to make for the progress of the company. If the executives inside an organization are willing to invest in an effective cost management system, it will help them tremendously. The use of cost accounting is essential in the operations of a business. With the emergence of globalization, it is even more important for a company to utilize cost accounting in an effective manner to capitalize on the trend.

Globalization

Currently, companies no longer have to imagine a world where businesses can operate on a global scale. The reality is that many multinational companies exist, and they cater to customers around the world. The boundaries that previously kept companies from exploring markets outside their own geographic location are now broken. Dr. Constantine Passaris defines the term *economic globalization* as “the global integration of economies through trade and investment flows, as well as the production of goods and services in order to enhance international competitiveness” or “the international integration of markets that result in an integrated global market without national economic borders" (Passaris 2). Countries are freely able to interact with one another through trade and other business transactions. The rise of globalization has allowed companies to expand tremendously by utilizing the resources, including natural resources, labor, and technology, which are abundant throughout the world. Businesses who take advantage of the global market are able to grow as a company and reach numerous consumers thousands of miles away.

The emergence of a global market comes from technological advancement and financial policies that have paved the way for global economic progress. With the invention of the internet, companies are able to connect with individuals across the world without being there physically. The internet has helped businesses to be "empowered by information and communications technology in a world with a tremendous capacity for virtual connectivity" (Passaris 8). Advances in communication have also allowed businesses to interact with one another from different countries. Improvements in telecommunications permit business conferences to occur through satellite imagery. This instantaneous access to information and communication through the new digital networks have created a fully integrated global economic system of tremendous scope and opportunity (Choudhry 1 & 217). Countries are also likely to pass policies that encourage international trade to boost the economy. Now, countries depend on one another to provide the necessary resources that they need on a daily basis. Globalization creates a direct link between countries and generates a dependence upon countries. Because of this inter-dependence that exists among countries, it is difficult for businesses to ignore the implications of a global market.

For a business to succeed as a multinational corporation, Dr. Passaris states they must adopt an "organizational vision that has a global reach" (11). Companies cannot be timid when striving to become a global company. Companies require communication skills to communicate with individuals with diverse cultural backgrounds. Companies will not only need to understand the tendencies of foreign consumers, but they also need to recognize the cultural values of their foreign employees. For a multinational company to operate successfully, the business needs to possess a strong organizational structure. Passaris also states that "product quality take on added significance" (11). Companies must have high quality standards so that individuals recognize the businesses as consistent and reliable. This aspect of quality lies in an effective cost management system. Cost information helps companies develop products that meet quality standards, but also reduce overall costs. In a global environment, companies have even more competitors to contend against in the industry. With reliable cost accounting, the business can achieve a competitive edge against its other competitors. A dependable cost management system helps in "reducing costs, improving productivity, and assessing product-line profitability" (Hansen 7). By using the concepts within cost accounting, businesses are better equipped to enter the global market and compete in today's modern world.

Problems with Traditional Cost Systems

Before implementing an effective cost management system, businesses must be aware of the problems of traditional cost systems. Companies must be willing to invest in a system that will accurately display cost information, or the system is of no value. Companies cannot simply use cost accounting concepts to gain value as an organization. Many companies' cost accounting systems do not measure costs accurately and are outdated. The various problems with current cost systems consist of using overhead rates instead of direct tracing, failing to segregate overhead costs, the improper use of cost drivers, and simply relying on a gross margin analysis.

First of all, businesses do not use direct tracing or costing whenever it is necessary to determine the exact costs of a product. The term *direct tracing* refers to "the process of identifying and assigning costs to a cost object that are specifically or physically associated with the cost object" (Hansen 25). Companies are not willing to invest the time and resources in a cost management system that allows for these costs to be interpreted using direct costing. Companies do not believe in the benefit of the system. Author Ralph Adler states that companies are ignoring the "advances in information technology [that] have greatly reduced the costs associated with tracking and assigning costs to specific products and services" (Adler 31). Instead, businesses place all the general costs into an "overhead" category. These costs are assigned to the products using singular cost drivers that are not representative of the cost object. By not utilizing direct tracing, companies do not get a sense of the real costs involved in producing a particular product. Adler states that by "using meters to measure different products' energy consumptions, motion sensors to detect the amount of time employees spend at given tasks, and bar codes to help calculate the costs associated with moving specific materials and finished products" (31), companies can become more competitive. Businesses must first make an investment in a reliable cost management system before executives can see results in the future. It is a valuable investment that will allow managers to see where the costs are located so that they can make the company more efficient. Companies are not recognizing the impact that an effective cost management system has on the organization.

Additionally, ineffective cost accounting systems exist because managers fail to separate overhead costs into different cost pools. Alder states that the "vast majority of companies categorize [overhead] into one cost pool" (Adler 31). The three costs associated with a product are the materials costs, the labor costs, and overhead costs. In these instances, management puts all costs that they cannot charge to materials or labor into overhead. This makes it difficult to examine the specific costs that are associated with a particular product. Management is unable to truly see the profitability of a product because the costs are not accurately allocated. These systems do not separate the overhead costs into familiar overhead categories. It is impossible to correctly associate overhead costs with these practices. (31)

Furthermore, traditional cost systems lack efficiency because of the "inappropriate use of cost allocation bases" (Adler 31). Cost management systems utilize cost drivers to allocate costs to products. In traditional cost systems, a functional-based cost accounting approach is used to acquire cost information. In these systems, usually only the cost drivers associated with direct labor hours or machine hours are used to assign overhead costs to products. In reality, though, these are not the only drivers that explain the relationships between the products and the costs associated with them. Adler writes that the use of direct labor to allocate overhead costs is "antiquated and outmoded" (31). He states that in many manufacturing companies, the direct labor costs are only representative of less than 10 percent of the product's total cost. Thus, using direct labor as the cost driver to allocate all overhead costs does not provide an accurate picture of where the costs came from. Some companies use "predetermined overhead rates that range from 500 to 2,000 percent of the direct labor cost. Products made using automated equipment tend to be charged an insufficient amount of overhead whereas products made using high proportions of direct labor tend to be overcharged" (Kinney 174). Many companies also use the cost driver, machine hours, to allocate overhead costs of materials purchasing, materials handling, scheduling, machine set-up, inspection, and product enhancement to products even though these activities do not relate to machine hours (Adler 31). The use of these traditional cost systems distorts product costs entirely. The use of activity-based cost accounting allows for more accurate costing methods, and will be discussed later in the paper. By not realizing the need for a more effective cost management system, management cannot truly compete against other organizations.

The final concern from traditional cost systems is the failure to penetrate beyond a gross margin analysis. Many companies ignore the costs of general sales and administrative expenses (e.g. marketing, distribution, or administrative) in the calculation of a product's costs. This failure stems from the fact that there is no requirement to include these costs from a financial accounting perspective. By ignoring these costs, managers do not recognize the total costs of a product. Companies that hire traveling salespeople to sell their products will accumulate more costs for each unit sold than products sold through brick and mortar stores and catalogs. Although there is a difference in the amount of costs, there will be no recognition in the cost analysis because these costs are ignored. Although it is not required by financial accounting standards, management recognizes the need to allocate these costs into the products. The assignment of these costs helps determine the true cost of a product, and allows for the company to recognize a need to change production levels. A traditional cost system does not provide the true potential for an organization. (Adler 32) It is important for companies to understand the shortcomings of traditional cost systems in order to develop an effective cost management system.

Developing an Effective Cost Management System

As companies enter a more competitive environment on a global scale, they "also require better cost information" (Kinney 174). This is made possible through the implementation of an effective cost management system. Advances in cost accounting have produced valuable tools that management can utilize in order to gain better information. A useful cost accounting system allows for business to acquire "accurate product and service costings for pricing, determining optimal product/service mixes, assisting with decisions on whether to and what to outsource, determining preferred channels of distribution, targeting activities for process improvement, managing customer relations, and making investment/disinvestment decisions" (Adler 30). It is important for businesses to adopt and utilize cost accounting methods that fully recognize costs and allow for innovation within the company.

In developing an effective cost management system, executives can apply several techniques that will undoubtedly assist in the operations of the organization. Executives should understand the importance of these methods in producing an efficient cost accounting system that will help cut costs and produce quality outputs. Techniques that management can utilize to develop a better cost management system to compete in the global market include standard costing, target costing, activity-based costing, and the just-in-time approach.

Standard Costing

For simply controlling costs, the usage of a standard costing system is beneficial for companies. The main reasons to develop a standard costing system are that it helps executives "manage costs, improve planning and control, facilitate decision making, and facilitate product costing" (Hansen 299). In this system, products costs are determined by using quantity and price standards for materials, labor, and overhead. For many organizations, the use of "standard costing variance analysis has been viewed as the most effective tool for cost control" (Kaplan 46). Managers develop standards on costs, or what they believe costs should be, and evaluate these predicted costs against actual costs. By using the standard costing system, companies can observe what parts of the process are over budget or take more costs to operate. However, standard costing does create some problems for the manufacturing industry.

One problem in many innovative companies is that executives are substituting actual employees with factory automation. Companies are reducing the costs of employees by using machines to manufacture the products. For this reason, many Japanese companies have lessened the importance of using standard costing. For example, in a company affiliated with Toyota, "standard costing is no longer the main tool for cost control or cost reduction" (Kaplan 46). Standard costing is a technique that improves the efficiency within a factory by focusing on the control of direct labor. Before, companies were able to use the variance analysis of direct labor within standard costing because they only hired employees to work inside the factory. However, as companies continue to innovate with unmanned factories, this variance has no value for management. The technological advances also hinder the implementation of standard costing methods. Standard costing stabilizes the production process. By setting particular cost standards, management knows the levels that the production department needs to operate in order to meet the specified standards. With new technological developments, factories already run on schedule with reduction in costs. Standard costing also places a burden on management to change standards once a new product is developed. Nowadays, the life cycle of many products is incredibly short, and it becomes extremely time-consuming to set the standard costs every time a product is discontinued and a new product is started. All of these factors lead to a caveat before investing totally in a standard cost system. (47) However, standard costing remains a popular tool for businesses because it does result in reduced costs. In many Japanese companies, the use of standard costing has reduced costs "by 2-5% at the production stage" (47). Since there is no viable substitute for accurately controlling cost at the production stage, it is still beneficial to utilize standard costing. If a business already excels in distribution and marketing, standard costing can help reduce costs in production.

Target Costing

Whereas standard costing reduces costs at the production stage, target costing helps reduce costs over the entire product life cycle. The term *target cost* is "the difference between the sales price needed to capture a predetermined market share and the desired per-unit profit" (Hansen 393). This difference is the allowable cost that managers permit for the cost of the product. This concept is captured in the formula below:[1]

TC = ESP – APM

Where: TC = target cost
ESP = estimated selling price
APM = acceptable profit margin

In this process, management must find cost reductions if current costs are higher than the target cost. This ensures that management changes the operations of the entire business in order to achieve such results. Target costing also requires "extensive interactions among the production, engineering, R & D, marketing, and accounting departments" so that everyone is in sync with the same idea (Kaplan 48). This cost management technique helps to reduce costs in each stage of the development of the product.

Companies that utilize target costing follow three distinct steps. The first step involves planning and designing a product of quality that meets the consumers' demands. The marketing department researches a need of the customer and develops a product that would be highly anticipated. When the results satisfy management, the project is available for the production stage. In the second step, executives set the target cost for the product. The exact cost is determined by the capabilities of the company and the desired profit that executives desire from the production of the product. The target cost is usually referenced as an allowable cost, which

[1] Formula taken from page 698 of Kinney, et al. *Cost Accounting: Foundations and Evolutions*.

the rest of the company understands to stay within the range. During this stage, the process of value engineering is utilized. *Value engineering* is "a disciplined search for various feasible combinations of resources and methods that will increase product functionality and reduce costs" (Kinney 699). The target cost that is set by top management is the attainable cost that is required by the production department. The final step is actually attaining the target cost at the production level. Employees attempt to achieve the results through trial and increased volume production. These target costs for products typically set standard costs for the business. It is a way for businesses to maintain relatively low costs levels during production. (Kaplan 48-50) The target cost is only the initial point of interest for management. With this in mind, the "target cost is continuously reduced in an effort to spur a process of continuous improvement in actual production cost" (Kinney 699). The use of target costing helps businesses to maintain a competitive attitude. It is important to always improve and innovate on current practices and methods. This cost management tool reduces costs across the company, and provides the profit margin that satisfies management. Target costing help companies achieve global success by continually cutting costs and enhancing the quality of the products.

<u>Activity-Based Costing</u>

As mentioned before, traditional cost systems do not reliably calculate total product costs. The system utilizes only a few cost drivers to allocate overhead costs, and most of the costs are placed in the same generic cost pool. Activity-based cost accounting, though, seeks to provide more accurate cost measures. An *activity-based costing (ABC) system* is "a cost accounting system that uses both unit and non-unit-based cost drivers to assign costs to cost objects by first tracing costs to activities and then tracing costs from activities to products" (Hansen 34, 96). In activity-based cost accounting, the system attempts to reveal costs through direct tracing instead of allocation. This creates a more accurate picture of the total costs associated with a product. Besides reducing costs, this cost management tool also improves the final price that customers pay for the product by focusing on the activities involved. The philosophy behind using activity-based costing is the value that it provides to customers "at a cost less than the price customers pay for that value" (Kaplan 65). Thus, managers need to control the sources of value and the drivers of costs in the resource-consuming activities. In activity-based costing, the "global competitor continuously attempts to eliminate nonvalue activities and to reduce resources consumed by value-adding activities" (65). The implementation of an activity-based costing system is vital to the success of any company that possesses global aspirations.

The implementation of an activity-based costing system requires five steps. The first step involves identifying all the activities associated with production. Activities are defined as the "groupings of related actions" (Adler 37). For example, the activity "paying for materials" might have several actions. These actions could include looking over the bill of lading to see if all the materials were received, checking the invoice, and actually paying for the materials. A company might either desire to have a detailed list of activities or a more generic listing. It depends on the costs that management is willing to invest in the system. If management wants a more exact and complex system, the "costs associated with operating the ABC system will be higher" (37). The exact specifications depend on the accuracy that the company requires. The second step is determining the costs of the activities. This requires the company to examine the records to trace all the costs associated with the activity. This means that management needs to know all the actions involved with the particular activity and accumulate the total costs. The third step is identifying the cost drivers to measure costs. This is divided into two distinct stages. Initially, the first-stage drivers are selected. The first-stage drivers trace costs into cost pools that make up each activity. It is important that the first-stage drivers are directly related to the activity to ensure accurate cost measures. The selection of an inappropriate first-stage driver "will likely jeopardize the usefulness and accuracy of the ABC system" (38). After the appropriate first-stage drivers are selected, second-stage drivers are chosen to allocate the cost pools to the products. It is also important for the second-stage driver to be related to the product's consumption of the particular activity. Choosing the right cost drivers is essential in developing an activity-based costing system that is beneficial to the company. The fourth step is deciding on the annual capacity for each activity. For example, if the cost driver for the activity "setting up lots" is direct labor hours, management must set the allocated labor hours for the activity. This decision is fixed and unable to be changed unless the resources are eliminated or redeployed. The last step involves calculating the activity overhead rates. This ultimately will be used to provide costs to products and helps management stay within budget. The implementation of an activity-based costing system may be exhausting and complex, but it provides management with important cost information that provides needed benefit to the company. By separating costs into activities, management receives a better indication of the total costs associated with a product. (Adler 37-39)

There are many benefits included in an activity-based costing system. The accuracy of costs in this system allows managers to distinguish the profitability of different products. Managers can identify the exact activities that are associated with each product and calculate the total costs. They can then compare the costs to the revenue that the product produces for the organization. If the profit margin is lower than the company's standards, management can filter through each activity to find ways to reduce costs. The use of ABC information also has allowed for the change in distribution channel profitability. Banks, in particular, have benefitted from the cost information received from activity-based costing systems. They realized that the "transaction costs arising from personal teller service is much higher than automated teller machines, telephone banking, and electronic banking" (Adler 41). With this in mind, banks have started developing different fee structures to mirror the different costs associated with each transaction medium. Banking institutions have used this information to gather costs and provide prices for their distribution channels. Further benefits exist that are associated with the activity-based costing system. This use of cost accounting is revolutionizing the operations of businesses around the world.

Just-in-Time Approach

Although not entirely a cost management tool, the just-in-time approach is important to mention briefly in this paper. Many companies that have adopted effective cost management systems also apply just-in-time approaches in their production. The two philosophies have similarities that have enabled companies to thrive in a global environment. The just-in-time philosophy is the "continual pursuit of productivity through the elimination of waste" (Hansen 172). The primary concern of the just-in-time approach is "supplying a product that is needed, when it is needed, and in the quantity it is needed" (172). It requires an extensive contract with the supplier so that the company knows it will deliver the necessary inventory when asked. In this system, process costing is used to calculate product costs. Work cells are created that monitor products from development to completion. Costs are calculated by cell for the period of time. Overall, the just-in-time philosophy produces an efficient inventory management system. The one requirement for a JIT approach to function properly is the "highly efficient coordination of the purchasing, production, and marketing functions" (Stefanovic 8). It needs all the components of the production process to be reliable or the system loses its efficiency.

GE Company represents a prime example of a company that implemented a new cost management system in order to complement its just-in-time approach. As a "global manufacturer of industrial and consumer products, with nearly 300,000 employees making about 135,000 different products in over 350 locations worldwide" (Kaplan 64), GE is the perfect model for a company that understood the need for an effective cost management system to continue to have success in the long-run. The company began its change in 1980 when it saw the need to change as new competitive pressures approached. The company visited Japanese plants since they were the first to develop the just-in-time technique and utilize other cost management techniques. The organization was "among the first to initiate pilot projects to implement just-in-time and computer automation concepts in American plants" (64). As GE developed these new JIT approaches, the company realized that its traditional cost accounting systems did not trace the benefits from the JIT approaches. It was later on that GE "began a concerted effort to design performance measures appropriate to manufacturing practices" (65). The company realized that a new cost management system was necessary to calculate costs accurately and continue the success it had from the JIT approach. The organization utilized both techniques to continue to diversify its product line and maintain its profitability. GE understood the need to implement cost management techniques for the future of the company.

These four main tools enable a company to develop an effective management system. Companies can invest in whichever tool they believe will assist them the greatest. Implementation can vary in scope because companies differ in the amount of resources that possess. The paper now describes three different case studies, in which companies utilized a cost management system for the success of the companies.

Case Study: Japan

In most Japanese companies, cost management is a relevant practice that extends through every industry. Many organizations understand the impact that cost management techniques have on the business, and utilize many of the practices in order to excel in the competitive environment. This part of the analysis considers the practices that the country uses as a whole, and analyzes its effects on the businesses. In Japan, cost management deals with the "problems of managerial decision-making for the purpose of achieving managerial goals" (Hiraoka 104). Companies use cost information to justify rational decision-making. The use of cost management has allowed Japanese companies to find hidden costs within their companies. This allows management to "find obsolete combinations of resources and create new alternatives for a better resource combination" (113). Companies want to utilize costs in an efficient manner, and not waste the resources on activities that do not create value. For Japanese companies, waste is a major issue that the country wants to eliminate from its businesses. They understand that the "waste of overproduction will cause excessive input of resources" (113). The country considers working too fast to be a form of waste. The surplus of waste represents the excessive costs that are used to create a singular product. Companies understand that there is always a way to reduce costs to improve the product. To remove the waste, Japanese companies implement the Toyota system, or the just-in-time approach. Japanese companies emphasize "continuous improvement of individual causal variables such as operations, machines, people's movement, and equipment" to reduce costs and create quality products (113). Japanese companies continue to innovate with the use of cost techniques.

Japanese management also uses target costing as a strategic weapon. Japanese companies emphasize that in order "to survive in the market, target costing is primarily a technique to strategically manage a company's future profits" (Hiraoka 118). Japanese companies follow six principles to achieve the target cost. The first principle comes from price-led costing. Referring back to the target costing formula noted above, the target cost comes from the selling price of the product minus the desired profit. Whenever management sets a particular price, they ultimately limit the costs involved with the product as well. In order to achieve a set profit margin, companies need to reduce costs to the target level. The second principle is the focus on customers. Companies want to provide value to the consumers of the product. Whenever the customer is dissatisfied with the outcome of the product, then the costs involved are too high. When the customer is satisfied with "the value of the product, the cost is justified" (119). Within Japanese companies, there is also a focus on design. The use of "cost management in target costing requires excellence in product and process design" (119). Management is unable to reduce costs unless they have a concrete understanding of the finished product. Thus, they can trim any unnecessary details from the product without damaging the integrity of the final design. The fourth principle is an emphasis on cross-functional teams. Japanese companies utilize individuals from all functions of the company to analyze the costs involved in the development of a product. They have the responsibility of managing the product from conception to final production. The fifth principle of target costing is value chain involvement. For target costing to be effective, Japanese companies require "participation from outside members who are connected via [the] value chain" (119). By getting involvement upstream and downstream the value chain, management is not restricted to reducing costs only within the company. They can negotiate costs with suppliers to reduce overall costs. The final principle is life cycle costing. Target costing needs to be used to allocate costs throughout the entirety of a product's life cycle. Management should be able to reduce costs whenever the product reaches its obsolescence stage so that the company still maintains its profits. Japanese companies follow these key principles in order to fully realize the impact of target costing.

Japanese companies are continually relying on cost management to help in the growth of their organizations. They even “organize small groups based on workplaces to encourage improvement activities” (Hiraoka 140). The country understands the importance of cost management and is persistent in finding new ways for cost reduction and product improvement.

Case Study: HomeHealth

In this case study, HomeHealth demonstrates the use of an effective activity-based costing system to improve overall business performance. HomeHealth is a non-profit home care agency that is part of a large Presbyterian-Medical Center located in the Midwest. The organization provides home health services to individuals surrounding the metropolitan area and other surrounding counties. (Adkins 42) Through mismanagement and quick decisions, the organization has hired too many employees and has developed a system with too many processes, forms, and activities. These added items have increased the complexity of the organization and raised the costs associated with operations. The problems that HomeHealth faced was a need to reduce costs, maintain quality standards, and provide services that are valued by the customers. Its traditional cost system could not handle the pressures that the organization faced. It was necessary to implement an activity-based costing (ABC) system to fight the problems. (43)

In the initial stages, the use of the ABC system was to identify “high-cost activities that would benefit from reengineering or process improvement” (Adkins 44). During these pilot phases, two main costs discoveries revolved around preauthorization referrals and nurse visits. With the ABC system, “it was discovered that nearly 20% of all referrals required preauthorization, a statistic that was previously unknown” (44). The findings also showed that preauthorization added $36 to the cost of each referral. The activity-based costing system also revealed the activities involved in a nurse visit. Nurses identified five common activities, and, through the use of ABC, management was able, "for the first time, to identify the cost of each of these activities" (45). The initial success of the activity-based costing system led to the development of the system agency-wide. Overall, HomeHealth "developed a dictionary that identifies and defines processes and 84 activities" (47). After the implementation of the ABC system, management was more aware of the true cost of providing its various services. The implementation of the ABC system led to many benefits. HomeHealth received increased customer satisfaction, reduced costs per visit, better coordination/continuity, and increased staff satisfaction. At the time, HomeHealth "was innovative and far ahead of others in its ability to use an ABC model" (62). The ABC system allowed the company to make changes to actual or budgeted data to better understand the impact of the changes. In its implementation, the organization used interviewing as the primary method to gather information about particular activities performed. Overall, the implementation of an ABC system is expensive and time-consuming, but the results may warrant such a change. The opportunity for change exists through this example of using activity-based costing to enhance performance and cut costs.

Case Study: Wendals Foods

Wendals Foods exists as a subsidiary of Aardvark Industries Ltd. Manufacturing 90 different products and distributing to over 24,000 outlets, the company possesses 35% of the South African snack food markets. (Adkins 136) Due to intense competition, Wendals Foods decided the company needed to change its cost systems in order to compete with the other multinational companies. Wendals Foods decided to develop an initial ABC project that took six steps. The first step involved identifying the value chain processes. It is important to understand all the processes involved within the company in order to recognize the activities associated with each stage of the process. The next step was defining the key activities within each process of the chain. This allows costs to be calculated using the most direct measure of each activity. Third, the organization created five teams from various functional areas of the company to collect financial and nonfinancial data. Next, the data that was collected was used in spreadsheets to test basic ABC principles within each process. The results were organized as a "snapshot" that represented a sample of products and customers. Finally, profitability statements were developed, and then the full-scale implementation approach and project were created. (139) Initial results showed that previously costs measures did not accurately portray costs. The ABC model showed that the previous measure of "cost per case" was "a gross simplification of the business and was more likely to mislead than to provide insight" (139). Wendals Foods, however, did not fully implement a total activity-based costing system. The company simplified the data in the ABC implementation to fit the system in its short period of time (140). Even with the shortened system, the company realized immediate results from use of more effective cost management. The company used the initial process to "restructure sales routes, close depots, and modify customer discount structures" (144). The use of the primitive ABC system allowed the company to recognize excessive costs and change to lessen the vulnerability of the company. Wendals Foods recognized that, when faced with fierce competition, it is important to "implement innovations in its business management processes" (135). Wendals Foods did this by developing an activity-based costing process to better recognize costs and compete against the multinational corporations.

Corporate Strategy in a Global Environment

Corporate strategy has completely changed from past generations. The traditional cost systems that worked for companies years ago have no value in today's global market. In a *Harvard Business Review* article, Cooper and Kaplan state that "distorted cost information is the result of sensible accounting choices made decades ago" (96). In those days, companies only managed a narrow product line and overhead rates determined by direct labor hours had only minor effects. These days, companies offer a variety of products and services that require more accurate cost information. The costs of these products stem from various activities that are not correctly portrayed through traditional cost systems. Also, direct labor represents a tiny fraction of cost of many products. Cooper and Kaplan realize that the "intensified global competition and radically new production technologies have made more accurate product cost information crucial to competitive success" (96). Companies that rely on traditional cost systems possess "bad information product costs [that] lead to bad competitive strategy" (96). Companies cannot maintain legitimacy without adopting effective cost management systems. The use of an activity-based costing system, in particular, leads to "radically different evaluations of product costs and profitability than more simplistic approaches" (102). The use of cost accounting is a way for a company to present innovative approaches to cost recognition and product quality. Companies that possess strong cost management tools are able to compete more effectively on a global scale.

Conclusion

In a gradually shrinking world, the "process of globalization is creating a world in which nation states are increasingly interdependent and interconnected" (Stefanovic 2). Although this allows for greater opportunities for businesses, it also leads to intense competition vying for market share. The use of cost accounting makes a company more effective in fighting these rivals. An effective cost management system is essential in pursuing future growth and maintaining an optimal level of costs. By recognizing the importance of cost accounting in a company's daily operations, management can more easily handle global markets and actually become a standard among other organizations.

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