CRISIS AS AN OPPORTUNITY FOR OPTIMIZING COMPANIES' COST MANAGEMENT SYSTEMS

Stipan Penavin, Faculty of Economics in Osijek
Dubravka Pekanov Starčević, Faculty of Economics in Osijek
Martina Harc, Electrodus d.o.o. Osijek

ABSTRACT

Typically rules that relation to available resources, especially financial always conditions companies' business success. In practice, it is evident that companies that have a more rational approach to their resources achieve better business results. However, there are situations where this need particularly manifests as scarcity of resources multiplies. It is a crisis. Crisis is a situation characterized by business disturbances. Its effects reflect primarily in the deterioration of companies' market position, mostly through the reduction of sales volume or decrease in sales price. In both cases, it affects the decrease in business results. As in these conditions access to external financing resources is somewhat difficult, the company has to orient to its internal reserves. They are located primarily in the more rational approach to costs, which basically means that companies have to develop an adequate cost management system. Through cost management, the relationship between sales and production prices can be balanced, especially in crisis. In this case, the ability to impact business results through cost management becomes a company resource. Although in all business conditions there are strong reasons for developing this cost approach, crisis represents an additional motive for its implementation. Effects of cost management will be conditioned by model that is applied. Therefore, alternative models of cost management represent the basis for its effectiveness. Although in the crisis it is much easier to develop sensitivity to cost management as an instrument for mitigating its effect, this approach needs to have a permanent character.

JEL clasiffication: D24

Key words: cost management, crisis, business results, production price, sales price

1. INTRODUCTION

Many factors, especially costs, determine companies' business success. The cost significance is great even in stable business conditions, and it especially comes to the fore in unstable ones. In the narrow sense costs affect the business results, and in broader, they determine the degree of competitiveness of each company, as well as its market position. This fact is reason enough to build a special approach to costs primarily through managing them. Cost management means full cost control and direction in those business segments that will ensure maximum business effects. It is essential that this practice is carried out permanently in the process of doing business, especially in crisis. The crisis is a situation characterized by business disturbances at the macro-level, where it affects the functioning of the entire economic system, and at the micro level, where it affects companies as elements of that economic system. In such circumstances, the availability of resources within the enterprise reduces to a minimum, making the business potential significantly reduced. That results in an increase in cost of products and services on one hand, and in a reduction of competitiveness on the other. This complex condition, caused by the crisis, provides an additional incentive for management to find all possible internal reserves of the company, which will enable normal functioning. There is no doubt that cost management opens significant opportunities to achieve a higher degree of rationality in the use of already scarce resources, allowing the company to survive competition. The fact is that cost management can significantly reduce the effects of the crisis in the functioning of individual enterprises. However, it would be entirely wrong approach to study the justification of cost management only in terms of crisis. It should be an integral part of business practice in all conditions, both in stable and unstable, and in this regard, it should have a permanent character.

2. EFFECTS OF CRISIS ON COMPANIES

The effects of the crisis on business come to the fore in many forms. They mainly manifest through two aspects, market and financial. In the first case, they usually lead to a sales reduction because of reduction in demand for most products, especially for small and medium enterprises. Other problems follow. Due to the reduced sales companies achieve worse financial results. Because of that, they cannot cover even the current business needs and opportunities for expanded reproduction significantly reduce. Since in such conditions internal sources of financing operations and investments are not sufficient, companies orient to external sources.

However, because of the high cost of capital and absence of adequate collaterals, most companies have problems in accessing to financial sources. This situation generates insolvency, which means that one company cannot collect their claims, and at the same time, it cannot meet its obligations to suppliers. Because of that, company cannot buy necessary raw materials for further production and business. Result is decrease in competitiveness and deterioration of market position. In the case of a longer duration of the crisis, that takes permanent form. The effects of these phenomena on the companies in the Republic of Croatia, as a direct consequence of the crisis can be seen in the following table.

Table 1: Overview of business condition indicators in the Republic of Croatia

Indicator	IX. 2007.	IX. 2009.	Index
The average interest rate on loans contracted without a currency clause	9.33	11.6	124.33
The average interest rate on loans contracted with a currency clause	6.35	8.1	127.56
Gross profit	32,226	21,822	67.72
Number of insolvent companies	24,992	26,196	104.82
Due reported orders for payment (000 kn)	14,316,302	20,748,604	144.93

Source: Financial Agency, Croatian National Bank

Impact of the crisis is much wider than shown on the indicators at the micro and macro level. Between these two levels, there is a strong interaction. Disorder of certain macro-economic conditions reflects in the business, which then poor results reflect on further movement of macroeconomic indicators.

3. THE IMPACT OF COST MANAGEMENT ON CRISIS EFFECTS IN BUSINESS

It is evident that the effects of the crisis reflect in the disturbances in business. Certainly that for the management of each company this situation is unacceptable and in the conditions of the crisis it must activate all available resources, which in these circumstances are unfortunately limited. Cost management, as a special management technique, is a very powerful business policy instrument, which can be used to reduce the negative effects of the crisis. The impact of cost management to the effects of the crisis results from the nature of this business function. That is, cost management in the narrow sense can be considered as a system of methods and techniques in the process of identifying opportunities for eliminating unnecessary costs (Peršić, M; 2006.)

Key term in this case is the cost and primarily the cost that is not necessary for conducting business processes. From this, it follows that the cost management is permanent examination of justification for individual costs and their level. If it is determined that there are costs that are not fully justified or that are unjustifiably high, they should be eliminated or at least reduced to a minimum. This sensitivity to the costs justifiableness and their level must exist in all business conditions, both stable and unstable. In the latter case, it must be even more developed as the business in crisis conditions is burdened with phenomena that diminish its effects. In a broader sense, cost management should create assumptions for establishing optimum relation between the resources involved in business processes and business results achieved. In other words, this means that it is necessary, often with scant resources, to achieve better business results. This need comes to the fore particularly in conditions of crisis because the resources limitation is then at the maximum. Technology of cost management consists of a series of activities that allow management to keep track of costs, estimate the effects of costs on the business results, and directing costs in that direction in which they will be able to ensure the realization of the previously mentioned optimal conditions. Activities in the process of cost management are:

a. Planning (budgeting) costs, as a form of their definition in the coming period. Cost planning is a management attempt to pre-define their objectives in cost movement in response to circumstances that may occur in the future. This is particularly important if the company expects certain negative effects that may occur because of the crisis. In this case, management through the plan has pre-defined business policy that allows neutralization of the negative effects that may arise.

b. Cost movement control, as a function of monitoring implementation of defined plans. In the case of any deviation from the plan, especially in a negative sense, the management will intervene to reduce possible negative effects. This will be achieved either through an attempt to influence the circumstances that have changed, or if they cannot be influenced, through the adjustment of the cost plan to new circumstances.

c. Cost rationalization, which means any management intervention in reducing the cost movement, especially if costs have a tendency to grow unjustifiably.

Management action in this regard will be in the supply market and within the business process.

d. Overhead allocation is perhaps the most significant activity in cost management. It defines the unit product cost, which directly affects the degree of competitiveness of the company and its market position. It has already been pointed out that a direct consequence of crisis is reducing the business volume. This causes reduction in direct costs and increase in overhead in the structure of total costs. The problem in overhead allocation is great in all conditions, and specifically in unstable conditions. If the overhead are not realistically allocated to certain products, there is a danger that the unit cost of some products will be unjustifiably increased, while the unit cost of other products would be lower, although should really be higher. In the first case level of competitiveness of such products will be disturbed, which will significantly reduce sales, and in the second, the competitiveness of the product will exist but unit cost will not be real because it did not include all costs. In both cases, the company will achieve negative financial results.

The purpose of these activities, carried out in the process of cost management, is primarily to achieve unit cost of products and services that will be in a function of increasing the company competitiveness and achieving better market position. In the implementation of these activities, especially the latter, the company can use a number of adequate models.

4. MODEL SELECTION IN A FUNCTION OF COST MANAGEMENT OPTIMIZATION

Cost management models must support the production of products that will meet the customer requirements at the lowest possible cost for the company. In addition, these models should help to reduce production costs of existing products in a way that eliminates waste. Traditional cost management models do not perform the specified function or operate in an extremely competitive environment. To achieve and maintain cost leadership while maintaining a satisfactory level of quality of their products, companies must use contemporary cost management models such as Activity Based Costing, Target Costing or Total Quality Management.

4.1. Activity Based Costing (ABC model)

ABC model allocates product direct costs to products in the same way as traditional models. The difference occurs in the allocation of indirect costs to products of which the amount per unit of output is determined by applying specific criteria. Unit cost of products or services established by the ABC model differs greatly from the same cost calculated by the traditional models if the company produces complex products, products to customer requirements and if it operates in a complex environment. The specificity of ABC model in comparison to traditional models of cost management is the fact that the term activity replaces cost centers in traditional models, while the cost drivers in the ABC model replace overhead rates used in traditional cost management models. ABC model looks at the costs through organizational activities, unlike traditional models that observe the same costs through organizational departments (cost centers). The essence of this approach is to show that almost all costs are variable. „The basic concept of determining the unit cost with ABC model states that the product cost equals the sum of the costs of raw materials used in production and costs of all activities used in production (Shields & Young; 1989).“ (Gunasekaran et al.; 1999, 387). The essence of ABC model is the assumption that products do not condition the use of resources in the company. On the contrary, activities that take place in the company use resources, and those activities condition the use of resources and therefore the costs.

According to Beheshti, H.M. (Beheshti, 2004, 382), a company can create and maintain a competitive advantage by using the ABC management so as to: a. identify key activities, b determine the industry value chain for key activities, c. identify cost drivers for each useful activity in the value chain, d. find ways to control the cost drivers in a better way than competitors and aspire reducing costs of activities and e. to find ways to increase the value of activities in the value chain. A large number of case studies showed that the ABC model delivers significant benefits for determining the sales price of products / services, in determining the production mix, determining the profitability of individual customers, as well as improving business processes. The company that offers a lower sales price than competitors for similar and / or the same product, becomes more competitive. The need for accurate cost determination is necessary in the circumstances of the crisis.

4.2. Target Costing

Target costing is the result of an extremely competitive environment in which customers punish any attempt to increase product prices. Management accounting aims to motivate behavior in accordance with market demands in a way to determine market acceptable cost that must be realized if the company wishes to be profitable in a competitive market. Target costing application starts by specifying an acceptable market price for the product / service. When you subtract desired profit from an acceptable sales price, the result is the target cost that must be achieved if the company wants to survive at the market. Target costing is a simple approach to reduce the company cost. However, significant difference compared to other models of cost management is the fact that the process of lowering costs takes place in preproduction phase of the product life cycle, i.e. at the stage of planning and product development. „The basic feature of this cost accounting technique is a significant market orientation and a broad and integrative approach to the key factors of the business. The basic simplified model of determining the target cost of a new product bases on the planning and creation of products that will satisfy the customer demands, determining the target cost of the product, comparing the target and the standard cost of product, and on redesign product process if the target costs exceed the standard costs. Using the technique of target costs can help in identifying market demands and creating products according to these requirements. In that way this method of calculating the cost largely contributes to strengthening the competitiveness in contemporary business conditions". (Potnik Galić & Galić; 2008, 17)

4.3. Total Quality Management

Total Quality Management is a technique through which management develops policies and practices to ensure that companies products and services meet consumer expectations. This approach includes increased product functionality, reliability, durability and serviceability. Cost management is used for analyzing cost consequences of different products designs and for measuring and reporting on various aspects of quality. (Blocher et al.; 2002, 14). It means identifying and reducing the costs associated with quality. The company that introduces the cost of quality benefits from a detailed analysis of its processes; it determines which activities add no value and thus becomes aware of waste that is generated in the company. Therefore, it gets the ability to eliminate activities without value added and to increase the efficiency and effectiveness of its operations. Costs in the domain of the cost of quality include the repetition of certain procedures, tests, guarantees and similar procedures related to the defect of the process or product. One of the reasons why the measurement of cost of quality is certainly justified is the fact that prevention is cheaper than fixing errors. The introduction of Total Quality Management in the company can increase the costs of prevention and evaluation in order to reduce the cost of errors. Cost of quality is not always easy to recognize. In its identifying can help Activity Based Costing, as it makes some of the costs more visible.

5. COST MANAGEMENT AS A PERMENENT FORM OF BUSINESS POLICY

While cost management is a powerful instrument of business policy in crisis situations, it would be wrong to depart from the approach when transition to stable business conditions occurs. This fact is indisputable, but the question is whether the role of cost management is same in the crisis and in a stable business conditions. Changing circumstances, exit from crisis to stable business conditions, will certainly change the role of cost management as an instrument of business policy. While in the crisis cost management priority role is preserving a borderline level of competitiveness and market position, in stable conditions, it must create conditions to increase the level of competitiveness and improve market position of the company. When in this regard some satisfactory level is achieved, through the cost management it can be permanently maintained. In addition, changes in business conditions, from the crisis to the stable, set new limits in terms of degree of optimization between resources involved and business results. While in the first case that means preserving the level of business efficiency at least at the level of break-even, in a stable business conditions aim is to ensure an adequate safety margin, which means to increase the level of business success. All the previously stated leads to the conclusion that despite the change in the role of cost management, moving from one business circumstance to another, its position within the business policy does not actually change. It should remain permanently integrated in a system of business policy instruments, and in that sense used in all business circumstances. It is therefore reasonably to conclude that the cost management has a permanent, not temporary character.

6. CONCLUSION

One of the key reasons for business success of every company is its market position. Stability of this position comes from the degree of competitiveness of company products, which is conditioned with cost of its products or services. Costs are the primary factor that determines the unit cost/production price, and hence the degree of competitiveness. Therefore, the cost management creates presumptions for managing market position of each company. Since the market state is subject to fluctuations, whose range is moving from crisis to stable, the role of cost management in the business policy is extremely important, especially in crisis conditions. What will be the contribution of cost management to market position of individual company will depend primarily on the choice of models that it will use. Traditional cost management models cannot fully meet all the needs in this regard, especially in crisis conditions, and because of that a number of contemporary models whose application gives more effective results were developed. However, the introduction of individual models in the process of cost management will have lower effects than the parallel application of multiple models, given that their combination gives a greater cost visibility and opportunities to improve the overall management system. It is important however to point out that, when exit from the crisis conditions occurs, cost management does not lose its meaning, which is why it has no temporary, but permanent character.

References:

1. Beheshti, H.M. (2004) Gaining and sustaining competitive advantage with activity based cost management system. *Industrial Management & Data Systems*, 104 (5)
2. Blocher, E.J., Chen, K.H. and Lin, T.W. (2002) *Cost management: A strategic emphasis*. USA: McGraw-Hill Irwin
3. Gunasekaran, A., Marri, H.B. and Grieve, R.J. (1999) Justification and implementation of activity based costing in small and medium-sized enterprises. *Logistics Information Management*, 12 (5)
4. Peršić, M.; *Upravljanje troškovima"njemačka metodologija"*, XLI Simpozij: Financijsko restrukturiranje profitnog i neprofitnog sektora u hrvatskoj, Zagreb-Pula, 2006.
5. Potnik Galić, K. i Galić Z. (2008) *Određivanje ciljnih troškova u procesu razvoja novog proizvoda*. Računovodstvo, revizija i financije, 2008 (10)