

Evaluating the application of strategic cost management in the South African automotive industry: A case study

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ABSTRACT

TITLE: Evaluating the application of strategic cost management in the South African automotive industry: A case study

KEYWORDS: Strategy, Strategic Cost Management, Cost reduction, Case study, Automotive

In the ongoing drive to maximising value for shareholders through revenue enhancement and cost rationalisation, organisations tend to pursue cost cutting as a mechanism to realise instant cost savings and the resultant increase in profits. This is achieved to the detriment of the long-term success of the business. Cost cutting is often reactive in nature and sometimes leads to the termination of value adding services. Strategic cost management aims to resolve the aforementioned shortcomings by adopting a strategic approach to cost management.

The purpose of the study is to evaluate how an automotive firm perceives the application of strategic cost management techniques. The theoretical background to the research is based on differentiating between traditional cost management and strategic cost management, analysing specific strategic cost management techniques relevant to the automotive industry, integrating the concept with the appropriate theoretical framework and analysing the significance of the various tools and methods pertinent to the successful application of the concept.

The study adopts a qualitative case study based approach to research, which considers Company A, an automotive company located in South Africa. Questionnaires and interviews demonstrating the qualitative nature of this study were administered to a group of participants representing primary and key support functions. The empirical study aims to establish the extent to which the automotive industry perceives the application of strategic cost management.

The findings indicate that strategic cost management is perceived as a concept that leads to optimisation of costs and consequently enhances the strategic positioning of firms. However, the application of the concept in the automotive industry to successfully realise its benefits continues to remain a challenge. It is recommended that sustainable objectives and related strategies, focussed on strategic cost management, be developed in the industry.

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CHAPTER 1

1 INTRODUCTION

1.1 BACKGROUND

The automotive industry remains one of the largest industries globally with 88.7 million vehicles sold in 2015, reflecting a 2% growth relative to the previous year (Petit, 2016). This is an acceptable growth rate given the marginal global economic growth in 2015 (World Bank, 2016). Although the industry is considered a major contributor to global gross domestic product (GDP) growth, it has realised a relatively modest growth of 3.6% on average sales since 2011 (OICA, 2016). This comes off the backdrop of the global financial crisis which resulted in considerable decline in global vehicle sales between 2008 and 2009 (OICA, 2016).

During this period and the years to follow, motor vehicle manufacturers were challenged to find other avenues to improve profitability. This led to the prioritisation of cost management as one of the key areas of focus, with specific emphasis on driving costs down without compromising quality. Globally, motor vehicle manufacturers are focused on relentless cost reductions to reduce prices through efficiency improvements, improved productivity and the relocation of manufacturing closer to markets with high demand in order to avoid logistics costs, trade barriers and currency risks (AIEC, 2015:9).

South African motor vehicle manufacturers produce vehicles for the world market, which means vehicles should be identical regardless of whether they were made in the United States of America (USA) or Europe or South Africa. This means that local suppliers must be able to deliver on technology and quality levels that are on par with those anywhere else in the world, at comparable cost (AIEC, 2015:9).

The question, however, remains on whether cost reduction is driven primarily as an operational goal with short-term benefits, or as a long-term strategic objective that leads to competitive advantage in the industry. The latter will result in sustained long-term benefits to shareholders, whose primary objective of investment in the automotive industry is to maximise returns. From this emanates the need for strategic cost management in the automotive industry. This is corroborated by research undertaken by Carr and Ng (1995:347) which affirms that Nissan's approach to total cost control is not merely operational and short term in nature, but entails a strategic approach through utilising target costing principles.

Cooper and Slagmulder (2003:23) defined strategic cost management as the application of cost management techniques so that they simultaneously improve the strategic position of a firm and reduce costs. This definition emphasises the importance of strategic cost management as a technique that leads to cost optimisation and competitive advantage. Miculescu and Miculescu (2012:863) concurred with the cost optimisation role of strategic cost management, but also incorporated its short- and long-term advantages into their definition. They defined strategic cost management as the methods and activities used by managers in planning and controlling decisions, in the short and long term, that allow reduced costs and increased commercial value for products and services (Miculescu & Miculescu, 2012:865). Anderson (2005:2) defined strategic cost management as deliberate decision making aimed at aligning the firm's cost structure with its strategy and optimising the performance of the strategy.

Based on the analysis of the above definitions, the following definition of strategic cost management was prescribed for the purposes of this study: *The efficient and effective use of cost management techniques by an organisation to support its implementation and achievement of strategic objectives.*

1.2 LITERATURE REVIEW

A number of studies exploring the relevance of strategic cost management in various activities of business were undertaken across industries in numerous countries. Research was also directed at expanding the scope of strategic cost management in business and at assessing the impact of contemporary trends on strategic cost management.

The significance of strategic cost management was raised by Blocher, Stout and Cokins (2010:viii), highlighting the importance of the role of cost management in assisting management of an organisation to attain success through strategy implementation.

A number of in-depth studies on strategic cost management have been developed in the field of value chain, supply chain and cost driver analysis. Shank and Govindrajana (2008:3) made reference to the importance of integrating strategic management with cost analysis. The emergence of strategic cost management results from a blending of the following three themes (Shank & Govindrajana, 2008:8):

1. Value chain analysis;
2. Strategic position analysis, and
3. Cost driver analysis.

A study conducted in Turkey by Apak, Erol, Elagöz and Atmaca (2012:528) reinforced the themes highlighted by Shank and Govindrajana (2008:8) by exploring the contemporary trends in cost management and analysing the impact these trends have on strategic cost management, with specific emphasis on value chain analysis, strategic position analysis and cost factor analysis. This is further supported by research undertaken by Savič, Vasiljevič and Đorđević (2014:1006) that studied strategic cost management as an instrument for improving the competitiveness of the agriculture business in Serbia. The study highlighted the limitations of conventional accounting systems, with emphasis given to modern costing systems which should be applied in conjunction with identifying all inefficiencies in current business operations. It requires introduction of innovation in business, continuous improvement and analysis of the value chain, not only at the enterprise level, but also in the entire supply chain (Savič *et al.*, 2014:1018).

Strategic cost management as a tool in optimising the effectiveness of supply chain management has extensively been researched, and new elements arising from strategic cost management have been introduced as a result of such research. A two-part study of the integration of strategic cost management into a firm's supply chain by Anderson and Dekker (2009a, 2009b) proposed that strategic cost management should be split into two elements: (1) Structural cost management, and (2) Executional cost management. Structural cost management is aimed at re-engineering processes to create a different cost structure (Anderson & Dekker, 2009a:202). Structural cost management furthermore employs tools of organisational design, product design and process design to create a supply chain cost structure that is coherent with firm strategy (Anderson & Dekker, 2009a:201). Executional cost management, on the other hand, employs measurement and analysis tools, e.g. cost driver analysis, supplier scorecards to evaluate supply chain performance and sustainability (Anderson & Dekker, 2009b:289). Therefore the primary purpose of executional cost management is to optimise the performance of a given strategy using appropriate management accounting techniques.

Henri, Boiral and Roy (2016:269) examined the relationship between the strategic cost management components identified above and their impact on financial performance. By analysing the environmental costs of 319 Canadian firms, the study investigated the links between the tracking of environmental costs (executional cost management), the implementation of environmental initiatives (structural cost management) and financial performance. More specifically, two research questions were investigated: (i) to what extent do executional and structural cost management influence financial performance specifically, and (ii)

to what extent does structural cost management mediate the link between executional cost management and financial performance (Henri *et al.*, 2016:272)? The study concludes with the assertion that: 1) tracking of environmental costs is one important executional cost management tool that helps align a firm's resources and associated cost structure with short-term tactics through cost reductions; 2) the development of environmental initiatives is one aspect of structural cost management that helps to align a firm's resources and associated cost structure with long-term strategy through the re-engineering of the value chain and production of a different cost structure, and 3) the tracking of environmental costs indirectly influences financial performance through the implementation of environmental initiatives. Therefore the two elements of strategic cost management, i.e. executional and structural cost management, work together to influence financial performance.

With specific focus attributed to the third theme emphasised by Shank and Govindrajana (2008:8) of cost driver analysis, Dubois (2003:365) demonstrates in her study that strategic cost management can lead to significant cost rationalisation of a firm's supplier base. The study proves that, through changes in purchasing strategy which shifts focus from individual transactions to buyer-supplier relationships and external relationships with other related stakeholders, considerable cost savings can be realised by firms (Dubois, 2003:373).

Anderson, Asdemir and Tripathy (2013:643), while researching the same function, illustrated how managers combine information in formulating a resource procurement plan as a means of strategic cost management. The study concludes that, while a strategy focusing on agility reduces unpredictability of cost behaviour, it leads to higher unit costs for resources and loss of control over resources. A strategy focusing on committed resources leads to greater cost irregularities, but may provide competitive advantages due to lower unit costs and greater control over resources (Anderson *et al.*, 2013:649).

The studies above are limited to analysing the relevance of strategic cost management on the value chain, strategic position analysis and cost driver analysis. To supplement these studies, Cooper and Slagmulder (2003:23) conducted a study on strategic cost management that addressed its impact on the broader organisation and beyond organisational boundaries. The study identified three distinct steps that require the conversion of a firm from unfocussed cost management to strategic cost management (Cooper & Slagmulder, 2003:23):

- Audit existing and planned cost management initiatives to ensure that they enhance the firm's strategic position.
- Extend the scope of internal cost management beyond the walls of the factory, and

- Extend the cost management program beyond the boundaries of the firm.

Gliaubicas and Kanapickiene (2015:255) also studied strategic cost management on a broader scale by researching the extent to which Lithuanian companies use strategic cost management practices. They noted in their conclusion that the size of a company is immaterial in the usage of strategic cost management techniques and companies tend to use more strategic cost management practices due to intensified competition and because they have adopted a strategy (Gliaubicas & Kanapickiene, 2015:259).

It is evident from the above literature that strategic cost management is studied comprehensively and applied extensively, both within and beyond the confines of business. However, there is no specific evidence of previous research done on the relevance of strategic cost management in neither the South African automotive industry nor in the global automotive industry. Notwithstanding the limitations of research on this topic, motor vehicle manufacturers have prioritised the importance of cost reduction techniques within their operations and moreover have integrated these practices into their strategic objectives.

1.3 THEORETICAL FRAMEWORK

The relevance of theory in management accounting research has become increasingly important. This is evidenced by the research done by Bromwich and Scapens (2016:3) which illustrates the increasing importance of theory in management accounting over the last ten years. According to Whetten (1989:491), the mission of theory development is to challenge and extend existing knowledge, not simply to rewrite it. In light of this context, Otley's (1999) framework for analysing the operation of management control systems was deemed the most appropriate theory for this study, and was subsequently integrated into this research through the practical application of the framework. There are five key questions that the framework addresses (Otley, 1999:365):

1. What are the key objectives that are central to the organisation's overall future success, and how does it go about evaluating its achievement for each of these objectives?
2. What strategies and plans has the organisation adopted and what are the processes and activities that it has decided that would be required for it to successfully implement these? How does it assess and measure the performance of these activities?
3. What level of performance does the organisation need to achieve in each of the areas defined in the two questions above, and how does it go about setting appropriate performance targets for them?

4. What rewards will managers (and other employees) gain by achieving these performance targets or, conversely, what penalties will they suffer by failing to achieve them?
5. What are the information flows (feedback and feed-forward loops) that are necessary to enable the organisation to learn from its experience and to adapt its current behaviour in the light of that experience?

The empirical study (Chapter 4) of this research includes an assessment of the response to the above questions and determines the extent of the effectiveness of strategic cost management with reference to the performance framework. Malmi and Granlund (2009:608) acknowledged the need for a coherent set of propositions on how to respond to each of these questions in a given situation. The results could be a managerially useful, yet disciplinary distinctive theory of how to use management control systems to achieve superior performance.

1.4 RATIONALE OF THE STUDY

A study undertaken by Wyman (2015:4) reveals that the continuous cost pressure in the automotive industry, created by legislation, competition, increasing risk and stagnating customer demands, has a strong impact on innovation management. Traditional cost cutting programs are not enough; motor vehicle manufacturers and suppliers will have to significantly improve efficiency in all research and development (R&D) processes to keep costs under control. Cost improvement measures, such as offshoring of engineering, complexity-reduction programs, standardisation and modularisation or the development of low-cost cars will help the industry to control some of the cost increases produced by the growing number of functions (Wyman, 2015:4).

This is demonstrated by the world's leading motor manufacturers, Toyota and Volkswagen, embarking on the adoption of an innovative production technology by shifting a considerable share of vehicle manufacturing to new cost saving production platforms which incorporate an increased use of common components. Toyota expects to reduce development costs by at least 20% through this new production technology (Bloomberg, 2015).

It is evident that cost pressures in the automotive industry justify the need for developing critical strategies on cost management. This study therefore aims to add to existing literature by evaluating critical principles and concepts of strategic cost management and how they interface with the organisational processes of an automotive company to achieve competitive advantage. The research will be in the form of a case study of an automotive company located in South Africa: Company A.

In addition to exploring new concepts pertaining to strategic cost management, the study will make regular reference to existing literature in its pursuit of evaluating the impact of strategic cost management on the automotive industry. The practical aspects of the concept will be explored, which will further enhance the understanding by stakeholders of the role of strategic cost management in the industry.

The core audience of this study would be the finance professionals in the automotive industry who would understand the relevance of strategic cost management by gaining insight into literature and results of the study. The peripheral audience would be students and academics who would stand to benefit from the study by gaining theoretical and practical understanding of the relevance of this topic in the automotive sector.

1.5 PROBLEM STATEMENT

Cost pressures in the automotive industry continue to pose a challenge to firms, but this also leads to an opportunity to realise that improved, innovative strategies are required to optimise costs and achieve objectives. This was highlighted by Ford when the company discovered a sudden escalation in production costs at its German plant. This required the development of a strategy that effectively and timeously addressed the issues that led to cost escalation. The company also implemented a new manufacturing operating system, called “One Manufacturing”, which would help the company improve efficiency, increase manufacturing capacity utilisation, and reduce overall production costs (Automotive-fleet, 2012). It is apparent from the analysis of existing research and literature that strategic cost management is essential in securing competitive advantage for firms. The analysis of current literature has identified a gap in research pertaining to the value of strategic cost management in the automotive industry.

The problem of the study can therefore be aggregated into the following research question: Are the cost management techniques adopted by the South African automotive industry perceived to be effective in the optimisation of costs and achievement of strategic objectives?

1.6 OBJECTIVES

In order to answer the research question, the main objective of this study is to evaluate how an automotive company perceives the application of strategic cost management techniques.

The main objective is supported by the following secondary objectives:

- Identifying and developing the relevant research methodology necessary to answer the set research objectives (Chapter 2).

- Conducting a literature review to explore the concept of strategic cost management, which included (but was not limited to) an evaluation of tools and techniques critical to the achievement of cost reduction objectives that have enhanced the strategic position of the firm (Chapter 3).
- Analysing processes, techniques and systems, adopted by the industry, to assess if they have contributed in any way to this study's primary objective. This includes the consideration of activities beyond the boundaries of primary functions (manufacturing, sales and marketing) (Chapter 4).
- Evaluating empirical evidence to discern the extent to which the automotive industry perceives the application of strategic cost management (Chapter 4).
- Concluding research findings by summarising the outcome of the empirical study, substantiated by the literature review, and recommending whether strategic cost management is effectively applied by the South African automotive industry (Chapter 5).

1.7 RESEARCH METHODOLOGY

The research methodology constitutes a combination of literature review and empirical study.

1.7.1 Literature Review

A literature review was undertaken to recognise and understand traditional and contemporary concepts pertinent to strategic cost management. A number of academic literature sources were considered, including books, journal articles and internet publications. Studying the existing literature was critical as it contextualised the topic and provided the framework for developing the relevant questions addressed in the empirical study. This set the foundation for the study to test the concepts discussed in literature by evaluating the practical application of such concepts in the automotive industry. The literature review comprised the following steps:

- A comparison of strategic cost management to traditional cost management and cost cutting initiatives.
- An analysis of specific strategic cost management techniques attributable to the automotive industry.
- Integration of the framework for management control systems with strategic cost management.
- An analysis of key tools and methods pertinent to the successful application of strategic cost management.

1.7.2 Empirical Research

The empirical research aimed to establish, through the study of Company A, if the concept of strategic cost management is applied successfully by the automotive industry. The results of the empirical study were analysed and evaluated to ascertain if the primary and the relevant secondary objectives were met. The empirical study, therefore, offered conclusive evidence in finalising the study.

The empirical study reflects the qualitative research method and design discussed in Chapter 2. As this empirical study was exploratory in nature, the qualitative techniques involved (1) developing an open-ended, structured questionnaire, and (2) administering direct interviews, reflective of qualitative research methodology. The information gathered in the literature review was used to develop the questionnaire and to formulate questions for the direct interviews.

The respondents included finance professionals, non-finance professionals in key strategic positions and professionals in core business activities, namely in engineering, sales and marketing and human resources.

1.8 PARADIGMATIC ASSUMPTIONS AND PERSPECTIVES

The results of this study comprise feedback from finance and non-finance professionals, based on specific questions pertaining to the concepts of strategic cost management, including an assessment of their perception of the impact of the concept on the organisation. This qualitative approach to research reflects a relativist perspective and the epistemological position is subjective in nature. Therefore the research paradigm adopted in this study could be concluded as interpretivist in nature.

Because business and management involve people as well as things, the interpretivist argument promotes the idea that subjective thought and ideas are valid. An interpretivist researcher aims to see the world through the eyes of the people being studied, allowing them multiple perspectives of reality, rather than the “one reality” of positivism (Greener, 2008:17). From an ontological perspective, interpretivists are not concerned with the objective reality that is “out there”, but instead with knowing and investigating specific subjective realities that exist “in here” (De Villiers & Fouché, 2015:128).

1.9 KEY DEFINITIONS

For the purposes of this study the following key terms are applicable:

Strategic Management / Strategic Planning: The art and science of formulating, implementing and evaluating cross-functional decisions that enable an organisation to achieve its objectives. Strategic management focuses on integrating management, marketing, finance, production, research and development, and information systems to achieve organisational success (Djordjevic, Mihailovic & Marjanovic, 2014:169).

Cost Management: Monetary valuation of the resources consumed in an efficient and effective manner to achieve some goal and objective (Barth & Sedgley, 2014:18).

Strategic Cost Management: The application of cost management techniques so that they simultaneously improve the strategic position of a firm and reduce costs (Cooper & Slagmulder, 2003:23).

Case Study Research: A qualitative approach in which the investigator explores a bounded system (a case) or multiple bounded systems (cases) over time, through detailed, in-depth data collection involving multiple sources of information and reports a case description and case based themes (Creswell, 2007:73).

Competitive Advantage: A competitive advantage is an advantage gained over competitors by offering customers greater value, either through lower prices or by providing additional benefits and service that justify similar or possibly higher prices (Ehmke, 2008:5-1).

Strategic Positioning: The perceptual location of an organisation relative to others. Strategic positioning is dependent on the following key parameters: Service, Quality, Access, Scope, Innovation, Demographics (Gershon, 2003:12).

1.10 CHAPTER OVERVIEW

This study is divided into five chapters.

Chapter 1: Introduction

This chapter introduces the study by providing the background, literature review and rationale for the research to be conducted. This section provides a clear justification for researching the topic and moreover the need to explore its relevance in the automotive industry. This is followed by the problem statement, objectives and a brief overview of the research methodology.

Chapter 2: Research methodology

The research methodology appropriate to the study is presented. It includes a review of the chosen research method and the motivation thereof. The data collection techniques, namely the questionnaire, interviews and secondary data analysis, are discussed.

Chapter 3: Strategic cost management

This chapter will include an evaluation of various sources of literature on strategic cost management. Although there is no evidence of existing studies pertaining to the impact of strategic cost management on the automotive industry, a number of studies have been undertaken on the impact of strategic cost management on other industries, and the relevance of these studies will be evaluated in the context of the South African automotive industry.

Chapter 4: Strategic cost management in Company A

The results of the qualitative research are analysed and discussed in detail in this chapter.

Chapter 5: Conclusions and recommendations

The results of the study are summarised and concluded in this chapter. It includes specific reference to whether the problem statement and objectives have been addressed successfully. Recommendations are made, and limitations of the study and further areas for future research are highlighted.

CHAPTER 2

2 RESEARCH METHODOLOGY

2.1 INTRODUCTION

This chapter documents the research design and methodology adopted in this study. The chapter aims to address the secondary objective raised in Chapter 1 (refer section 1.6, first bullet) of identifying and developing the relevant research methodology necessary in answering the set research objectives. Mouton (2001:55) defined research design as a plan or blueprint of how the researcher intends conducting the research. It is important to clearly differentiate between research design and methodology. Marczyk, DeMatteo and Festinger (2005:22) refer to research methodology as the entire process of conducting research, which involves planning and conducting the research study, drawing conclusions and disseminating the findings. Below is a summary of the differences between research design and methodology (Table 2.1).

Table 2.1: Summary of the differences between Research Design and Methodology

Research Design	Research Methodology
Focuses on the end product: What kind of study is being planned and what kind of result is aimed at?	Focuses on the research process and the kind of tools and procedures to be used.
Point of departure = Research problem or question	Point of departure = Specific tasks (data collection or sampling) at hand
Focuses on the logic of research: What kind of evidence is required to address the research questions adequately?	Focuses on the individual steps in the research process and the most “objective” (unbiased) procedures to be employed.

Source: (Mouton, 2001:56)

The chapter also provides an overview of the research paradigm and identifies the paradigm relevant to this study. This is followed by a discussion of the three approaches to research and identifies the qualitative approach as the research approach adopted by this study. The research design section includes a discussion of the qualitative nature of the research design and identifies the case study approach as the most appropriate design for this study. Research methodology discusses the three sampling strategies pertinent to qualitative research and recommends the use of questionnaires and interviews as the means of data collection. The application of the two methods of data analysis performed in this study, namely category aggregation and direct interpretation, are discussed. The study is concluded by discussing the means of evaluating the validity and reliability of the research, and the ethical considerations pertinent to the study.

2.2 PARADIGM

Bogdan and Bilken (2007:24) defined the paradigm as a loose collection of logically related assumptions, concepts, or propositions that orient thinking and research. Paradigms are about several things, most notably about what is to be studied, what kind of research questions are supposed to be formulated in relation to these subjects, with what methods these studies should be conducted, and how their results should be interpreted (Lukka, 2010:111). It is important to define the paradigm in the context of research. According to Ponterotto (2005:128) “a research paradigm sets the context for an investigator’s study”.

Filstead (1979:34) identified the following key objectives of the paradigm:

- Serves as a guide to professionals in a discipline as it identifies the important problems and issues confronting the discipline.
- Develops models and theories which will place the problems and issues into a framework that allows practitioners to solve them.
- Establishes criteria for the appropriate methodologies, instruments and data collection techniques applied to solve problems and issues.
- Provides an epistemology (as discussed below).

A paradigm is comprised of two key assumptions: ontological and epistemological assumptions (Mack, 2010:5). Ontology concerns the nature of reality and being. More specifically, ontology addresses the following question: What is the form and nature of reality and what can be known about that reality (Ponterotto, 2005:130)? Epistemology is concerned with the relationship between the “knower” (the research participant) and the “would-be knower” (the researcher) (Ponterotto, 2005:130).

There are a number of paradigms applied in research, namely positivist, interpretivist and critical paradigms. This research is based on the interpretivist paradigm. The interpretive paradigm is characterised by a concern for the individual. The central endeavour in the context of the interpretive paradigm is to understand the subjective world of human experience. To retain the integrity of the phenomena being investigated, efforts are made to get inside the person and to understand from within. The imposition of external form and structure is resisted, since this reflects the viewpoint of the observer as opposed to that of the actor directly involved (Cohen, Manion & Morrison, 2007:21).

Cohen *et al.* (2007:21) identified two key concepts that differentiate interpretivism from other paradigms:

- **Action:** This may be thought of as behaviour-with-meaning; it is intentional behaviour and, as such, future oriented. Actions are meaningful to us only in so far as we are able to ascertain the intentions of actors to share their experiences. A large number of our everyday interactions with one another rely on such shared experiences. Interpretive research begins with individuals and sets out to understand the interpretations of the world around them.
- **Theory:** Theory is emergent and must arise from particular situations; it should be 'grounded' in data generated by the research. Theory should not precede research, but follow it. Investigators work directly with experience and understanding to build their theory on them. The data thus yielded will include the meanings and purposes of those people who are their source. Further, the theory so generated must make sense to those to whom it applies. Thus, theory becomes sets of meanings which yield insight and understanding of people's behaviour. These theories are likely to be as diverse as the sets of human meanings and understandings that they are to explain. The interpretive perspective is characterised by multifaceted images of human behaviour, as varied as the situations and contexts supporting them.

The following table (Table 2.2) summarises the ontological and epistemological assumptions of the interpretivist paradigm.

Table 2.2: Summary of Ontological and Epistemological Assumptions

Ontological Assumptions	Epistemological Assumptions
▪ Reality is indirectly constructed based on individual interpretation and is subjective. ▪ People interpret and make their own meaning of events. ▪ Events are distinctive and cannot be generalised. ▪ There are multiple perspectives on one incident. ▪ Causation in social sciences is determined by interpreted meaning and symbols.	▪ Knowledge is gained through a strategy that "respects the differences between people and the objects of natural sciences and therefore requires the social scientist to grasp the subjective meaning of social action." ▪ Knowledge is gained inductively to create a theory. ▪ Knowledge arises from particular situations and is not reducible to simplistic interpretation. ▪ Knowledge is gained through personal experience.

Source: (Mack, 2010:8)

2.3 APPROACH

Creswell (2013:4) identified the following three approaches to research:

- **Qualitative Research:** Is a means for exploring and understanding the meaning individuals or groups ascribe to a social or human problem. The process of research involves emerging questions and procedures, data typically collected in the participant's setting, data analysis inductively building from particulars to general themes, and the researcher making interpretations of the meaning of the data. Those who engage in this form of inquiry support a way of looking at research that honours an inductive style, a focus on individual meaning, and the importance of rendering the complexity of a situation.
- **Quantitative Research:** Is a means for testing objective theories by examining the relationship among variables. These variables can be measured, typically on instruments, so that numbered data can be analysed using statistical procedures. Like qualitative researchers, those who engage in this form of inquiry have assumptions about testing theories deductively, building in protections against bias, controlling for alternative explanations, and being able to generalise and replicate the findings.
- **Mixed Research:** Is an approach to inquiry that combines or associates both qualitative and quantitative forms. It involves philosophical assumptions, the use of qualitative and quantitative approaches, and the mixing of both approaches in a study. Thus it is more than simply collecting and analysing both kinds of data, it also involves the use of both approaches in tandem so that the overall strength of a study is greater than either qualitative or quantitative research.

This research involves the collection, analysis and interpretation of information derived from the subjective views and experiences of research participants. The style adopted by this study is inductive in nature. As described in section 2.2, this study adopted an interpretivist paradigm. Mackenzie and Knipe (2006:5) associate this paradigm with qualitative research.

The main objective of this research is to evaluate how an automotive company perceives the application of strategic cost management techniques. This objective reflects the characteristics of qualitative research. It can therefore be surmised that the research approach adopted by this study is qualitative in nature.

2.4 RESEARCH DESIGN

Yin (2003:20) defined research design as “the logical sequence that connects the empirical data to a study's initial research questions and ultimately to its conclusions.” Creswell (2007:5) broadened the definition of research design to incorporate the entire process of research from conceptualising a problem to writing research questions, and on to data collection, analysis, interpretation, and report writing.

Creswell (2007:42) identified the first step in designing a qualitative research study as defining broad assumptions central to qualitative inquiry, a worldview consistent with it, and in many cases, a theoretical lens that shapes the study.

In addition, the researcher defines a topic or substantive area of investigation, and perhaps has reviewed the literature about the topic and knows that a problem or issue exists that needs to be studied. This problem may be one in the "real world" or it may be a deficiency in the literature or past investigations on a topic (Creswell, 2007:43).

After stating the research problem of the topic, the researcher asks several open-ended research questions, gathers multiple forms of data to answer these questions, and makes sense of the data by grouping information into codes, themes or categories, and larger dimensions (Creswell, 2007:43).

Creswell (2007:43) emphasised the importance of shaping a narrative throughout the research process. The final narrative the researcher composes will have diverse formats, from a scientific type of study to narrative stories (Creswell, 2007:51).

The overriding theme in qualitative research design is determined by the type of approach or type of qualitative design adopted. Creswell (2007:53) identified five qualitative approaches to research: Narrative research, Phenomenological Research, Grounded Theory Research, Ethnographic Research and Case Study Research. This study has adopted a case study based approach to research.

Creswell (2007:73) defined case study research as a qualitative approach in which the investigator explores a bounded system (a case) or multiple bounded systems (cases) over time through detailed, in-depth data collection involving multiple sources of information (e.g. observations, interviews, audio-visual material, documents and reports), and reports a case description and case-based themes. E.g. several programs (a multi-site study) or a single program (a within-site study) may be selected for study.

Stake (1995:133) outlined the process of case study research which involves organising, data gathering and reporting. He stated that it is useful to organise the study around an issue or problem, and choosing issues helps us define data sources and data gathering activities. The researcher is likely to make observations, to hold interviews to get observations of things that cannot be directly observed, and to review documents (Stake, 1995:133). Stake (1995:134) recognised that case study is subjective, and that a qualitative case study is a highly personal research method and that the participants studied are studied in-depth (Stake, 1995:135). By adopting Robert E. Stake's approach to undertaking a case study research, this study incorporates the following elements into its research design:

Qualitative nature: This case study research reflects the characteristics of qualitative research. Unlike quantitative research, which is characterised by cause and effect relationships, qualitative case studies orientate towards personal interpretation (Stake, 1995:43). The epistemology of qualitative researchers is existential (non-determinist) and constructivist, thus the case, the activity and the event are seen as unique as well as common. Understanding the one, requires an understanding of other cases, activities and events, but also an understanding of each one's uniqueness. Uniqueness is expected to be critical to the understanding of the particular case. Qualitative researchers are non-interventionists. They try to see what would have happened had they not been there. During fieldwork they try not to draw attention to themselves, or to their work. Other than positioning themselves they try to avoid creating situations to test their hypotheses. For them, naturalistic observation has been the primary medium of acquaintance: when they cannot see for themselves, they ask others who have seen (Stake, 1995:44).

Interpretation: A considerable degree of emphasis was placed on interpretation while undertaking this research. In designing studies, qualitative researchers do not confine interpretation to the identification of variables and the development of instruments before data gathering, or to analysis and interpretation of the report. Emphasis is rather on placing an interpreter in the field to observe workings of the case. One records objectively what is happening, but simultaneously examines its meaning and redirects observation to refine or substantiate those meanings (Stake, 1995:8). The function of the qualitative researcher during data gathering is clearly to maintain vigorous interpretation. On the basis of observations and other data, researchers draw their own conclusions (Stake, 1995:9). Ultimately, the interpretations of the researcher are likely to be emphasised more than the interpretations of the people studied, though the qualitative researcher tries to preserve the multiple realities, the different and even contradictory views of what is happening (Stake, 1995:12).

Experiential Understanding: Qualitative researchers have pressed for understanding the complex interrelationships among all that exists (Stake, 1995:37). Qualitative research tries to establish an empathetic understanding for the readers, through description - sometimes thick description - conveying to the reader what experience itself would convey (Stake, 1995:39). To sharpen the search for understanding, qualitative researchers perceive what is happening in key episodes or testimonies, and represent happenings with their own direct interpretation and stories, i.e. narratives. Qualitative research uses these narratives to optimise the opportunity of the reader to gain an experiential understanding of the case (Stake, 1995:40).

Data Gathering: Data gathering needs to be a plan rooted in the research questions. Absolutely essential parts of a data-gathering plan include: definition of a case, list of research questions, identification of helpers, data sources, allocation of time, intended reporting (Stake, 1995:51). The data gathering techniques adopted by this case study research comprise interviews and questionnaires (Stake, 1995:53).

Analysis and Interpretation: Analysis is a matter of giving meaning to first impressions as well as to final compilations. Analysis essentially means taking something apart. We take our impressions apart (Stake, 1995:71). Two strategic ways that researchers reach new meanings about cases are through direct interpretation of the individual instance and through aggregation of instances until something can be said about them as a class (Stake, 1995:74). This case study incorporates both strategic methods discussed above and discusses analysis and interpretation in section 2.6.

2.5 RESEARCH METHODOLOGY

Kothari (2004:8) defined research methodology as a means to systematically solve the research problem. Research methodology has many dimensions: researchers not only need to know how to apply particular research techniques, but they also need to know which of these methods or techniques are relevant and which are not, what they would mean and indicate, and why. Researchers also need to understand the assumptions underlying various techniques and they need to know the criteria by which they can decide that certain techniques and procedures will be applicable to certain problems. Therefore research methodology is not only restricted to research methods, but it also considers the logic behind the methods used - in the context of the research study - and provides an explanation on why a particular method or technique has been used instead of others so that either the researcher himself or others would be able to evaluate the research results (Kothari, 2004:8).

Taylor, Bogdan and DeVault (2016:7) argue that qualitative research methodology is more than a set of data-gathering techniques. It is a way of approaching the empirical world. It refers in the broadest sense to research that produces descriptive data: people's own written or spoken words and observable behaviour. This section is categorised into two sub-sections: sampling and site selection and data collection.

2.5.1 Sampling and site selection

Marshall (1996:523) identified the following three sampling strategies pertaining to qualitative research:

Convenience Sampling: This is the least rigorous technique, involving the selection of the most accessible subjects. It is the least costly to the researcher in terms of time, effort and money, but may result in poor quality data and lacks intellectual credibility (Marshall, 1996:523).

Theoretical Sampling: The iterative process of qualitative study design means that samples are usually theory driven to a greater or lesser extent. Theoretical sampling necessitates building interpretative theories from the emerging data and selecting a new sample to examine and elaborate on this theory. It is the principal strategy for the grounded theoretical approach, but will be used in some form in most qualitative investigations necessitating interpretation (Marshall, 1996:523).

Purposeful Sampling (Judgement Sampling): The researcher actively selects the most productive sample to answer the research question. This can involve developing a framework of the variables that might influence an individual's contribution and will be based on the researcher's practical knowledge of the research area, the available literature and evidence from the study itself. This is a more intellectual strategy than the simple demographic stratification of epidemiological studies, though age, gender and social class might be important variables. If the subjects are known to the researcher, they may be stratified according to known public attitudes or beliefs (Marshall, 1996:523).

This study adopted the purposeful sampling strategy in identifying participants: particular individuals are chosen with characteristics relevant to the study that are thought to be most informative (Anderson, 2010:4). In total, nine participants were selected for this research. The levels of responsibility and authority they represented ranged from staff level to management, senior management and director grades. These participants represented all critical functions of Company A. It is important to note that, in complying with the confidentiality agreement in place, anonymity of all research participants was maintained at all times. Therefore no further

information about research participants will be divulged in this study. The following techniques of purposeful sampling were applied when identifying participants for this research study:

- Maximum variation sampling: This technique aims at capturing and describing the central themes that cut across a great deal of variation (Patton, 2002:234). This sampling technique was applied through the selection of a wide spectrum of professional expertise, ranging from engineering, human resources and marketing to finance, thus ensuring a wide variety of views in addressing the research objective.
- Critical case sampling: Critical cases are those that can make a point quite dramatically or are, for some reason, particularly important in the scheme of things (Patton, 2002:236). Critical case sampling was evident in the selection of participants who were specialists in the area of research, namely strategic cost management.
- Key informant: Patton (2002:3221) defined key informants as people who are knowledgeable about the inquiry setting and articulate about their knowledge, people whose insights can prove particularly useful in helping an observer understand what is happening and why. They are well placed to identify cutting edge issues (Patton, 2002:194). The application of this technique was evident in this study through the selection of experienced professionals who possessed highly skilled expertise, and who are in senior management positions.
- Confirming and disconfirming: During interpretation of the data, it is important to consider participants who support emerging explanations and, perhaps more importantly, participants who disagree (Marshall, 1996:523). This technique was critical in ensuring that there were divergent views on the topic of research. This is evident in the empirical results (refer Chapter 4).

2.5.2 Data collection methods

It is important that a qualitative study carefully describes the methods used in collecting data. The appropriateness of the methods selected to use for the specific research question should be justified, ideally with reference to the research literature. It should be clear that methods were used systematically and in an organised manner (Kuper, Lingard & Levinson, 2008:687).

A hallmark of case study research is the use of multiple data sources, a strategy which also enhances data credibility. Potential data sources may include, but are not limited to: documentation, archived records, interviews, physical artefacts, direct observations and participant-observation. In case study research, data from these multiple sources are then converged in the analysis process, rather than handled individually. Each data source is one

piece of the “puzzle”, with each piece contributing to the researcher’s understanding of the whole phenomenon. This convergence adds strength to the findings, as the various strands of data are braided together to promote a greater understanding of the case (Baxter & Jack, 2008:554).

This study adopted the following methods of data collection:

Questionnaire: In the process of designing questionnaires, Stake (1995:68) advised that research questions should be carefully developed in advance and a system set up to keep things on track. A structured, open-ended questionnaire was administered in this research. It included a number of dichotomous questions based on yes/no answers and drop-down questions. Due to the qualitative nature of the questionnaire, the respondents were required to elaborate in their own words the reasons for their choices. Open-ended questions are designed to permit a free response from the respondent rather than one limited to certain stated alternatives. Such questions give the respondent considerable latitude in phrasing a reply. Getting the replies in the respondent’s own words is thus the major advantage of open-ended questions (Kothari, 2004:8).

Questions were framed using critical observations and findings raised in research sources and articles, namely: Anderson and Dekker (2009a:201-220), Anderson and Dekker (2009b:289-305), Cooper and Slagmulder (2003:23-30), Otley (1999:362-382), Shank and Govindrajana (1993:13-28) and Verma (2013:1-3). The following key topics pertinent to strategic cost management were evaluated in the questionnaire: determining the relevance of strategic cost management; best practice cost management; tools and techniques including product lifecycle costing, value chain analysis, strategic position analysis and cost analysis management, and the application of strategic cost management as a management control system and strategic tool. Further information pertaining to the sections and results of the questionnaire are discussed in Chapter 4.

Interview: According to Stake (1995:64) the two principal uses of a case study are to obtain the descriptions and the interpretations of others. The case will not be seen the same by everyone. Qualitative researchers take pride in discovering and portraying the multiple views of the case. The interview is the main road to multiple views (Stake, 1995:64). This study includes face to face interviews - the first interview was a structured one and the second interview was based on an unstructured format. Results of the interviews are discussed in Chapter 4.

A qualitative case study seldom proceeds as a survey with the same questions asked to each respondent. Rather each interviewee is expected to have had unique experiences, special

stories to tell (Stake, 1995:65). Stake (1995:66) prescribed the following guidelines on effectively undertaking interviews in qualitative case study research:

- The purpose, for the most part, is not to get simple *yes* or *no* answers, but to articulate a description of an episode, a linkage, an explanation. Therefore, formulating the questions and anticipating probes that evoke good responses is crucial.
- During the actual exchange the interviewer needs most to listen and to stay in control of the data gathering, thinking about what form the account will take on in writing.
- The interviewer should be a repository of the interview. Keeping a record of an interview is part of the artistry. Getting the exact words of the respondents is usually not very important; it is what was meant that is important.
- A good interviewer should reconstruct the account and submit it to the respondent for accuracy and stylistic improvement.
- Rather than to record or to write furiously, it is better to listen, to take a few notes and to ask for clarification.
- The most important thing is to insist on ample time and space immediately following the interview to prepare the interpretive commentary.

Once data collection has been concluded, the study should allow for the consolidation of results (data) and an in-depth data analysis to derive meaningful interpretations, recommendations and conclusions from the study.

2.6 DATA ANALYSIS

Anderson (2010:4) emphasised the importance of describing the analytical approach in detail, and theoretically justifying it in light of the research question and suggested that an adequate account of how the findings were produced should be included, including a description of how the themes and concepts have been derived from the data. The analysis should not be limited to those issues that the researcher thinks are important (anticipated themes), but should also consider issues raised by participants, referred to as emergent themes (Anderson, 2010:5).

The qualitative data contained in this study are conventionally presented by using illustrative quotes. Quotes are “raw data” and are compiled and analysed, not just listed. The interpretation presented by this study is grounded in interviewees’ contributions and is semi-quantified, for example: “Half of the respondents said...”; “The majority said...”; “Three said...”. The readers are presented with data that enable them to see what the study is talking about (Anderson, 2010:5).

Baxter and Jack (2008:554) view the data collection and analysis stages as concurrent processes, suggesting that the type of analysis engaged will depend on the type of case study. This study is based on the analysis techniques prescribed by Robert E. Stake. Stake (1995:71) defined analysis as “giving meaning to first impressions as well as to final compilations. Analysis essentially means taking something apart. We take our impressions, our observations apart.” Two strategic means of analysis have been identified by Stake: *direct interpretation* of the individual instance, and through *category aggregation* of instances, until something can be said about them as a class. Case study relies on both of these methods (Stake, 1995:74).

In this study the analysis of the results from the questionnaires administered is performed using category aggregation. The responses from interviewees are aggregated and analysed and specific patterns are identified. Direct interpretation is applied to both interviews undertaken in this study. In conformance with Stake’s theory on direct interpretation, this research concentrates on the instance (the interview), trying to pull it apart and put it back together again more meaningfully, with the objective of analysing and synthesising results (Stake, 1995:75).

2.7 METHODOLOGICAL RIGOUR

Methodological rigour is a characteristic of evaluation studies that refers to the strength of the design’s underlying logic and the confidence with which conclusions can be drawn. An evaluation that incorporates attention to methodological rigour will be in a better position to afford evidence and conclusions that can stand up to critical analysis (Braverman & Arnold, 2008:72). Tobin and Begley (2004:388) identified reliability, validity and generalisation as the key variables of methodological rigour. However, in the same study, the concept of triangulation has been used to demonstrate confirmability and completeness and has been one means of ensuring acceptability across paradigms. Emerging criteria such as goodness and trustworthiness are proposed as additional mechanisms to evaluate the robustness of naturalistic inquiry (Tobin & Begley, 2004:394).

In qualitative research validity is dependent on the skill, competence and rigour of the person doing fieldwork, as well as on things going on in a person’s life that might prove a distraction (Patton, 2002:14). Validity refers to the soundness of the research design being used, with high validity typically producing more accurate and meaningful results (Marczyk *et al.*, 2005:23). Validity is evident in the study through the use of an open-ended questionnaire which allowed respondents to document their views. Interviews were transcribed word for word to ensure accuracy of results. Results were evaluated for meaningfulness and where appropriate follow-up discussions were pursued with respondents to confirm validity of information.

Reliability refers to the consistency or dependability of a measurement technique, and it is concerned with the consistency or stability of the score obtained from a measure or assessment over time and across settings or conditions (Marczyk *et al.*, 2005:103). Reliability of this research may be tested by examining the standard questionnaire administered to all research participants.

Stake (1995:107) advocated for the use of triangulation to validate if a comprehensive and accurate description of the case study is established and if the intended interpretations are developed. In the search for both accuracy and alternative explanations, discipline is necessary and protocols which do not depend on mere intuition and good intention to “get it right”, are required. In qualitative research those protocols come under the name “triangulation” (Stake, 1995:105). Taylor *et al.* (2016:93) defined triangulation as a combination of methods or sources of data in a single study, it is a way of validating insights gleaned from different informants or different sources of data. By drawing on other types and sources of data, observers also gain a deeper and clearer understanding of the setting and people being studied (Taylor *et al.*, 2016:93). This study applied triangulation by administering a combination of questionnaires and interviews and comparing results.

2.8 ETHICS

Orb, Eisenhauer and Wynaden (2001:93) described the nature of ethical problems in qualitative research studies as subtle and different compared to problems in quantitative research. Qualitative studies are frequently conducted in settings involving the participation of people in their everyday environments. Therefore, any research that includes people requires an awareness of the ethical issues that might be derived from such interactions (Orb *et al.*, 2001:93).

Orb *et al.* (2001:95) promoted the awareness and use of the three ethical principles of autonomy, beneficence and justice in alleviating ethical challenges in qualitative research. Marczyk *et al.* (2005:103) defined the concept of autonomy as the right of human beings to decide what they want to do and to make their own decisions about the kinds of research experiences they want to be involved in. This principle is therefore strongly associated with the value of respect. This study recognises participants’ rights, including their right to be informed about the study, the right to freely decide whether to participate in the study or not and the right to withdraw at any time without any repercussions (Orb *et al.*, 2001:95). This is demonstrated by the distribution of an official document to selected participants describing the research topic, assuring participants of non-disclosure of their personal details or information provided by them

on questionnaires or interviews. Participants were given the option to partake (or not) in the research and were not pursued for non-participation.

Beneficence means being kind. Every care is taken in ensuring that this study does not harm participants, and ultimately the benefits to participants are maximised and potential harms and discomforts are minimised (Marczyk *et al.*, 2005:241).

The principle of justice relates most directly to the researcher's selection of research participants. Importantly, there should be no bias or discrimination in the selection and recruitment of research participants (Marczyk *et al.*, 2005:243). This research applied the principle of justice by selecting and approaching participants from both genders, representing a wide range of demographics, cultural orientation and expertise. Justice also refers to equal share and fairness. One of the crucial and distinctive features of this principle is avoiding exploitation and abuse of participants. This study's understanding and application of the principle of justice in qualitative research studies is demonstrated by recognising vulnerability of the participants and their contributions to the study (Orb *et al.*, 2001:95).

2.9 SUMMARY

This chapter discussed the relevant research design and methodology critical in meeting the research objectives. The chapter also described the purpose of the research paradigm, identified the interpretivist paradigm as the paradigm relevant to this research and discussed the ontological and epistemological assumptions supporting this paradigm. The three approaches to research were discussed, namely qualitative, quantitative and mixed approaches. This research is based on the research participants' perceptions of the research problem and the study therefore reflects the characteristics of a qualitative research approach.

The research design was based on a case study approach, specifically the approach prescribed by Stake (1995), and incorporated the characteristics of qualitative research, interpretation, experiential understanding, data gathering, analysis and interpretation. The sampling strategy was based on purposeful sampling and data collection techniques involved the use of questionnaires and interviews. Category aggregation was used to evaluate the results of the questionnaire and the interviews were analysed using direct interpretation. The validity and reliability of the research were corroborated using triangulation, and the highest standards of ethical practice were observed while undertaking this study.

The next chapter aims to meet the 2nd secondary objective identified in Chapter 1 by discussing the literature on strategic cost management.

CHAPTER 3

3 STRATEGIC COST MANAGEMENT

3.1 INTRODUCTION

The purpose of this chapter is to address the following secondary objective identified in Chapter 1 (refer section 1.6, bullet 2): A literature review to explore the concept of strategic cost management, which included (but was not limited to) an evaluation of tools and techniques critical to the achievement of cost reduction objectives that have enhanced the strategic position of the firm.

The literature review was critical in identifying questions pertinent to the development of the questionnaire discussed in the empirical study, and the results thereof are analysed in the next chapter (Chapter 4). The literature review comprises the following critical areas of focus: The chapter commences by comparing strategic cost management to traditional cost management and cost cutting initiatives. The chapter proceeds to analyse specific strategic cost management techniques attributable to the automotive industry. This is followed by a discussion of a study commissioned by Deloitte (Aguilar, Biondi, Puleo & Ferraro, 2016) which identified three steps necessary in achieving strategic cost reduction. The next section explores the integration of Otley's (1999) framework for management control systems with strategic cost management. The chapter concludes with an analysis of key tools and methods pertinent to the successful application of strategic cost management.

3.2 COST CUTTING vs. STRATEGIC COST MANAGEMENT

In this section the relevance of strategic cost management is explored by comparing the concept to traditional cost management and cost cutting mechanisms. The significance of a strategic approach to cost management and its application in industries is studied. This includes a study of how cost reduction practices in the automotive industry have contributed to enhancing the strategic position of automotive manufacturers.

A study by Nazarko (2011:228) of the National Health System (NHS), a publicly funded national healthcare system for England and the largest and oldest single-payer healthcare system in the world, exposed the perils of cost cutting by demonstrating that services delivering real benefits were terminated when they should have been expanded, whilst the NHS continued to retain services that should be rationalised. Nazarko (2011:228) examined the benefits of a strategic approach to cost management and identified mechanisms to mitigate risks associated with cost

cutting. A second study by Buchler (2014:42) in the American medical industry substantiated this finding by suggesting, with evidence, that cost cutting efforts are usually reactive and cutting costs on even high dollar supplies may do little to reduce total expenses.

To achieve a meaningful impact in reducing costs, Buchler (2014:42) advocated for an approach which involves identifying the biggest cost saving opportunities while providing practical cost reduction targets.

According to Flint (2007:48), the *automotive industry* fails to learn from its mistake of making cost cutting its major goal, as it always leads to disaster. However, if cost reduction is managed with a strategic approach, it will result in considerable value for the organisation through reduced costs and competitive advantage. This was demonstrated by Hyundai Automotive Group during 2006, when its Chairman ordered a 30% reduction in costs. The company did not execute sweeping cuts across the board, but instead chose to adopt a strategic approach by exempting value adding activities from cost reductions. This involved proactively supporting and agreeing to cost increases from suppliers engaging in greater responsibilities for engineering, design and quality improvements. The company also chose not to cut back on research and development expenditure, nor curtailed expansion programs in key markets such as the US, China and India (Courtenay, 2006:44).

Bill Ford's top priority when he was appointed CEO of Ford was to reduce costs and create a business structure that would make financial sense (Witzenburg, 2004:22). He proposed a strategic, systematic reviewing of everything that was done, taking out small, incremental amounts of unnecessary costs. This approach led to the reduction of non-production related costs, material cost reductions and contributed to more efficient means of product development, including shared components and platforms. Ford also introduced process improvement techniques such as Team Value Management and Six Sigma, which led to a disciplined, systematic approach that could be applied across the board to cut costs (Witzenburg, 2004:23).

There are similarities in the manner in which different industries apply *strategic cost management*. A study by Hsu and Qu (2012:500) of the concept of strategic cost management in the Canadian medical industry concluded that hospitals adopt different cost management strategies, depending on their market position: A cost revenue enhancing strategy is adopted by hospitals with lower inter-organisational dependence with payers. With strong market power, these hospitals can charge a high price to recover the increased costs. Non-dominant hospitals adopt the cost reduction strategy, complying with the institutional expectation of cost containment. In the automotive industry, Mercedes Benz does not put much emphasis on cost

reduction, but rather adopts a cost revenue enhancing approach through a differentiation strategy (Baroto, Abdullah & Wan, 2012:120), whereas Nissan Motor Limited has been highly successful in optimising costs through cost reduction strategies through its highly effective alliance with Renault (Greimel, 2016:1).

3.3 STRATEGIC COST MANAGEMENT TECHNIQUES

This section discusses the following contemporary strategic cost management techniques, successfully deployed by the automotive industry to achieve strategic objectives: 1) World Class Manufacturing; 2) Global Value Chain; 3) Logistics Cost Behaviour and Management in the Auto Industry; 4) Strategic Alliances in the Automotive Industry, and 5) Product Tear Down Analysis.

3.3.1 World Class Manufacturing

Chiarini and Vagnoni (2015:590) did research on how Fiat created a strategic cost advantage by reinventing the concept of World Class Manufacturing (WCM). The results of their study reveal how adopting a WCM strategy contributes to an aggressive impact on cost reduction and leads to a stronger strategic position (Chiarini & Vagnoni, 2015:597). However, a limitation of WCM is that cost reduction is restricted to within the boundaries of the factory; this means that other core operations such as sales and marketing do not benefit from cost reduction associated with WCM (Chiarini & Vagnoni, 2015:597). A key outcome of the study by Chiarini and Vagnoni (2015:598) was that all interviewees of Fiat interpreted cost saving as a non-negotiable and insisted that it could not be sacrificed for any other kind of strategy, and cost deployment was considered the most peculiar pillar with regard to the WCM strategy. On several occasions, the importance of the cost deployment pillar was highlighted by research results, with emphasis on how it forces the company to quantify all wastes and losses (Chiarini & Vagnoni, 2015:599).

3.3.2 Global Value Chain

Sturgeon and Van Biesebroeck (2011:181) analysed how the global value chain has been enhanced extensively post the economic crisis in 2008 to highlight: 1) strong regional organisation of production; 2) importance of globally engaged suppliers, and 3) persistence of regional linkages between lead firms and first tier suppliers. The advent of a global value chain has led to organisations developing aggressive strategies in cost management. This is demonstrated by Sturgeon and Van Biesebroeck (2011:192) in their study of distinctive strategies pursued in the Chinese automotive industry which involved aggressive localisation of automotive components by leading multinational automotive companies. This has led to lower production costs, which enable firms to compete directly with domestic manufacturers in China.

This results in cost advantages and strengthens the strategic positioning of the international companies operating in China.

3.3.3 Logistics Cost Behaviour and Management in the Auto Industry

A case study by Porporato (2016:389) on analysing logistics costs in the automotive industry concluded that, although logistics costs represent a small fraction of total costs in automotive companies, they can negatively affect the bottom line if left unattended. Porporato (2016:393) emphasised the importance of analysing logistics costs to create competitive advantage which will involve the careful evaluation of logistics contracts to optimise the relevant costs.

3.3.4 Strategic Alliances in the Automotive Industry

This section discusses how strategic alliances in the automotive industry impact on strategic cost management by demonstrating how the merger between Renault and Nissan in 1999, two large players in the automotive industry, led to reduction in costs. It simultaneously enhanced the strategic positioning of both firms, particularly that of Nissan, which was on the verge of bankruptcy prior to the merger.

Prior to the merger in 1999, Nissan was number two in the global and Japanese automobile industry, but failed to generate a profit for eight years, experiencing a 26 year decline in market share and was near bankruptcy. Nissan was in a critical financial position with debt amassing to \$22 billion. Operational problems that led to this position included low product margins, high purchasing costs and major underutilisation of production plants. Japanese factories were operating at half their capacity (Gill, 2012:438). Stevens (2008:20) identified key shortcomings in Nissan's strategic objectives, which included:

- a lack of clear profit orientation;
- a preoccupation of chasing competitors instead of focussing on customers;
- poor sense of urgency, and
- no shared vision or common long-term plan.

Renault, on the other hand, generated considerable turnover growth at sustainable profit levels over the same period, and factories were operating close to full capacity. However, due to the high concentration of its market in Europe, Renault was extremely parochial in scope relative to its European competitors (Donnelly, Morris & Donnelly, 2005:431). Renault needed to expand beyond the confines of its European base to survive in the long term. Therefore, to be credible in a global context, a presence was required in North American and Asian Pacific markets. Such

an expansion was prohibitively expensive and could not be executed without a partner (Donnelly *et al.*, 2005:432).

Nissan enjoyed a strong market presence in the United States and in Asia, and with its considerable expertise in manufacturing and engineering technology, Nissan proved to be the ideal partner for Renault to realise its market expansion objective. Renault offered expertise in research and development, concept design and marketing (Donnelly *et al.*, 2005:433). In the Nissan-Renault alliance, Renault also offered Nissan much needed financial support and management skills (Stevens, 2008:25).

A strong organisational culture can reduce an organisation's costs by coordinating employee effort, leading to competitive advantage (Gill, 2012:433). Strong leadership is essential to acquire success and is perhaps the single most important success factor (Schuler & Jackson, 2001:246). It was important that Nissan was led by a leader aligned with the objectives of the merger. Carlos Ghosn led the pre-merger negotiating team and was subsequently tasked with turning Nissan around. Ghosn had a reputation for successfully restructuring Renault - getting costs under control and revitalising the firm, and he was successful in changing Nissan's organisational culture, which had a positive impact on organisational performance (Gill, 2012:435). He selected employees who promoted his change vision and who were able to execute his plan to address a lack of accountability and organisational silos. This signalled a break with the past and a desire to create a new organisation while being sensitive to the cultural context (Gill, 2012:442). Ghosn focused on the implementation of cross-company teams (CCTs) and cross-functional teams (CFTs) as the main intervention for change. This approach modelled teamwork, focused on bottom-line performance and was the main mechanism for addressing Nissan's cultural problems of lack of accountability, no profit orientation and no sense of urgency (Gill, 2012:443).

Under Ghosn's leadership the Nissan Revival Plan (NRP) was conceived. NRP was not about cost reduction and a short term recovery. It was designed to reposition Nissan in the market place for long-term growth and to identify where market and technological complementarities and other synergies could be identified and achieved (Donnelly *et al.*, 2005:434). Key elements of NRP are shown on Table 3.1.

Table 3.1: Summary of Nissan Revival Plan

Function	Key Objectives
Business development	Introduce a minicar model in the Japanese market by 2002
Manufacturing and logistics	Close three assembly and two power train plants in Japan
	Increase capacity utilisation to 80% by 2002
Purchasing	Reduce the number of suppliers by 50%
	Reduce purchasing cost by 20% by 2002
General and administrative costs	Reduce SG&A (Sales, General & Admin) costs by 20% by 2002
	Reduce direct labour force by 21,000 by 2002
Research & Development	Organise globally and raise output by 20% by 2002
Sales and marketing	Use a single global advertising agency
	Close 10% of retail outlets and 20% of distribution subsidiaries in Japan
	Create common back office centres
Finance and cost	Sell noncore assets
	Reduce automotive debt by 50% to \$5.8 million
	Reduce inventories
Phase out of products and parts	Reduce the number of Japanese plants from seven to four by 2002
	Cut the number of platforms used in Japan from 24 to 15 by 2002
	Reduce by 50% parts used due to differences in engines or destinations
Organisation	Set up regional management committees
	Empower programme directors and managers
	Introduce performance related pay incentives, including stock options

Source: (Donnelly, Morris & Donnelly, 2005:435)

In the search for synergies and cost control through economies of scale and scope, the NRP argued that there should be a sharing of platforms, engines and transmissions across models. Further areas identified in the NRP for cost savings and pooling resources lay in the field of suppliers. This became apparent when the problems Nissan was experiencing through reliance on the traditional Kereitsu system came to light, even though several main suppliers were managed by former Nissan managers. It was made clear that the situation could not continue and so annual price cuts were imposed on all suppliers, amounting to 20% over three years. Moreover, Ghosn announced that the total number of first tier suppliers would be reduced from circa 1,300 to around 600 by 2002, with exacting quality standards being imposed on those who remained with the firm. Eventually, the two firms decided to go further in the search for synergies and established a common purchasing organisation, called Renault Nissan Purchasing organisation (RNPO) as an equal, joint venture in April 2001. Given the scale of purchasing by both firms, this was an area where their combined strength was bound to increase bargaining power over suppliers and yield considerable savings, improvements in quality and delivery (Donnelly *et al.*, 2005:437).

The NRP was a success, proving that adopting a sustained, focussed approach to reducing costs by restructuring business operations, and entering into synergistic activities with its partner Renault, resulted in Nissan halting its erosion of market share and launching a small car that became the third best-selling car globally by the end of 2002 (Gill, 2012:443).

3.3.5 Product Tear Down Analysis

A specific approach to strategic cost management in the automotive industry involves the concept of Product Tear Down: a method of comparative analysis in which disassembled products, systems, components and data are visually compared and their functions determined, analysed and evaluated to improve the value adding characteristics of the project under study (Rains & Sato, 2008:2). General Motors (GM) introduced the static tear down method to Isuzu in the early 1970s. Isuzu further developed the tear down process into a more extensive version than the original one offered by GM, and incorporated it into their Value Analysis and Value Engineering processes (Gerhardt & Rand, 2016:6).

A study on product tear down by Kahveci and Okutmus (2015:343) concluded that teardown analysis is an effective technique in reducing costs without any decrease in the quality of the product. Consequently, it can be said that gaining cost advantage by using teardown analysis will increase the competitiveness of the firms. With the teardown analysis gained, cost advantage can be used for new products which are better in means of quality and functionality compared to the rivals, or this gained cost advantage can be used for satisfying the demand of customers by differentiating the product (Kahveci & Okutmus, 2015:354).

This concludes the discussion on the strategic cost management techniques relevant to the automotive industry. The next section will present the topic of strategic cost reduction, a concept coined by Deloitte (Aguilar & Puleo, 2016), which comprises the following three steps pertinent to the creation of sustainable, scalable cost improvements to businesses: 1) rethinking a company's business model; 2) aligning operational governance with the business model, and 3) redefining functional service delivery to achieve organisational scalability and efficiency.

3.4 STRATEGIC COST REDUCTION

A study commissioned by Deloitte (Aguilar & Puleo, 2016) on strategic cost reduction focussed on structural, enterprise wide changes that lead to sustainable cost savings and margin improvements. Aguilar and Puleo (2016:3) identified three critical steps in creating sustainable and scalable improvements to a company's cost structure:

1. Rethinking a company's business model;
2. Aligning operational governance with the business model, and
3. Redefining functional service delivery to achieve organisational scalability and efficiency.

Aguilar and Puleo (2016:5) discussed the mistake that many companies tend to commit of leaping into restructuring their businesses or redeploying resources to reduce costs without considering the need to neither review their existing business models nor to undertake effective operational governance.

Each one of these three critical steps will now be discussed.

3.4.1 Business Model

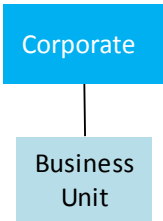
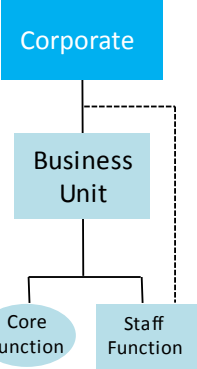
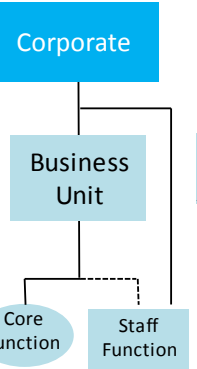
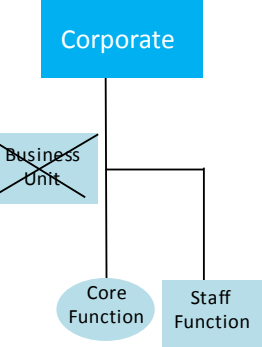
Aguilar and Biondi (2016:4) identified the careful analysis of the existing business model as the first step to achieving sustainable and scalable cost improvements. This provides a blueprint for effective structural change. The company's business model defines how it goes to market, interfaces with stakeholders (such as customers and suppliers) and reacts to market conditions.

The business model can have a major impact on the company's cost structure and operating complexity and is used to determine how services are delivered and resources deployed. It affects the company's decision and ability to scale up or down during economic upturn or downturn. Although it is considered a daunting task by most companies, modifying the business model represents an excellent opportunity to transform business which leads to increased efficiency and effectiveness (Aguilar & Biondi, 2016:5).

According to Aguilar and Biondi (2016:6), business models can be grouped into four broad categories, ranging from the highly decentralised holding company to the centrally managed integrated operating company (IOC), as shown in Figure 3.1.

The extent of cost reduction is directly proportional to the level of strategic integration in the organisation (Aguilar & Biondi, 2016:6), i.e. moving from the left (Holding Company structure) of Figure 3.1 to the right (IOC), cost synergies increase as the level of integration increases. In holding companies, duplication of activities and a greater staff complement will result in greater autonomy. This is, however, achieved at significantly higher overall company costs, whereas an integrated operating company creates cost synergies, because General and Administrative costs (G&A) are managed at a corporate level, services are provided centrally, and the corporate office - through its greater buying power - can negotiate better deals with service providers and suppliers (Aguilar & Biondi, 2016:12).

Figure 3.1: Four categories of Business Models

Business Model	Holding company	Strategic guidance	Strategic control	Integrated operating company
Operating structure				
Executive leadership strategic role	Sets and monitors financial targets and defines fundamental objectives	Coordinates business strategies, sets and monitors financial and business objectives	Participates in development of business strategies and their implementation	Develops plans, policies, and guidelines, and monitors operations
Executive leadership decision role	Delegates operating decisions	Provides input into some decisions	Participates in all major operating decisions	Makes major operating decisions
Operational model	Stand-alone business units	General management team	General management team	Operating units
SG&A model	Central services typically not provided	Some central services provided on as-needed basis	Significant portion of services provided centrally	Vast majority of services provided centrally

Source: (Aguilar & Biondi, 2016:6)

Cost synergy transformation is demonstrated through the example of a global oil producer cited by Aguilar and Biondi (2016:7): The company's strategic guidance model had not optimally captured economies of scale, with major concerns on G&A. Rationalising its business model by shifting to a strategic control model realigned company costs, resulting in recurring costs savings of \$150 million.

A second example referenced by Aguilar and Biondi (2016:8) involves a large specialty retailer which adopted a strategic control model and realised in excess of \$60 million in savings for controllable expenses and staff. The shift in business model was prompted by two major acquisitions which led to an administrative structure that could not efficiently and effectively support all three businesses. To address this issue, the company developed a model that incorporated all 3 steps of the strategic cost reduction model prescribed by Deloitte:

1. The adoption of a strategic control model (as described above).
2. The establishment of a new operational governance model that clearly defines decision-making roles and responsibilities between corporate and the divisions, and improved communications and coordination.
3. The development of a shared services centre to capture G&A synergies: This enabled the company to setup a scalable administrative infrastructure that would reduce its overall selling, general, and administrative (SG&A) expenses and non-merchandising costs by eliminating redundant activities at the business unit level and that led to achievement of its growth objectives.

Business model dimensions:

Aguilar and Biondi (2016:11) identified seven dimensions that are critical in determining the appropriate business model:

Governance: How much decision-making control does corporate have? How much do the business units have? In a holding company, corporate has little decision making control. In an IOC, it has a lot.

Operational independence: What is corporate's relationship with operating units? Does corporate direct the operating units, or are they independent? In a holding company, the business units are autonomous and have an indirect relationship with corporate. In an IOC, divisions are directly linked to corporate.

Service delivery: Are support services embedded in the business units or provided centrally? Holding companies typically localise services, while IOCs tend to centralise them.

Culture: Are the culture and core values unique to each business unit, or are they common throughout the company?

Core skills: Are standardised skill sets applied across the company, or do the business units have special needs? Holding companies generally do not standardise; IOCs generally do.

Infrastructure and technology: Is the level of technology standardisation high or low? Holding companies typically do not integrate infrastructure and technology. IOCs tend to have a high level of technology integration.

Digital enterprise enablement: Is the speed at which the company gains efficiency from technology fast or slow? IOCs can generally gain efficiencies more quickly than holding companies.

After analysing the business model, company leadership may decide to continue with the existing model. This is acceptable as long as it is a conscious decision (Aguilar & Biondi, 2016:11).

Selecting the appropriate business model

A critical factor in determining the relevant business model is about whether a company is in a high or low growth market. In low growth markets, shifting to a synergy friendly business model (such as the strategic control model and integrated operating company) may be the only way to enhance earnings and overall performance, as such markets do not require a strong focus on independence, thereby neutralising the need for central control. Firms in mature markets follow the same approach, with many Fortune 500 companies moving to a strategic control or IOC model to benefit from potential synergies as a result of centralisation (Aguilar & Biondi, 2016:13).

Although both strategic control and IOC models, referred to as integrated models, generate synergistic benefits, some important differences exist between the two - as Table 3.2 illustrates. Many companies find that the strategic control model provides the balance needed between reducing costs and giving the business units sufficient autonomy to foster creativity and entrepreneurial spirit (Aguilar & Biondi, 2016:14).

Table 3.2: Strategic control vs. integrated operating models

	Strategic control	Integrated operating company
Pros	• More balanced roles and responsibilities between corporate and business units • Easier application to companies with multiple business portfolios • Stronger market focus • Higher level of flexibility at business unit level • May provide more flexibility in deploying digital enterprise capabilities	• Higher level of synergy • Lower SG&A costs • Easier to attract and retain corporate executives • Faster decision-making process • Cost to deploy digital enterprise capabilities may be lower
Cons	• Lower level of synergy • Higher SG&A costs	• More difficult applications to companies with different business portfolios • Higher risks of bureaucracy • Difficult to retain business unit executives

Source: (Aguilar & Biondi, 2016:14)

Across industry sectors, SG&A costs are 7% lower in companies operating integrated business models compared to companies with more decentralised models (holding company/strategic guidance models). However, integrated models may not be appropriate for all companies. High

paced growth companies and companies with diverse businesses may need to compromise on some efficiency in exchange for increased agility and entrepreneurial spirit. These companies may find the strategic guidance or holding company structures more appropriate (Aguilar & Biondi, 2016:14).

Aguilar and Biondi (2016:15) stated that, although the four business models offer a distinct blend of efficiency and effectiveness, the most optimal model may be a customised version which incorporates various elements from the four business models, e.g. highly decentralised companies may centralise support activities (e.g. G&A), but leave the rest of the business the way it is or centralise non-core competency areas to be effective - e.g. creation of wholly owned procurement functions that use the entire organisation's combined buying power to get the lowest prices on raw materials and supplies, or the reduction of costs through the establishment of separate operating units for administration or shared services.

The second critical step in creating sustainable and scalable improvements to a company's cost structure is aligning operational governance with the business model.

3.4.2 Operational Governance

Operational governance is the second step in the process of realising sustainable and scalable cost advantages. Aguilar and Puleo (2016:4) defined operational governance as how a company's decisions are made and executed that conforms to the business model. They emphasised the importance of operational governance by stating that many corporate and business unit executives do not fully understand their roles and responsibilities, which lead to inefficiency and wasteful expenditure. A well-defined operational governance structure will identify who is responsible and accountable for key decisions, who needs to be involved and how decisions will be made. It also defines a clear process on how disputes will be resolved (Aguilar & Puleo, 2016:5). Optimal corporate governance, which is akin to effective decision making in the corporate environment, involves three steps:

Strategic roles

Aguilar and Puleo (2016:6) emphasised the importance of clearly defining the roles and responsibilities of corporate and business units, as it is critical in articulating the organisation's strategic direction. A decision making approach is influenced by the type of business model. With a highly decentralised model, the corporate executive's role is limited to setting corporate and financial objectives, while the business units are responsible for all operational decisions. Operating autonomously, they perform the roles of decision making, execution and monitoring (Aguilar & Puleo, 2016:6). In a centralised model, corporate executives make all decisions.

Between the two extremes, decision making can vary based on the strategic guidance and control models: The strategic guidance model leans towards decentralised control, with the business units as primary decision makers. The strategic control model leans towards centralised control, with corporate executives serving as primary decision makers responsible for monitoring results, but business units own the core functions and participate in strategy development and implementation (Aguilar & Puleo, 2016:7).

Operational responsibilities

This step involves identifying key decisions, defining the decision making process for each one, and detailing responsibilities for how these critical decisions will be made (Aguilar & Puleo, 2016:8). Company A, the automotive company researched in this study, has adopted the strategic control business model. The decision making process of a company operating under the strategic control business model involves significant give and take between corporate and business units. Corporate executives set the overall direction, but the business unit is responsible for strategy proposal, budget development and execution (Aguilar & Puleo, 2016:8). Aguilar and Puleo (2016:7) recommended the RACI (Responsible, Accountable, Consulted and Informed) matrix as an effective tool in mapping out detailed decision making roles. The RACI matrix is applied across Company A and has been useful in mapping out key roles responsible for executing strategic cost management practices.

Key Business Forums

The last element of operational governance involves the setting up of business forums. Business forums are committees or councils that facilitate coordination and information sharing that supports structured decision making processes. Business forums provide the following benefits to corporates (Aguilar & Puleo, 2016:10):

- Improve the effectiveness and efficiency of decisions by bringing members from different parts of the organisation together to discuss effective practices and confirm if decisions are monitored and executed successfully.
- Clearly establish objectives, roles and expected outcomes of different functions.
- Use the collective power of the organisation.
- Promote continuous improvement through the open sharing of information, ideas and lessons learned.

Aguilar and Puleo (2016:11) identified three types of committees with the following structures:

1. Executive committee: The CEO is part of this committee regardless of the business model used. Under the holding company and strategic guidance models, business unit presidents are included while corporate executives are omitted from the committee. Under the strategic control and integrated operating models, the inverse will apply.
2. Operating committee: Due to the high degree of autonomy in holding company and strategic guidance models, business unit presidents and executives are the main members of the committee. However, with strategic control and integrated models, the committee is comprised of mainly executives at the corporate level.
3. Functional committees: Under the holding company and strategic guidance models, functional executives of the business units are included on the functional committees, but their corporate counterparts are excluded and vice versa for strategic control and integrated models.

The final step in achieving strategic cost reduction will now be discussed.

3.4.3 Redefining the Service Delivery Model

The final stage addresses the need to redefine functional service delivery to achieve organisational scalability and efficiency. A function's service delivery model (SDM) defines how work adds value and relates to the business, as depicted in Figure 3.2. It identifies ways companies can deploy resources to create a cost structure and generate performance improvements that are able to satisfy the specific needs of the business. Maximum value at minimum cost is the ultimate objective of the functional service delivery model (Aguilar & Ferraro, 2016:5).

Figure 3.2: Service Delivery Model

		Method of adding value		
		Transactional	Knowledge-based	
Relationship to the business	Specific	1 Site Support • Distributed to location(s) for local service needs • Required for local input/ data capture or local programs • Manual or end-user intensive	4 Business partner • Aligned with function/unit Line/management focus • Knowledge and know-how transfer • Decision/action intensive	1. Site Support Rationalise to generate savings, focus on exception-based, transactional work that must be done locally.
	Generic	2 Transaction processing • Consolidated organisation • Operational focus • Standardised services • Process intensive • Could cover countries or region	3 Centre of Expertise • Organised by knowledge set • Expertise focus – ability to leverage • Best practice development • Issue/knowledge intensive • Organised by country or region	2. Transaction processing Rationalise to generate savings and scale: consolidate transactional work that should or could be done generically. 3. Centre of Expertise Rationalise to create effectiveness and value: consolidate knowledge-based work to scale capabilities, define common policies, and enhance functional expertise. 4. Business partner Rationalise to create value: localize capabilities to enhance decision support and value creation.

Source: (Aguilar & Biondi, 2016:5)

In terms of how work relates to the business, a company should allocate resources based on whether the work is or should be generic and consequently delivered companywide, or whether it is specific to a business unit or division, and therefore should be delivered locally. There are four different types of components for each function, depicted by the quadrants in the SDM matrix in Figure 3.2. Each quadrant calls for a different skill set or capability, and each should be managed differently. Work adds value by meeting defined service levels or efficiency requirements, e.g. through processing transactions at the lowest possible cost or through more strategic ways that require management involvement and knowledge transfer activities (Aguilar & Ferraro, 2016:5).

This framework is used to analyse the current distribution of work and explore other approaches that might improve efficiency and effectiveness. This method of segregating the activities within a functional or operational area involves looking at individual activities, their nature, and what the service requirements are for these activities to support the business appropriately. To determine the optimum distribution of work, the first step is to identify those activities that absolutely must be delivered on site to be effective. This can be called “inextricable” work, since it requires on-site knowledge or relationships to effectively meet service requirements. All work that is not inextricable should be considered for consolidation and standardisation (Aguilar & Ferraro, 2016:6).

Components of the Service Delivery Model

This section examines in detail the SDM components to ascertain how SDM analysis may be used to generate value for firms.

Site Support:

Site support work includes processes or activities specific to each business unit or division. This work tends to be so unique that it is considered inextricable, it must be performed at the business unit or division to maintain responsiveness to customers, facilitate a quick turnaround time, or meet location or physical proximity requirements. It requires local interaction or data capturing and manual processes. Therefore it cannot be consolidated at a global or regional level (Aguilar & Ferraro, 2016:10).

However, decentralised business models, incomplete or ineffectively integrated mergers or acquisitions, management preferences as well as legacy differences in systems, processes and policies often cause companies to keep work local, even when it could clearly be consolidated or centralised. Any of these factors can be the source of inertia that holds back the rationalisation and realignment of functions. Ultimately, local site support work should be kept to a minimum, leaving truly unique work at the business units, divisions, or other local sites. By applying an SDM analysis to each function, widely dispersed work can be consolidated into a shared services centre, or outsourced where it can be managed far more efficiently. This allows the firm to redefine policies and processes and consider more automation of existing processes (Aguilar & Ferraro, 2016:10).

Transaction Processing:

Work that is not sensitive to location and is not knowledge based falls into the category of transaction processing. Typically, these activities are process intensive, such as payroll, accounts payable, collections and the IT help desk. Although much of this work could and should be consolidated because it is rule-based, many companies still spread it across their organisations among divisions and business units. In an SDM analysis, it often shows up in the site support quadrant disguised as site specific work (Aguilar & Ferraro, 2016:10).

The SDM analysis can help the firm in distinguishing transaction processing work from that which really should stay local. Everything else should be consolidated at the corporate level, in shared services centres, or through an outsourced provider. The analysis also helps address process issues involving local site support work and transaction processing in parallel, with the

objective of minimising site support activities and maximising the degree of standardisation, wherever possible (Aguilar & Ferraro, 2016:10).

While work consolidation, policy and process standardisation as well as automation are the main levers for this quadrant, establishing service levels is critical in achieving the proper balance between cost and service performance, moving to either point of the spectrum (in Figure 3.2) according to specific needs (Aguilar & Ferraro, 2016:10).

The vast majority of most companies' activities fall into this quadrant. Value is added through economies of scale that allow low-cost execution, while meeting defined service needs, whether delivered regionally or through single-point delivery. Shared service centres also tend to be more easily scaled upward or downward than decentralised operations. They allow a firm to adjust related SG&A spending faster in response to business and environmental changes. To obtain additional savings, firms need to consider pursuing opportunities to offshore or outsource the shared service centre (Aguilar & Ferraro, 2016:10).

Centre of Expertise (COE):

An effective centre of expertise (COE) leverages a company's core strengths by centralising resources for any type of specialist activities or expert services that are not transaction based. These expert areas require knowledge intensive competencies and are able to drive policies and program design for the corporation. These typically include, for example, compensation and benefits design, internal audit, treasury and tax planning, architectural planning, engineering standards, product pricing and knowledge management (Aguilar & Ferraro, 2016:11).

Companies often have underdeveloped or overly distributed COEs that is a loose network of resources assembling around a process or activity. E.g. business units will have their own dedicated internal auditors instead of consolidating this service centrally in order to apply the knowledge across the company. The challenge is to connect these loose networks to define a community or working group and to standardise the group's efforts to facilitate the ease of operations and a more coordinated impact in defining common policies or deploying leading practices (Aguilar & Ferraro, 2016:11).

Another common challenge with decentralised COEs is that employees with specialised knowledge often become distracted by transaction related duties. This dilution of the specialised capabilities can lead to sub-scale performance in both types of work. Dilution can also prevent proper alignment and leverage of the employee's expertise (Aguilar & Ferraro, 2016:11).

At the other extreme, some companies that have established COEs can over-centralise, thereby becoming more of an administrative or transactional function - functions that have a stranglehold on the company as they too vigorously pursue “functional excellence” can lose touch with value creation (Aguilar & Ferraro, 2016:11).

Ideally, COEs should manage enterprise-wide knowledge work, as well as related policies and programs. This means deciding what activities require a concentration of expertise, determining whether these activities can be consolidated across the globe or at a minimum regionally and assessing what changes to the organisation and talent pool are warranted. The goal is to organise experts and related resources and information so that they can be shared, compared and leveraged across all business units and divisions (Aguilar & Ferraro, 2016:11).

Although COE activities can carry a high price tag for the specialised knowledge they require, the expense can be offset by applying that knowledge to many different parts of the company. The new structure can provide high synergies, lower costs and organisational flexibility (Aguilar & Ferraro, 2016:11).

Business Partner:

Business partnering tends to be non-transactional and knowledge based. It requires local management involvement and relates to decision support (Aguilar & Ferraro, 2016:12). Similar to site support, business partnering focuses on maintaining responsiveness to customers, improving turnaround time, and meeting unique location and physical proximity requirements by supporting local decision making or local management (Aguilar & Ferraro, 2016:12).

Business partners typically support local management teams, using three competencies (Aguilar & Ferraro, 2016:12):

1. Use local knowledge to advise on and support site specific decisions.
2. Use relationships with site leaders to influence those decisions.
3. Help local teams understand how their policies and practices fit into the larger corporate design.

This concludes this section on strategic cost reduction. The next section will focus on the theoretical framework of this study.

3.5 APPLICATION OF OTLEY'S (1999) THEORETICAL FRAMEWORK

Otley's (1999) framework for analysing the operation of management control systems is integrated into the literature review of strategic cost management by demonstrating the application of the relevant steps of the framework in research studies. By means of a case study analysis, Read and Kaufman (1999:6) discussed the application of the framework:

- The CEO, along with senior management, developed financial objectives and supporting strategic actions.
- An enterprise wide Key Performance Indicator (KPI) program, which secured the necessary buy-in from all departments for high level KPI development and implementation, was subsequently launched by the CEO.
- High level performance measures were translated into individual performance objectives to ensure that individuals are held accountable for performance and delivery of objectives.

With reference to a reward structure, Read and Kaufman (1996:20) proposed the following for employees:

- Compensation structure needs to be consistent with organisational strategy.
- Incentives should be linked to the right goals, and
- Policy should be influenced by short vs. long-term considerations and by relationships (e.g. interdepartmental, interdivisional or parent and subsidiary relationships).

Fiat introduced a performance measurement system to evaluate its World Class Manufacturing (WCM) model which aimed at identifying the important measures introduced by the model, at what level and frequencies they were managed and by whom (Chiarini & Vagnoni, 2015:593). The performance measurement system within the WCM model introduced a detailed and ramified set of KPIs at all organisational levels. All KPIs were integrated into the enterprise resource planning (ERP) system, the machines and the shop floor workplaces. Fiat's performance measurement system is also deeply characterised by the auditing system which allows companies to measure their performance levels (Chiarini & Vagnoni, 2015:599).

3.6 STRATEGIC COST MANAGEMENT TOOLS AND METHODS

This section discusses specific tools and methods relevant to the concept of strategic cost management.

3.6.1 Target costing

Target costing is primarily a technique to strategically manage a company's future profits. It achieves this objective by determining the lifecycle cost at which a company must produce a proposed product, with specified functionality and quality, if the product is to be profitable at its anticipated selling price. By estimating the anticipated selling price of a proposed product, and by subtracting the desired profit margin, a company can establish its target cost. The key is then to design the product so that it satisfies customers and at the same time be manufactured at its target cost (Cooper & Slagmulder, 1999:23).

In the automotive sector, target costing is considered to be an effective cost management technique in the lowering of costs and creation of competitive advantage. Goodyear uses target costing to bring higher quality products to consumers faster, more profitably and at lower costs than ever before (Gibara, 1999:49). This also led to competitive advantage, which translated into gains in market share (Gibara, 1999:52).

Mercedes Benz used target costing to its advantage during the development of a new product. Albright (1998:13) demonstrated in his study how Mercedes successfully applied target costing as an effective tool in designing a new product (M-Class), while concurrently constructing a new manufacturing facility. The following interrelated elements were critical in managing the successful implementation of target costing principles:

Concept Phase: Mercedes used cross-functional teams to perform market, product and competitor analysis. The team estimated potential sales and quantified costs, including materials, labour, overheads, product development and project costs to perform an investment appraisal (Albright, 1998:16). Similarly, Goodyear set up cross-functional teams to take responsibility for all costs. What used to be only a finance function has now become the responsibility of each strategic business unit. Goodyear also took the position that cost management has to begin before manufacturing, namely at the product and process design stages (Gibara, 1999:49).

Customer Orientation: Using customer focus groups, Mercedes gained access to acquire market information necessary to develop a new vehicle (Albright, 1998:17).

Price-led costing: Mercedes did not use target costing to produce the lowest priced vehicle in an automotive class. Rather, the company's strategic objective was to deliver products that were slightly more expensive than competitive models but with a greater perceived value on the part of the customer (Albright, 1998:17).

Flexibility: Japanese companies strive in a single minded effort to achieve a static target cost. In contrast, Mercedes recognises the importance of flexibility in setting and achieving target costs (Albright, 1998:18).

Targeting Costing and the M-Class: The target costing process was led by cost planners who were engineers, not accountants, because the cost planners were engineers with manufacturing and design experience, they could make reasonable estimates of costs that suppliers would incur in providing various systems. To gain a better understanding of the various sources of costs, function groups, together with their target cost estimates, were identified. Mercedes divided the vehicle into function groups that included panel parts, interior trim, electrical system and powertrain. The process of achieving target cost for the M-Class began with an estimate of the existing cost for each function group. Team members set cost reduction targets by comparing the estimated existing cost with the target cost for each function group. Finally, cost reduction targets were established for each component (Albright, 1998:19).

3.6.2 Activity Based Methods

By evaluating the application of Activity Based Costing and Activity Based Management in wholesale distribution companies, Player and Gibson (1999:52) demonstrated how the two activity based methods successfully achieve the principles of strategic cost management. Companies that implemented some form of ABC had higher return on total assets than companies that had not implemented some form of ABC. When conceived, designed and implemented, ABM systems provide the tools and information to (Player & Gibson, 1999:52):

- Understand customer and product profitability;
- Identify cost improvement opportunities;
- Evaluate the cost of value added services;
- Screen profitability potential for new customers.

The importance of ABC and ABM as tools in supporting strategic cost management is summarised as follows (Player & Gibson, 1999:53):

- ABC exposes the hidden costs and complexities in business and provides ways to measure them.

- ABC helps management understand what goes on in their companies, what it costs and where the impact occurs.
- In contrast to traditional costing systems, ABC and ABM deepen the focus on cost by addressing the underlying physical activities that drive costs, thus giving companies a more comprehensive platform for managing them.

3.6.3 Benchmarking

Benchmarking is the process of comparing and measuring your organisation against others, anywhere in the world, to gain information on philosophies, practices and measures that will help your organisation take action to improve its performance. Benchmarking gathers the tacit knowledge, the know-how, judgments and enablers that explicit knowledge often misses (APQC). A study by Voss, Ahlström and Blackmon (1997:1055) shows that the use of benchmarking is linked strongly to both improved operational performance and business performance. The research (Voss *et al.*, 1997:1056) also established the below benefits of benchmarking that are applicable to the automotive sector:

- Benchmarking is a vital part of the learning company's repertoire for performance improvement and learning organisations will be more likely to use benchmarking.
- Benchmarking promotes higher performance directly through helping a company to identify best practices and set challenging performance goals.
- Benchmarking improves a company's understanding of its strengths and weaknesses relative to competitors.
- This understanding in turn benefits performance, since improvement agendas will be focused on real needs.

3.6.4 Lifecycle management

Stark (2015:1) defined Product Lifecycle Management (PLM) as the business activity of managing, in the most effective way, a company's products all the way across their lifecycles from the very first idea for a product until it is retired and disposed of. PLM is the management system for a company's products. It manages, in an integrated way, all of its parts and products as well as the product portfolio. At the highest level, the objective of PLM is to increase product revenues, reduce product related costs, maximise the value of the product portfolio, and maximise the value of current and future products for both customers and shareholders (Stark, 2015:1).

3.6.5 Just in Time (Manufacturing and Purchasing)

Just in Time (JIT) is based on the notion of eliminating waste through simplification of manufacturing processes such as elimination of excess inventories and overly large lot sizes, which cause unnecessarily long customer cycle times (Flynn, Sakakibara and Schroeder, 1995:1327). Swanson and Lankford (1998:335) explained in their study of supplier relationships that an organisation will reap many benefits in terms of costs and time savings by reducing the number of suppliers and by improving relationships with these valued partners in the JIT manufacturing process. The costs of quality with the JIT system is much lower than the wait and see system of traditional manufacturing. The result is that, with continuous refinement in the quality process, an organisation utilising JIT manufacturing will see far greater cost savings by implementing these quality steps (Swanson & Lankford, 1998:337).

The JIT inventory system runs smoothly with no peaks or valleys. The typical inventory system, on the other hand, is fraught with peaks and valleys that represent costs to the organisation in the form of inventory holding costs, back order and stock-out costs, overtime and idle time labour costs, and waste of materials and space. The JIT manufacturing process is structured so that the entire operation is continually improved upon and is not static but rather dynamic in nature. The process is not thought of as a short-term investment, but rather a long-term philosophy of company management that yields many benefits (Swanson & Lankford, 1998:340). It is evident from the studies performed on JIT that it is an effective tool in reducing costs and creating competitive advantage for the manufacturing and supply chain process of the organisation.

3.6.6 Idea Generation Systems

In a wide variety of settings, organisations generate a number of possible solutions or ideas to a problem and select a few for further development. Virtually all innovation processes include generating and selecting opportunities or ideas. When a company develops the branding and identity for a new product, it creates dozens or hundreds of alternatives and picks the best of these for testing and refinement. Generating the ideas that feed subsequent development processes thus plays a critical role in innovation. The success of idea generation in innovation usually depends on the quality of the best opportunity identified (Girotra, Terwiesch & Ulrich, 2010:591).

3.6.7 Breakeven Analysis

The breakeven point refers to the revenues needed to cover a company's total amount of fixed and variable expenses during a specified period of time. The revenues could be stated in dollars (or other currencies), in units or in hours of services provided (Drury, 2012:168).

3.6.8 Other Tools

Other strategic cost management tools considered in the empirical study include total cost analysis, cause and effect analysis, value stream mapping, zero based budgeting, 5S and waste analysis.

3.7 SUMMARY

The main objective of this chapter was to address the secondary objective of conceptualising the topic of strategic cost management by evaluating the tools and techniques critical to the achievement of cost reduction objectives and consequently enhancing the strategic positioning of the firm.

The chapter began by comparing and contrasting the concept of strategic cost management to traditional cost management and cost cutting techniques. Key benefits of adopting a strategic approach to cost reduction were highlighted in this section. The next part of the chapter focussed on contemporary techniques that were relevant to the automotive industry in successfully implementing strategic cost management. This was followed by a discussion of a study undertaken by Deloitte in 2016 that emphasised a three-step approach to strategic cost reduction and which involved evaluating the firm's business model, aligning it with the company's operational governance and redefining functional service delivery to ensure cost efficiencies. The integration of the appropriate theoretical framework and its application to appraise the concept was discussed. The chapter concluded by discussing contemporary tools and methods appropriate to strategic cost management.

The next chapter will discuss the third and fourth secondary objectives, referred to in Chapter 1, by executing the plan outlined in Chapter 2 (research methodology and design) and by incorporating the topics discussed in the literature study into the questionnaire and interviews adapted in the chapter. A number of the topics discussed in the literature study were not covered in the questionnaire, but were discussed to contextualise the study. The reason why it was not covered in the questionnaire was due to the limited scope of a mini-dissertation. These topics are: product tear down analysis (refer section 3.3.5) and strategic cost reduction (refer section 3.4).

CHAPTER 4

4 STRATEGIC COST MANAGEMENT IN COMPANY A

4.1 INTRODUCTION

This chapter discusses the secondary objectives raised in Chapter 1 (refer section 1.6, the third and fourth bullets): Analysing processes, techniques and systems, adopted by the industry, to assess if they have contributed in any way to this study's primary objective. This includes the consideration of activities beyond the boundaries of the firm's primary functions. The chapter goes on to further evaluate empirical evidence to discern the extent to which the automotive industry perceives the application of strategic cost management. The results of the empirical study undertaken on Company A are examined. These results are critical in establishing if Company A was successful in the adoption and execution of strategic cost management. The empirical study included a combination of a structured, open-ended questionnaire as well as structured and unstructured direct interviews. The qualitative nature of this study was embedded in the structure of the questions.

4.2 PARTICIPANTS' PROFILE

Twelve participants were approached to partake in this empirical study. Seven participants were supportive in answering the structured questionnaire and two consented to direct interviews. Part A of the structured questionnaire (refer Appendix 1, page 104) reflects the profile of all the participants who took part in answering the structured questionnaire. The participants in this study hold various qualifications, experience and skill sets, which include expertise in finance, engineering, sales and marketing and human resource fields. The levels of seniority range from staff level to management, senior management and director level professionals. The functions these participants represent include corporate finance, internal auditing, sales and marketing, business planning, organisational development, product planning, manufacturing and supply chain management. The spread across various fields of expertise, along with a mix of male and female respondents, ensured a broad set of views expressed on the questions presented.

4.3 STRUCTURED QUESTIONNAIRE RESULTS

The structured questionnaire included a number of dichotomous questions characterised by Yes / No answers and drop-down questions that required respondents to rank the importance of certain concepts. Due to the qualitative nature of this questionnaire, the dichotomous and drop-

down type questions are followed by open-ended questions that prompt respondents to elaborate on their answers and justify their selections.

4.3.1 Strategic Cost Management: Determining its Relevance

Part B (refer Appendix 1) aimed to determine the relevance of strategic cost management. The first question in this section of the questionnaire asked respondents if they were familiar with the concept of strategic cost management. If the answer to the question was affirmative, the respondents were asked to explain in their own words the concept of strategic cost management. All respondents acknowledged their familiarity with the concept. The descriptions of the concept reflected below were provided by respondents:

“The application of cost management techniques to reduce cost whilst improving the strategic position of the company at the same time.”

“It is a means of strategically managing costs in the long term, ensuring competitive costs and better management of the firm’s bottom line.”

“Application of business strategies to minimise cost impact and maximise revenue opportunities whether it is regulatory or market driven.”

“Management of costs in line with company strategy and future direction.”

“This study is about implementing decision making tools and sourcing tools that ensures that the company only expends its funds on costs which are necessary and favourable to the company. It is also about managing working capital such that the company takes advantage of the credit terms available to it, from its suppliers, and that payments are deferred as much as possible.”

“The organisations cost management plans that incorporate all levels of departments across the organisation. This does not always have to be quantifiable.”

The next question required respondents to categorise the following types of activities into either strategic cost management or cost cutting. A graphical illustration of the results is provided in Figure 4.1.

Short-term in nature: All seven respondents perceived cost cutting as short-term in nature.

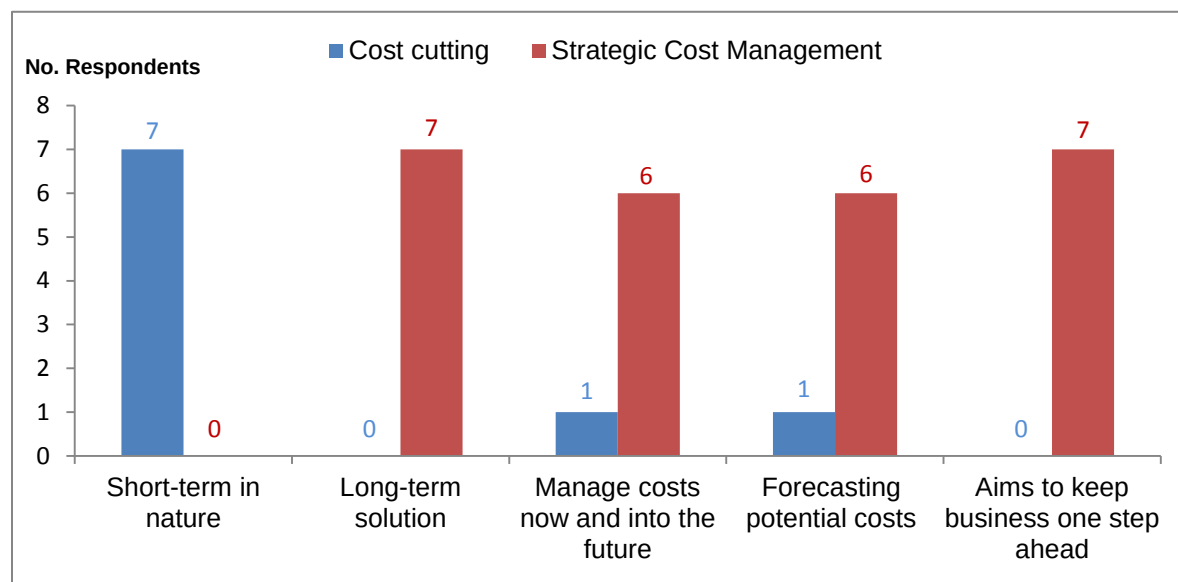
Long-term solution: All respondents believed that strategic cost management is a long-term solution.

Manage costs now and into the future: The majority of respondents (six out of seven) believed that the management of costs now and into the future is a strategic cost management activity.

Forecasting potential costs: The majority of respondents (six out of seven) were of the view that forecasting potential costs is a strategic cost management activity.

Aims to keep business one step ahead: All seven respondents concurred that strategic cost management aims to keep business one step ahead.

Figure 4.1: Cost Cutting vs. Strategic Cost Management



Respondents were then asked if Company A had successfully developed, executed and reviewed strategic cost management. Six of the seven respondents did not agree that the organisation was successful in this task. When prompted to substantiate their answers, the first respondent mentioned that the maturity level of the organisation and finance division “*was influenced by narrow minded bookkeeper mind-sets.*” Another respondent cited the predominantly short-term focused decision making. One participant was of the view that, due to the nature of the business with global partners, the best effort for strategic cost management might sometimes be impeded due to profit centre management and other factors. The fourth respondent believed that business was not driven by strategic thinking and did not articulate strategic cost management initiatives. However, this respondent did state that one area that might be more proactive is the supply chain function.

The component of *sourcing tools* was raised by another participant. The concern expressed was that it was not broad enough, in that the supplier population used was not sufficient to realise

benefits from strategic cost management. The effort made to find additional suppliers was inadequate. Further to this, the participant stated that *“the company does not perform sufficient research in managing costs, e.g. rent or buy trucks for transportation of goods.”*

The last respondent disagreed based on the following rationale:

“Strategy is disconnected from cost management. Strategy is centred around product (cars) and the future direction of the market. Strategy also takes into account the local production facility and locally produced vehicles (here, there is some link between strategy and cost management). However, strategic cost management is not applied to imported vehicles; since it is largely outside local control, control is on the manufacturing or supply side and fluctuates with exchange rate movements.”

Contrary to the above responses, one respondent who agreed that Company A successfully developed, executed and reviewed strategic cost management, explained that the organisation recognised that cost cutting measures are short-term in nature and may overlap with long-term measures. On the other hand, strategic initiatives of cost control were long-term initiatives in nature and were managed effectively by the organisation.

A follow-up question to the above one asked respondents if they perceived strategic cost management as a means of improving organisational efficiency and effectiveness. With the exception of one respondent, all respondents agreed that strategic cost management contributed to an improvement in organisational efficiency and effectiveness. Responses ranged from organisational efficiency, which resulted in the automatic reduction in costs, to the concept of strategic cost management being based on better long-term focused, balanced decision making. Other responses included:

“Strategic cost management ensures that firms do not simply cut costs to improve their bottom line (for which the benefit may be lost due to qualitative impact), but manage costs in such a way to ensure the longevity of cost improvement and improving the bottom line sustainably.”

“Applying the principles would allow the organisation to have a competitive edge and should form part of its SWOT analysis.”

“It will enable the company to identify (based on cost) inefficiencies and non-effective activities impacted or affected by future strategy.”

The respondent who disagreed contended that the concept was more about managing costs than on business process improvement and maintained that Company A created the most value

through optimal sourcing, which would ultimately lead to higher efficiencies in cost management.

The question of whether Company A successfully realised its cost reduction objectives was posed to respondents. Five of the seven respondents noted that the firm was unsuccessful in realising its cost reduction objectives. One participant believed that the population of suppliers from which sourcing was executed, was too narrow to justify cost reductions. Another respondent was of the view that the organisation was undergoing changes, including restructuring. Therefore it was premature to realise or test cost reduction plans incorporated into restructuring. A third respondent referred to external factors such as external cost centres that limited the success of implementing cost management principles. The last respondent implied that the organisation was rather reactive to cost pressures and did not demonstrate strong business transformation capability to realise cost reduction.

Two respondents who maintained that the organisation realised its cost reduction objectives believed that pure cost reduction, at a functional level, hinged on the Manufacturing, Purchasing, and Engineering functions at that stage and that they had clear strategies and activities to achieve cost reduction objectives. The second respondent alluded to the organisation consistently achieving its cost reduction targets.

The consideration of cost reduction techniques as a mechanism to support the strategic objectives of the organisation was posed to respondents. Six of the seven respondents were of the opinion that cost reduction techniques should be considered as a mechanism to support the strategic objectives of the firm. The following views were expressed by the six respondents:

“Cost reduction may not be a strategic initiative but is always part of it. Strategically, an organisation may position itself to be the most cost efficient in the industry, and as part of this, may reduce some of the costs.”

“Based on experiential learning, cost reduction techniques will support strategic objectives.”

“To be competitive, a firm needs to ultimately develop very good cost management techniques, especially in a manufacturing environment.”

“If an organisation develops the techniques then it can apply the mechanisms to various strategic initiatives. If there is a formula then it can be taken off the shelves for operational implementation.”

“Globalisation forces a natural increase in competitiveness between and within companies. In order to be successful for future (strategic) product allocation, then the organisation must be the most competitive (lowest cost).”

The respondent who differed in view from the other six respondents was of the opinion that cost reduction techniques were limited to meeting operational objectives of the business.

The next question posed to respondents addressed the topic of whether cost reduction initiatives enhanced the strategic position of the organisation. All respondents agreed that cost reduction initiatives enhanced the strategic position of the organisation. When asked to substantiate their answers, one participant's view was that it supported the financial health and sustainability of the organisation. Another one explained that it had better positioned the organisation to compete both locally and internationally. Other respondents viewed cost reduction as a mechanism to either improve a firm's margin, or to create competitive price positioning, both enhancing the firm's leverage in the market place, and lastly that any organisation that is well geared to lead in their industry on lowest cost position provides a competitive edge.

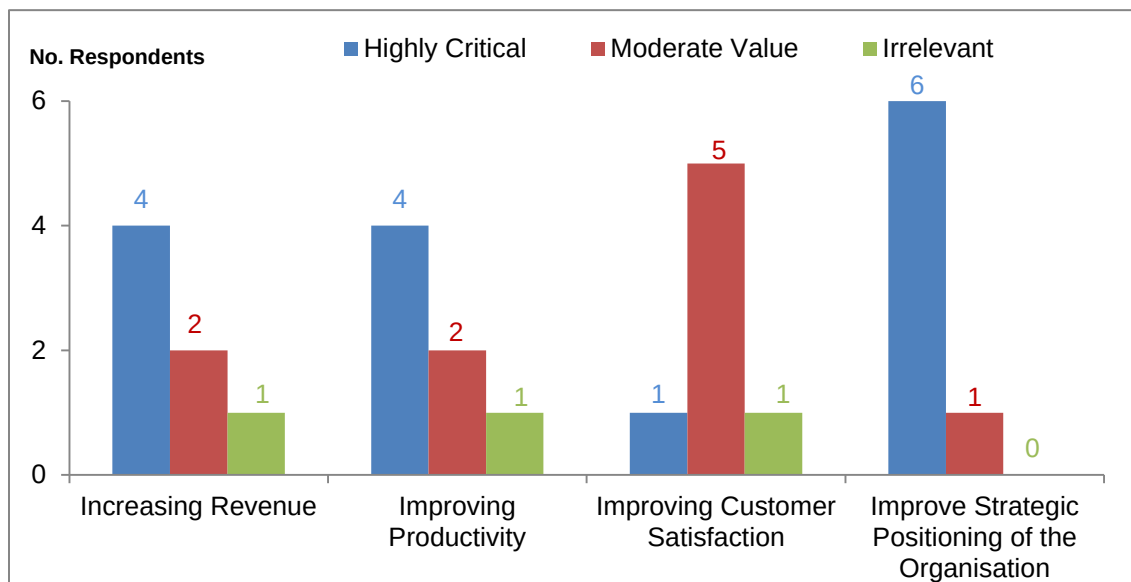
The structured questionnaire addressed the organisation's ability to develop and implement innovative techniques to support strategic cost management. Four of seven respondents challenged Company A's ability to develop and implement innovative techniques to support strategic cost management. They were of the view that, although the firm had been benchmarking with other manufacturing subsidiaries within the group in terms of local production, the company had not localised the sourcing of parts and components to the same extent as its competitors. Therefore from a sourcing point of view, Company A was limited in terms of cost management. Some innovative techniques might have been developed, for example in the Supply Chain function, but the organisation was lagging in other areas such as Sales and Marketing and leveraging of the national regulatory framework, the Automotive Development Programme (APDP). The organisation depended on manufacturing, supply chain and purchasing functions to achieve the required cost reduction. However, there was no evidence of innovation or transfer of strategic cost management techniques to other functions within the organisation (e.g. Sales and Marketing).

The three respondents who agreed that the organisation was successful in developing and implementing innovative techniques were of the view that there were significant manual processes to justify innovation and that the company had incorporated such techniques into the restructuring process, but its success was yet to be tested for effectiveness, and lastly that the

company was focussed on global benchmarking and best practice implementation to improve innovation and reduce costs.

The last part of this section aimed to determine the relevance of strategic cost management in increasing revenue, improving productivity, improving customer satisfaction and improving the strategic positioning of the organisation. Figure 4.2 provides a graphical illustration of the respondents' feedback on the four key activities identified.

Figure 4.2: Relevance of Strategic Cost Management



The results are summarised as follows:

Increasing Revenue: Four of the seven respondents rated the role of strategic cost management in increasing revenue as highly critical. Two respondents stated that the value of strategic cost management in enhancing revenue was moderate. One respondent rated the concept as irrelevant.

Improving productivity: The outcome of the impact of strategic cost management on this activity is identical to the revenue enhancing activity.

Improving customer satisfaction: The majority of respondents (five out of seven) were of the view that strategic cost management is of moderate importance in improving customer satisfaction. One respondent indicated that it was irrelevant and the other classified it as highly critical.

Improving strategic positioning of the organisation: The impact of strategic cost management in enhancing the strategic positioning of the organisation was deemed as highly

critical by most respondents (six of the seven respondents). The participant who differed from the above view stated that the concept was of moderate importance in improving the strategic positioning of the organisation.

4.3.2 Best Practice Cost Management

The next section of the questionnaire aimed to evaluate Company A's success in best practice cost management by establishing the effectiveness of the following four elements in managing costs efficiently. The analysis below is an interpretation of the results shown in Figure 4.3.

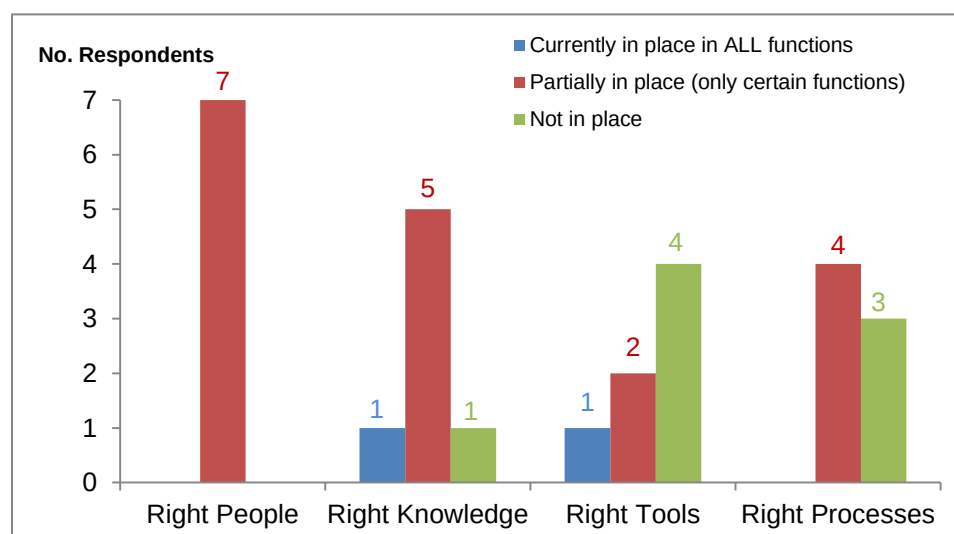
Right People: All respondents were of the view that the right people were only partially in place in ensuring cost efficiencies.

Right Knowledge: Five respondents affirmed that the right knowledge to support cost efficiencies was partially in place. One respondent was of the view that the right knowledge was in place for all functions, and one interviewee stated that there was no knowledge in place to support cost efficiencies.

Right Tools: Four respondents did not believe that the right tools were in place to manage costs efficiently. Two respondents stated that the tools were partially in place, and one participant believed that all tools were in place to reduce costs.

Right Processes: Four respondents were of the view that the right processes were only partially in place, and the other three did not believe that the right processes were in place.

Figure 4.3: Best Practice Cost Management



4.3.3 Strategic Cost Management: Tools, Techniques and Cost Behaviour Management

Tools and Techniques: A number of critical tools and techniques to support strategic cost management were identified and respondents were asked to rate their levels of importance and determine the extent of use by the organisation. Figures 4.4, 4.5 and 4.6 illustrate the results of the respondents' feedback on the tools and techniques. The results are summarised as follows:

Figure 4.4: Strategic Cost Management – Tools & Techniques

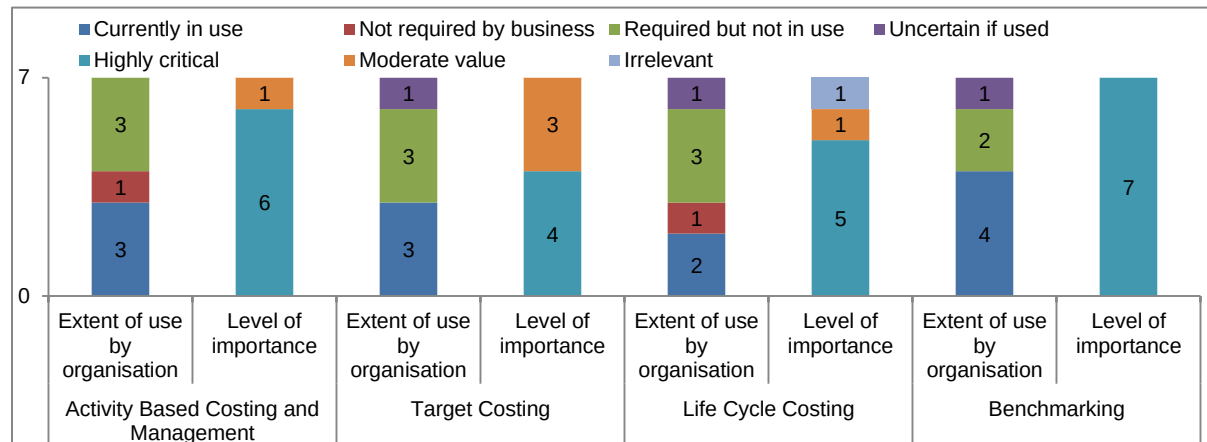


Figure 4.5: Strategic Cost Management – Tools & Techniques

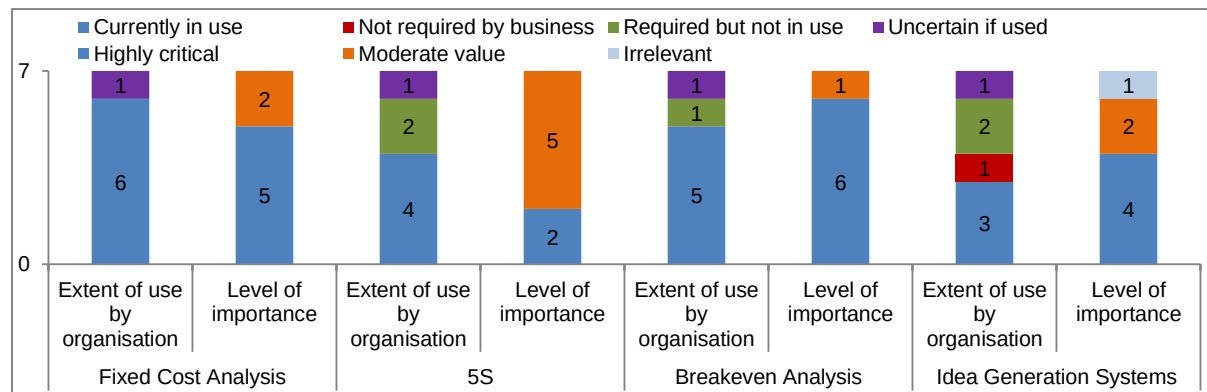
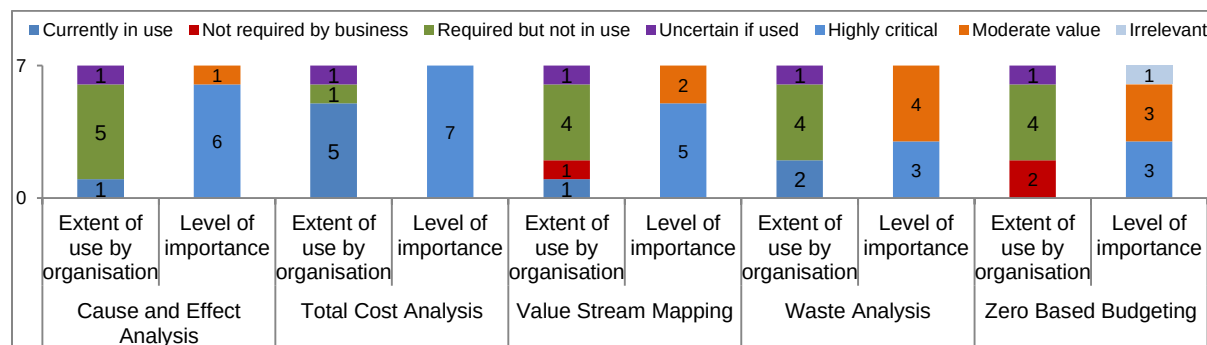


Figure 4.6: Strategic Cost Management – Tools & Techniques



Activity Based Costing and Management:

- Extent of Use: Three respondents rated activity based costing and management as a concept that was, at that time, being used by the organisation, three respondents rated it as required but not in use, and one stated that it was not required.
- Level of Importance: Six respondents believe that activity based costing and management is a highly critical concept and one ranked it as moderate in value.

Target Costing:

- Extent of Use: Three respondents rated target costing as a concept that was, at that time, being used by the organisation, three respondents rated it as required but not in use and one was uncertain if it was in use.
- Level of Importance: Four respondents believed that target costing is a highly critical concept and three ranked it as moderate in value.

Lifecycle Costing:

- Extent of Use: Two respondents rated lifecycle costing as a concept that was, at that time, being used by the organisation, three respondents rated it as required but not in use and of the remaining two respondents, one was uncertain if it was in use and the other believed it was not required by the organisation.
- Level of Importance: Five respondents believe that lifecycle costing is a highly critical concept, one participant ranked it as moderate in value and the other as irrelevant.

Benchmarking:

- Extent of Use: Four respondents rated benchmarking as a concept that was, at that time, being used by the organisation, two respondents rated it as required but not in use and one participant was uncertain if it was used.
- Level of Importance: All seven respondents agreed that benchmarking is a highly critical technique for the organisation to deploy.

Fixed Cost Analysis:

- Extent of Use: Six respondents rated fixed cost analysis as a concept that was being used by the organisation, and one participant was uncertain if it was used.
- Level of Importance: Five respondents believe that fixed cost analysis is a highly critical concept and two ranked it as moderate in value.

5S:

- Extent of Use: Four respondents rated 5S as a concept that was being used by the organisation, two respondents rated it as required but not in use and one was uncertain if it was in use.
- Level of Importance: Two respondents believed that 5S is a highly critical concept and five ranked it as moderate in value.

Breakeven Analysis:

- Extent of Use: Five respondents rated breakeven analysis as a concept that was being used by the organisation, one respondent rated it as required but not in use and one was uncertain if it was in use.
- Level of Importance: Six respondents believed that breakeven analysis is a highly critical concept and one ranked it as moderate in value.

Idea Generation Systems:

- Extent of Use: Three respondents stated that idea generation systems were being used by the organisation, two respondents were of the view that the tool was required but not in use and of the remaining two respondents, one was uncertain if it was in use and the other believed it was not required by the organisation.
- Level of Importance: Four respondents believe that an idea generation system is a highly critical concept, two respondents ranked it as moderate in value and the other as irrelevant.

Cause and Effect Analysis:

- Extent of Use: One participant stated that cause and effect analysis was being used, five respondents were of the view that the tool was required and the last respondent was uncertain if it was in use.
- Level of Importance: Six respondents believed that cause and effect analysis is a highly critical concept, one ranked it as moderate in value.

Total Cost Analysis:

- Extent of Use: Five respondents recorded that total cost analysis was in use at that time, one was uncertain if it was in use and the other believed it was required but not in use by the organisation.
- Level of Importance: All seven respondents believed that total cost analysis is a highly critical concept.

Value Stream Mapping:

- Extent of Use: One respondent stated that value stream mapping was at that time in use by the organisation, four respondents rated it as required but not in use and of the remaining two respondents, one was uncertain if it was in use and the other believed it was not required by the organisation.
- Level of Importance: Five respondents believed that value stream mapping is a highly critical concept, two respondents ranked it as moderate in value.

Waste Analysis:

- Extent of Use: Four respondents selected waste analysis as required but not in use, two respondents believed it was at that time in use by the organisation and the last respondent was uncertain if it was in use.
- Level of Importance: Three respondents believe that waste analysis is a highly critical concept and the remaining four respondents ranked it as moderate in value.

Zero Based Budgeting:

- Extent of Use: Four respondents selected zero based budgeting as required but not in use, two respondents believed it was not required by the organisation and the last respondent was uncertain if it was in use.
- Level of Importance: Three respondents believe that zero-based budgeting is a highly critical concept, three respondents ranked it as moderate in value and the last respondent felt that it was irrelevant.

Cost Behaviour Management. In this sub-section, respondents were asked if they believe the managers understood how costs behave. This was crucial in establishing if managers could control costs effectively, particularly variable, fixed and mixed costs. Four respondents were of the opinion that managers understand how costs behave and that the process was well managed. This was substantiated with activities such as monthly management meetings to discuss costs and other expenditure in the manufacturing and administrative process, a team of finance professionals responsible for vehicle costing that was led by managers who were kept up to date on cost element changes. In addition to this, it was pointed out that there was a business unit responsible for the analysis of actual costs vs. budgets with regular updates of forecasts to reflect changes in costs. The last of the four respondents who concurred raised a possible limitation:

“There is an understanding of this, and the management thereof is done, however with the limitation of maximum throughput not achieved.”

Two respondents disagreed that managers understood and controlled costs effectively.

“Current framework is to look at cost from the chart of accounts point of view with no understanding of drivers.”

“Management were not responsible for costs, and that they do not even attend the monthly meeting on cost management to review, discuss and recommend countermeasures to control cost overruns.”

The last respondent was of the view that only certain members of the leadership understood the relationship between activities, plans and the possible cost impact.

Cost Level and Cost Structure Management were also examined to ascertain the extent to which Company A was managing Marginal, Fixed and Overhead costs. All three cost categories are considered by respondents to have an impact on strategic cost management. However, as summarised below, not all respondents agreed that these costs were effectively managed by Company A.

Marginal Costs: Most respondents indicated that marginal costs were not well managed, and the application thereof was missing in the organisation. There was no distinction between marginal costs and operating costs. In addition to this, business in general did not comprehend the difference between various profit indicators and the value they provide in decision making. One respondent confirmed that the reason for this was the complicated marginal costing measures and calculations used by Company A, e.g. Marginal Consolidated Profit. Another respondent inferred, based on his experience, that there was limited focus on activities supporting marginal costing as a result of the company's prioritisation of total delivered costs, which is a key metric in manufacturing, engineering and purchasing, but this was done at the expense of addressing marginal costs. Two (of seven respondents) were of the view that Company A was in control of marginal costs. They concurred that the organisation considered marginal costing, that it was well managed - ensuring that all stakeholders understood and kept costs within targets - and moreover optimised throughput on local production to maximise government incentives.

Fixed costs: All respondents agreed that fixed costs are a very important attribute of cost management, and controlled relatively well by Company A, as this is driven by global functions. The approval process was infallible in ensuring fixed costs were controlled, with a robust delegation of authority process to keep costs in check. However, respondents did mention that there was scope for improvement in the management of fixed costs. This

requires a proactive approach and involved increasing throughput to improve absorption rates. One respondent stated the following challenges on fixed cost management:

“Fixed cost management is hard to do, since you cannot simply let people go when volumes are low, and rehire them when volumes improve. In manufacturing, there is room to manage (short time, non-workdays, remanning, etc.) fixed cost.”

Overhead costs: As with fixed costs, all respondents viewed overheads cost management as critical for Company A, but required improvement in the management process with more management intervention, commitment and control recommended. Some respondents commented that *“It is seen as a paper exercise, with no thought put behind it”* and *“Although current monitoring is done with extensive reporting, the level of management can be optimised.”*

4.3.4 Strategic Cost Management: Application as a Management Control System

The purpose of this section of the questionnaire was to determine how Company A developed objectives, strategies and supporting processes and activities to successfully execute strategic cost management. This section also aimed to ascertain how the organisation evaluated achievement of objectives, including the types of tools and techniques to measure performance, the performance target setting process, rewards and recognition for achievement of objectives and the feedback and feed-forward activities necessary to improve the entire process.

Respondents were asked what, in their opinion, are the key objectives of the organisation critical to the success of strategic cost management. Respondents in the interview had very divergent views on the objectives. This included *“Sustainability and objectivity”*, *“Revenue optimisation, cost efficiency in sales and marketing and manufacturing expenses, maximising return on marketing investment”*, *“Management and staff buy in and communication to ensure everyone understands the objective”* and *“NPV measurement, long term strategic impact measured in Quality, Cost and Time performance and overall net profit achievement”*. Other respondents were of the view that maximising the production plant usage and throughput by manufacturing the relevant product for domestic and export markets would lead to duty neutrality, minimise losses due to exchange rate volatility, increase cost efficiencies and ultimately enhance vehicle profitability. An overriding objective for Company A was to develop lowest cost capability to enhance competitiveness and thereby outperform rivals.

In the questionnaire, respondents were requested to describe the challenges encountered by the organisation in developing the above identified key objectives. The following concerns were raised by respondents:

“Risk management remains a concern and lack of rotation of employees.”

“Analytical abilities not valued in the organisation, no process or system to support data driven decision making process (archaic), no pressure on finance organisation to be a strategic business partner.”

“Currently there is no sufficient communication at relevant levels.”

“Individual KPIs do not always support overall company KPIs, limits on capital expenditure investments, lack of understanding of projects from certain decision makers.”

“Certain KPIs need to be met to get the allocation of key products to be introduced in local production. Current economic climate, labour issues and quality of output needs to be acceptable.”

“There is not enough skill developed or attracted to the organisation to drive strategic cost management. It is not seen as a strategic lever or not important enough to drive the business.”

“Due to current declining volume and exchange rates, people are mainly focussed on short term countermeasure and improvement activities, rather than more long term objectives.”

The next question posed to respondents involved ascertaining how the organisation evaluated achievement of its objectives. Three respondents alluded to the use and measurement of KPIs to evaluate achievement of objectives. Counter measures were then recommended as a means of rectifying underperformance. One respondent indicated that objective evaluation was as a result of increasing pressure from global functions. The analysis of costs, benchmarking with other manufacturing plants, and the tracking of regional product and corporate profitability were raised as additional options by other respondents. Three respondents identified shortcomings in the evaluation process. This included weaknesses such as company objectives that are not always critically reflected upon. On a global scale, the organisation evaluated various cost measures, but the organisation did not have the capability to evaluate business decisions on its own.

Respondents were asked what strategies and plans the organisation had adopted to successfully implement its objectives. Respondents referred to the organisation's adoption of the Hoshin Kanri strategic planning process to focus on its priorities that were subsequently cascaded to various functions. Witcher and Butterworth (2001:651) defined Hoshin Kanri as a

form of corporate-wide management that combines strategic management and operational management by linking the achievement of top management goals with daily management at an operational level. Other considerations included a plant and product strategy to improve export volumes as a natural hedge against exchange rate risk and the sales and marketing initiative to optimise revenue, driven by global headquarters. However, this was not anticipated to reach the expected level of maturity. Two respondents pointed out that the organisation had embarked on a restructuring process which involved the implementation of strategic cost initiatives. However, the success thereof was yet to be realised. Lastly, a respondent referred to the positioning of the company's location as a key site for growth markets, consistently aiming to optimise current sales performance of local production to ensure continuity of local production.

As a follow-up to strategies and plans, the next question addressed which processes and activities were defined for the successful implementation of the aforementioned strategies. Key processes and activities identified included budget planning, forecasting, benchmarking against other plants, best practice adoption, training programmes, people development; closing of specialised skills gaps through the employment of specialised and experienced expatriates from within the group for knowledge and skill transfers. However, respondents expressed the following concerns on processes and activities:

"The organisation would have monthly, quarterly, bi-annual and annual reviews. However, the response to these reviews needs improvement to create better strategies or countermeasures to targets set."

"Shop-by-shop action plans to support increase in plant quality/cost/delivery and global rank (vs. all other plants within the group) however this is subject to securing additional export volumes."

Respondents were asked to explain the challenges encountered by the organisation in developing the above-mentioned strategies, processes and activities. Key challenges discussed included lack of long-term focus, complexity as a result of numerous KPIs to be achieved under challenging trading environment, reluctance of employees to align cultural behaviours with best practice, limited management accountability and ownership to deliver organisational objectives. Other concerns included global competition.

"While we are improving, internal "competitors" are also improving and bidding on additional volume - global competition."

One respondent was of the view that Company A had embarked on organisational restructuring and it was too early to determine success or challenges in the implementation of strategies.

Respondents were asked to identify tools and techniques used to assess and measure the performance of the activities. The following tools and techniques were identified.

“Budgeting, forecasting, reporting, hoshin kanri, lean manufacturing, KPI tracking, benchmarking vs. other entities within the global organisation, monthly tracking of results vs. plan and active involvement from management to identify any concerns in order to resolve it before it is too big to address.”

Respondents had to determine the level of performance needed by the organisation to achieve KPIs and how it set appropriate performance targets for them. The first question in this section addressed the level of performance required from the organisation to achieve objectives. Respondents discussed the need to establish high performance levels on sales and to establish clear KPIs on profitability. Other key requirements surmised by respondents included meeting all global performance criteria, and achieving benchmark performance in industry against similar entities within the global organisation. Progressing in the manufacturing plant's performance rankings would convince top level management to make investment decisions to support expansion of the organisation. According to one respondent, breaking into the “*top 10 within the global organisation's ranking*” should be considered as a performance objective that would secure the long-term sustainability of the organisation in South Africa.

The second part of the question addressed the setting of appropriate performance targets. An overriding performance target raised by respondents was the development of performance targets based on long-term planning cycles agreed with global headquarters to support achievement of global targets. Respondents also alluded to short- and long-term target setting, including KPI development, business planning, lean manufacturing, benchmarking, tracking internal competitor results and developing Hoshin Kanri targets cascaded throughout the organisation. One respondent raised the following observation about the performance targets set by Company A:

“Performance is pushed very hard, with extensive opportunity and risk discussion, measurement vs. top performance and goal setting based on global requirement.”

Respondents had to identify what incentive schemes were adopted to reward management and employees to achieve performance targets. Respondents referred to the performance bonus scheme based on variable compensation (pay-out based on percentage of salary) for managers and upwards. Performance assessment is based on a combined, weighted average result of the region's performance, Company A's results, functional and individual performance. A

shortcoming noted by one of the respondents was *“it rewards short-term behaviours which are not aligned to long-term strategy”*.

Respondents were requested to discuss the consequences in the event of non-achievement and to identify the penalties (if any) for non-achievement. Respondents were of the view that non-achievement would lead to reduction in investments into the business by the parent company. Penalties are usually limited to discontinuing bonus pay-outs. However, this outcome depends on the performance contract between employer and employee.

Respondents also had to define the mechanisms, if any, in place to ensure that the organisation learns from its experience and adapt its behaviour to ensure performance improvement. Respondents identified the *“Plan, Do, Check, Act (PDCA)”* cycle as a mechanism to ensure performance improvement. Other tools included Hoshin Kanri, the setting up of cross teams and six-sigma. Other feedback from respondents included:

“Performance is analysed regularly as a preventative measure and a monitoring tool.”

“First and second level reviews for non-achieving items.”

“The mechanisms are strategic reviews and if applied honestly then improvement can be achieved in performance.”

4.3.5 Strategic Cost Management: Application as a Strategic Tool

The purpose of this section of the questionnaire was to ascertain how the organisation:

- Prioritises its strategic objectives.
- Categorises costs by processes and activities.
- Manages resources.
- Balances cost optimisation vs. organisational performance, and
- Compete on key attributes of the business, product, customers etc.

Respondents had to indicate if the organisation was able to successfully prioritise its strategic goals. Six respondents attempted this part of the questionnaire. Three respondents agreed that the organisation was able to successfully prioritise its strategic goals and three disagreed. Respondents had to describe the challenges encountered by the organisation in prioritising its strategic goals. Respondents cited constant pressure from global functions to deliver short-term results, short-term profit and other objectives which lead to short-term focus. Other challenges included:

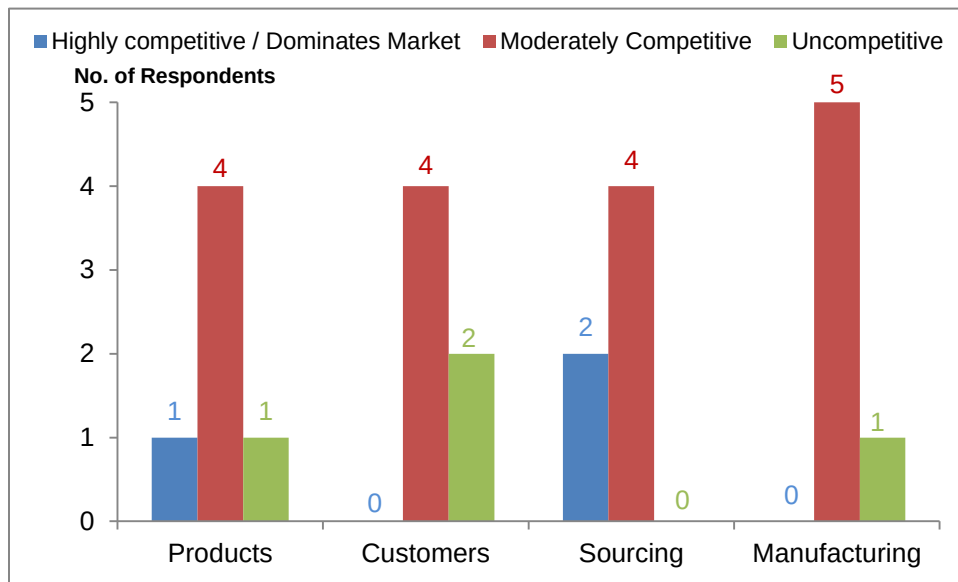
- The highly competitive market with equally ambitious goals which further challenged Company A's progress towards growth.
- Conflicting KPIs which resulted in trade-offs, ultimately limiting the impact of activities.
- The organisation losing focus on its strategies due to the need to redress short-term operational challenges.
- Review mechanisms which are not robust enough in ensuring compliance and validation of the PDCA cycle.
- Fluctuating exchange rates divert focus away from strategic activities and result in re-focussing activities on volume and profit recovery.

The organisation's ability to differentiate between the costs of different processes and activities was investigated. Almost all respondents were of the view that the organisation had no or limited ability to differentiate between the costs of different processes and activities. However, certain functions like manufacturing displayed some application and differentiation of cost measurement across various processes and activities.

Respondents had to explain the organisational challenges in differentiating the costs of different processes and activities. A number of challenges were pointed out by respondents: This included the lack of urgency on the part of the finance function to understand drivers of cost evolution. The focus has been predominantly on reporting on activities to comply with global reporting requirements, rather than seeking to understand processes and activities, and doing more in-depth analysis to optimise the business using techniques such as activity based costing. Limitations in budget allocations, poorly documented processes, undefined or inadequately structured roles and responsibilities were other concerns raised. One respondent raised a risk that, although initial cost allocation might be done correctly, top management could intervene and change the allocation of certain costs.

Respondents were asked to rate the competitiveness of Company A in key strategic elements, namely Products, Customers, Sourcing and Manufacturing. The results (based on feedback from six respondents) are summarised as follows and further supplemented by Figure 4.7:

Figure 4.7: Company A Competitiveness



Products: The majority of respondents (4/6) rated the company as moderately competitive in products. One rated the organisation as competitive and the other rated the organisation as uncompetitive.

Customers: The majority of respondents (4/6) rated the company as moderately competitive in the customer segments and two respondents rated the organisation uncompetitive.

Sourcing: The majority of respondents (4/6) rated the company as moderately competitive in sourcing of parts and components. Two respondents ranked the organisation as highly competitive.

Manufacturing: Almost all respondents (5/6) viewed the competitiveness of the manufacturing facility as moderate, with one participant being of the view that the manufacturing facility was uncompetitive.

Respondents had to discuss whether competitiveness was achieved in an economical way. The feedback on this discussion point was divided, with three respondents agreeing that competitiveness was achieved in an economical way, and the other three disagreeing. Respondents who agreed were of the view that minimal resources and funds were expended to support competitiveness, resulting in low total delivered cost vs. competitors for the same product. To enhance competitiveness, the company had adopted cross functional measures to achieve business objectives and adopted more efficient, interactive relationships with end customers. Respondents who disagreed, justified that no consideration was given to cost

efficiency and consequences of economic costs. Respondents made the following observations of the company's competitiveness:

"To be competitive based on costs, you have to achieve maximum production incentive and have sufficient exports to naturally hedge against forex movements."

"The organisation has dropped production volume significantly in the last three years and therefore become economically uncompetitive due to high fixed cost structures."

Respondents had to articulate how the achievement of competitiveness could be established in a more cost efficient way. Respondents referred to the use of benchmarking within the group companies, which would facilitate best practice learnings without the need to expend additional funds or resources. Other alternatives included: 1) Development of better long-term planning of Company A's product portfolio; 2) Increasing domestic and export volumes of locally manufactured products to reduce overhead costs and attain economies of scale; 3) Increasing localisation content of parts sourced from local suppliers; 4) Focussing on return on investment; 5) Cost efficiency analysis, and 6) Analysis of economic costs including cost of opportunities.

The question of how the organisation could integrate performance and cost management techniques was posed to the respondents. One respondent pointed to the establishment of cross functional work structures. Other ideas included implementing activity based costing, performing better marginal profit analysis and rewarding cost management performers for actual results. Respondents also made the following remarks.

"By managing costs efficiently and understanding the drivers, the organisation can drive campaigns by leveraging the opportunity cost of losing the production unit vs. losing the sale."

"Cost management and performance can be linked where cost improvements are rewarded for improving operational performance."

Respondents were asked if they had identified activities that were only of limited value in supporting the achievement of objectives. If answered affirmatively, the follow-on question addressed the issue whether the resources held up by the aforementioned activities could be reassigned to more productive work. All respondents acknowledged that Company A had engaged in activities of limited value in supporting an objective and the related resources could be reassigned to more productive work.

Respondents were asked what the impact would be on achieving strategic goals if the above activities were not performed. Two respondents mentioned that the impact would be limited to nothing. Key comments included.

“There are some basic pillars not yet in place, on which improvement is required; in the short term the goal may not be achieved, but in the mid to long term will be more beneficial if resourcing can focus on getting the basics right.”

“If certain activities were limited, then it can be better placed to meet cost management objectives with effective management oversight. The impact would support achieving strategic goals.”

“It will most likely delay the achievement of the strategic goal.”

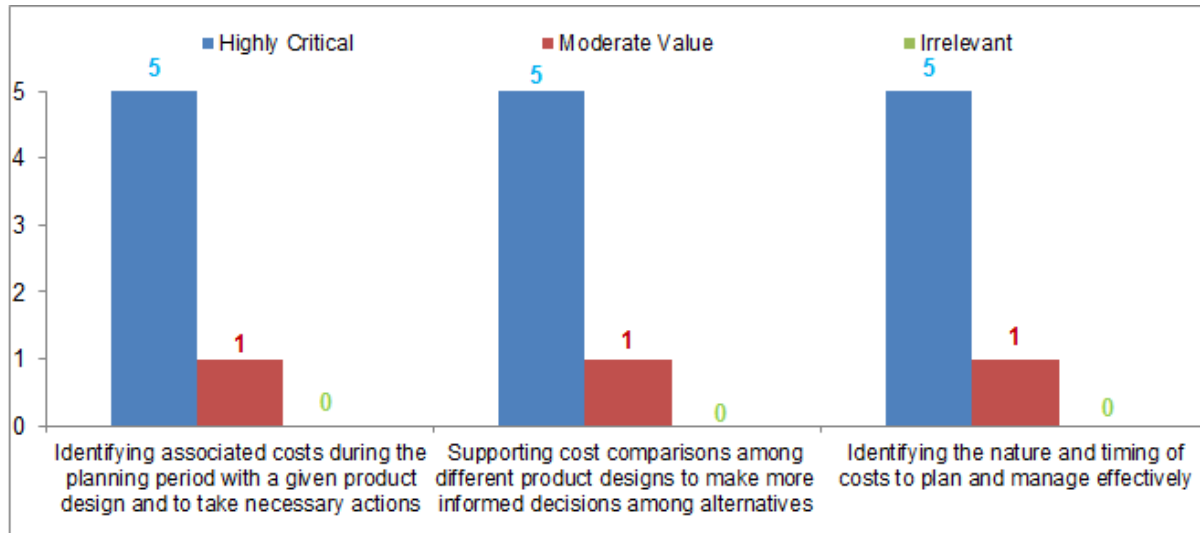
Respondents were asked if, in their opinion, the organisation had opportunities to consolidate similar functions and to remove duplication to achieve economies of scale. Respondents identified various reporting events which could be cross-functionally managed to reduce duplication of efforts, including Finance and Sales and Marketing as functions with opportunities to consolidate similar activities and remove duplication. One respondent referred to the organisation embarking on outsourcing initiatives in certain areas of operations. This included the firm concluding an organisation re-design to lower duplicated activities and to eliminate inefficiencies, but this would be dependent on highly skilled employees supported by the appropriate business systems.

4.3.6 Product Lifecycle Costing

Respondents were asked to indicate the level of importance of the following activities in the context of strategic cost management and its relevance to product lifecycle costing. All three product lifecycle costing activities were ranked as highly critical in nature by five respondents, with regard to their relevance to strategic cost management, with one respondent indicating that the activities were of moderate impact. Figure 4.8 provides a graphical illustration of the results.

- Identifying associated costs during the planning period with a given product design and to take necessary actions.
- Supporting cost comparisons among different product designs to make more informed decisions among alternatives.
- Identifying the nature and timing of costs to plan and manage effectively.

Figure 4.8: Product Lifecycle Costing



Respondents had to explain how product lifecycle costing could further contribute to reducing costs and simultaneously improve the strategic positioning of the organisation. Respondents provided insight into how the concept supported strategic cost management, and how it could be better managed to increase its efficiency with regard to the topic under consideration. A respondent pointed to its ability to influence the level of fixed costs planning, required by the entity on products, which would lead to strategic cost benefits (including economies of scale). A second respondent emphasised the value of Product Lifecycle Management as follows:

“Over the product lifecycle, VME (Variable Marketing Expenditure) will increase as the product is ageing. At the same time, FMI (Fixed Marketing Investments) should decrease. Product lifecycle events can reverse this trend: VME decrease and FMI increase. Utilising the correct feedback from the market, the product offering can be increased at the same time.”

Other respondents alluded to the importance of managing Product Lifecycle Management to leverage its impact on strategic cost management. They were of the view that making informed and reliable decisions from the inception of the product lifecycle would lead to benefits in years to come. It would also require an in-depth understanding of the payoff period and throughput on products to be able to identify opportunities in reducing costs or reinvesting savings from throughput performance and positioning the organisation better.

“Product Life Cycle costing is heavily influenced by forex rates and FOB pricing as well as any transfer pricing schemes. This must be managed by understanding the influence and mitigation to keep costs down.”

4.3.7 Value Chain Analysis

The following questions were posed to respondents to ascertain the impact of the value chain on Company A:

- How does the organisation use its value chain to successfully allocate costs, revenues and assets to each activity? One respondent was of the view that no consideration was given to the economic impact of cost allocation and that the existing allocation and reporting was arbitrary, based on the criteria of ease of implementation. Other respondents maintained that costs were allocated directly to each function in the value chain and would be allocated to general and administrative activities, manufacturing costs and sales and marketing costs.
- How are the cost drivers regulating each value activity identified and investigated? Respondents provided the following feedback and recommended further improvements to this activity.

“Detailed analysis done for each process.”

“Each area's cost management would be assigned to controllers who would evaluate the respective cost drivers.”

“Cost drivers are identified using actual cost results. Deeper investigation on each activity is required to ensure the correct actions to support improvement.”

- How does the organisation attempt to build sustainable competitive advantage? The following options were presented to respondents :
 1. By controlling cost drivers.
 2. By reconfiguring the value chain.
 3. By controlling cost drivers and reconfiguring the value chain.

It should be noted that all respondents selected this option.

4.3.8 Strategic Position Analysis

Respondents were questioned about the strategy the organisation pursued and the impact of strategic cost management in establishing competitive advantage for Company A. The first question addressed the type of strategy the organisation was pursuing in achieving competitive advantage. Respondents were divided on this, with three respondents selecting differentiation as the preferred strategy by Company A, and the other three were of the view that the organisation pursued a low cost strategy.

As follow-on to the above question, respondents had to comment on whether the organisation used strategic cost management to support the achievement of competitive advantage. Four respondents agreed that Company A was pursuing strategic cost management. Respondents were of the view that, to be a region of choice for products to manufacture and import, the firm needed to implement and follow through on the elements of strategic cost management. This requires a combination of cost management elements to support strategic goals through investment and change in business activities and processes. One respondent alluded to the directive from global headquarters which compelled the firm to adopt an approach focussed on long-term economic cost and return. Two respondents were of the opinion that the organisation had limited or no ability to pursue strategic cost management to support the achievement of competitive advantage. One respondent cited the reason for this being the finance function's inability to successfully develop and execute strategic cost management projects. The second respondent who challenged Company A's success in utilising strategic cost management to generate competitive advantage was of the view that only selected vehicle models were being produced locally in South Africa, and that the firm had more control on the costs of these models than on imported products.

4.3.9 Cost Analysis and Management

The final section of the questionnaire aimed to establish if the organisation managed costs successfully. This involved establishing if respondents:

- understood the process of auditing cost management initiatives;
- understood the scope of cost management [Is it restricted to manufacturing, or does it encompass the whole organisation?];
- were of the opinion that the organisation was able to determine if the cost management process supported the achievement of its strategic objectives.

Respondents had to rate the importance of using a cost analysis framework in the positioning of the organisation. Five out of six respondents rated the importance of using a cost analysis framework in the positioning of the organisation as highly critical, and the sixth respondent rated it as moderate in value.

Respondents had to explain how management initiatives were audited in order to determine if the strategic position of the organisation was enhanced. Most respondents referred to the annual audits, internal audit and monthly tracking of results. One respondent noted that the process was not audited, but two respondents described the audit process:

“Initiatives are monitored and feedback on the return on investment is translated into benefit to the organisation.”

“This can be applied through the internal audit function but is more operationally focused. The cost management is also reviewed under the direction of claiming rebates from the government agency. This process helps track if the organisation is on track to improve its strategic goals against industry incentive schemes.”

The next question addressed the topic as to what extent cost management activities were applied successfully to change the cost structure (fixed and variable costs) of the company. Some respondents were of the view that it was, at that time, reactive rather than proactive in approach, performed on an intermittent basis, with lack of strong focus on cost structure management. One respondent was of the view that intentional cost management concepts were not necessarily aimed at achieving successful cost management by the firm. A second respondent noted that it was almost non-existent due to the nature of existing global cost structures that impeded the ability of Company A to successfully change cost structures.

Respondents were requested to describe how the organisation was applying cost management activities to improve the performance for given strategies. Respondents created the impression that there was limited application of cost management activities by the firm to improve performance of selected strategies, and only specific strategies warranted the application of cost management activities. One respondent used the example of *“allocation of government incentive credits where profit improvement was required”*. Another respondent reiterated the role of headquarters in driving this activity:

“The organisation would have a tendency to go through phases of cost management driven by global directives e.g. management of reduction of total manufacturing costs per unit produced.”

The question of whether cost management was extended beyond the boundaries of the factory, was also posed to respondents. Three of the five respondents who attempted this question were of the view that Company A did extend cost management beyond the boundaries of the manufacturing plant. They were of the view that there had been a concerted effort by the firm to become leaner by expanding cost management beyond the factory and into 1) general and administrative activities; 2) non-factory related overheads; 3) supply chain processes; 4) fixed and variable marketing expenditure management through volume, product and sales channel mix optimisations, and 5) capital expenditure management. Two respondents disagreed, based on the following notion:

“Outside manufacturing there is only Sales & Marketing and finance. Finance is seen as only reporting cost/profit, and Sales & Marketing wants to sell more volume. Selling more volume = spending more money.”

The last question of this section aimed to establish if cost management was extended beyond the boundaries of the company. All four respondents who answered this question agreed that the firm extended cost management beyond its boundaries. The main activities with regard to cost management beyond the firm centred around supply chain of the organisation, which included inbound and outbound distribution of vehicles, parts and components, external storage facilities and suppliers/manufacturers of parts and components sourced by the manufacturing plant for current and future products. Suppliers were challenged to reduce costs on an annual basis to establish more competitive rates. Shipping line cost reductions and global supplier cost reductions were challenged by the firm.

4.4 INTERVIEW RESULTS

A direct interview was conducted with two employees. The first participant was an executive director of Company A who has thirty years of experience in the automotive sector and approximately ten years at Company A. A structured interview format was administered in this interview. In the interest of optimising the value/feedback from the interview, the types of questions posed during the interview were different to those in the structured questionnaire in section 4.3. Questions were prioritised and recorded by taking into account the participant's wealth of experience and position within the organisation. The discussion also took into account the interviewee's perception of the relevance of strategic cost management and its impact on both Company A and its holding company. It should be noted that, in the context of this interview, cost reduction is attributable to strategic cost management and is therefore seen as beneficial to the firm, whereas cost cutting is perceived as detrimental.

The second participant is an experienced finance professional who was employed in a senior management capacity in the Sales and Marketing division. This interview was based on an unstructured format, as the interviewee intended to discuss her perspectives on the role of the South African finance function in industry as part of her views on strategic cost management. She believed a prescriptive, structured approach to answering questions would not suit her.

4.4.1 Interview 1

The first question addressed the question whether Company A planned, executed and reviewed strategic cost management. The participant stated that:

“It is more about cost cutting and is not strategic, and no applying of minds, which damages the business. Cost cutting is short term knee jerk reactive type of cost reduction which can have a very detrimental impact on the organisation.”

The participant was of the view that there has always been a relentless focus on costs, specifically focussed on cost reduction, and this is often a non-negotiable directive from global headquarters. However, a drawback of this approach is that a fixed cost reduction target cascaded to various regions is not practical, particularly in high inflation environments, as the view is that inflation is ignored when determining cost reduction targets. This had a major impact on general and administrative costs which, according to the participant, had been *“kept flat for the last three, four, five years.”* An exception to this has been manufacturing, specifically the purchasing function (which is a division of manufacturing). In this environment an inflationary adjustment was allowed, which takes into account exchange rate adjustments and raw materials impact with invariably an adjustment for cost reduction to partially offset the inflationary impact.

The second question was concerned with whether the interviewee considered the concept of strategic cost management as a means of improving efficiency within Company A. The interviewee stated that *“in principle from a strategic point of view, probably not”* and was of the view that, other than when the company embarked on a restructuring programme, it was more a top down approach from headquarters, with no regard to whether it would damage the business or not; a task was simply allocated. The participant expressed concerns with regard to improving efficiency globally.

“Whether it is strategically global, you almost wonder if it is not just a narrative.”

The next question discussed whether the firm achieved cost reduction objectives. The interviewee was of the view that the manufacturing division had been relatively successful in delivering cost reductions, particularly the purchasing function. It was pointed out that in instances where there had been a strong focus on cost management, this had led to significant savings in costs which strengthened the strategic positioning of the brand. However, of concern was the difficulty of measuring avoidable costs as a result of the deferment of critical activities, the delay of which was likely to damage the long-term fabric of the organisation. The participant raised concerns about the actions of sales and marketing in cost reduction activities that were

sometimes to the detriment of the strategic positioning of the organisation. This had led to the weakening of the competitive positioning of the brand.

“Sales and Marketing have achieved significant cost reductions, but at the expense of share of voice, it is not where it should be, and is at the expense of selling fewer cars to save costs. How many vehicles could we have sold if we maintained consistency of investing in the brand, investing in making sure people know about our product? We’ve tended to cut it, which impacts on Share of Voice which has been lower as a result. Sales and Marketing’s quickest way to cover a lack of a sale is cut off Fixed Marketing Investments, which invariably results in more costs as it means increase in Variable Marketing Expenses to execute the sale.”

As a follow-up question to the above, the participant was asked if he believed that cost reduction was supporting the strategic objectives of Company A. The respondent felt that, unfortunately, it was seen as not being strategic in nature, but rather as cost cutting. He was of the view that the organisation and its holding company had been extremely short-term focussed and it was often at the expense of resource restrictions (e.g. Headcount freeze).

“The way we run the company from quarter to quarter have become progressively more and more short term focussed. The short term objectives are sometimes achieved to the detriment of the longer good of the company.”

With reference to the industry, the participant had to express his opinion on whether cost reductions implemented by firms would enhance the strategic positioning of the organisation. The respondent was of the view that cost focus is critical and it could be successfully managed if costs are eliminated without compromising the future viability of the firm. The industry is highly competitive, so the organisation would find it hard to compete if it overlooked cost reduction management. Therefore an overall well-run lean business that prevents cost wastage would certainly create a stronger strategic position for the organisation.

The next question addressed to the interviewee focussed on whether he believed Company A had developed innovative ways to support strategic cost management. The participant was of the view that the manufacturing plant was successful in developing innovative ways, and there had been a *“very strong focus on finding ways to do things better”* to support strategic cost management.

“From a production perspective there’s been a very strong drive using innovative ways to manage costs and not compromise ability to deliver.”

He pointed out that engineers at the manufacturing plant were driving innovation and cost saving processes, and that the Supply Chain Manufacturing had been extremely successful, generating some real cost reductions with strategic benefits. This was because the function avoided window dressing and was not short-term focussed with regard to its objectives; it had adopted long-term, sustainable and innovative activities driving long-term benefits. The participant, however, presented a different view on other functions.

“As an administrative team have we pushed ourselves enough to ensure there is an improvement in process? No. There is a gap, tending to do many things the same way all the time. Sales and Marketing have also been less innovative.”

He alluded to the point that innovation is also about employing the right people instead of saving costs, as the right people would bring in cost reductions, and a freeze on general and administrative costs implies that the firm needs to physically reduce headcount continuously. The participant expected that, with the recent organisational restructuring, the firm would be able to deliver on more innovative ways to support strategic cost management. He also emphasised the importance of factoring an increase in general and administrative costs into the long-term plan and ensuring that it is linked to growth in revenue.

The participant had to indicate if the organisation had the following elements in place in managing costs efficiently and effectively:

Right People: The firm was in a stronger position with respect to having the right people in place, particularly relative to four to five years ago. His view was that the organisational restructuring process, coupled with the recently concluded voluntary severance program, had been *“beneficial and rejuvenating”*.

“Restructuring helped with bringing key new people, new fresh blood is good to have.”

Right Knowledge: The participant was of the view that the people had reasonably good knowledge.

Right Tools: The Company was paying the price for archaic systems, and there was a big gap on tools because the company was of the opinion that it was saving on costs. He believed that, for Company A to gain a strategic advantage, it needed to be on the cutting edge of technology and systems.

Right Processes: The plant had robust processes in place, and was always challenging and driving the status quo. The participant was of the view that specific processes adopted by sales and marketing (e.g. revenue enhancement strategies) might benefit the organisation. Concerns

were raised specifically about the measurement and KPI setting process. The participant alluded to the firm's over emphasis on marginal costs and profit and the fixing of exchange rates in profit tracking, which he believed was to the detriment of the firm as it overlooked the impact of fixed costs, overheads and exchange rate volatility.

The participant was asked to identify key objectives of the organisation critical to the success of strategic cost management. He was of the view that the key objective is to secure buy-in from senior management and executives who fundamentally disregard the importance of deploying the right people, which could end up being too detrimental to the organisation and at the expense of the best resources (people). He emphasised the importance of having long-term sustainable objectives in place (rather than short-term in nature).

The participant had to define the strategies and plans the organisation had adopted to successfully implement its objectives. The organisational restructuring was considered to be the most significant strategic cost management initiative which was expected to generate substantial cost reductions. Previously this had led to 25% reduction in costs, resulting in a leaner, efficient organisation, more adept at pursuing strategic objectives.

The next question addressed the type of incentive schemes adopted to reward management and employees in achieving performance targets. The participant referred to the *"Performance Management Development"* incentive scheme. The incentive scheme had evolved and been improved over the years. It was previously based on *"achieving all or nothing"*. Therefore, if the budget was poorly set with unachievable targets, then no incentives were paid out. It has since been improved with better coordination between departments and regional integration and support has improved.

"Better process now and it does add value from a performance perspective and reward, progressively has improved, brought in an individualistic element. There has been an improvement in levelling between departments. However the interaction between headquarters and the region needs to improve."

The next question addressed the issue of whether the organisation was able to successfully prioritise its strategic goals. The participant was of the view that the organisation was, two to three years ago, exceptionally short-term focussed but has had a better balance of late through the development of long-term strategies and priorities. However, key concerns remained on product and manufacturing strategies. The participant believed that Company A should have had clarity on strategies that define which new or future products to import and to manufacture three to four years ago.

“Product for South Africa has been poorly managed, which is a more structural problem at headquarters, we should not need to fight for everything. Competitors have global products developed, initial costs might have been expensive, but significant savings are realised on the Research and Development process for every market. However our global headquarters has focussed on more developed markets such as EU and US. Non-core businesses have really struggled, a difficult process to get a vehicle for a market, with South Africa as an example, key products are missing as a result. Too many products that should be in the market are not offered in South Africa.”

The competitiveness of the organisation on Products, Customers, Sourcing and Manufacturing was then discussed.

Products: The participant indicated that the Company had not leveraged the opportunities offered by the Automotive Production and Development Programme (APDP). As a result, the firm was paying a significant portion of the industry’s duty on imported products, while key competitors did not need to factor in duty payments as they were optimising the benefits offered by the above-mentioned government incentives scheme through optimal (local) manufacturing and exports. However, product design is viewed as relatively competitive. The participant viewed their product costs as uncompetitive, since the firm had not fully leveraged APDP. To compete in the market, the firm needed to be highly competitive on costs and to be on a level footing with competitors.

The participant viewed the most expensive strategic decision as the inability of headquarters to make the right decision on manufacturing the relevant product at the manufacturing plant in South Africa, but instead chose a different location which led to higher costs and which reduced the level of competitiveness of the product globally. The participant noted that the poor strategic decision led to headquarters expending “millions” in additional costs.

“Knowing the infrastructure of how APDP works, we should have produced in South Africa, put in the resource and make sure it happens here, if we had launched earlier, this organisation would have been a very different one globally. It should have been a strategic decision and not prove that you can manufacture in South Africa because all successful manufacturers are doing it here. Other OEMs have not had to prove themselves; it was a strategic decision to manufacture a product in South Africa and use South Africa as a base, strategically it would have been the right decision.”

The participant also believed that comparisons on product costs against plants that were manufacturing significantly higher volumes was not fair, as these plants benefited from fixed

cost efficiencies and economies of scale as a result of the higher production volumes allocated by headquarters.

Customers: The participant was of the opinion that Company A has a “*strong and loyal customer base (end retail customer)*”. However, there were gaps in certain key product segments that were previously addressed and getting these customers back would pose a challenge. It was also important for the participant that the firm should not underestimate the launch of new products, as this would impact on the potential customer base.

Sourcing: The participant was of the view that the purchasing function was doing reasonably well in reducing costs to improve the competitive positioning of the organisation, but that they found it extremely challenging to do so with the significantly low volumes of vehicles.

Manufacturing: This was viewed as extremely competitive with the scope to significantly improve if new products and additional volumes were allocated.

The last question in this interview was focussed on whether the participant believed that competitiveness was achieved in an economical way. The participant was of the view that, at certain times, competitiveness had been achieved in an economical way. However, the long-term success of the company had been sacrificed due to prioritisation of short-term gains.

4.4.2 Interview 2

This interview was based on an unstructured format, as the participant intended to discuss her specific perceptions on the topic. According to this participant, strategic cost management has a number of elements applied in South Africa (and Company A) that differ from those in other countries. The first aspect that is specific to South Africa is the education system of the finance discipline, which promotes a “*certain bias*”.

“There is clear segregation of various finance disciplines that does not encourage any cross discipline thinking. Whatever finance professionals you find in South African companies is the result of this. E.g. in France students pursuing a career in finance are not pushed to make a decision on finance specialisations, it is a generalist view first, covering all finance topics, including strategic management and all topics are integrated. Students are made to master the big picture first.”

The second aspect addressed by the interviewee was the impact that the organisational culture had on the approach that the finance function adopted, which was based on the educational system. The participant was of the view that, if headquarters had a prescriptive approach to the role of finance, it would be more suited to the finance functions of organisations in South Africa,

as their way of thinking was shaped for them. However, if the approach is more unrestricted and less prescriptive by headquarters, finance functions of South African companies are likely to face challenges due to their rigid and inflexible approach, which is likely to impact negatively on concepts such as strategic cost management.

“Headquarters freestyles on 80% of activities, so finance hold onto what they know best which is statutory reporting. Freedom given to local finance professionals creates certain bias and could potentially negatively influence performance.”

The participant believed that in South Africa the finance function is largely influenced by the bias of Chartered Accountants CA(SA) which is oriented around standards, procedures and statutory reporting. She was of the view that this hinders the ability of the finance function to think strategically and integrate all aspects of the business with the finance function.

“Studies comparing US and Asia, amongst CFOs and the degrees they hold, almost all MBAs and Engineering backgrounds (US, Europe, Asia) vs. South Africa which is CAs, because of this education system they are more oriented around statutory reporting. Company A is the result of all that bias. Overseas belief is that finance professional is the business partner, e.g. in France not all CFOs are accountants and in France other people are encouraged to progress onto finance positions. The role of Finance in strategic cost management is to improve decision making, statutory accounting is not enough for them. They should ask what is needed to improve decision making.”

The participant was of the view that financial strategy is about optimal resource allocation. The reporting function should require limited resources and the majority of time and resources should be directed towards developing financial strategies and business partnering, which includes aiding decision making.

“80% people should be focussed on strategy, at Company A, 90% is split on statutory reporting and replicates the chart of accounts.”

As a last point the participant identified four types of tools required in finance to develop and execute strategic cost management successfully:

“1. Economic situation of the company: This is key and looks beyond statutory accounts, which is a literal interpretation of what finance is.

2. Strategic profit management: Because the CEO is not a financial professional he expects the CFO to assist him in decision making, and provide a range of possibilities in profit management. This also includes grouping by family of costs or nature of costs.

Replicate the same vision as statutory accounts. In France it is grouped by purpose or destination.

3. Portfolio management: Optimising profitability of Products and Customers.

4. Optimisation of all activities.”

4.5 SUMMARY

This chapter addressed the secondary objectives of analysing processes, techniques and systems to assess if the study's primary objective was met, and evaluated empirical evidence to discern the extent to which the automotive industry perceives the application of strategic cost management.

The study was administered using structured, open-ended questionnaires and semi-structured interviews. Members who partook in the research included a mix of male and female participants, who brought a wide range of automotive expertise to the study. The results of the questionnaire reflected a mixed response. Respondents valued the importance of strategic cost management, but on the other hand raised concerns on the shortcomings in Company A's ability to plan and execute the concept successfully.

The first part of the questionnaire assessed the relevance of strategic cost management in Company A. This involved exploring the meaning of the concept, the extent to which it benefited the organisation, and whether Company A successfully applied the concept to reduce costs and enhance its strategic positioning. The majority of respondents were familiar with the concept of strategic cost management and were able to differentiate between cost cutting and strategic cost management. Almost all respondents expressed their concern that Company A did not successfully develop, execute and review strategic cost management, and agreed with the perception that the concept (if applied correctly) would improve organisational efficiency and effectiveness. Five of the seven respondents were of the view that Company A did not realise its cost reduction objectives, with the majority agreeing with the notion that cost reduction techniques supported the achievement of strategic cost management and enhanced the strategic positioning of the organisation. The last part of the section surmised that Company A did not develop and implement innovative techniques to support strategic cost management. The section concluded by assessing the importance of strategic cost management in enhancing revenue, productivity, customer satisfaction and improving the strategic positioning of the organisation.

In evaluating best practice cost management, the majority of respondents concurred that the right people, knowledge and processes were only partially in place. Furthermore, most participants believed that the right tools were not in place in ensuring that costs were managed efficiently and effectively. Company A's use of tools and techniques pertinent to the successful execution of strategic cost management were evaluated. This included (but was not limited to) tools and techniques such as activity based costing, target costing, benchmarking, fixed cost analysis, waste analysis and value stream mapping. Company A's leadership's perception of cost behaviour management was analysed and respondents were required to rate the extent to which marginal, fixed and overhead costs were managed.

The next section of the questionnaire evaluated the application of strategic cost management as a management control system which involved 1) establishing the objectives critical to the success of strategic cost management; 2) identifying the strategies and plans crucial in achieving objectives; 3) describing the processes and activities pertinent to the implementation of the above-mentioned strategies; 4) ascertaining the level of performance required; 5) developing an appropriate reward scheme, and 6) performance improvement mechanism.

Company A's competence in utilising strategic cost management as a strategic tool was assessed by evaluating 1) how well the firm prioritised strategic goals; 2) its differentiation between processes and activities; 3) its competitiveness on products, customers, sourcing and manufacturing; 4) its ability to achieve competitiveness economically, and 5) how efficiently the organisation integrates performance and cost management.

The last section of the questionnaire addressed Company A's ability to analyse and manage costs. The majority of respondents rated the importance of using a cost analysis framework as critical in the positioning of Company A. They emphasised the importance that the organisation was placing on auditing cost management initiatives, but raised the inability of the firm to modify cost structures or to improve performance of given strategies as weaknesses. Most respondents noted that Company A had extended cost management beyond the boundaries of manufacturing and the boundaries of the company.

The interview was based on a structured format for the first participant and an unstructured format was administered for the second interview. The first participant was of the view that Company A pursued cost cutting rather than strategic cost management, which had detrimental consequences to the organisation. He did not believe that, from a strategic perspective, the company employed strategic cost management to improve efficiency, nor was he of the opinion that cost reduction supported achievement of Company A's strategic objectives. However, with

reference to meeting cost reduction objectives, the participant stated that the manufacturing function was successful in meeting its goals and had developed innovative ways to support strategic cost management, but that sales and marketing remained a concern - as the function pursued cost reduction activities that damaged the competitiveness and strategic positioning of the firm. It was pointed out that Company A had the right people and knowledge in place to manage costs efficiently and effectively. However, tools and processes remained a concern. The importance of buy-in from senior management and executives was raised, and the value of setting long-term sustainable objectives as elements critical to the success of strategic cost management was emphasised. Lastly, the participant emphasised the importance of developing robust strategies centred on products, customers, sourcing and manufacturing that were essential in realising strategic cost management objectives.

The second participant was of the view that the educational system of the finance profession in South Africa does not promote cross discipline thinking, and that it is based on a prescriptive approach oriented around standards and procedures. This hinders the ability of finance professionals to think strategically and therefore limits their contribution towards strategic cost management. The second interview concluded with the participant identifying four tools critical to the finance function in achieving strategic cost management.

The next chapter will summarise this study and will make the relevant conclusions and recommendations.

CHAPTER 5

5 CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

This chapter concludes this research by (1) summarising the literature and empirical studies, (2) recommending whether strategic cost management was successfully adopted and executed by Company A and (3) providing a final conclusion on the study.

The primary objective of this study was to evaluate how an automotive company perceives the application of strategic cost management techniques. The following secondary objectives were identified to support the achievement of the primary objective:

- Identifying and developing the relevant research methodology necessary to answer the set research objectives (Chapter 2, page 112).
- Studying the concept of strategic cost management by evaluating tools and techniques critical to the achievement of cost reduction objectives and consequently enhancing the strategic positioning of the firm (Chapter 3, page 266).
- Analysing processes, techniques and systems adopted by the industry to assess if they contributed in any way to this study's primary objective. This also considered activities beyond the boundaries of primary functions (manufacturing, sales and marketing) (Chapter 4, page 50).
- Evaluating empirical evidence to discern the extent to which the automotive industry perceived the application of strategic cost management (Chapter 4, page 50).
- Conclude research findings by summarising the outcome of the empirical study, substantiated by the literature review and recommend whether strategic cost management is effectively applied by the South African automotive industry (Chapter 5, page 87).

The study was performed by conducting both a literature review and an empirical study. A summary of each will be provided below.

5.2 LITERATURE REVIEW SUMMARY

The literature review, titled strategic cost management, began by evaluating the difference between strategic cost management, traditional cost management and cost cutting initiatives. Traditional methods of cost reduction and cost cutting were perceived as reactive in nature and due to their shortcomings, led to the inadvertent elimination of activities that created real benefits. However, strategic cost management demonstrates that meaningful cost reductions

could be realised by prioritising the biggest cost saving opportunities using a systematic, strategic and practical approach to cost optimisation. Competitive advantage could be achieved by proposing different cost management strategies, depending on the market position of the firm. Key value adding techniques, pertinent to strategic cost management, include: (1) World Class Manufacturing (WCM); (2) Global value chain principles; (3) Logistics cost behaviour management; (4) Automotive alliances, and (5) Product tear down analysis. The above-mentioned techniques were successfully applied and benefits were realised by the automotive sector in the execution of strategic cost management. One such example involved the successful global alliance between Renault and Nissan.

The concept of strategic cost reduction was introduced by Deloitte in 2016. The concept aligned with the principles of strategic cost management and is thus considered as a method corporates may adapt to benefit from sustainable cost reductions and the consequent profit generation. Aguilar and Puleo (2016:3) proposed three criteria necessary in creating cost and competitive advantage for the firm: (1) Rethinking a company's business model; (2) Aligning operational governance with the business model, and (3) Redefining functional service delivery to achieve organisational scalability and efficiency.

Otley's (1999) framework for evaluating management control systems was integrated into the research by analysing the practical application of the framework to strategic cost management. This was evident in the automotive industry when Fiat implemented a performance measurement system to evaluate the success of the WCM model (a strategic cost management technique) the firm had implemented as part of its long term strategic planning.

Key tools and methods relevant to the application of strategic cost management include: (1) Target costing, a method successfully applied by Mercedes Benz (in the development of new products) and Goodyear to improve product quality and profitability; (2) Activity based methods; (3) Benchmarking; (4) Lifecycle management; (5) Just in time manufacturing; (6) Idea generation systems; (7) Break-even analysis; (8) Total cost analysis; (9) Value stream mapping and (10) waste analysis.

5.3 EMPIRICAL STUDY SUMMARY

The empirical study involved an evaluation of the application of strategic cost management in Company A. Results were sourced using structured, open-ended questionnaires and interviews. Questions reflected the qualitative design and nature of the research. Participants represented a broad spectrum of knowledge and expertise in Company A, ranging from financial competencies to manufacturing (engineering), human resources and sales and marketing. The majority of

respondents acknowledged the relevance of strategic cost management, and were able to clearly differentiate between the drawbacks of cost cutting and the benefits of strategic cost management. Respondents agreed that strategic cost management offered: (1) Long term solutions; (2) Management of costs in the current environment and into the future; (3) Ability to forecast potential costs, and (4) the advantage of keeping the business one step ahead. With reference to whether Company A effectively adopted strategic cost management, the consensus amongst respondents was that Company A was not successful in developing, executing and reviewing strategic cost management. Notable reasons for the firm's inability to adopt and execute strategic cost management included the inability to drive and articulate strategic thinking on strategic cost management initiatives and the disconnect between cost management and strategy.

Strategic cost management was perceived as a means of improving organisational efficiency and effectiveness, leading to an automatic reduction in costs and ensuring the longevity of cost improvement for firms. The majority of respondents did not believe that Company A successfully realised its cost reduction objectives. The most profound reasoning to support this answer alluded to the point that Company A was reactive in nature to cost pressures and did not demonstrate strong business transformation capability to realise the firm's cost reduction targets. Respondents supporting the notion that Company A achieved its cost reduction objectives reasoned that manufacturing, engineering and purchasing functions developed clear strategies to reduce costs for Company A, thereby creating a strategic advantage for the organisation.

Cost reduction techniques as a mechanism to achieving strategic objectives and enhancing the strategic positioning of an organisation were supported. The majority of respondents challenged Company A's ability to develop and execute innovative techniques to support strategic cost management. Consensus was reached on the critical role strategic cost management played in enhancing revenue, productivity and the strategic positioning for a given organisation. In the evaluation of whether Company A adopted best practice, it was concerning that the right people, knowledge and processes were only partially in place, with the company lacking in the right tools critical for achieving strategic cost management.

Strategic cost management tools and techniques identified by this study were rated as highly critical. Although rated as highly critical to the successful execution of strategic cost management, many of the techniques, including Activity Based Costing and Management, Target Costing, Lifecycle Costing, Cause and Effect Analysis, Idea Generation Systems and

Value Stream Mapping were not actively used by Company A. However, other tools and techniques such as Benchmarking, Fixed Cost Analysis, 5S and Breakeven Analysis were actively deployed by Company A to support cost optimisation and strategy achievement.

It was noted that managers of Company A understood how costs behaved, as this was crucial in influencing their ability to control costs effectively. Cost structure management involved optimising marginal, fixed and overhead costs. Respondents ranked all three cost elements as very important attributes of cost management, but concluded that Company A was weak in the management of marginal and overhead costs. Fixed costs were well controlled and managed due to the influence of global functions.

The main objective (for Company A) critical to the achievement of strategic cost management was identified as the development of lowest cost capability to enhance competitiveness and outperform business rivals. Key obstacles encountered by Company A that hindered the achievement of strategic cost management included poor KPI development, short-term focus at the expense of long term planning, limitations in analytical ability and decision making, the finance function's reluctance to become a strategic business partner, limited management accountability, and limited skills and capability to execute strategic cost management. Addressing and strengthening the above identified shortcomings were proposed as the means to achieving key objectives pertaining to strategic cost management.

Company A's application of strategic cost management as a strategic tool was assessed. This involved assessing how the firm prioritised its strategic objectives, categorised costs by processes and activities, managed resources, optimised costs and competed on key attributes (business, product, customers). Half of the response was in favour of the firm's ability to prioritise strategic objectives, and the other respondents cited the above weaknesses (in achieving strategic cost management) as reasons for poor prioritisation. It was also evident that Company A was not able to differentiate between costs of various activities and processes. Challenges included the lack of interest on the part of the finance function to understand cost drivers, poorly defined roles and responsibilities, considerable focus on reporting activities at the expense of driving strategic initiatives, processes and optimising operational activities. The organisation was rated moderately competitive on key strategic elements, namely products, customers, sourcing and manufacturing.

On the topic of achieving competitiveness in the most economical way, the opinions of respondents were divided, with half the number of respondents believing that Company A was

successful and the other half believing that further opportunities were available to achieve economies of scale by increasing production volumes.

Respondents placed specific emphasis on activities that supported strategic cost management, namely product lifecycle costing, value chain analysis and strategic position analysis. Differentiation and low cost strategies were identified by participants as the strategies pursued by Company A. The company pursued strategic cost management to achieve competitive advantage, however it was noted that the company needed to follow through on the elements of strategic cost management to be successful.

The relevance of using a cost analysis framework was evident in the positioning of Company A. Company A had placed emphasis on auditing the cost management initiatives, but the inability of the organisation to change cost structures or to improve performance of given strategies was identified as a weakness. The company was successful in extending cost management beyond the walls of its manufacturing facility to manage costs in sales and marketing and in support functions. The firm extended its reach on management of costs beyond its boundaries by managing suppliers and distribution channels.

The two interviews led to similar outcomes on the perception of Company A's application of strategic cost management. Both participants were of the view that Company A did not benefit from strategic cost management. The first participant believed that Company A pursued cost cutting rather than strategic cost management, which was detrimental to the long-term sustainability of the company. However, an exception to this was Company A's manufacturing function, which was perceived by the participant to be more strategic in nature, by employing innovative and sustainable ways to reduce costs to create strategic advantage. The firm's people and knowledge were identified as strengths, but tools and processes remained major drawbacks. The participant emphasised the need to develop long-term sustainable strategies focussed on products, customers, suppliers and manufacturing that were crucial in meeting strategic cost management objectives.

The empirical study concluded by highlighting the need for corporates to broaden the ability of the finance division to operate cross functionally and to perform beyond the confines of standards and procedures. Currently this is seen as a weakness in the finance function, thereby limiting its ability to support sustainable reduction in costs and attainment of strategic objectives. It was pointed out that it is critical for finance professionals to think strategically and to make invaluable contributions towards strategic decision making. This could be achieved through the

adoption of four tools: (1) Economic situation of the company; (2) Strategic Profit Management; (3) Portfolio management (Customers and Products), and (4) Optimisation of all activities.

5.4 RECOMMENDATIONS

It is clearly evident from the empirical results that the concept of strategic cost management is, in broader terms, an effective mechanism in the optimisation of costs and achievement of strategic objectives. However, through the study of Company A, it is apparent that the successful execution of strategic cost management remains a challenge within the automotive industry. A number of recommendations are proposed on how to overcome this drawback.

- The organisation needs to develop an overriding corporate plan focussed on developing comprehensive and effective strategic cost management initiatives that will benefit the organisation. This will require a change in organisational mind-set. A number of respondents and participants raised concerns on the organisation's short-term focus on activities. Firstly, the firm needs to transform its business towards long-term planning, which should include the development of sustainable objectives and strategies focussed on achieving strategic cost management. This should include the integration between strategies and cost management, as this is pertinent in realising the benefits of strategic cost management. Although the manufacturing function has been relatively successful in strategic cost management, the role of other critical functions (Sales and Marketing and Finance) has been lagging. The recommendations proposed by this study address primary and relevant supporting functions.
- Specific strategies on products, customers and manufacturing are crucial in supporting the achievement of strategic cost management. On product strategy, it is recommended that the company introduces and markets the type of products that will optimise market share and lead to sustainable cost advantage. Sales and Marketing should manage marketing expenditure (both fixed and variable) optimally and should deploy key strategic cost management methods such as product lifecycle management (refer section 4.3.6, page 71) and strategic position analysis (refer section 4.3.8, page 73) to ensure that the firm's product strategy generates sustainable cost reductions and competitive advantage. It is also recommended that the organisation should manufacture products that generate sufficient production volumes that will result in economies of scale and leverage the benefits offered by the Automotive Government Incentive Programme. Therefore Company A and its holding company should identify the most relevant product(s) that will minimise costs and create strategic advantage.

- The sales and marketing of products would be futile without a growing and reliable customer base. Therefore the sales and marketing function should enhance its strategies on customer segmentations, customer distribution channels and customer retention. Customer profitability should be managed efficiently by optimising the activities supporting customer strategies to ensure that the firm benefits from sustainable cost reductions.
- During the empirical study, a number of respondents and participants alluded to the point that strategic cost management was confined within the walls of the manufacturing and supply chain functions. Upon further analysis, it became evident that the manufacturing function (including purchasing) has to a certain degree benefited from strategic cost management activities. However, there are further areas of opportunities. The organisation needs to develop a long-term manufacturing strategy that will secure optimal manufacturing volumes, leverage the government incentive program and manage manufacturing costs to the effect that the manufacturing cost per unit reaches benchmark levels within the group.

The firm needs to implement or enhance (in some instances) a number of activities crucial to the achievement of the recommended strategies identified above:

- **Best Practice Cost Management:** The organisation is only moderately ranked in best practice cost management. The introduction of the right people, knowledge, tools and processes into all functions will ensure the optimisation of cost management. Employees need the requisite training and upskilling, and where appropriate the right people should be hired. Knowledge should be strengthened through the provision of the relevant expertise. Specific processes attributable to KPI setting (discussed below) and profit measurement and tracking need to be simplified. This may require considerable investment, but will lead to long-term scalable cost improvements and sustainable competitive advantage.
- **Tools and Techniques:** It is recommended that the firm adopts and enhances a number of strategic cost management techniques including Target Costing (refer section 3.6.1, page 45), Activity Based Costing and Management (refer section 3.6.2, page 46), Lifecycle Management (refer section 3.6.4, page 47), Idea Generation Systems (refer section 3.6.6, page 48), Value Stream Mapping and Cause and Effect Analysis (refer section 3.6.8, page 49).
- **Marginal and Overhead cost management:** A clear differentiation between marginal and operating costs is required. The importance of marginal costs and overhead cost tracking and reporting in strategic cost management should be emphasised. The relevance and impact of all profit indicators should be clearly communicated to the respective members of

the organisation. It is also recommended that an increased involvement from management is crucial in ensuring improved control and commitment from the organisation.

- Communication: The development of improved communication levels within the organisation and with the holding company is required in ensuring that the organisational objectives are aligned.
- Risk Management: The management of business risk is critical in ensuring efficient cost management and promoting business sustainability. Risk management includes the introduction of robust standards and sustainable corporate governance structures that promote management accountability and ensures adherence to strategic objectives.
- KPI improvement: KPIs need to be simplified and effectively integrated into the measurement of activities. KPIs should be redeveloped where necessary, or amended, to ensure that employees clearly understand their relevance to strategic and cost objectives.
- Lastly the role of the finance function within the organisation should be considerably enhanced to support the achievement of strategic cost management. The importance of complying with the regulatory framework and reporting standards cannot be discounted, but to remain relevant and to be regarded as a value adding function, the finance division should go beyond the reporting function and play its part in achieving the firm's strategic objectives. Therefore the finance division needs to be strategic in its functionality and orientated towards a closer integration with the rest of the organisation to drive strategic cost management. The function should encourage members to engage in business partnering and risk management, particularly with the primary functions - manufacturing and sales and marketing. It is also recommended that the function 1) promote the understanding and focus on drivers of costs, 2) educate members on the relevance and impact of business processes and activities, and 3) encourage the analysis of business through the use of key strategic cost management tools and methods such as activity based costing, target costing, lifecycle costing and value chain analysis.

5.5 CONCLUDING REMARKS

The current economic climate has prompted corporates to revise their strategies and to consider further cost reductions. It is critical that costs are not cut to the detriment of the long-term sustainability of the organisation. This can be avoided through the planning and implementation of strategic cost management within the organisation. This study has demonstrated through an evaluation of how an automotive company perceives the application of strategic cost management, the long-term, sustainable benefits that the concept provides to the automotive

industry. Moreover, it offers the possibility of applying the concept successfully to other industries. The research objectives of this study have therefore been achieved.

5.6 LIMITATIONS OF THE STUDY

The evaluation of strategic cost management was performed on the automotive industry, and is therefore confined within this industry. The conclusions drawn from the study can thus not be applied to other industries. Furthermore, the study is based on the South African automotive industry, the results and recommendations thereof cannot be applied to automotive industries of other countries.

It should also be noted that this research was in the form of a case study of a single automotive company located in South Africa, and has considered only a select number of participants for the research. The results may not be generalised across the automotive industry in South Africa. Although the South African company forms part of a larger conglomerate, the organisational culture is likely to be different to other subsidiaries. Organisational culture influences strategic decision making, which would in turn influence how the firm frames and executes strategic cost management.

5.7 AREAS OF FUTURE RESEARCH

The limitations described in section 5.6 provide a guideline for areas of future and further research. This study provides the following opportunities for further research:

- Further research to be undertaken within the automotive industry by considering more automotive companies for research purposes.
- Extend research undertaken in the South African automotive industry into other regions or countries.
- Expanding research in strategic cost management beyond the confines of the automotive industry and into other industries.
- Research the influence of different organisational cultures on the relevance and impact of strategic cost management within and outside the automotive industry.

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APPENDIX 1: QUESTIONNAIRE

Part A : General Information	
1	In which division are you currently employed ?
2	Please specify your department if you have selected "Other" from the list above
3	How many years experience do you have in the automotive industry ?
4	How many years experience do you have with your current employer ?
5	Indicate your field of expertise (e.g. Accounting, Engineering, etc.)
PART B : STRATEGIC COST MANAGEMENT : Determining its Relevance	
1	Are you familiar with the concept of Strategic Cost Management ?
1.1	<i>Explain in your own words the concept of Strategic Cost Management</i>
2	Strategic Cost Management vs. Cost Cutting : Categorise the following activities as either Strategic Cost Management or Cost Cutting
	Short-term in nature
	Long-term solution
	Manage costs now and into the future
	Forecasting potential costs
	Aims to keep business one step ahead
3	Does the organisation successfully develop, execute and review Strategic Cost Management ?
3.1	<i>Explain the reason for your choice</i>
4	Do you perceive Strategic Cost Management as a means of improving organisational efficiency and effectiveness ?
4.1	<i>Explain the reason for your choice</i>
5	Does the organisation successfully realise its cost reduction objectives ?
5.1	<i>Explain the reason for your choice</i>
6	In your opinion do you consider cost reduction techniques as a mechanism to support the strategic objectives of an organisation ?
6.1	<i>Explain the reason for your choice</i>
7	Do cost reduction initiatives enhance the strategic position of the organisation ?
7.1	<i>Explain the reason for your choice</i>
8	Has the organisation developed and implemented innovative techniques to support Strategic Cost Management ?
8.1	<i>Explain the reason for your choice</i>
9	Rate the importance of Strategic Cost Management in the following activities :
	Increasing Revenue
	Improving Productivity
	Improving Customer Satisfaction
	Improve Strategic Positioning of the Organisation

PART C : Best Practice Cost Management

- 10 Indicate if the organisation has the following elements in place in managing costs efficiently and effectively :

<i>Right People</i>	
<i>Right Knowledge</i>	
<i>Right Tools</i>	
<i>Right Processes</i>	

**PART D :
STRATEGIC COST MANAGEMENT : Tools & Techniques**

- 11 Rate the **importance** of the following cost management techniques and **extent of use** by the organisation :

	Level of importance	Extent of use by organisation
Activity Based Costing and Management		
Target Costing		
Life Cycle Costing		
Benchmarking		
Fixed Cost Analysis		
5S		
Breakeven Analysis		
Idea Generation Systems		
Cause and Effect Analysis		
Total Cost Analysis		
Value Stream Mapping		
Waste Analysis		
Zero Based Budgeting		

- 12 Briefly explain the extent to which the organisation in your opinion successfully manages the following activities :

Cost Behaviour Management

Cost Level and Cost Structure Management :

Marginal cost management

Fixed cost management

Overhead cost management

PART E :
STRATEGIC COST MANAGEMENT : Application as a Management Control System

Note : Please respond to the following questions in the context of Strategic Cost Management and its relevance to the organisation

- 1 What, in your opinion, are the key objectives of the organisation critical to the success of strategic cost management ?
- 1.1 Describe the challenges encountered by the organisation in developing these key objectives
- 1.2 How does the organisation evaluate its achievement of these objectives ?
- 2 What strategies and plans has the organisation adopted to successfully implement its objectives ?
- 2.1 What processes and activities are defined for the successful implementation of these strategies ?
- 2.2 Please explain the challenges encountered by the organisation in developing the above mentioned strategies and processes / activities ?
- 2.3 What tools & techniques are used to assess and measure the performance of these activities?
- 3 What level of performance does the organisation need to achieve ?
- 3.1 How does it set appropriate performance targets for them?
- 4 What incentive schemes are adopted to reward management and employees to achieve performance targets ?
- 4.1 What penalties are in place (if any) for non-achievement ?
- 5 What mechanisms, if any, are in place to ensure that the organisation learns from its experience and adapt its behaviour to ensure performance improvement ?

**PART F :
STRATEGIC COST MANAGEMENT : As a Strategic Tool**

1	Is the organisation, in your opinion, able to successfully prioritise its strategic goals ?	
1.1	Describe the challenges encountered by the organisation in prioritising its strategic goals	
2	Is the organisation able to differentiate between the costs of different processes and activities ?	
2.1	Explain the organisational challenges in differentiating the costs of different processes and activities	
3	How competitive is the organisation, in your opinion, on :	
	Products	
	Customers	
	Sourcing	
	Manufacturing	
4	Is competitiveness, in your opinion, achieved in an economical way ?	
4.1	Explain the reason for your choice	
4.2	How can the achievement of competitiveness be established in a more cost efficient way ?	
5	How can the organisation integrate performance and cost management ?	
5.1	Are there activities of limited value in supporting an objective?	
5.2	If so, can resources be reassigned to more productive work?	
5.3	What would be the impact on achieving strategic goals if that activity were not performed?	
6	Where, in your opinion, does the organisation have opportunities to consolidate similar functions and remove duplication to achieve economies of scale?	

PART G : PRODUCT LIFECYCLE COSTING

Please indicate the level of importance of the following statements in the context of strategic cost management and its relevance to Product Lifecycle costing

Level of importance

1	Identifying associated costs during the planning period with a given product design and to take necessary actions	
2	Supporting cost comparisons among different product designs to make more informed decisions among alternatives	
3	Identifying the nature and timing of costs to plan and manage effectively	
4	Explain how Product Lifecycle costing can further contribute to reducing costs and simultaneously improve the strategic positioning of the organisation	

PART H : VALUE CHAIN ANALYSIS

- 1 How does the organisation use its value chain to successfully allocate costs, revenues and assets to each activity ?
- 2 How are the **cost drivers** regulating each value activity **identified** and **investigated** ?
- 3 How does the organisation attempt to build **sustainable competitive advantage** ?
Select the most appropriate option :

PART I : STRATEGIC POSITION ANALYSIS

- 1 What strategy does the organisation pursue in achieving competitive advantage ?
- 2 Does the organisation use Strategic Cost Management to support the achievement competitive advantage ?
- 2.1 *Explain the reason for your choice*

PART J : COST ANALYSIS & MANAGEMENT

- 1 Rate the importance of using a **cost analysis framework** in the positioning of the organisation :
- 2 How are cost management initiatives audited to determine if the strategic position of the organisation is enhanced ?
- 3 To what extent are cost management activities applied successfully to change the cost structure (fixed and variable costs) of the company ?
- 4 How does the organisation apply cost management activities aimed at improving the performance for given strategies ?
- 5 Is cost management extended **beyond the boundaries of the factory** ?
- 5.1 *If the answer to the above is **NO**, please explain why cost management is not extended beyond the boundaries of the Factory*
- 5.2 *If the answer to the above is **YES**, please provide examples whereby cost management is extended beyond the boundaries of the Factory*
- 6 Is cost management extended **beyond the boundaries of the company** ?
- 6.1 *If the answer to the above is **NO**, please explain why cost management is not extended beyond the boundaries of the Company*
- 6.2 *If the answer to the above is **YES**, please provide examples whereby cost management is extended beyond the boundaries of the Company*

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TO WHOM IT MAY CONCERN

LINGUISTIC REVISION OF MINI-DISSERTATION

**SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE
MAGISTER COMMERCII IN MANAGEMENT ACCOUNTANCY
AT THE POTCHEFSTROOM CAMPUS OF THE NORTH-WEST UNIVERSITY**

For

RATHEESH PILLAI : Student number: 26814617

I, Magda Burger, ID number 521006 0038 080, hereby declare that I have linguistically revised the mini-dissertation "Evaluating the application of strategic cost management in the South African automotive industry: A case study" for student R Pillai, student number 26814617.

Yours sincerely



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