The Link Between Strategic Cost Management and Value Creation

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Abstract: The study investigates the link between modern organizational frameworks and stakeholder-oriented strategies to enhance long-term value for various stakeholders. The synthesis of value creation and advanced costing systems reflects the emerging nature of business strategy where value is measured by the broader contribution of the company to society. To achieve the study objective, the research followed a qualitative explanatory approach. Explanatory research clarifies why and explains how there is a relationship between two aspects of the study phenomenon which are, value creation and cost control. A systematic literature review analysis was conducted to emphasize the impact of stakeholder theory and contemporary costing methodologies. The findings reveal that strategic cost management facilitates long-term value creation by aligning cost control, particularly Activity-Based Costing with priorities of the stakeholder. Organizations employing approaches that are stakeholder-centric and modern costing systems and frameworks, an organization can achieve higher returns in the long run, maximize long-term value, and achieve sustainable competitive advantage. To support stakeholder value creation and optimize cost allocation, organizations should integrate traditional costing systems with Activity-Based Costing. To foster sustainable business practices, policymakers can promote frameworks that are stakeholder orientated. By bringing up the stakeholder theory with strategic cost management, the study contributes to the literature on management accounting and offers a framework for value creation in complex business environments.

Keywords: value creation; cost control; accounting systems; stakeholder theory

1. Introduction

The term "value creation" has become an increasingly important and emerging trend in every economic enterprise. Value creation has become very topical in today's research and has been stressed as the primary objective of organizations (Busch et al., 2018). However, the question is "for whom

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value is created?". According to O'Connell and Ward (2020), the value should be created only for shareholders as they are the owners of the firm. On the other hand, Goedhart and Koller (2020) argue that organizations are also responsible for the society in which they operate and therefore should also consider the interest of their stakeholders. Recently, it has become morally acceptable for organizations to consider their stakeholders.

The single-valued objective of any entity is to maximize profit and shareholder wealth (Khan & Hussanie, 2018). The contender against the concept of profit maximization is the stakeholder theory which argues that owners and managers should balance the interests of financial claimants and other stakeholders such as employees, customers, and communities amongst others (Jensen, 2010; Jones et al., 2018; Laukkanen & Tura, 2020). In particular, understanding the link between value creation and profit maximization is the key for a firm to reach its competitive advantage potential. Busch et al. (2018) conducted a study to determine who is the value created. The literature reveals that value creation is for customers, shareholders, and other stakeholders. Customer value includes financial and non-financial value.

The customer being able to afford the product or services of the organization is what creates value. The quality of a product or service offered is what creates customer loyalty, customer satisfaction, and the image of the organization. Shareholder value also includes financial and non-financial value. Financial value essentially relates to an increase in market share (capital appreciation) and returns (dividends) received from the company (Khan & Hussanie, 2018). Non-financial value is when a company pays consistent dividends to its shareholders, it creates reliability and can attract more shareholders to invest while keeping the existing one.

Nosratabadi et al. (2019) state that organizations have grown rapidly and are now more complex than before thus indicating that information that is precise and accurate is necessary. Because of the growing and changing business environment, the traditional costing system is becoming more and more irrelevant and inappropriate (Alsharari & Lasyoud, 2019). However, this does not completely make the traditional method irrelevant. For short-term decision-making, businesses can still adopt the traditional costing method. Businesses are engaging in more complex operations such as producing more than two products and operating in a hybrid structure (offering both manufacturing and non-manufacturing services), thus, changing to emerging costing techniques may result in better economic decision-making. Ideally, firms should not only focus on cost reduction but should also maintain the quality of product/service functionality, stabilizing their selling prices and at the same time remaining competitive in the market (Drury, 2018). This will generally reflect on profit and there will be increased sales which result in increased profit as the cost will be kept at a minimum.

2. The Accounting Systems and Value Creation

In this rapidly changing business environment, accounting systems are assumed to provide useful and accurate information to be used for strategic performance and decision-making for managers Nosratabadi et al. (2019). As technology is evolving, the existing systems quickly become irrelevant because of newly proposed systems which are assumed to be producing better benefits to the organization compared to the existing ones (Mushonga, 2015). This is because of innovations and advancements in manufacturing and other business operations. The complexity involved in today's business environment and operations has produced evidence of the weaknesses identified when employing traditional costing systems.

The primary purpose of accounting systems in the management accounting perspective is to measure the cost of a unit. Costing a product remains a very difficult job in this highly competitive business environment. The cost of a unit is made up of direct costs and indirect costs (Drury, 2018). Direct costs (i.e., direct materials and direct labour) can easily be measured and can be traced directly to the unit (Hansen et al., 2021). The problematic components are the indirect costs which cannot be easily traced back to the unit being produced (Perčević & Hladika, 2016). This led to more arguments on whether they are accurately allocated using the traditional system or not. With all the weaknesses identified, the ABC system was introduced and is assumed to address all the weaknesses identified in using the existing system and has been emerging since the 1980s.

Managers always look for better ways of making an informed decision and the adoption of ABC became more prominent as it is assumed to provide a better basis for better strategic decision-making (Alsharari & Lasyoud, 2019). Practitioners defined and promoted the concept of ABC was developed and introduced in the teaching cases at Harvard Business School. ABC was first developed for manufacturing industries or companies. The theory behind its promoters was that manufactured product complexity differs and the proportion of activities accompanied also differs when compared to the traditional costing system. Jalalabadi et al. (2018) state that ABC produces better, more accurate, and more efficient cost information as it draws indirect costs to specific activities (Moisello, 2012).

Mushonga (2015) highlights that traditional costing was developed back early in the day and the theory behind its development was for manufacturing organizations and all the indirect costs are driven by one factor (Drury, 2018). This is assumed to result in cost distortion as indirect costs are allocated on a single basis. This results in the cost of high-volume products and the cost of low-volume products. This negatively affects profitability, competitive advantage, loss in sales, and customer value. Traditional costing does not only produce unreliable information but also provides incomplete information in the form of charts and other forms that cannot be used for decision-making (Perčević & Hladika, 2016).

The current manufacturing environment is characterized by technological advances and flexibility in the manufacturing process. The organizations are more capital-intensive which has reduced the use of direct labour in the manufacturing process of the product unlike before. Myers and Le Moyne (2009) argue that back in the days before the emerging technology, organizations were more labour-intensive thus it was appropriate to allocate the indirect costs based on labour hours. In addition, the indirect costs were less while direct costs were significantly more. Currently, the indirect costs are considerably more which makes the allocation more problematic. Further, argue that traditional systems would be inappropriate in this new capital-intensive business environment. Drury (2018) attested that with the increase in fixed costs because of capital-intensive evolvement, improved accounting systems are necessary.

On the contrary, the contingency theory literature by Mahmood Albalaki et al. (2019), states that the changes in management business accounting systems and structures is influenced by contingency factors. This includes organizational and environmental factors such as better service quality, privatization, deregulations, IT costs, etc. However, this contradicts the findings, that the environmental factors do not result in the need for changes in accounting systems and the adoption of ABC.

With the number of benefits associated with adopting ABC, it is evident from the literature that ABC is not a complete replacement for the traditional costing system but a supplement to the existing system. This is evidenced by Mushonga (2015) literature which further reveals that most companies use the hybrid system which is a combination of both ABC and the traditional costing system. In addition to the above-mentioned, de La Villarmois and Levant (2011) have found that traditional costing can be used with either ABC or any other accounting system. Thus, it has not been fully neglected or removed. There's also evidence that organizations that use ABC still use the traditional costing system for external reporting while ABC is mostly used for internal strategic decision-making by management.

It is appropriate to preclude that the primary objective of any organization is to create value not only for its owners but for other stakeholders as well. This helps the organization to have long-term sustainable growth and competitive advantage. This study has revealed that customer satisfaction is the centrality of value creation. Without customers, there is no growth for the organization. Likewise, without shareholders, the organization would not be in existence. This supports the conclusion that an organization's focus is its stakeholders.

3. Research Methodology

The primary objective of this study was to determine the link between value creation and cost control. To achieve the abovementioned objectives, explanatory research was adopted. This was essential for the researcher because explanatory research attempts to clarify why and explain how there is a relationship between two aspects of a phenomenon. In this study, two aspects are cost control and value creation. As a result, the explanatory research assisted the researcher in determining the link between the two aspects. The study followed the qualitative approach because it allows the researcher to comprehend concepts and opinions. The qualitative approach involves the analysis of non-numerical data which allows a researcher to identify how things have changed over time, and the emerging concepts and enables the researcher to make future assumptions. Qualitative data collection includes various methods such as conducting interviews, paper analysis, and observations (Klopper and Brink, 2023, Friedman, 2011, Caudle, 2004). This secondary data was collected using key terms such as activity-based costing, value, accounting, and value creation amongst others from the Google Scholar database.

The study adopted Google Scholar as its research paper database to ensure that the risk of missing relevant literature was minimized. Google Scholar is a common research database used in related fields and one of the most recognized research paper databases. Thus, most of the journals used in this study are indexed in the Google Scholar database. The study excludes publications such as editorials, letters, unrelated literature, unavailable full text, abstract-only papers, and technical reports. The reported outcomes used in this study include outcomes that are not self-reported but rather objectively measured. The study reviewed papers that were not older than five years. Therefore, to ensure the robustness of the literature, up-to-date and comprehensive papers were used and aligned with the scope of the review. The findings from papers older than the mentioned range were referred to and used in the introduction of this study. To ensure validity, a quality assessment of the papers was conducted. During the process of study, the risk of bias Publications, Selection bias, and others, were evaluated to ensure an accurate and valid overall review process.

4. Results and Discussion

When determining the link between the value creation and cost control using the qualitative explanatory research approach, it was found that by focusing more on the long-term value creation perspective, an organization can achieve higher returns in the long run. As one of the strategies in creating customer value is to identify what customers want, the organization can use that as an input in the production process and charge higher prices on the output as all the customers' needs would be satisfied. Value creation allows the organization to stand out from its competitors. This is because the organization achieves customer loyalty where customers prefer a certain organization to buy their product even if competitors offer the same product. By creating value, the business can have repeated transactions with the same customers and will increase its market by also attracting new customers through word of mouth to the already existing customers. Winning customer perception and loyalty allows the business to save costs in the long term as they will not have to spend more on advertising and promotions.

Organizations become more concerned with innovations and focus more on product development and research. It allows critical thinking and strategies to be fully utilized. Creating value for shareholders allows the management of the business to have a long-term financial view for strategic planning and future operations. Organizations can attract more investments as they will be perceived as a better-performing entity. Allows the business to have a long-term sustainable operation. From what has been discussed, there is a direct relationship between the costing systems and value creation. Value for the firm depends on shareholder and customer value creation. We have explored that one of how customer value can be created is through lower prices. This can be achieved through cost management by the firm using relevant costing systems such as activity-based costing and other costing systems. Should the firm not be able to manage its cost effectively will have a detrimental effect on customer value. However, lower prices may be an indication of a low-quality product thus maintaining high quality at the same time charging lower prices is what is crucial for the firms. High-quality services or products require a higher cost and the only way the firm can recover those costs is by charging higher prices.

5. Conclusion

The business era has changed rapidly and maintaining customers is one of the key areas to survive in this competitive business environment. Being a responsible corporation adds to the growth of the organization. The institute's international reporting council has also created a framework where an organization needs to not only report about its financial affairs but to adopt integrated reporting which requires an organization to report about its stakeholders. This further adds to the fact that the stakeholders are the heart of any organization and satisfying them is the critical success factor for the entity. It is necessary to note that no system should be considered superior to the other and ABC should not be treated as a replacement for the traditional costing system although it addresses the weaknesses identified and cannot remove the traditional costing system because of its limitations by implementing ABC. The only difference between the two systems is that ABC has more than one cost driver to allocate the indirect costs. The direct cost does not differ. Thus, the two systems result in different costs of units produced. Nonetheless, cost management researchers conclude that using traditional costing systems results in cost distortion. After careful consideration of the literature, one can argue that no method is better than the other however there is only a suitable method to be adopted for a certain type of organization. For example, ABC is mostly applicable to organizations that offer a diverse range of products or services. However, the biggest concern is that the adoption rate of ABC is not as high as expected. Is it maybe because the cost outweighs the benefit? Or is it because of the failed implementation rate? Or is it because organizations are not ready to move as this may disrupt their entire operations? Or maybe is because they want to prove that ABC is not a better costing system when compared to the traditional costing system.

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