Strategic cost management

The conventional cost management is based on the assumption that the cost can be controlled or reduced or managed by changing volume, improving labour productivity, or reducing overheads. Its focus is inward, emphasizing the process of cost control and cost reduction, oblivious of the other opportunities. Therefore, conventional cost management, it is said,“ starts too late and ends too early” and in the process ignores linkages and the process of value creation outside the firm’s boundaries. SCM addresses this limitation and expands the cost management beyond the firm’s boundaries.

SCM blends three important strategic analytic approaches viz. value chain analysis, strategic positioning analysis and cost driver analysis, taken from the strategic management:

Value chain analysis basically focuses on value creation by identifying value activities such as, firm infrastructure, procurement, technology, human-resource management, in-bound logistics, operations, out-bound logistics, sales and services and seeks to establish linkages among these activities to achieve optimal efficiency in terms of cost and benefit. In a larger sense this approach can be extended beyond the firm so as to include the suppliers’ value chain, channels value chain and customers’ value chain.

Strategic positioning analysis basically emphasizes that instead of competing in the same product-market if a company could choose a product market scope not covered by others, the chances of success would be better. Such positioning would be in terms of cost leadership,
focusing on certain target segment, or producing a distinct product not produced by others. Strategic positioning can also be conceptualized in terms of product portfolio positioning inside the company using the concept of product life cycle.

Cost drivers analysis, basically seeks to identify all factors affecting the cost. In conventional cost management, cost are collected on the basis of the centers or departments and allocated to products using the process of primary and secondary allocation using approximate bases, which in many cases result in distortions in cost estimates and consequently to inaccurate pricing and other managerial decisions. Cost driver analysis seeks to eliminate such distortions.