STRATEGIC MANAGEMENT
ACCOUNTING

(BB315009S)

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What is this module about?

- This module looks at the management accounting needs of those making strategic decisions.

- Provides the knowledge and skills required to make quality decisions when managing an organisation's (or strategic business unit’s) resources.
Module Learning Outcomes

1. Select and use appropriate analytical techniques to optimise employment of resources.

2. Critically appraise such techniques and their outputs, suggesting appropriate adaptations and other factors relevant to related decisions.

3. Judge the validity of their findings in relation to the strategic management of an organisation.
Assessment

- An unseen three-hour examination.
- There will be five questions and you will have to answer four of those.
- Each question will carry equal marks.
- To pass = an overall mark of 40%.
Chapter 1:

What is SMA, incorporating Kaisan, target costing and lifecycle costing
A) What is strategic management accounting (SMA)?

Definitions

- The provision of information to support strategic decisions in organizations (Innes, 1998).

- Review of literature by Lord (1996) identified the following strands:
  1. Extension from internal focus of management accounting (MA) to include external information about competitors.
  2. The relationship between the strategic position chosen by the firm and the expected emphasis on MA.
  3. Gaining competitive advantage through exploiting linkages in the value chain.

- Target costing, is also identified as falling within the domain of SMA.

- Strategic role of MA emphasized in formulating and supporting the overall strategy of an organization by developing an integrated framework of performance measurement.
External information about competitors

• MA should help firm evaluate its competitive position relative to the rest of the industry.

• Managers require information that indicates by whom and by how much they are gaining or being beaten.
Accounting in relation to strategic positioning

- Advocates that firms should place more emphasis on particular techniques depending upon the strategic position they adopt.

- Evidence to suggest that:
  
  1. Business units following a defender strategy place a greater emphasis on the use of financial measures for rewarding managers.
  2. Non-financial measures for determining executives’ bonuses increases with the extent to which firms follow prospector strategies.
  3. Businesses following a build strategy rely more on non-financial measures of performance for determining managers’ bonuses.

- Advocated that defenders (Miles and Snow) and business units pursuing a low cost strategy (Porter) should adopt results measures that emphasize cost reductions and budget achievement.

- Business units competing on the basis of differentiation (Porter) or those prospecting new markets should require more information than a cost leader about new product innovations, design cycle times and R&D.
Gaining competitive advantage through exploiting linkages in the value chain

• Focuses on each link in the chain from the customer’s perspective.

• Claimed that traditional management accounting starts too late and finishes too soon in terms of the value chain.

• Porter advocates identifying the value chain and operation of cost drivers of competitors in order to understand relative competitiveness.
What is this?

Egg → Caterpillar → Pupa → Emerging Butterfly → Adult Butterfly
B) Life-cycle costing (LCC)

• Traditional management accounting procedures have focused primarily on the manufacturing stage of a product’s life cycle.

• LCC focuses on costs over the product’s entire life cycle to determine whether profits earned during the manufacturing phase will cover the costs incurred during the pre-and post-manufacturing stages.

• A large proportion of a product’s costs can be committed or ‘locked in’ during the planning and design stage (see Figure 22.1).

• Cost management can be most effectively exercised during the planning and design stage.
Figure 22.1 Cost committed and incurred during a products lifecycle
C) Target costing

- Focuses on managing costs during a product/service’s planning and design phase.

- Involves the following stages:
  1. Determine the target price which customers will be prepared to pay for the product.
  2. Deduct a target profit margin from the target price to determine the target cost.
  3. Estimate the actual cost of the product.
  4. If estimated actual cost exceeds the target cost investigate ways of driving down the actual cost to the target cost.

- Iterative process involving:
  1. Tear-down analysis
  2. Value analysis and functional analysis

- It is important that target costing is supported by an accurate costing system using appropriate cause-and-effect cost drivers.
Why?

• Customer focus
• Covers all related production costs
• Covers life cycle
• Iterative process – all functions – team approach
• Basis for monitoring performance
An example of target costing

Projected lifetime sales volume: 300,000 units
Target selling price of the product: £800
Target profit margin (30% of selling price): 240
Target cost: £700
Projected cost: £700

Analysis of the projected cost before and after the target costing:

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<td><strong>Manufacturing cost</strong></td>
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<td>Direct materials (bought in parts)</td>
<td>390</td>
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<td>Direct labour</td>
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<td>Quality assurance</td>
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<td>Engineering and design</td>
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<td><strong>Non-manufacturing costs</strong></td>
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<td>Marketing</td>
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<td>Distribution</td>
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<td>After-sales service and warranty costs</td>
<td>27</td>
<td>97</td>
<td>19</td>
<td>64</td>
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<tr>
<td><strong>Total cost</strong></td>
<td>700</td>
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<td>555</td>
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D) Kaizen Costing

• *Kaizen* costing is applied during manufacturing stage whereas target costing is during planning stage.

• *Kaizen* costing focuses on production processes whereas target costing focuses on the product.

• *Kaizen* costing aims to reduce costs of processes by a pre-specified amount relying on employee empowerment.
E) Benchmarking

• Objective is to improve key activities/processes
• Compares key activities/processes with world-class best practices.
Questions
Group Discussion:

New techniques are often described as contributing to cost reduction. You are required to discuss about benchmarking, kaizen costing and target costing technique in aspect:

• What are the objectives?
• How it’s working?
• How it would contribute to a cost reduction programme?