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Building sustainable business through Strategic cost considerations

Abstract

Sustainable growth, transparency and concern on environmental, social and governance issues is becoming central in the success of today's business. Cost and Management Accountants have a key role to play in linking the impact of environment or society to the mainstream organizational decision making. Sustainability revolves around the idea that with increase in human population, demand for resources will also grow and since we have finite natural resources, to ensure our survival and a better future for coming generations, we need to duly consider impact of business outcomes on society and environment. Strategic Cost Management approach offers several action options for building a sustainable business.

The Perspective

Traditionally companies have been interested in single agenda of focusing on bottom line or the profit. But now business leaders are understanding the importance of simultaneous attention on social, and environmental dimensions as part of their growth plans and are not satisfied solely with the financial performance. Sustainable growth, transparency and progress on environmental, social and governance issue is also important in the success of today's business. Modern global businesses are built on fundamental principle that actions of the business must deliver a positive financial, social and environmental outcomes within a definable time frame. So the businesses must decide to change to a Sustainable Value Business Model, which would ensure that the organizational effort and investment provides a measurable return on the balance sheet and also have a positive impact on Social, Environmental and Governance metrics reflecting a fundamental shift towards focus on sustainability. The choice for companies today is not if, but how they should manage their sustainability activities. Business leaders should identify and understand the key sustainability issues and drivers relevant to their organization and develop their strategy accordingly

Sustainability and Business strategy

In today's dynamic and uncertain business world importance of building Sustainable Value into the strategy of a business cannot be underestimated. Business strategy is most simply defined as the set of actions and activities a company invests in to gain competitive advantage and to maximize long-term value. A clear and defined strategy provides the necessary focus for effective executive decisions, management actions and business investments. Making sustainability a part of the formal business strategy, and measuring results in terms of improved financial and non-financial business value, is critical for developing a Sustainable Value Business Model.

Consumer confidence, shareholder value, brand equity and the very sustainability of today's global businesses, and the planet, rely on a major shift towards new business models that focus on the intentional

creation of enduring social and economic value for all stakeholders. Enduring business value is created when an organization conducts its operations such that commercial, social and environmental goals are inextricably linked, and these are duly considered and represented in strategic planning, operating budgets, balance sheet and corporate culture of the companies.

The Development of Sustainable Competitive Advantage

An organization in a free-market economy, especially one that is becoming increasingly global, aims to achieve its strategic goals on the basis of a competitive advantage in which the company implements a value-creating strategy that remains unique despite attempts at imitation by current and future competitors. This means that the organization is capable of offering greater value to buyers in its industry that have a choice from several alternatives. We must emphasize that the value offered to customers by products or services is determined by the customers themselves. As such it may include: (a) Better quality, i.e. increased functionality, reliability, safety, etc. (b) Lower price for comparable quality level (c) Faster delivery when quality and cost are the same (d) Easier use (e) Greater customer satisfaction (f) Provision of good after sale support.

The most recurrent mistake made by successful organizations is the failure to assess the impact of ongoing changes on their customers and stay with the same strategy assuming continuity in environmental conditions. In what seems the rational thing to do, considering the cost structure with big overheads imposed by their large size, they keep making products that offer, even though temporarily, the most attractive profit margins, by investing in incremental improvements that satisfy their most demanding customers. As a result they often pay little or no attention to the moves made by new competitors operating with a new strategy based on some disruptive innovation that gradually eats away their market share

In a relatively stable environment most organizations can develop a strategic plan with a clear focus and direction. Its successful execution can achieve strategic goals mainly through operational excellence. However, when change in the external environment is volatile and rapid and when outcomes cannot be anticipated, leadership must shift its priority to the exploration of new value opportunities and systematically experiment to see what works and what does not. Under such conditions what matters most is the capability to experiment efficiently, to test and to adapt to an environmental context undergoing significant change

In periods of rapid change the focus for most business firms must shift from meeting profitability targets to the need for survival in the face of intense competition at a global scale. The conventional approach of cutting costs through extensive employee layoffs, plant closures, outsourcing to low-cost countries or increasing productivity with new technologies, does not address the fundamental challenges posed in the era of globalization through networked economies. What is primarily needed is the development of new capabilities that enhance the continual development of innovations that offer maximum value to customers and other stakeholders. Such a new strategic response demands the significant improvement of the quality of an organization's value-innovation process.

Leveraging Strategic cost considerations for building a sustainable business

Strategic Cost Management is a term used to describe the strategic planning, restructuring and re-alignment of a company's costs to an operating model that will deliver their revised strategy and strategic ambitions. Such programs undergo a grassroots diagnostic that allows organizations to focus on operating costs, that are either no longer aligned to the strategy (destroy value), or integral to supporting the underlying growth, or maintaining positions in markets, businesses and functions (create value). The importance of managing costs and aligning them with the business strategy of an entity is critical especially in the midst of challenging economic times faced by businesses today. By attacking costs comprehensively and strategically, companies are able to buy time for growth measures to work.



To achieve high performance with strategic cost management, it is recommended that companies create maximum impact sustainable development by using a timely combination of:

Tactical Cost Reduction : seek rapid cost reduction of non-strategic expenses, the low hanging fruit, to fund ongoing strategic cost management initiatives.

Proactive Cost Governance: Create, implement and manage a proactive cost governance model to sustain cost reductions using an organizational mindset that is focused on Kaizen - continuous improvement.

Strategic Cost Management/Operational Transformation: Implement structural changes using new technologies and digital interventions to the operating model and business processes to maximize value, sustain cost reductions and move to a more variable (vs. fixed) cost structure.

Cost Management as a Core Value : Every business has its own challenges, risks, and ways of doing things – but through it all, cost management remains a core value that can drive success. The differentiation and competitive advantage for a high growth business emanates from its ability to innovate. Effective cost management supports and supplements business innovation. Embracing a cost management framework is a key step towards building a sustainable business.

Cost management as business design : Companies and entrepreneurs typically believe cost management implies a restructuring of business – this simply isn't the case. The idea is to make it an integral part of the business design that indicates the company's aspiration for achieving all round operational efficiency.

Measuring and monitoring ROI on all spends : Effective cost management is a business philosophy and it starts with fostering a culture of questioning and evaluating every rupee spent. The entire organization should be oriented towards measuring and monitoring the return on investment (ROI) on all costs and investments. Every spend decision should be driven by the expected outcome or ROI it will generate.

Unitizing Costs: High growth businesses are structured in such a way that they can very quickly operate at much larger scale. This requires 'investing' in operating infrastructure well in advance of achieving the targeted scale. Adopting a high fixed cost model in the growth phase typically results in 'unproductive' cash expense, since the firm is spending on capacity and resources it cannot currently fully utilize. This model also leaves the business exposed to negative operating leverage, i.e. volatility in monthly revenues directly transmitting into volatility in monthly cash flows. For most firms adopting a high fixed cost model, this risk remains elevated until they achieve operating break-even.

A smart approach which deals with inflexibility associated with a high fixed cost model is to tie in these costs to business activity or production volumes (i.e. converting fixed costs into variable) wherever possible. This 'unitization' of costs or linking the expense outflow to business activity or revenues enables firms to spend as needed, and to save on operating expenditure during lean months.

Focusing on cash flow and not just EBITDA : The hype-led funding and the subsequent distress observed in some cases led the industry to place emphasis on EBITDA improvement along with revenue growth. However, an effective cost management framework should be more comprehensive in its approach and therefore, focus on cash flows. Working capital can be a significant cash expense for a growing business, especially in the B2B segment. Many companies have struggled to sustain, despite being EBITDA break-even, because the companies couldn't meet working capital requirements.

Sustainability Accounting : Accounting for sustainability involves linking sustainability initiatives to company strategy, evaluating risks and opportunities, and providing measurement, accounting and performance management of corporate actions to ensure that sustainability is embedded into the day-to-day operations of the company. At the core of business decision making, regardless of the area, is



quantitative information that can be leveraged and applied to business decision making and evaluation of different options on a real-time basis. CMAs are well positioned to capitalize on the growing demand for comparable, real-time, and actionable management information linking sustainability to profitability more particularly :Identifying opportunities for more efficient use of resources; Helping to assess the potential costs of failing to undertake environmental initiatives; Helping to improve methods for reallocating internal environmental costs, such as energy or water costs, to specific products and activities; Identifying and estimating costs resulting from the organization's activities that have to be met by others (externalities)

Conclusion

Only recently have organizations begun to really consider the interplay between business strategy and sustainability. Organizations will inevitably be affected by the increasingly complex sustainability agenda emerging internationally and within national and regional markets. Those that set out to develop a sustainable business will gain in stature and enhance their reputation and business results in a daunting and challenging world. Strategic cost management is vital to building a sustainable business through integration of Environmental , Social and Governance (ESG) considerations alongside tracking, monitoring and reporting of information on financial and operational impacts and performance.