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Cost Management Models in Businesses

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Abstract

In today's market economy, the role of management accounting information in cost control is increasingly expanding and asserting its developmental position. The fundamental reason lies in the fierce competition among businesses and economic conglomerates. In this competitive landscape, companies and economic groups can either succeed or fail. A critical factor that leads to success or failure is the information on cost management accounting. The significance of cost information for management activities has

driven the need to develop a method capable of providing relevant, timely, and reliable cost information to aid in planning, controlling, and resource utilization, as well as evaluating operational effectiveness and making business decisions. Cost is the starting point of price, and it represents the minimum threshold that prices cannot fall below in the long run. The article discusses various cost management models for manufacturing enterprises.

Keywords: Cost Management Model, Manufacturing Enterprise

1. Cost Classification

For managers, cost is a top concern as it directly impacts profit. The challenge is how to control costs effectively. Identifying and classifying costs are crucial steps in managing them, which in turn helps make informed decisions during the management of business operations. There are various ways to classify costs within a company, and each method provides cost information from different perspectives for the manager.

Table 1: Cost Classification Table

Purpose	Classification basis	Cost type
Costing and financial reporting	Based on operational functionality	Production costs and non-production expenses
Costing and budget preparation	According to the economic content	Material costs, labor costs, tools and equipment expenses, depreciation of fixed assets...
Budget estimation and cost control Planning, evaluation, and decision-making	Depending on the scope of the relationship and the level of activity	Variable costs, fixed costs, and mixed costs.
Inventory valuation and financial reporting	Understanding the relationship with business outcomes	Product costs and period costs
Making business decisions.	For the purpose of control and decision-making.	Controllable costs, uncontrollable costs, sunk costs, opportunity costs, and differential costs
Determining the cost. Making business decisions.	According to the source of costs.	Actual costs and standard costs
Determining cost prices, analyzing profits, and controlling expenses.	Depending on the ability to allocate costs to the responsible party,	Direct costs and indirect costs.

Source: Compiled by the author

The details and accuracy of cost information vary depending on its intended use. For instance, external financial reports require the determination of production costs for products. Therefore, for inventory valuation purposes, these costs must be allocated to products using a distribution method, even if the allocation basis has no causal relationship with the costs. Moreover, for inventory valuation purposes, Kaplan & Atkinson (1998) ^[4] suggest that precise product cost measurement may not be necessary as they are required to measure the cost of goods sold and determine the value of inventory at an aggregate level. On the other hand, for decision-making purposes, non-production costs may need to be determined for a product. With decision-making in mind, cost determination methods should accurately reflect the product's resource consumption to avoid distorted

product costing. More detailed and accurate product cost information facilitates effective planning, management control, and decision-making. Thus, the purpose for which product cost information is used can influence how different cost information is processed, according to the requirements and accuracy level of the product cost information.

2. Cost Management Models

Value-Added Thinking in Cost Management Models

The value-driven management approach, based on Adam Smith's operational management philosophy, breaks down the business production process into its simplest and most fundamental stages, guiding managerial actions at each step. This method is applied in enterprises with long product life cycles, relatively stable operations, small production scales, connections limited to within individual countries, simple information processing technology, and without the rapid global integration we see today. Nowadays, this value-driven management approach is still popular among monopolistic businesses, medium- and small-scale enterprises, and those with less advanced scientific and technical levels.

Embracing a Value Chain Mindset for Cost Management

It is an escape from the local management method based on stages and divided functions to reach the entire process based on the philosophy of connection and cooperation along the value chain. A value chain is a system that includes and links all elements of a value creation process from the beginning to the end of production and business activities. The value chain approach was introduced by Michael Porter in the 1980s [Competitive Advantage: Creating and Sustaining Superior Performance in Business]. The concept of added value within the value chain framework is considered a factor in creating and maintaining an organization's sustainable competitive advantage in business in the 21st century. According to Michael Porter, the concept of the value chain is used to help businesses find profit from their competitive position. He believes that a business can provide customers with a product or service of equal value to its competitors at a lower or higher cost but with the characteristics that customers want. He argued that, if you look at a business as a whole of activities and processes, it is difficult or even impossible to find out exactly what their competitive advantage is. But this can be done completely when decomposing into internal activities. In this way, Porter clearly distinguishes between basic activities or primary activities that directly add value to the production of goods and services and support activities that indirectly affect the final value of the product.

Thus, the value chain of the production and business processes is a system of links and cooperation to take advantage of the commercial, technological, labor, and resource advantages of the participants in the value creation process of the activity. Production and business are only a part of a chain of value-creation activities, always in close relationship with the interests of suppliers and customers. According to this philosophy, management activities are determined according to each value chain, and each administrator is just a link in the management of the value creation process. Therefore, the issue that administrators are concerned with is the connection and positioning of their

production and business activities in the linked system and the value they contribute to creating in the value chain. The production and business management method based on value chain thinking was a revolutionary innovation in management methods in the 1980s.

Target Costing as a Cost Management Model

This model is built on the principle that operations and costs must be managed and controlled with specific goals in mind, namely those costs that are planned with both short-term and long-term objectives. The product life cycle costing method provides information that aids in cost management throughout the value chain, from design, development, production, advertising, distribution, warranty services, and disposal. The product life cycle is divided into three stages: (1) research, design, and deployment phase; (2) production phase; and (3) post-sales support and product disposal phase. Costs arise at each of these stages and need to be controlled and reduced to maximize profits. However, the potential for cost reduction varies across stages due to differences in the proportion of mandatory costs within the product life cycle. In the research, design, and deployment phases, mandatory costs account for 80%–85% of the total life cycle costs. Therefore, decisions regarding product design, manufacturing processes, and methods will largely determine the costs incurred in subsequent phases. Once a product enters production, opportunities for cost adjustment and reduction are limited because it's not easy to change the entire invested infrastructure. Most cost-cutting opportunities lie in the research, design, and deployment phases because it's easier to adjust costs by tweaking product designs and manufacturing processes at this stage. Numerous theoretical and practical studies on target costing in various manufacturing and service industries across different countries have confirmed that target costing is the most suitable method for providing information that serves cost management during the product's research, design, and development stages.

Target costing marks an improvement over the typical new product development method, which involves designing the product, estimating costs, and then setting its price. Instead, target costing zeroes in on reducing the product's cost right from the planning and design stages, rather than attempting to rearrange misaligned costs after the product has entered production.

The Management Model of Continuous Cost Improvement is Known as Kaizen Costing

This model is built on the theory that cost management must be embedded in continuous cost improvement. This approach is similar to target cost management but focuses primarily on the ongoing management and control of costs during the production stage. According to this theory, even a minor improvement in production can lead to a significant increase in value and benefits. The Kaizen costing method not only ensures a more streamlined production process but also helps save costs and eliminate waste, thereby enhancing value for the business. Therefore, managers worldwide consider this method a philosophy of production management across various industries.

The Kaizen method, much like target costing, aims to reduce costs, but its focus is on the production phase of a product's life cycle. However, cost reductions aren't as substantial as in the research and design stages because major changes

during production can be costly. Therefore, improvements at this stage are incremental to ensure actual costs remain below predetermined ones. To achieve this, companies must continuously refine their production processes and product designs. They need to set regular cost-cutting targets through measures such as enhancing equipment efficiency, boosting worker training, and encouraging employees to implement daily changes that eliminate non-value-adding activities. Originating in Japan in 1950, it wasn't until after 1986 that the Kaizen costing method was fully researched and widely applied, particularly in mass production enterprises with large volumes. When products are mass-produced on a large scale and processes are repeated, improving procedures, increasing efficiency, and cutting costs at every stage of production remain the core objectives of management.

Activity-Based Cost Management (ABC/M) Approach to Cost Management

Activity-Based Cost Management (ABC/M) was developed in the 1980s to address some limitations of traditional cost management and to enhance the benefits of ABC/M for strategic decision-making. In 1992, Cooper and his colleagues stated, "Activity-based business cost management is a process where business managers use the cost information provided by activity-based costing methods to manage business activities and processes." In their book "Implementing Activity-Based Cost Management: Moving from Analysis to Action," Cooper and his associates described ABC/M as the integration of activity-based costing (ABC) with activity-based management (ABM). Robin Cooper, Robert Kaplan, and H. Thomas Johnson were the pioneers in 1988 who studied ABC, which stands for "a costing method used to directly trace the origins of overhead costs to cost objects such as products, services, processes, or customers, aiding managers in making informed decisions about product mix strategies and competitive tactics." Based on the fundamental principle that products consume activities and activities consume resources, ABC identifies costs by activities and then allocates them to products based on cause-and-effect relationships.

Activity-Based Management (ABM)

ABC's computational data helps managers gain a clearer understanding of the relationship between time, quality, factory capacity, flexibility, and various business costs. ABM utilizes cost information provided by ABC to manage these business expenses. According to Kehoe *et al.* (1995), "activity-based management is a tool that managers at all levels are responsible for using activity-based costing methods to analyze, control, and improve operations. ABM has two fundamental elements: recognizing activities carried out within the company and analyzing the costs and execution methods of these activities in terms of both time and quality. Thus, ABM is a management approach focused on planning, executing, and measuring activities, helping businesses survive and thrive in a competitive environment. ABM uses information from ABC to reduce or eliminate non-value-adding activities and outcomes, aiming to enhance the entire production and business process.

3. Conclusion

Cost management is absolutely crucial and has a significant impact on a company's survival, while also playing a

decisive role in determining each business's market position. It allows business owners to accurately assess their current operations, leading to strategies for growth and cost control, as well as future decisions and plans. Cost management is part of growth strategies aimed not just at cutting costs but also at creating clear competitive advantages in the market. Finding optimal financial solutions for sustainable development strategies in the post-integration era remains one of the toughest challenges for today's manufacturing businesses. Therefore, one solution every company must consider is managing and saving costs more effectively to ensure their products and services continuously improve in quality and become more competitively priced for customers.

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