



COST MANAGEMENT

UNIT 1 COST CONTROL AND COST REDUCTION

MEANING OF COST MANAGEMENT:



Cost management is used to describe the approaches and activities of managers in the short term and long term planning and control decisions that increase value for customers and lower cost of products and services.

In other words, Cost Management identifies collects, measures, classifies and reports information that is useful to managers in costing, planning, controlling and decision making.

COST CONTROL



Cost control is the practice of identifying and reducing business expenses to increase profits, and it starts with the budgeting process. A business owner compares actual results with the budgeted expectations and if actual costs are higher than planned, management takes action.

Cost control is utilization of the available resources economically and prevention of the wastage within the existing environment. It is the function of keeping cost within the prescribed limit.

COST REDUCTION



Cost Reduction is defined by CIMA London as “the achievement of real and permanent reduction in the unit cost of goods manufactured or services rendered without impairing their suitability for use intended”

Example: waste elimination, modernization, and dematerialization

COMPARISION BETWEEN COST CONTROL AND COST REDUCTION

BASIS	COST CONTROL	COST REDUCTION
Meaning	Achievement of pre-determined target of costs	Achievement of real and permanent reduction in cost
Nature or assumption	Tends to assume a static state of affairs and that standard once set are not challenged or changed.	It assumes the existence of concealed potential savings in the standards or pre-determined cost subject to challenge
Analysis of pre-determined cost	It is concerned with pre-determined costs, analyzing the variances and taking corrective action	It is not concerned with maintenance of performance according to pre-determined targets. It is rather concerned with finding out new product design, methods etc
Function	It is a preventive function as it aims to prevent the costs.	It is a corrective function because it seeks to improve performance by correcting the targets
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Approach	It lacks in dynamic approach to cost improvement	It is more a dynamic approach to cost improvement and elimination of waste
Exercise	Cost control is a routine exercise which is carried out for attainment of operational efficiency.	Cost reduction aims at permanent and real savings by a continuous search for improvement
Applicability	Cost control is generally applicable to items of costs which have standards.	Cost reduction is applicable to every activity of the business
Tools and techniques	Budgetary control and standard costing	Value engineering, value analysis, ABC analysis

SCOPE OR AREAS COVERED BY COST CONTROL AND COST REDUCTION



- Product design
- Target costing
- Value analysis
- Value engineering
- Value chain analysis
- Business process re-engineering

PRODUCT DESIGN



The design of the product provides the greatest scope for cost reduction. Product design being the first step in production, if cost reduction can be made at design stage, then it is likely that the benefits can be availed to the maximum in the following ways:

- Material cost
- Labor cost
- Standardization and simplification
- Packing and transportation
- Reduction in after sales service cost.

TARGET COSTING



Target costing is a method of determining the cost of a product or service on the basis of competitive price prevailing in the market. It is the market price that determines the selling price. It is the cost that determines the selling price (cost-plus pricing)

But in target costing it is the selling price that determines the cost.

Definition of target cost and target costing:

According to CIMA terminology 'A target costing is a product cost estimate derived by subtracting a desired profit margin from a competitive market price'

TARGET COST = competitive market price - required profit

VALUE ANALYSIS



Meaning:

Value analysis process is used to offer a higher performing product or services to the customer at a minimal cost by substituting an existing product which offers inferior solution.

Definition:

Value analysis is defined as a process of systematic review that is applied to existing product designs in order to compare the function of the product required by a customer to meet their requirements at the lowest cost consistent with the specified performance and reliability needed.

VALUE ENGINEERING



Meaning:

Value engineering is carried out at new product design stage or engineering of the product.

Definition:

It is defined as ‘a systematic and organized approach to provide the necessary functions in a product at the lowest cost

VALUE CHAIN ANALYSIS

Meaning:



The value chain is a full range of activities which a business has to go through to bring a product or service from the stage of conception to the stage of delivery.

Definition:

CIMA London defines value chain analysis as ‘a sequence of activities by which, in the perspective of end users, value is added to the product or services produced by an entity’.

BUSINESS PROCESS RE-ENGINEERING



Meaning:

BPR is the practice of rethinking and redesigning the way work is done to better support an organization mission and reduce cost.

Definition:

Hammer and Champy have defined BPR as ‘the fundamental rethinking and radical redesign of business process to achieve dramatic improvement in critical, contemporary measures of performance such as cost, quality, service and speed’.