**Strategic Decisions and the Management Accountant**

Strategy specifies how an organization matches its own capabilities with the opportunities in the marketplace to accomplish its objectives. In other words, strategy describes how an organization will compete and the opportunities its managers should seek and pursue. Businesses follow one of two broad strategies. Some companies, such as Southwest Airlines and Vanguard (the mutual fund company) follow a cost leadership strategy. They have been profitable and have grown over the years on the basis of providing quality products or services at low prices by judiciously managing their costs. Other companies such as Apple Inc., the maker of iPods and iPhones, and Johnson & Johnson, the pharmaceutical giant, follow a product differentiation strategy. They generate their profits and growth on the basis of their ability to offer differentiated or unique products or services that appeal to their customers and are often priced higher than the less-popular products or services of their competitors. Deciding between these strategies is a critical part of what managers do. Management accountants work closely with managers in formulating strategy by providing information about the sources of competitive advantage—for example, the cost, productivity, or efficiency advantage of their company relative to competitors or the premium prices a company can charge relative to the costs of adding features that make its products or services

distinctive. Strategic cost management describes cost management that specifically focuses on strategic issues. Management accounting information helps managers formulate strategy by answering questions such as the following:

* Who are our most important customers, and how can we be competitive and deliver value to them? After Amazon.com’s success in selling books online, management accountants at Barnes and Noble presented senior executives with the costs and benefits of several alternative approaches for building its information technology infrastructure and developing the capabilities to also sell books online. A similar cost-benefit analysis led Toyota to build flexible computer-integrated manufacturing (CIM) plants that enable it to use the same equipment efficiently to produce a variety of cars in response to changing customer tastes.
* What substitute products exist in the marketplace, and how do they differ from our product in terms of price and quality? Hewlett-Packard, for example, designs and prices new printers after comparing the functionality and quality of its printers to other printers available in the marketplace.
* What is our most critical capability? Is it technology, production, or marketing? How can we leverage it for new strategic initiatives? Kellogg Company, for example, uses the reputation of its brand to introduce new types of cereal.
* Will adequate cash be available to fund the strategy, or will additional funds need to be raised? Proctor & Gamble, for example, issued new debt and equity to fund its strategic acquisition of Gillette, a maker of shaving products. The best-designed strategies and the best-developed capabilities are useless unless they are effectively executed. In the next section, we describe how management accountants help managers take actions that create value for their customers.

**Value Chain and Supply Chain Analysis and Key Success Factors**

Customers demand much more than just a fair price; they expect quality products (goods or services) delivered in a timely way. These multiple factors drive how a customer experiences a product and the value or usefulness a customer derives from the product. How then does a company go about creating this value?

**Value-Chain Analysis**

Value chain is the sequence of business functions in which customer usefulness is added to products. Exhibit 1-2 shows six primary business functions: research and development, design, production, marketing, distribution, and customer service. We illustrate these business functions using Sony Corporation’s television division.

1. Research and development (R&D)—Generating and experimenting with ideas related to new products, services, or processes. At Sony, this function includes research on alternative television signal transmission (analog, digital, and high-definition) and on the clarity of different shapes and thicknesses of television screens.

2. Design of products and processes—Detailed planning, engineering, and testing of products and processes. Design at Sony includes determining the number of component parts in a television set and the effect of alternative product designs on quality and manufacturing costs. Some representations of the value chain collectively refer to the first two steps as technology development.2

3. Production—Procuring, transporting and storing (also called inbound logistics), coordinating, and assembling (also called operations) resources to produce a product or deliver a service. Production of a Sony television set includes the procurement and assembly of the electronic parts, the cabinet, and the packaging used for shipping.

4. Marketing (including sales)—Promoting and selling products or services to customers or prospective customers. Sony markets its televisions at trade shows, via advertisements in newspapers and magazines, on the Internet, and through its sales force.

5. Distribution—Processing orders and shipping products or services to customers (also called outbound logistics). Distribution for Sony includes shipping to retail outlets, catalog vendors, direct sales via the Internet, and other channels through which customers purchase televisions.

6. Customer service—Providing after-sales service to customers. Sony provides customer service on its televisions in the form of customer-help telephone lines, support on the Internet, and warranty repair work.

In addition to the six primary business functions, Exhibit 1-2 shows an administrative function, which includes functions such as accounting and finance, human resource management, and information technology, that support the six primary business functions. When discussing the value chain in subsequent chapters of the book, we include the administrative support function within the primary functions. For example, included in the marketing function is the function of analyzing, reporting, and accounting for resources spent in different marketing channels, while the production function includes the human resource management function of training front-line workers. Each of these business functions is essential to companies satisfying their customers and keeping them satisfied (and loyal) over time. Companies use the term customer relationship management (CRM) to describe a strategy that integrates people and technology in all business functions to deepen relationships with customers, partners, and distributors. CRM initiatives use technology to coordinate all customer-facing activities (such as marketing, sales calls, distribution, and post sales support) and the design and production activities necessary to get products to customers. At different times and in different industries, one or more of these functions is more critical than others. For example, a company developing an innovative new product or operating in the pharmaceutical industry, where innovation is the key to profitability, will emphasize R&D and design of products and processes. A company in the consumer goods industry will focus on marketing, distribution, and customer service to build its brand. Exhibit 1-2 depicts the usual order in which different business-function activities physically occur. Do not, however, interpret Exhibit 1-2 as implying that managers should proceed sequentially through the value chain when planning and managing their activities. Companies gain (in terms of cost, quality, and the speed with which new products are developed) if two or more of the individual business functions of the value chain work concurrently as a team. For example, inputs into design decisions by production, marketing,

distribution, and customer service managers often lead to design choices that reduce total costs of the company. Managers track the costs incurred in each value-chain category. Their goal is to reduce costs and to improve efficiency. Management accounting information helps managers make cost-benefit tradeoffs. For example, is it cheaper to buy products from outside vendors or to do manufacturing in-house? How does investing resources in design and manufacturing reduce costs of marketing and customer service?



**Supply-Chain Analysis**

The parts of the value chain associated with producing and delivering a product or service—production and distribution—is referred to as the supply chain. Supply chain describes the flow of goods, services, and information from the initial sources of materials and services to the delivery of products to consumers, regardless of whether those activities occur in the same organization or in other organizations. Consider Coke and Pepsi, for example; many companies play a role in bringing these products to consumers. Exhibit 1-3 presents an overview of the supply chain. Cost management emphasizes integrating and coordinating activities across all companies in the supply chain, to improve performance and reduce costs. Both the Coca-Cola Company and Pepsi Bottling Group require their suppliers (such as plastic and aluminum companies and sugar refiners) to frequently deliver small quantities of materials directly to the production floor to reduce materials-handling costs. Similarly, to reduce inventory levels in the supply chain, Wal-Mart is asking its suppliers, such as Coca-Cola, to be responsible for and to manage inventory at both the Coca-Cola warehouse and Wal-Mart.

**Key Success Factors**

Customers want companies to use the value chain and supply chain to deliver ever improving levels of performance regarding several (or even all) of the following:

* Cost and efficiency—Companies face continuous pressure to reduce the cost of the products they sell. To calculate and manage the cost of products, managers must first understand the tasks or activities (such as setting up machines or distributing



products) that cause costs to arise. They must also monitor the marketplace to determine prices that customers are willing to pay for products or services. Management accounting information helps managers calculate a target cost for a product by subtracting the operating income per unit of product that the company desires to earn from the “target price.” To achieve the target cost, managers eliminate some activities (such as rework) and reduce the costs of performing activities in all value-chain functions—from initial R&D to customer service. Increased global competition places ever-increasing pressure on companies to lower costs. Many U.S. companies have cut costs by outsourcing some of their business

functions. Nike, for example, has moved its manufacturing operations to China and Mexico. Microsoft and IBM are increasingly doing their software development in Spain, eastern Europe, and India.

* Quality—Customers expect high levels of quality. Total quality management (TQM) aims to improve operations throughout the value chain and to deliver products and services that exceed customer expectations. Using TQM, companies design products or services to meet the needs and wants of customers and make these products with zero (or very few) defects and waste, and minimal inventories. Managers use management accounting information to evaluate the costs and revenue benefits of TQM initiatives.
* Time—Time has many dimensions. New-product development time is the time it takes for new products to be created and brought to market. The increasing pace of technological innovation has led to shorter product life cycles and more rapid introduction of new products. To make product and design decisions, managers need to understand the costs and benefits of a product over its life cycle. Customer-response time describes the speed at which an organization responds to customer requests. To increase customer satisfaction, organizations need to reduce delivery time and reliably meet promised delivery dates. The primary cause of delays is bottlenecks that occur when the work to be performed on a machine, for example, exceeds available capacity. To deliver the product on time, managers need to increase the capacity of the machine to produce more output. Management accounting information helps managers quantify the costs and benefits of relieving bottleneck constraints.
* Innovation—A constant flow of innovative products or services is the basis for ongoing company success. Managers rely on management accounting information to evaluate alternative investment and R&D decisions.

Companies are increasingly applying the key success factors of cost and efficiency, quality, time, and innovation to promote sustainability—the development and implementation of strategies to achieve long-term financial, social, and environmental performance. For example, the Japanese copier company Ricoh’s sustainability efforts aggressively focus on energy conservation, resource conservation, product recycling, and pollution prevention. By designing products that can be easily recycled, Ricoh simultaneously improves efficiency, cost, and quality. Interest in sustainability appears to be intensifying. Already, government regulations, in countries such as China and India, are impelling companies to develop and report on their sustainability initiatives. Management accountants help managers track performance of competitors on the key success factors. Competitive information serves as a benchmark and alerts managers to market changes. Companies are always seeking to continuously improve their operations. These improvements include on-time arrival for Southwest Airlines, customer access to online auctions at eBay, and cost reduction on housing products at Lowes. Sometimes, more-fundamental changes in operations, such as redesigning a manufacturing process to reduce costs, may be necessary. However, successful strategy implementation requires more than value-chain and supply-chain analysis and execution of key success factors. It is the decisions that managers make that help them to develop, integrate, and implement their strategies.