COST MANAGEMENT STRATEGY: A TOOL FOR IMPROVING EFFICIENCY IN BUSINESS PERFORMANCE

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ABSTRACT

Cost management is an activity which functions as a strategy to cut down on all unnecessary costs so as to achieve a higher level of profit in business performance. The aim of this study was to investigate into ways to eradicate or minimize excess expenditure over revenue. The survey research design was employed in generating relevant data for the study. Questionnaire and direct observation were the major research instruments used in generating data. A total population of sixty respondents was administered with questionnaire but only fourty respondents completed and returned. It was revealed that Cost management is a good strategy to improving efficiency as well as profit maximization and growth of businesses. It is therefore concluded that with meaningful recommendations among others, management of businesses should try to establish areas in which unnecessary costs can be minimized at regular basis in the course of daily business activities.

Keywords: Cost management, strategy, efficiency, business performance

INTRODUCTION

Cost management is especially useful in business activities because it allows for efficient capital utilization available to the business organization. In addition to this development, managers of either small or large scale businesses are set up for the common goal of minimizing costs and maximizing profits. Cost management in business performance, if properly practiced, will greatly improve efficiency in business performance. The process will help proprietors or managers of businesses to reduce unnecessary excess expenditures/costs over revenue or income from sales. Some of the costs to be minimized include purchase or cost prices, cost of material, manufacturing costs, fixed asset cost and administrative costs.

Brown (1997) viewed cost in the economic sense to mean the summation of all outlays of an operational nature. He further stated it to mean an amount which represents interest on investment and/or profits. All firms continually need to reduce costs, not only in times of recession, but also in periods of expansion and consolidation. Therefore, cost management or minimization is a process of cutting down on all unnecessary costs or expenses so as to achieve the ultimate aim of profit maximization. The reasons behind cost minimization and management leads to more efficient use of materials, maximization of profits, successful survival and growth of business entity and efficiency in overall or general performance of the businesses.

For cost management to be effective, there are some key areas in which its applications is vital. Such areas include: reduction in the use of raw material, reduction of fixed assets costs, reduction of administrative costs. Arising from the study, we shall discuss on the concepts of cost control, methods/techniques of cost management, application of cost minimization in business operations.

COST MANAGEMENT

Cost may be defined in numerous ways. Lucey (1996) defines cost as the amount of expenditure (actual or notional) incurred on or attributable to a specified thing or activity. Lucey stresses further that costs include two components; quantity used and price, that is to say, always related to some object, product or service. Brown (1997) also defined cost as in economic sense, to mean the summation of all outlays of an operational nature. He further stated it to mean an amount which represents interest on investment and/or profits. According to Lucey, cost may be classified in numerous ways, but a fundamental and important method of classification is into direct and indirect costs. Direct costs (comprising direct material costs, direct wages or salaries costs and direct expenses) are those costs which can be directly identified with a job, batch, product or services. While direct material cost and direct labour costs plus direct expenses are known as prime costs.

Conversely, indirect costs are all material, labour and expense costs which cannot be identified as direct costs are also known overhead costs. These include indirect material: lubricating oil, stationery, consumables, materials, maintenance materials, spare parts for machinery etc, indirect labour consists of factory supervision, maintenance wages, storemail wages etc, indirect expenses, include rent and rates for the factory, plant insurance etc. The term cost is used in more broad cases such as historical cost which refers to the total cost incurred in accordance with money outlays or the equivalent of money outlays. Conversion costs (production costs) which denote the costs of converting purchased raw materials into finished or semi-finished products, it may be also called estimated targeted cost. Fixed costs are those costs incurred irrespective of volume within a particular range of activity, examples are depreciation of equipment, insurance and rent. Variables costs are those that vary according to volume within a particular range of activity. Examples are repairs and maintenance, cost of fuel and lubricants, and labour.

Cost management is the process of managing for efficient costs in business activities. It includes the planning and controlling of excess expenditures in business, in order to minimize unnecessary costs and maximize profits. In other words, cost control or management involves the determination of what ought to be spent. It is concerned with setting standards and finding out what excess is made from them. Cost control or management is operational in two ways such as Static Cost Reduction and Dynamic Cost Reduction. The Static Cost Reduction conceptualizes the items from an addition to the productivity cost in which costs are minimized to the level of established standards. While the Dynamic Cost Reduction method is applied for setting readily achievable costs standards for every phase of the business operation.

Dhiglatch (1997) introduced the concept of dynamic cost that allows flexible standard. The first step in dynamic cost reduction programme is setting the profit goals. These are growth rate for the business organization, profitability index for exact product and profit rate for each product. Good market research is essential to competitive pricing, which in turn is important in setting cost goals for dynamic cost reduction, competitive pricing is that price which will permit the organization to compete with time and further the organization goal but at the same time dynamic cost reduction can be applied as:

(a) Start -ups which refer to business plan based on dynamic cost reduction should have a better chance of obtaining capital because the plan for organization growth is solidly detailed.

(b) Business organizations in trouble, it can pinpoint the trouble and permit the remedies to be applied effectively

(c) Special projects: the dynamic cost reduction can be profitably applied to the planning of special projects.

METHODS OF IMPROVING PRODUCTIVITY EFFICIENCY

To ensure productive efficiency in general business performance, then time and motion study must be carried out through:

(a) The analysis of each operation involved in selecting piece of work

(b) The determination of unnecessary elements (that is, costs in operations)

(c) The selection of test methods of unnecessary operations

(d) The standardization of methods equipments and all related working conditions.

The measurement of standard of time in which an average man performs the task; there is general time of approach used in carrying out a study that has been made; the steps are as follows:

(i) Determine the strategy to be made to the employees in general

(ii) Analyze the operations and performance study

(iii) Compute standard time

(iv) Adjust standard time for allowances and calculated allowed time

(v) Prepare the data for use

The theory is that increase production at lower unit cost means higher profits. The theory also holds that cost management is of utmost importance for business survival and growth. Cost management needs goals and plans, operating budgets or cost standards. It is concerned with keeping unit cost below established standards under estimating conditions. Attention should be paid to the fact that it is not sufficient for profitability to merely cut costs. It is also important to control cost upon completion of their reduction programme in order to maintain the profitability. As long as the cost standards are not exceeded, management believes that its cost control is effective. When the completion starts to under sell and remains profitable, it is time to re-examine the cost standard, it is time for cost management.

COST MINIMIZATION AND MANAGEMENT TECHNIQUES

All business organizations continually reduce cost, not only in times of recession, but in periods of expansion and consolidation. One process of planned cost minimization has three phases; preparation, practical execution and verification of progress. A cost reduction programme will succeed only if systematical effort is made to achieve clear targets. The first task in a planned cost reduction programme is to identify areas where measurable reductions are possible. It is essential to identify those areas where productive short term cost reduction can be operated using normal strategy of business accounting and without imposing an excessive workload. There are three possible ways or strategies of determining costs.

(a) The acceptable cost level at the time of identification is the lowest cost per unit in the past fpr the;

(b) The acceptable cost level at time of identification corresponds to the cost level of firm with the lowest cost in the industry;

(c) The acceptable cost level at time of identification is the right percentage below the effective selling price allowed by the market to allow for profit after tax on an acceptable percentage, say reasonable percentage of the capital invested. It should be noted that special circumstances such as location, size, equipment, labour force, production programme, all play their part.

The decision to initiate a cost reduction campaign is taken by top management. It is only top management which can place the whole weight of its authority and prestige behind the success of the campaign. It does this by setting clearly defined targets, and must conduct a monthly verification of the operation and take necessary action if targets are not achieved. Before top management determines target for the operation, it must assess the possibility of realizing the computed theoretical cost reduction. The accountants who made the calculation will be required to give a verbal presentation.

STEPS FOR COST REDUCTION MINIMIZATION CAMPAIGN

There are six steps to put the cost reduction minimization campaign in motion. These are:

(i) Top management compromise with departmental managers either individually or collectively in cost reduction and minimization campaign.

(ii) Top management conveys to the departmental managers the need to achieve specific cost reduction targets in the next accounting year.

(iii) Before starting cost reduction programme, top management decides the dates of monthly meetings at which departmental manager will report.

(iv) The top management will instruct the works department to take account of the cost reduction targets in its advance cost planning and to reduce individual cost targets correspondingly

(v) Top management communicates to the departmental manager in writing, the agreed cost reduction target for the next accounting year.

(vi) The top management instruments the work department to prepare special cost reduction verification system and submit a monthly report.

However, the development of the Nigerian economy indicates that the survival and growth of businesses is very crucial to the success of the current culture of self-reliance and technological advancement. The survival of any business entity for example, a company is determined by the amount of profit realized as compared to its cost of production. Business organizations have been faced with different problems. The problems of such business organizations include wastage of raw materials (that is, improper allocation of raw materials purchased), embezzlement of funds, that is to say funds that are supposed to be used for enhancement of work in the organization would be embezzled or diverted by personnel in the business, leading to insufficient funds to boost the business operations. Finally, placing emphasis on quantity rather than quality, most business organization prefer to produce large amount of goods that are of low quality instead of producing less goods that are of higher demand and better quality.

The purpose of this study therefore is to determine the costs to be minimized as well as to identify the process involved in reducing costs and to investigate into the ways to eradicate the problem of excess expenditure or costs over revenue or income from sales in business organizations. In the course of the study, it was tentatively assumed that:

Ho_1: Cost management/minimization does not lead to profit maximization in business.

Ho_2: Cost management is not an effective strategy for survival and growth of business organizations.

Ho_3: Effective cost management does not lead to reduction of wastage/high costs in business performance?

METHODOLOGY

The study was carried out in Delta State. A survey research design was undertaken to generate data using questionnaire as administered to sixty small scale industries and employees but a total sample of fourty respondents who actually completed and returned for detailed analysis.

The major research instruments used for data collection are questionnaire and direct observation. The questionnaires were configured with Likert scales of strongly agreed (SA), Agree (A), Disagree (D), Strongly Disagree (SD), undecided (U). The research also drew out an important hypothesis from the research question. The collected data were analyzed using simple percentage. The results are computed and tresented on tables.

RESULTS AND DISCUSSION

Table 1: Distribution of frequency and percentage of responses on cost maximization/ management does not lead to profit maximization in business performance.

Variables	**Frequency**	**Percentage**
Strongly agree	21	52.5
Agree	13	32.5
Disagree	2	5
Strongly disagree	3	7.5
Undecided	1	2.5
Total	40	100

Source: Survey, 2010

From the above table, less than twenty percent of the total respondents opposed the fact that cost minimization leads to profit maximization. Based on this, the stand point of the tentative assumption one is elusive as that cost minimization/management leads to profit maximization.

Table 2: Distribution of frequency and percentage of responses on cost management as an effective strategy for survival and growth of business organizations

Variables	**Frequency**	**Percentage**
Strongly agree	16	40
Agree	15	37.5
Disagree	3	7.5
Strongly disagree	2	5
Undecided	4	10
Total	40	100

Source: Survey, 2010

From the above analysis, it is therefore affirmed that the practice of cost minimization and management could bring about desired effect of maximizing profit. This could easily lead to growth and survival of business organizations as majority opinions are sampled under study as opposed to the fact that cost management is not an effective strategy for survival and growth of business organisations.

Table 3: Distribution of frequency and percentage of responses on effective cost management does not lead to reduction of wastage/high costs in business performance.

Variables	Frequency	Percentage
Strongly agree	16	40
Agree	12	30
Disagree	7	17.5
Strongly disagree	3	7.5
Undecided	2	5
Total	40	100

Source: Survey, 2010

The table above represents evidence to the fact that effective cost management leads to reduction of wastage/high costs in business performance as more than half of the respondents answered in the affirmative. The result of the entire findings of the study has exhumed the efficacy of the cost minimization or management. It points bluntly to the fact that any organisation that operates at a pace where it overhead is higher or equal to the revenue is nothing but a loser and will give up as a going concern. In relation to profit maximization, the study has made it unequivocally obvious that there must be proper management of the costs of general operations of an organisation before it could maximize profit. Similarly, it has been revealed that cost management is an effective strategy that enhances the survival and growth of business as well as leads to the reduction of wastage/high cost in business performance. Therefore, absolutely, there is a significant relationship between cost management strategy and improvement in business performance.

CONCLUSION AND RECOMMENDATIONS

In as much as all relevant costs such as manufacturing costs, fixed asset costs, distribution cost, publicity cost and other administrative cost are minimized; there will be drastic reduction in wastage/high costs in business. In the light of the above, it can be concluded that cost management leads to profit maximization in business performance. Consequent upon this, every employee of business organizations should involve in cost minimization.

Therefore, it was recommended that management of business organizations should try to establish the areas in which the costs involved in producing should be minimized. Cost managers should be employed who are cost accountants to assist in the cost minimization process. It should also be ensured that communication should flow throughout the organization concerning cost management procedure. The management of such business organizations should involve all employees to work hand-in-hand with cost reduction programme. Business Directors and managers should work hard at minimizing cost so as to ensure survival and growth of the firms. Management of business firms should organize regular cost reduction campaign within the firm so as to ensure greater heights and achievement of desired organizational results. Finally, management should train key officers and other subordinates from time to time on cost reduction/minimization seminars/workshops.

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