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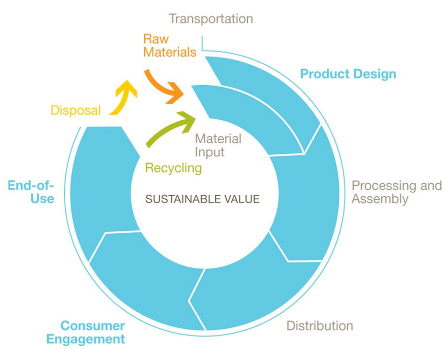
STRATEGIC COST MANAGEMENT AND THE VALUE CHAIN



The value chain in any firm or business is linked set of value-creating activities from basic raw sources to the ultimate product or services that is delivered to consumers. The strategic cost management (SCM) that emerge from value chain analysis are different and better than the traditional accounting approaches. The traditional management accounting adopts a focus that is largely internal to the firm with each firm viewed in the context of its purchase, its processes, its functions, its products and its customers where else in SCM the focus is external to the firm, with each firm viewed in the context of the overall chain of value-creating activities from raw material to end user. The management accounting takes a value added perspective that starts with payments to suppliers and stops with charges to customers. This article proves that value chain analysis is more efficient than value added analysis.

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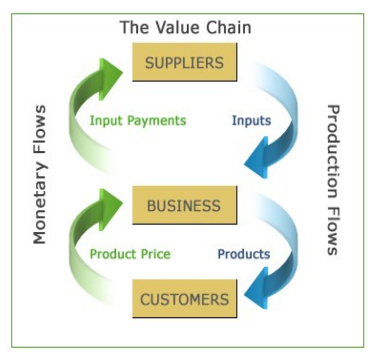
CONCEPT OF VALUE CHAIN

A business can develop a sustainable competitive advantage by following one of two strategies:

* Low cost strategy
* Differentiation strategy



"We have to choose between a global market driven only by calculations of short-term profit, and one which has a human face." - Kofi Annan

Low Cost Strategy

The primary focus of a low cost strategy is to achieve low cost relative to competitors (i.e., cost leadership). Cost leadership can be achieved through such approaches as:

1) Economies of scale in production;
2) Tight cost control
3) Cost minimization in such areas as research and development, sales force, services and advertising

Differentiation Strategy

The primary focus of a differentiation strategy is to create something that customers perceive as being unique. Product uniqueness can be achieved through such approaches as brand loyalty, superior customer service, dealer network, product design and product features.

THE VALUE CHAIN FRAMEWORK

The value chain framework is a method for breaking down the chain from basic raw materials to end use customers into strategically relevant activities in order to understand the behaviour of costs and the sources of differentiation. So, a firm is typically only one part of the larger set of activities in the value delivery system. Suppliers not only produce and deliver inputs used in a firm's value activities, but they importantly influence the firm's cost or differentiation as well.

"Quality is never an accident; it is always the result of high intension, sincere effort, intelligent direction and skill execution; it represents the wise choice of many alternatives"

- William foster

METHODOLOGY

The value chain concept just described has a unique methodology. It involves the following steps:

1) Identify the industry's value chain, then assign costs, revenues, and assets to value activities
2) Diagnose the cost drivers regulating each value activity
3) Develop sustainable competitive advantage, either through controlling cost drivers better than competitors or by reconfiguring the value chain

Value Increase

While continuing the focus on managing the existing value chain better than competitors, a company should devote more effort toward identifying where in the value chain payoffs could be significant.

CONCLUSION

There are several significant challenges in using value chain analysis. First, accounting systems are not designed for classifying costs by value activities. But as we have learned with the implementation of activity based costing, this type of cost classified problem can be solved

Second, it may be difficult to obtain accurate return on sales and return on asset data to construct the industry value chain. However, important insights can be gleaned from rough estimates. Finally some companies and some industries may have very complex value chains, which make the analysis difficult.

In spite of these challenges, value chain analysis is an important tool for strategic management, and when competition is intense, companies must manage activities and costs strategically or they will lose their competitive advantage.