CGMA®

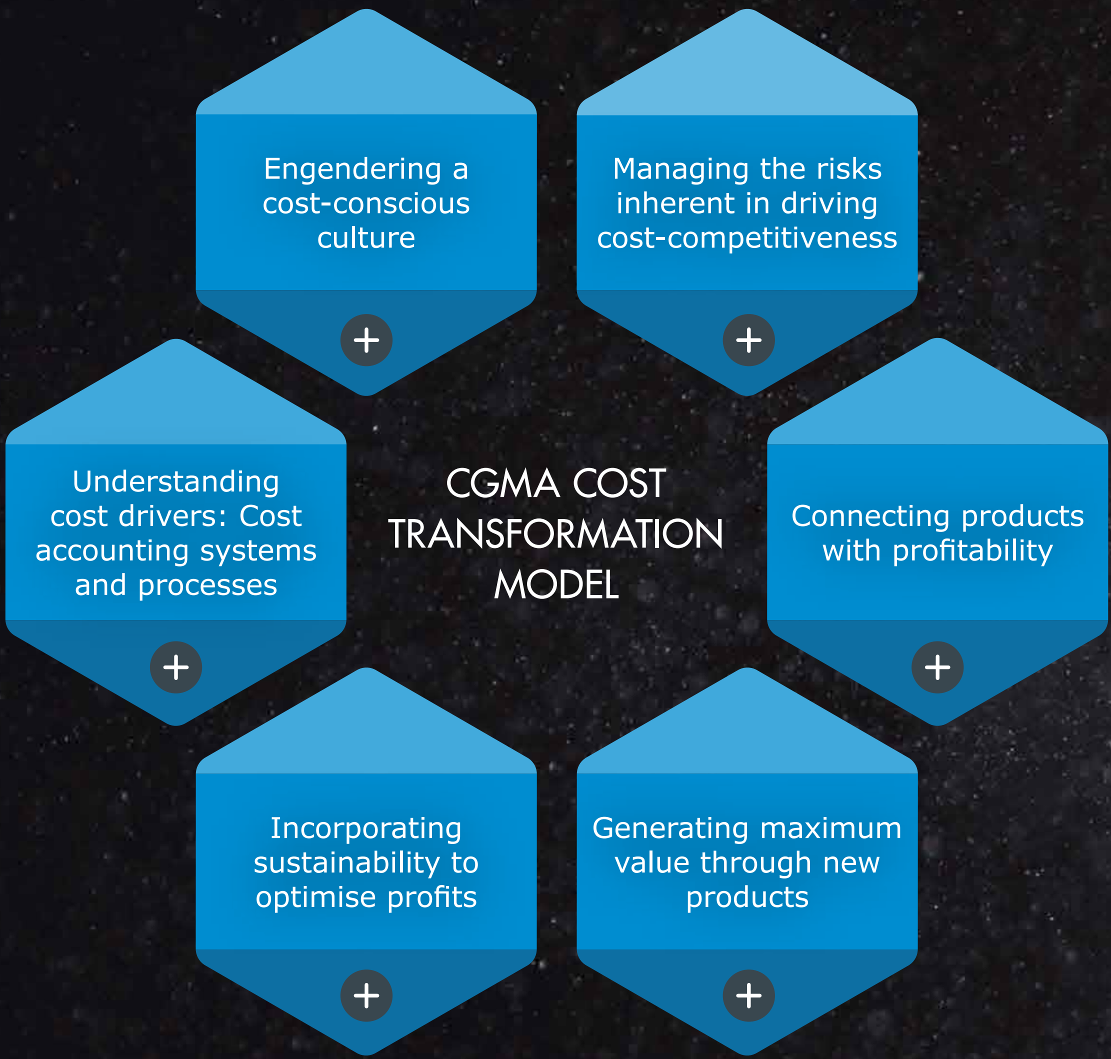
COST TRANSFORMATION AND MANAGEMENT

Create a business that is not just leaner, it's more competitive too.

CGMA℠
Chartered Global Management Accountant

Powered by AICPA® | CIMA

Two of the world's most prestigious accounting bodies, AICPA and CIMA, have formed a joint venture to establish the Chartered Global Management Accountant (CGMA®) designation to elevate and build recognition of the profession of management accounting. This international designation recognises the most talented and committed management accountants with the discipline and skill to drive strong business performance. CGMA® designation holders are either CPAs with qualifying management accounting experience or associate or fellow members of the Chartered Institute of Management Accountants.



The CGMA Cost Transformation Model is designed to help businesses to achieve and maintain cost-competitiveness. It serves as a practical and logical planning and control framework for transforming and continuously managing a business' cost competitiveness. The model transcends the finance function, requiring the full participation of and buy-in by all functions and processes.

www.cgma.org/cost

COST TRANSFORMATION AND MANAGEMENT

A new industrial revolution is challenging traditional businesses models. The combined effects of rapid changes in technology, communications and information are the key forces that threaten to disrupt the ways in which businesses have traditionally operated.

The competitive advantage

To survive, businesses must become globally cost competitive and carefully scrutinise their business models. Leadership must look for transformative opportunities to improve their cost structures while continuing to generate value for customers and aggressively exploit these opportunities.

Failure to deploy measures to dramatically improve cost-competitiveness risks a business being eclipsed by more nimble competition that can spring out of anywhere and at virtually no notice. In a world where competition is rife, it is vital that businesses release resource to fund growth strategies and innovation and retain competitiveness.

This means that cost management is simply not enough anymore – businesses need to move from being good cost managers to cost leaders.

> "After 2008, we were feeling the effects of an economic climate where a strong pound was making imports cheaper than locally produced goods and impacting our sales volumes. The steel industry is fixed cost-intensive and reducing our variable costs would not have a significant enough impact. Our challenge was to find a way to re-structure our fixed costs base and differentiate our sales."
>
> Claire Osmundsen-Little, ACMA, CGMA, Finance Controller, Packaging, Tata Steel Europe

Technology eliminating cost

Technology is eliminating cost as a barrier to entry. Fixed costs of production are now becoming less costly. For example:

- Computer aided design (CAD) software has become a commodity, with some basic versions free to download.
- 3D printing is making the printing of components that previously needed costly machining processes.
- Digital technology has made it technically possible to produce a film at a fraction of the fixed cost that used to be needed.

In some disruptive business models variable costs are significantly reducing. An example of this is transport company Uber. After setting up a web based platform (its primary fixed cost) all that remains to grow its business is for operators (individuals or fleet operators) to sign up to the Uber platform at very low marginal cost to Uber.

With rapid and ongoing improvements in communications and logistics competitors can be anywhere. Increasingly, producers are having to change the way they do business to maintain competitiveness. The supply chains of the largest businesses have become global to take advantage of lower cost centres and the ready availability of high calibre people globally. Components of business models retained as core competencies have to be continuously improved to generate value on a sustainable basis.

The information revolution

The information revolution, epitomised by the internet, makes product price information readily accessible and, therefore, competition on price more pervasive. This is forcing producers to drive down costs to maintain competitiveness. Knowhow is a lot more accessible with the democratisation of knowledge made possible by the internet.

"When looking to bring down costs, a key area that can benefit from extra scrutiny is your supply chain management. It's not enough to simply seek out the lowest cost suppliers."

Bob Cortese, CPA, CGMA, Canadian Controller, CTS Corporation

"We all know the saying 'watch the pennies and the pounds will take care of themselves', suggesting that micro managing small expenditure paves the way for profits. But I believe that being penny wise can in fact mean being pound foolish. It's crucial to see the bigger picture of your business costs."

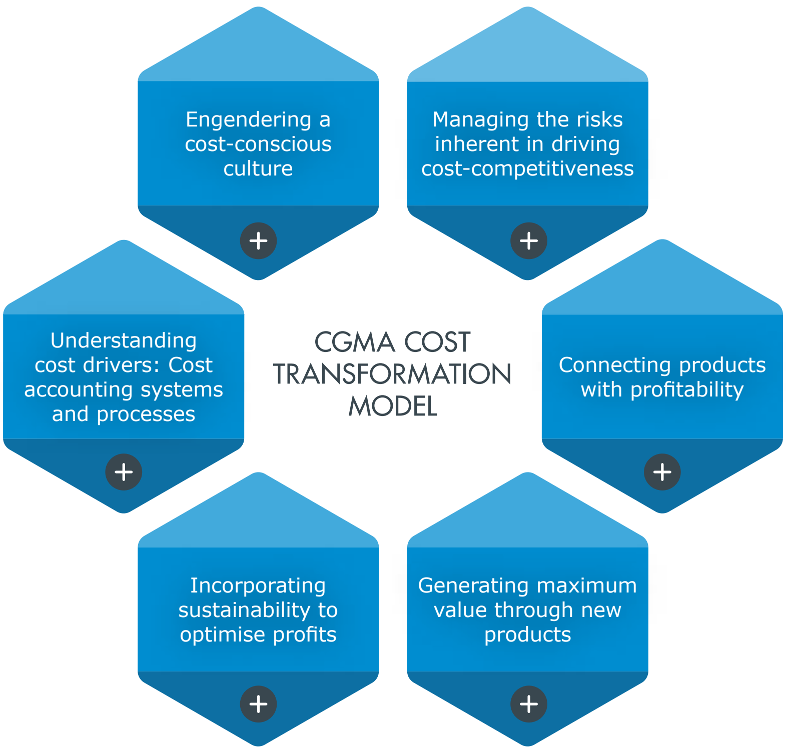
Kevin Eidelman, ACMA, CGMA, Group Financial Manager, Calgro M3 Holdings Ltd

CGMA COST TRANSFORMATION MODEL

The CGMA Cost Transformation Model is designed to help businesses to achieve and maintain competitive advantage. It serves as a practical and logical planning and control framework for transforming and continuously managing a business' cost-competitiveness. The model transcends the finance function, requiring the full participation of and buy-in by all functions and processes.

The framework consists of a set of six co-dependent areas that are based on the following principles:

- If you don't have a strategy to transform costs then how can people be focused on your cost-competitiveness?
- Maintaining the cost-competitiveness of an organisation requires the ongoing focus of appropriately skilled and motivated people across the business, supportive systems and processes and aligned organisational structures that, together, engender a cost-conscious culture.
- Even if you do have a strategy to transform costs then there will be risks associated with the strategy, which will need to be managed to ensure successful execution of strategy.
- The best way to transform costs is to avoid incurring them in the first place by understanding what the customer's needs and wants are and only responding to these if sustainably profitable to do so.
- It's easy and quick for competitors to copy your cost transformation initiatives. Therefore, to succeed in beating competitors you need to keep them copying (to keep them chasing). The only way of doing this is to continuously drive and hold costs down by eliminating waste.
- For people to be motivated to drive and hold costs down they need understand and to trust the numbers (transparent and logical cost accounting processes), be able to see the discrete results of their efforts reflected in the numbers (information), and be in a position to make a difference (structure aligned to responsibility).



1. Engendering a cost-conscious culture

Any business can cut costs on a one-off basis. It takes a great deal more sophistication to drive cost-competitiveness on a continuous basis whilst preserving or enhancing customer value. To make cost-competitiveness front of mind a business' strategy must explicitly focus on cost transformation and management. However, nothing happens without people and, so, to execute the cost transformation and management strategy well people need to be aligned to the organisation's purpose and to respond in ways that keep the organisation agile in the face of destabilising influences. Since it is easy for competitors to copy a leading cost transformation and management strategy people must be motivated to continuously improve cost-competitiveness as part of their everyday responsibilities.

2. Managing the risks inherent in driving cost-competitiveness

The focus of risk management, in this context, is around what could get in the way of the business achieving its cost transformation and management objectives. Whilst businesses in differing markets will invariably face risks that are unique to their markets or even to their business, certain risks to cost-competitiveness may be more prevalent, depending on circumstances.

Globalisation

In the past businesses needed only to consider their immediate environment as a source of risks and opportunities. Developments in communications and logistics, for example, have contributed to the globalisation of competition. Globalisation also provides opportunities for the supply chain; businesses may find that they are able to source inputs at lower cost, components and skills for example. It may pay a business to offshore elements of its business model to reduce costs. However, this could have implications for business agility.

Technology improvements

Technology improvements and breakthroughs present both opportunities and risks to business models. New technologies can enable a business to reduce its cost base. However, there can be implications for the cost structure of the business and these technologies are usually readily accessible to competitors, which means that businesses are sometimes faced with stark adopt-or-die scenarios to maintain cost-competitiveness. The rapidity of technology evolution can expose a business to having to accelerate the writing-off of previously adopted technology earlier than originally planned, which could be disruptive to cost models.

Commodity costs

Commodity costs typically fluctuate with supply and demand. Mitigating this risk is fraught with uncertainty. For example, a business may base its plans on an assumption that the cost of a key input commodity increasing and hedge against this scenario. However, the commodity could drop below the hedged cost potentially leaving the business with a cost disadvantage relative to competitors.

Businesses must consider, and manage, their ability to withstand possible risk events. Financial strength is a factor in determining a business' capacity, or ability, to withstand possible risk events. It must also consider its tolerance, or willingness, to expose the business to the possible risks inherent in its cost strategies.

In planning to exploit opportunities the management accountant must consider the risks inherent in potential opportunities. This should not be an ad-hoc exercise; rather, risk should be managed more formally using tools designed for the purpose. The risk management framework should raise levels of awareness amongst staff of the possible impact that perceived risks could have on the ability of the business to achieve its strategic goals. The framework should also assign ownership for accountability of risks to individuals, whose role it is to develop countermeasures to neutralise or reduce the impact or lessen the likelihood of occurrence of a risk event. These individuals are then tasked with reporting risk events and the effectiveness of countermeasures to management.

3. Connecting products with profitability

The word profitability is usually associated with the financial bottom line of a business – and the bigger the better. It is a construct that simplistically represents the net value generated for owners by a business over a defined period of time. Commercial businesses seek to maximise this to generate maximum value for owners.

However, some businesses, such as charities, exist not to make as big a profit as possible but to make only as much profit as is required to sustain their reserves. Charities strive to maximise the value they generate for targeted beneficiaries. Any profits in excess of the amount required to sustain reserves represents value not delivered to beneficiaries. Whatever the type of business, the value generated by its products for its customers must be analysed and understood. If a targeted beneficiary segment of a charity does not value its product offerings then demand will drop and donors will no longer be inclined to contribute. Turnover will decrease and the charity could face an existential threat.

This is similar for a commercial business. If its targeted customers do not value its products they will either pay a lower price or transfer their custom to alternative sources of supply. Therefore it is important for the management accountant to analyse product profitability within customer segment and devise strategies to maximise product profitability by customer segment. Understanding the product value generated by customer segment will enable the business to tailor its product portfolio and improve methods for serving its customers.

4. Generating maximum value through new products

New products should be designed for flexibility to facilitate the addition or elimination of features to suit as many markets as possible without sacrificing margin. The purpose of creating value for customers is to enable higher prices to be charged to stimulate what economists call customers' "willingness to pay."

It is vital to engage relevant stakeholders, including for example sales and marketing, engineering, production, logistics and the management accounting function early in the conceptualisation of new products to agree variants to serve each targeted customer segment. Whilst multiple variants of the product may be indicated by sales and marketing this can be achieved most efficiently and effectively if the creative and development functions are represented, since due consideration can be given to commonality of components and modules. Production representatives can consider how components from differing modules or sub-assemblies can be most efficiently and effectively routed through production and can influence product development on component or module options.

Since 80 percent of a product's cost is determined at the design stage it is vital that product design takes account of the marketable price and required margin. Once the design of the product is established, relatively little latitude exists to reduce the cost of a product. Decisions made after the product moves into production typically account for another 10 to 15 percent of the product's costs. The role of the management accountant in the new product development phase cannot be over stated. The management accountant must work alongside colleagues to drive down costs, drive up customer value and develop and gain buy-in to the costing and pricing logic and structures at this conceptualisation phase.

Sustainability is good for profits too. Costs that are avoided by design not only improve cost-competitiveness but can also reduce resource consumption, therefore contributing to the sustainability of operations. For example, reducing the number of machining steps in a manufacturing process could reduce material waste, power consumption and tool wear. Avoiding such costs will have a direct positive impact on the bottom line.

5. Incorporating sustainability to optimise profits

Reducing the detrimental impact of a business' activities on the natural capital upon which we all depend enhances a brand's image and therefore sales, improves profitability by reducing long-run costs and helps address future natural capital availability and tightening regulatory requirements.

Adopting sustainable approaches across the business model, for example in research and development, manufacturing, packaging, logistics and marketing, drives resource optimisation across the value chain. Product cost structures should reflect the costs of natural capital consumed or the costs of replenishing this consumption. A business' strategy should specify sustainability objectives and describe the general approaches, measures and targets for achieving these. Since a business exists in wider society its operations should be in harmony with its surrounding society. It should specify corporate social responsibility objectives and describe the general approaches, measures and targets for achieving this harmony. Practices, processes and activities across the value chain should continuously advance the sustainability of the business model. The costs of sustainability initiatives, practices and processes should be accounted for in product costs, including, were applicable, full lifecycle costs.

6. Understanding cost drivers: Cost accounting systems and processes

To drive and hold down costs whilst at the same time preserving or enhancing customer value on an ongoing basis you need the right information. Whilst some scenarios may be intuitive, at some point taking decisions based on intuition alone is likely to result in some value destruction. Even when intuitive decisions are taken it can be challenging to assess the impact of decisions without an appropriately comprehensive record to report systems and processes. Whilst not all the components of robust cost accounting systems and processes will be relevant to every organisation, every organisation should critically evaluate their systems and processes from time to time to ensure they can continue to support effective decision making into the future. This means that management accountants, with their knowledge of the business model and future plans and strategies, should plan for the future decision support needs of decision-makers.

CONCLUSION

Cost management is central to the finance and accounting functions and a key component of a management accountant's role. In order to survive, businesses must become globally cost-competitive and carefully scrutinise their business models.

Organisations need to identify opportunities for fundamental changes in the ways they generate value for customers and transform and become cost leaders – not just cost managers. CGMAs have a critical role to play in cost transformation.

Visit the CGMA **Cost Transformation Model** to access all that is needed to make your business globally cost-competitive.

www.cgma.org/cost

HOW TO BE A COST LEADER: CGMA SOLUTIONS

Each of the six areas of the CGMA Cost Transformation Model are supported by guides, practical tools and templates to help management accountants implement cost transformation and management within their organisations.

Tools

Your practical toolkit to help you embed cost transformation within your business and become a cost leader:

ABC Inventory Management

ABC / XYZ Inventory Management

Achieving Alignment, Shared Purpose and Agility Analysis

Activity-Based Budgeting (ABB)

Activity-Based Costing (ABC)

Balanced Scorecard

Beyond Budgeting

CIMA's Strategic Scorecard

EFQM

Enterprise Risk Management

Environmental Management Accounting

Kaizen

Kotler's Five Product Level Model

Lean Production

Lifecycle Costing

McKinsey 7-S Framework

Porter's Five Forces of Competitive Position Analysis

Product Family Master Planning

Risk Heat Maps

Target Costing

Value Chain Analysis (VCA)

XYZ Inventory Management

Case Studies

Case studies featuring perspectives from finance professionals who have embedded cost transformation within their business:

Bob Cortese, CPA, CGMA, Canadian Controller, CTS Corporation

Kevin Eidelman, ACMA, CGMA, Group Financial Manager, Calgro M3

Claire Osmundsen-Little, ACMA, CGMA, Finance Controller, Packaging, Tata Steel

Global Management Accounting Principles©

Cost transformation and management is one of the CGMA Global Management Accounting Principles© practice areas. Developed by the AICPA and CIMA, the Principles reflect the perspective of CEOs, CFOs, academics, regulators, government bodies and other professionals in 20 countries across five continents.

The purpose of the Principles is to support organisations in benchmarking and improving their management accounting systems. They help the public and private sectors make better decisions, respond appropriately to the risks they face and protect the value they generate.

American Institute of CPAs

1211 Avenue of the Americas
New York, NY 10036-8775
T. +1 212 596 6200
F. +1 212 596 6213

Chartered Institute of Management Accountants

The Helicon
One South Place
London EC2M 2RB
United Kingdom
T. +44 (0)20 7663 5441
F. +44 (0)20 7663 5442

CIMA REGIONAL OFFICES:

Africa

4th floor, 54 Melrose Boulevard
Melrose Arch
Melrose North
Johannesburg, South Africa
T: +27 (0)11 788 8723
F: +27 (0)11 788 8724
johannesburg@cimaglobal.com

Europe

The Helicon
One South Place
London EC2M 2RB
United Kingdom
T: +44 (0)20 8849 2251
F: +44 (0)20 8849 2250
cima.contact@cimaglobal.com

Middle East, South Asia and North Africa

356 Elvitigala Mawatha
Colombo 5
Sri Lanka
T: +94 (0)11 250 3880
F: +94 (0)11 250 3881
colombo@cimaglobal.com

North Asia

1508A, 15th floor, AZIA Center
1233 Lujiazui Ring Road
Pudong Shanghai, 200120
China
T: +86 (0)21 6160 1558
F: +86 (0)21 6160 1568
infochina@cimaglobal.com

South East Asia and Australasia

Level 1, Lot 1.05
KPMG Tower, 8 First Avenue
Bandar Utama
47800 Petaling Jaya
Selangor Darul Ehsan
Malaysia
T: +60 (0) 3 77 230 230/232
F: +60 (0) 3 77 230 231
seasia@cimaglobal.com

CIMA also has offices in the following locations:

Australia, Bangladesh, Botswana, China, Ghana, Hong Kong SAR, India, Ireland, Malaysia, Nigeria, Pakistan, Poland, Russia, Singapore, South Africa, Sri Lanka, UAE, UK, Zambia and Zimbabwe.

cgma.org

Association of International Certified Professional Accountants

AICPA | CIMA