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Cost Drivers - An Influencing Attribute in Profitability and Strategic Cost Management Decision Making

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Abstract
Every company's underlying objective is to earn and sustain profitability. It is an inevitable sense of duty of the Management to understand the factors that affect their profitability and cost. This requires a re-visit on their strategies at regular intervals to modify its strategies in order to align with the changes keeping them on par with its competitiveness in the market and to maintain the profitability. Effective financial decision making of an company lies in increasing its operational efficiency by identifying, analyzing and allocating Resources and Cost Drivers as per the requirements. The main concern of a business is to identify key cost drivers within their operations which influence the operating expenses. Cost Drivers play a major role in calculating the accurate Profit Margin, providing information about the company's profitability. The Changes in the business environment, economic changes and changes in the Market condition as well as the associated risk can be hedged by the Cost Drivers. The company's competitive pricing and ability in sustaining the profitability decisions are connected to the Cost Drivers. This study envisages the influencing attributes of Cost Drivers in Strategic Management Decision Making.
Keywords: Cost Drivers, Strategic Cost Management, Profitability and Decision Making.

Introduction

The Excellence of the Corporate depends on the Strategic Decision they adapt for sustainability, Competitiveness and Survival in a highly vulnerable complex and competitive market condition. Every company pushed to sustain their growth through innovation, adapting to the new changes and periodical review of their strategy. Corporates uses tools and system help them to control and manage it's costs and offer more to their customers than their competitors. Cost factors, Cost Behaviour, Cost Planning, Cost reduction and Customer Satisfaction is the Slogan of every corporate to stay in the competition. Identifying and analyzing the factors which affects the profitability and influence the cost is and inevitable exercise to make a sound financial decisions. With the frequent changing business environment and facing intense competition and cost pressure, it's further more critical to understand the cost factors and it's significance.

Objective of this study

1. Recognize the Cost Drivers and It's Importance
2. Application of Cost Drivers
3. Evaluation of Alternatives on Cost basis and decision making
4. Effects of decision on company's profitability
5. Validation of Strategic Decision Making.

Literature Review

Strategic cost management in the literature is discussed from many perspectives.

Porter's Contribution to the development of strategic cost management is vital 1998, that the firm has a choice from the three generic strategies in order tosustain the competitive advantage Namely cost leadership, differentiation, and focus.

Porter 2000 and Shank and Govindarajan (1988, 1992) exhibited their concept more clearly on strategic cost management using cost-based activities and analyzed value chain for the strategic direction of the cost.

Kajüter (2000) claims that the methods of cost management and cost management structure are two basic conceptual frameworks for Strategic cost management. According Kajüter (2000), the elements of a cost management system include activities like cost planning and cost monitoring, objects (resources, processes, and products), and techniques that support cost management activities.

These studies claim that the factors that affect the successful implementation of Strategic cost management methods include behavioral and organizational factors. To explain further, these factors include support from the most senior management, connection methods of cost management strategies, competitive, connection methods of cost management performance evaluation and reward (compensation), and adequacy of internal resources, training,commitment, motivation.

Cost Drivers & Types of Cost Drivers

Cost drivers are essential factors that impact company's operational expenses. Company can determine which specific activities or processes contribute to higher costs and where cost reduction and cost-cutting measures can be implemented by analyzing these areas. Cost drivers provide information about a company's profitability. Company will be able to accurately calculate their profit margins and make appropriate adjustments to improve profitability only if they understand the various factors that impact their costs. Cost drivers are essential in pricing decisions. Company can set competitive prices while still making profit by considering the various cost drivers for a product or service. Cost drivers aid in foreseeing and managing risks associated with the business environment. Cost drivers enable the company to anticipate any changes in the industry and respond accordingly to remain competitive as the economic landscape changes change in the customers behaviours.

1. Direct labor
2. Machine hours
3. Units produced
4. Direct material cost
5. Number of setups

Cost Drivers and Business Strategies

1. **Labor Costs:** One of the most significant cost drivers that businesses could encounter is labor costs. If the business hires numerous individuals or involves highly skilled labor, the labor cost could become the largest expense. A strategy that relies on hiring offshore or technological updates to reduce labor needs may be considered.

2. **Raw Material Costs:** Another significant cost driver is raw materials. Raw material costs typically fluctuate due to changes in supply and demand. Price fluctuations can severely impact companies that rely heavily on raw materials. Businesses can change their strategy by strengthening relationships between distributors or suppliers, revising the supply chain, or exploring alternative raw material sources.
3. **Equipment and Technology Costs:** Innovative technology and equipment can optimize productivity and reduce costs but also require investment. Company can add to the cost if it integrates new technology or equipment. The need for upgrades, maintenance, or repair and the associated costs can be significant. A comprehensive plan and analysis of the business needs and investment requirements can help build an effective strategy.
4. **Energy:** Energy costs can be a considerable driver for businesses, particularly those with energy-intensive operations. Companies can implement strategies such as investing in renewable energy, reducing energy waste and enhancing energy efficiency, upgrading to more energy-efficient machinery, and more. Moreover, environmental regulations and market competition significantly impact overall energy costs.
5. **Overhead Costs:** Overhead expenses represent indirect costs necessary for the operation of the business. These costs can be challenging to analyze and manage because they do not directly contribute to revenue. Developing a strategy for handling overhead expenses by prioritizing and analyzing the costs can lead to reducing overhead expenses and optimizing resources to maximize profitability.
6. **Regulatory Compliance Costs:** Companies must be aware of regulations in their industry and location, such as taxes, licensing, safety standards, and environmental regulations. These regulations can create additional costs, making regulatory compliance a significant business driver. Companies can employ strategies such as compliance audits, consultations with legal professionals, and upgrades to technology or equipment.

Cost Drivers and Profitability

Cost drivers are key factors affecting the costs of running a business. These drivers can significantly impact a company's profitability by increasing expenses and reducing revenue streams. Therefore, understanding the various cost drivers and their impact is essential for any business owner who wants to create a sustainable and profitable business. High profitability of the company earns high earning to the shareholders. To maximize the shareholder's wealth, companies focusing on optimization of its available resources. Cost and profitability are mainly focused on nature of products and services offered. Management is always concerned to plan costs, before they are actually incurred, exercise cost control. Variances obtained from this are analyzed to determine the efficiency of operations and to take necessary remedial action for evaluating the cost variables. 1) Labor costs2) Raw material costs3) Marketing costs. Cost reduction is critical for survival and growth in a highly competitive business environment. Businesses that cannot reduce their cost drivers will struggle to remain profitable and achieve their long-term goals. When businesses fail to reduce their cost drivers. For starters, higher operating expenses will result in lower profit margins and earnings per share for shareholders. This can harm investor confidence and make it difficult for the company to attract new investment opportunities, second, higher costs may increase prices, causing customers to switch to cheaper alternatives offered by competitors, ultimately harming brand loyalty. Furthermore, a company may be forced to lay off employees or reduce wages to stay afloat financially. Finally, failure to reduce cost drivers can result in financial hardship and business failure.

Internal & External Cost Drivers

Internal costs are easy to see and explain. They are costs that a business bases its price on. They include costs like materials, energy, labour, plant, equipment and overheads.

External costs are costs that are NOT included in what the business bases its price on. External costs are costs imposed upon a third party when goods and services are produced and consumed. Goods and services with external costs are effectively being subsidised by society-at-large which ends up paying them. These include: 1)The cost of disposing of the product at the end of its useful life 2) The environmental degradation caused by the emissions, pollutants and wastes from production 3) The cost of health problems caused by harmful materials and ingredients 4) Social costs associated with increasing unemployment due to increasing automation

Cost Factors in Decision Making

The analysis of costs factor plays a vital role in selecting the alternatives available before the management. Costs factors could shape alternative opportunities and therefore, it influences and shapes future profits. After analyzing different types of costs factors according to their nature, one can be able to select one out of the various optimal alternatives. When costs are future oriented then only the cost Factors remain important for the decision maker. Decision-making is a process of selecting any of the alternatives available after evaluation of all the options. Selection of one alternative out of two or more should maximize the profits of the concern. Decision-making is very much related with future planning with a particular goal. In this process, available information regarding the options should be analyzed properly to make a beneficial decision for the benefit of the company. Before taking decision firstly one should recognise the problem, secondly identify the various alternatives, thirdly evaluate different alternatives with helps of cost benefit analysis and finally adopt the most profitable course of action. Quality Characteristics of the Strategic Decisions are: 1) Contribution of the decision to achieve the objectives of the company. 2) The availability of correct and accurate standards in helping to make decisions. 3) Dealing with the long-term future. 4) The decision is exceptional, i.e., a non-recurring occurrence is a rare and routine decision. 5) Guidance is the future actions and actions within the company for the success of the decision taken. 6) The effect of the decision is comprehensive for all parts and units of the company. 7) These decisions require the allocation of resources for the purpose of implementation, particularly rare ones. Following table consists of the Tools to Evaluate the Decision Making.

Recommendations and Conclusions

In conclusion, identifying cost drivers is crucial for conducting an effective cost analysis. By understanding the factors that influence costs, businesses can make informed decisions to optimize their operations and maximize profitability. Throughout this study, we have explored various cost drivers and discussed their significance in cost analysis. Now, let's summarize the key takeaways from the discussion:

Cost drivers can be both internal and external factors that impact the cost of producing goods or delivering services. Identifying and analyzing cost drivers are essential for accurate cost estimation. It is crucial to differentiate between direct and indirect cost drivers. Direct cost drivers have a direct correlation with the cost of producing a product or delivering a service. Indirect cost drivers, on the other hand, have an indirect influence on costs but are still important to consider in cost analysis. Constant monitoring and reassessment of cost drivers are essential for staying competitive. As market conditions change and new cost drivers emerge, businesses must adapt their cost analysis strategies to remain agile and responsive.

The new approach to the cost management does not mean that the traditional method of costing to be rejected or discontinued completely. Many businesses are still using traditional methods while using traditional products and traditional way of preserving markets owing to set environmental, geographical, strategic and practical considerations.

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