Building a Sustainable Cost Leadership Culture

By Jonathan B. Schiff, CMA

As management accountants evolved from “bean counters” into strategic business partners, their focus also evolved, shifting from cost accounting to cost management and, ultimately, cost leadership. This involves a proactive attitude of striving for lower costs, improved customer focus, and enhanced market share. As cost leaders, management accountants can help enable their organization to compete and thrive in today’s complex global economy. But they can’t do it alone.

Figure 1: Selected Cost Acumen Survey Results

Cost leadership comprises three related components. The first component involves tools, and the accounting and finance profession has developed many innovative tools, such as activity-based costing (ABC) and Six Sigma, to help companies understand and manage costs. The second component is understandable and goal-congruent metrics tied to compensation, such as customer/channel profitability and cost to serve. The third component is building and sustaining a culture that's supportive of attaining and sustaining cost leadership.

Establishing a successful cost leadership culture is probably the most difficult component. Experience has shown that tools and metrics alone don't guarantee success. Metrics can drive behavior, but without an appropriate culture, managers will do what they have done for decades—find ways to deliver the numbers expected of them regardless of whether the intended benefits are realized. Building a sustainable cost leadership culture within a company reduces that behavior and enables success.

To better understand the current state of cost leadership within organizations and identify areas for improvement, I recently conducted a survey of 120 financial executives. The results of the Cost Acumen survey indicate that failures in cost initiatives are rarely caused by broken tools. Rather, the problem is something far more elusive, elegant, and enduring: Without staff confidence, support, and acumen, sustainable cost initiatives are unlikely to achieve their goals.

Cost Acumen Survey

Survey participants work for companies of various sizes across manufacturing, financial services, and other services industry sectors. Thirty percent work for companies with revenues greater than $1 billion, 35% are from companies with revenues between $100 million and $1 billion, and 35% are from companies with revenues of less than $100 million. They hold finance and accounting leadership titles including director, assistant controller, and controller.

The results of some of the key survey questions are shown in Figure 1. Cost containment is clearly very important in today's business setting. When asked its importance on a scale of 0-4, respondents gave an average rating of 3.64. Yet question 2 suggests that almost half of the opportunities for containment are "left on the table." Only 55% of respondents reported that cost-reduction opportunities are pursued on a regular basis. As one participant observed, "Opportunities are only explored if there is a budget overrun."

This reminds us that the tyranny of the budget is still alive and well in many organizations. By relying almost exclusively on budget variances to trigger actions that reduce costs, many productive cost-reduction opportunities go unexploited. In his article, "Forward Roll" (*Journal of Accountancy*, October 2013), Neil Amato discusses the weaknesses of this approach, pointing out that budget variance information may not be provided on a timely basis and that traditional budgets may be too out of touch with reality given the length of time from when the budget is conceived to when the budget is compared with actual results.

Question 3 shows that staff perception of past cost-reduction initiatives is also a source for concern. With a grade of 2.13 out of 4, this finding is a sad commentary on historical initiatives that weren't designed, communicated, and/or executed well. Sometimes change management, performance measurement, and educational and behavioral issues aren't considered or sufficiently "fleshed out" in the initiative's planning process. One of the painful lessons that I've learned over the years is that it's very important to conduct an often unpleasant, candid post mortem to identify and understand the reasons an initiative failed before embarking on the next one. Skipping this step increases the likelihood that future projects will also fail to achieve their intended objectives and, thus, squander precious leadership credibility, staff support, and enthusiasm.

When rating the cost acumen of their company's upper management, participants gave a rather pedestrian grade of 2.0 out of 4. In letter grade equivalents, this would be a flat C. If the leadership of the organization is just "passing" on this topic of strategic importance, what can be expected from the staff that reports to them across the entity?

That finding is compounded by the next result. Respondents gave the same 2.0 out of 4 rating for their staff's expertise in process improvement. This assessment is disturbing given the importance of process improvement in the contemporary scene. This point is reflected by comments from two survey respondents: "No real support from the top or buy-in from the bottom" and "We nod our heads in agreement [to pursue process improvement] and don't invest the resources."

To combat this lack of expertise, some companies leverage the use of Six Sigma, internal audit teams, or specialized "hit squads" to drive process improvements. But perhaps the time has come to consider process improvement as everyone's business and not just an adjunct, "as needed" activity for specialists. Survey respondents echoed this point in their comments. One noted, "Global cost leadership is one of our strategic objectives," while another reported, "Regardless of strategy and positioning, being a cost (management) leader is imperative."

The results of the survey seem to not only confirm the important role that company culture plays in cost leadership, but also that there are areas companies can focus on to improve and develop a cost leadership culture.

Table 1: Considerations of the Status Quo

1. What is your organization's current cultural inventory?
2. What are the "default" cultural values in your organization?
3. Is there cultural consistency across business functions? What are the outliers?
4. Is the current culture too complex to understand and embrace?
5. How much is your current culture influenced by
   - **a.** your industry?
   - **b.** your customers?
   - **c.** your operational context/locale/setting?
   - **d.** regulatory oversight?
6. Is your company's culture "rootless"? What is the legacy of this effect?

Examine the Status Quo

The first step in building a cost leadership culture is to examine the existing culture to identify what changes are needed. You merely have to look at recent news headlines to find an example of how a company's culture can negatively impact execution, performance, reputation, and shareholder value. It has been well documented how the company culture within General Motors (GM) contributed to defective switch-related airbag failures linked to at least 54 crashes and 13 deaths. An article in the *The Wall Street Journal*, "GM Takes Blame, Vows Culture Shift" (June 6, 2014), detailed a culture that included the GM nod, which is a "meeting where participants appeared to nod in agreement that action should be taken, then did nothing," as well as the GM salute, which "is identified as crossing arms or pointing to another employee to indicate that responsibility belongs to someone else."

Even the absence of a contemplated, defined culture results in the existence of a "default" culture that needs to be understood. With this understanding, finance and accounting leaders can be even more successful in their important, challenging, and vital roles.

Begin by asking and answering questions that will describe the status quo (see Table 1). What is your organization's current cultural inventory? Detail all the significant cultural features, factors, and values present in the organization, both intended and unintended. This includes identifying the "default" cultural values in your organization. And if these aren't articulated, explore the kind of impact that has had on the organization.

Also describe the foundation and structure of the culture. Is it too difficult to understand and embrace? Think of how a new employee would experience and interpret the current culture. After two months, would that individual be able to accurately describe the desired goals and values of the culture? And is there cultural consistency across business functions? The same cultural values within the finance area should also live in research and development or IT. Identify any outliers.

To complete the picture, examine what influences the culture. Get an understanding of how much the company's industry, customers, operational context, location, and/or regulatory oversight impact and drive the culture. As part of that, consider the strength of the culture and if it has taken root or can be easily redirected. One sign of a rootless culture is the ease in which each new business leader is able to impose his or her own cultural values. Finally, if that's the case, explore the legacy that effect has had on the overall culture and the company itself.

Envision the New Culture

Identifying the current culture gives you a clear understanding of the starting point and the areas that need improvement. The next step in building a cost leadership culture is envisioning where you want to go (see Table 2).

In a November 2009 article, Allen Schiff and I described how cost leadership needs to be "reflected in a culture that, independent of macroeconomic circumstances, pursues a low-cost, high-quality customer-centric approach to managing the business" ("Cost Leadership for the Current Challenge," *Strategic Finance*). Using this as a foundation, develop a list of the desired aspirational or cultural values of the organization that will move it further in a direction of cost leadership. An essential step in this process is getting leadership buy-in. Work with top management and the board of directors so that everyone understands and is committed to this overarching approach. For inspiration, look at other corporate practitioners. Learn from their failures, and determine how their successes can be applied in your company.

It's also important to understand the management implications of the new culture. How will it affect decision making, and what methods can managers use to keep the focus on the new values? Build a clear, understandable, and sustainable culture communication plan so that everyone knows and embodies the essential values.

Finally, in order to ensure the culture is sustainable, consider the possible inhibitors and risks in establishing and maintaining the cultural values. This helps prepare for any challenges that may arise during implementation and afterward.

Table 2: Building the Culture

1. Obtain buy-in from top management and the board of directors.
2. Identify the desired aspirational values of the organization.
3. Learn from corporate practitioners.
4. Describe the the management implications of the new culture.
5. Build a clear culture communication plan.
6. Consider the inhibitors and risks in establishing and sustaining the cultural values.

Instilling the Culture

A cost leadership culture is brought about in much the same way as any other company culture. It's a living thing that should guide and support business decisions in every facet of the organization. Employees need to understand how those values impact their work and the tangible value it adds.

Companies use all sorts of means to ensure their cultural values permeate every level of their organization and to instill those values within new employees. At a premium ice cream maker, every new staff person without exception must take a rotation on the merchandising team. In that role, the individual is able to experience firsthand the central nature of the appearance and placement of the company's product in the retail setting. This experience builds a cultural bond among all staff.

To be considered for any upper-level management positions at a global beverage and snack food maker, all managers must have an in-function rotation (i.e., not a decision-support role) in distribution and logistics. Because distribution and logistics are so vitally important to the company, management decided to include this common experience in all the future leaders who will help refine its culture.

And a large global conglomerate expresses its cultural values in great detail and then uses extensive in-house training curriculum elements to tie in, promote, and reinforce them. This approach results in the company's cultural values "coming alive" in a relatable business context.

These are only a few examples of how companies spread their cultural values. When developing the new culture, identify a method that will work best within the context of your organization. Once the plan is in place, everyone can begin working together to achieve cost leadership.

Cost Culture in Action

Building a sustainable cost leadership culture within a company can have significant, lasting effects. One example of this is Toyota. After World War II, the Japanese industrial complex and economy were in shambles. In the 1950s, Japan started exporting a variety of simple products, including housewares and toys, that were inexpensive but of very poor quality. In the United States, these products earned the derisive moniker "Japanese junk." Leaders in Japan realized that their approach was unsustainable. They turned to W. Edwards Deming to jump-start their revolution in quality.

Deming's statistical process control methodology isn't all that different from the "analytic skills" that companies today use to support improved business decisions, and his transformational teachings weren't limited to analysis. He persuaded his Japanese clients to break the barriers between leaders and staff. He also preached that leaders should drive out fear so everyone from top to bottom can work together, and he recommended the elimination of distracting "sloganeering." Toyota was one of the many Japanese companies that embraced and adapted Deming's teachings.

Toyota's adaptation is known today as the Toyota Production System (TPS). TPS has resulted in the building of a sustainable cost leadership culture that involves participation by every Toyota employee—without exception. TPS has led to generations of growth, industry quality, and profit margins that are the envy of its industry. Toyota's approach to *kaizen* (continuous improvement) is an understanding that regular, incremental "base hits" are far more important than the rare "home run." TPS is no guarantee of perfection, but it's hard to argue with the multigenerational success of a globally translatable cost leadership culture that drives long-term business leadership.

Another example is MiCRUS, an IBM business unit. This semiconductor fabrication unit in New York was nearly "unplugged" and "mothballed" after years of delivering uncompetitive cost and quality. To survive and thrive, MiCRUS leaders designed, developed, and inculcated a cost culture that yielded a complete turnaround in less than three years. The cultural shift turnaround was fueled by a combination of activity-based cost management (ABCM) , open-book management, and an inclusive incentive compensation system tied to reaching aggressive "cost per wafer goals." (Unique in the industry, the incentive system included all MiCRUS employees.) In addition to keeping MiCRUS viable and vital, the change in culture resulted in a dramatically enhanced valuation and in winning the semiconductor industry's highest honor, Fab of the Year, for top quality, low cost, and innovation. One of the key features in the MiCRUS case is the alignment of culture, metrics, and tools.

Experience has shown that tools and metrics alone don't guarantee success.

A Sustainable Success

Although the focus of this article is cost leadership, how it's described within the corporate context is important. There are some who consider "cost" to be a four-letter word, i.e., not something to be said in polite company. The Toyota Manufacturing System, for example, makes no mention of the word "cost." A lesson here is that some serious thought should be given to what this inclusive approach is called as it's developed within your organization. Remember that the ultimate goal is to move toward realizing positive outcomes for generations to come.

The key aspect of realizing cost leadership is understanding the mutual interdependence of culture, metrics, and tools. In striving for cost leadership as a management accountant, you should consider the quality, understandability, and effectiveness of each of these three components within the organizations you serve. This will enhance the value of your organization as well as your value within it. **SF**

Jonathan B. Schiff, CMA, Ph.D. is professor of accounting at Fairleigh Dickinson University. He is also a member of IMA's Bergen-Rockland-Meadowlands Chapter. You can reach Jonathan at schiff@fdu.edu.