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Managing Costs. Tools Used for Achieving the Cost Advantage

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Abstract: *Competition is a fundamental economic force that put firms under pressure to constantly improve products and offer attractive prices. It could determine the success or failure of firms. In a competitive context, the economic entities are forced to find to compete effectively and use its resources and capabilities to develop organizational competences that, in turn, create value for customers. Competitive advantage has generated a large debate over time, both theoretical and empirical and competitive advantage is universally accepted in strategic management literature as an essential concept in strategy. Understanding sources of competitive advantage for economic entities and selecting and implementing competitive strategies has become an extended area of research. This paper examines the theoretical bases of competitive strategies, focusing on cost advantage. The aim scope is to identify areas of action and tools that can be use by the economic entity in order to achieve competitive advantage.*
Keywords: *cost, competitive advantage, cost advantage, competitive strategy*

Introduction

Strategies developed by management bodies play an essential role in designing and substantiating the activity of economic entities. Realized in forecasts, they determine the development of each organization. The strategies determine the efficiency with which the entities interact with the systems of which they belong, the way they maintain and amplify their market share, the profitability obtained.

The strategy of an economic entity, includes a set of medium and long term objectives, which refers either to the whole of the activities or to its major components, the volume and structure of the available resources, the main actions to be taken, the main responsible and executors, the sources of financing, final and intermediate terms, global and partial efficiency indicators. It serves as a basis for developing the short and long-term development policy by each entity separately.

It turns out that a strategy will materialize in defining the areas of activity: establishing the major objectives of the entity, establishing policies and plans to reach the objectives, determining the responsibilities of the management, shareholders, employees, customers, suppliers, establishing the available resources necessary to implement the strategy.

Competition is a fundamental economic force that benefits customers as firms are under pressure to constantly improve products and offer attractive prices, it could determine the success or failure of firms. Success in any competitive context depends on offering superior customer value (value advantage) or operating with lower relative costs (cost advantage) or both according to Porter [1] and Christopher [2]. The survival of any business depends on its ability to compete effectively, Madu [3]. The competitive advantages occur when a firm uses its resources and capabilities to develop organizational competences that, in turn, create value for customers, Sago [4].

Competitive advantage has generated a large debate over time, both theoretical and empirical (Bowen and Wiersema [5], Rouse and Daellenbach [6], firms do, by all accounts, attempt to identify, create and leverage competitive advantages (Collis and Montgomery [7], Porter [8], and competitive advantage is universally accepted in strategic management courses and textbooks as an essential concept in strategy (Barney [9], Grant [10], Afuah [11], Zenger [12].

Understanding sources of competitive advantage for firms and selecting and implementing competitive strategies has become an extended area of research.

This paper examines the theoretical bases of competitive strategies, focusing on cost advantage. The aim scope is to identify areas of action and tools that can be use by the economic entity in order to achieve competitive advantage.

1. Competitive Strategies – Literature Review

The strategy represents a result of the strategic management process and includes some defining features: it is based on an appreciable volume of aggregated information, subordinates to the set objectives, is interchangeable with the objectives, defines the major directions in which the entity focuses its activity in the future, and does not mark the beginning its implementation, is the basis of the elaboration of the strategic plans, requires the existence of the strategic feed-back, in order to obtain the competitive advantage.

In strategic management, the competitive strategy was described by Porter [13] and become a major area of theoretical and empirical research (Campbell-Hunt [14], Dagnino [15], Dess and Davis [16], Miller [17] and Walker [18].

For a strategy to be useful to the economic entity it is essential to aim and ensure the competitive advantage regarding the cost or quality of the product. Those strategies that allow the economic entity to obtain a competitive advantage are called competitive strategies. The competitive advantage is materialized in the realization by an entity of superior products or services from a significant point of view for consumers in comparison with the offers of competition.

Referring to one or more components of essential importance for the consumer, the competitive advantage determines him to buy the respective product or service, which is characterized by parameters higher than that of other producers.

Porter's Five Forces is a business analysis model that helps to explain why various industries are able to sustain different levels of profitability. The model was published in Michael E. Porter's book, "Competitive Strategy: Techniques for Analyzing Industries and Competitors" in 1980. The Five Forces model is widely used to analyze the industry structure of a company as well as its corporate strategy. Porter identified five competitive forces that play a part in shaping every market and industry in the world. The five forces are frequently used to measure competition intensity, attractiveness, and profitability of an industry or market. Porter's five forces are: the entry of new competitors, the threat of substitutes, the bargaining power of suppliers and the rivalry among the existing competitors. Porter also identifies three generic strategies (Figure no.1) for achieving competitive advantage: cost leadership, differentiation and focus (cost focus and differentiation focus).

		COMPETITIVE ADVANTAGE	
		Lower cost	Differentiation
COMPETITIVE SCOPE	Broad Target	**1. Cost Leadership**	**2. Differentiation**
	Narrow Target	**3A. Cost Focus**	**3B. Differentiation Focus**

Figure no. 1. Three Generic Strategies
Source: [1, 12]

Each of these generic strategies involves different route to competitive advantage. As far as obtaining the competitive advantage, the source can be the innovation that consists in the product, technology and equipment renewal, in the management, marketing, financing, personnel renewal etc.

The basic condition for the competitive advantage to be viable is its durability, respectively the possibility of sustaining it for a long time. If this condition is not met, we cannot speak of a strategic competitive advantage, but of a temporary one, based on a favorable situation or the use of an opportunity.

2. The Cost Advantage - Areas of Action and Tools Used

The Cost leadership strategy is a widespread strategy at the microeconomic level. This view is argued by the fact that the competitive fight is often carried by price.

By choosing this strategy, an entity with classical production systems aims to become the producer with the lowest cost in the respective industry. The entity will have a broad competitive purpose, serving many market segments, being able to operate even in related industries.

Economic entities achieve lower cost when they are able to produce their products at a lower cost than their competitors. According to Porter "a cost leader must achieve parity or proximity in the bases of differentiation relative to its competitors to be an above-average performer, even though it relies on cost leadership for its competitive advantage" [1, 13].

The cost management is a strategy containing a number of procedures which is made to manufacture goods having some characteristics with the aim of satisfying customers' needs in terms of quality and price but at the same time produced at lowest cost than firm's competitors. Cost leadership as a strategy allows the economic entity to be a low-cost producer and thus making more profits than rivals due to low costs of production and economies of scale.

Cost supremacy involves identifying and exploiting all sources of cost advantage. The producers with the lowest cost, sell a product or base their cost advantages on collecting absolute costs from all possible sources. If an economic entity manages to achieve and sustain the overall cost of leader, it will achieve performance above the average in its industry and will be able to impose prices at the industry level. At prices equivalent or lower compared to those of the competition, the position of leader with minimum costs results in higher profits. In the specialized literature it is stated that in order to minimize the cost of the manufactured products, the economic entity frequently acts to maximize the production in order to obtain the savings related to mass production, or large series. Other modalities are considered, such as: preferential access to certain raw materials, major technical innovations, factors that cause decreases in the production cost etc.

According to Porter [1, 73] once low cost has been achieved, the position provides high profit margins which can be re-invested in new equipment, modern facilities and technology to maintain the cost leadership.

Pearce and Robinson [19] considered that this strategy can be executed successfully by using superior management techniques, concentrating on cost saving opportunities, minimizing waste and not adding values which customers regard as unimportant to the product and thus they are not willing to pay for that.

The successful use of the cost leadership strategy requires the organization of the activity and the concentration of financial accounting information on cost centers. In this situation, the following aims are:

- determining the activities and the areas that generate costs, respectively those areas where resource consumption takes place;
- establishing responsibilities for each type of activity;
- more efficient organization and administration of the general activity of the economic entity;

- consolidating the internal decision-making process.

The option of an entity aimed at choosing the cost leadership strategy is determined by the prospect of acquiring advantages such as:

- achieving higher revenues than the average registered across the entire industry, because those producers who obtain goods or services at lower costs than those of competition have the opportunity to use this cost advantage to determine a higher profit margin;
- occupying a position that outweighs the competitors and which results from the possibilities to compete offensively, based on prices for extending the activity on the covered market segment and to defend itself in the event of a "price war";
- obtaining a safe profit margin in front of strong customers, because their pressures to lower prices can be exercised only up to the survival level of the next competitor on the market;
- adopting an offensive attitude, also in relationships with strong suppliers. The greater efficiency that the entity achieves will give it a wider range of price negotiation in the case of raw materials, materials, energy purchased;
- gaining a strong position, in relation to the potentials entered on the market, because the reduced costs constitute a strong entry barrier for them, but also a weapon to counteract the imbalances that a new entrant can create on the market;
- the possibility of using the price reductions as an effective competitive weapon, in order to defend against the substitution products or services offered by the competition at attractive prices.

Choosing the strategy of cost domination forces the entity to find those areas that can be potential sources of savings, respectively cost reduction. M. E. Porter considers that the relative cost position of an entity is dependent on the "major cost driving forces". “The driving forces of cost are the structural determinants of the cost of an activity, and they are differentiated by the degree of control that a firm exercises over them. The driving forces of cost determine the behavior of costs within an activity, reflecting any relationships or interdependence that influences it. The cost performance of a firm in each of its separate activities is aggregated to determine the relative cost position of the firm.” [20, 70] In addition to these factors, P. F. Drucker attaches major importance to the quality of information. “The biggest problem that we will continue to face is getting the right external information to make the right decisions. This depends on the internal market, the changes that have taken place at the level of customers and distribution channels” [21, 60].

The factors that M. Porter considers decisive in gaining the cost advantage are: economies of scale, learning, the pattern of capacity utilization, the connections, the relationships of interdependence, the integration, the coordination in time, the discretionary policies, the location and the institutional factors.

In other words, we can consider that the main factors that contribute to reducing costs are:

- the results obtained from the experience and the transfer of knowledge that the entity has benefited in each activity;
- reduced production costs due to the rigorous control of the resources used in the manufacturing processes;
- the degree of integration that influences differently from one industry to another;
- the degree of use of the production capacities;
- the moment of entry into the industry. Old age can bring advantages, such as notoriety, training effect etc., but it can also be followed by disadvantages such as the need to find suppliers, train distributors, customers etc.;
- privileged access to some resources that are offered at attractive prices;
- relations with the institutional partners (government, trade unions, public power etc.) that are inaccessible to other competitors and which allow the achievement of important economies such as: financial exemptions, the absence of social conflicts, good prices etc.

The cost advantage can be created and maintained in two ways:

- by rigorous control of the use of cost instruments compared to the achievements of competition, which means identifying all sources of cost reduction and taking appropriate measures in this regard;

- by re-analyzing the structure of the chain activities-costs in order to determine the substantive corrections necessary to achieve a significant reduction of the cumulative costs.

"Modern cost management research has focused extensively on the "production" portion of the value chain. Although studies are predominately conducted in manufacturing settings, even studies of service firms tend to focus on the physical aspects of the delivery of service (health care management, passenger air travel). The cost management literature developed in parallel with advances in modern manufacturing, including technological advances (flexible manufacturing systems) as well as advances in the organization and management of operations (quality management, inventory management, cell manufacturing and team production)" [22, 184].

In the strategic cost analysis it is necessary to go through several stages that involve: identifying the activities and sub-activities generating expenses, establishing the factors that act on the costs, determining the costs of competition, identifying the elements of differentiation of own costs, those of the other producers, outlining the strategic directions in order to reduce costs, implement and verify the strategy. The most widespread ways of achieving cost savings are related to material and salary expenses (with staff).

If we refer to capital as a factor of production, a first package of measures to reduce costs concerns the costs of materialized labor. In this case, it is possible to act in the following directions:

- use of raw materials, materials, fuel, energy, etc. which are abundant and cheaper;
- promotion of new or modernized manufacturing technologies;
- reorganization of technological processes;
- redesigning the products already manufactured in order to reduce the consumption of resources or designing new products that require a lower consumption of materials;
- reassessment of consumption norms and / or elaboration of new norms, and monitoring of the integration of consumption, in these norms;
- finding ways to reduce the number of rejects or to revalue them;
- improving the organization of the activity of supplying, producing and selling, of the resulting goods and services;
- increasing the turnover rate of working capital;
- the purchase of machines, efficient installations, so as to reduce the expenses with repairs;
- the intensive use of the production capacities that leads to the decrease of the depreciation rate that returns to the product;
- the purchase of some machines at advantageous prices, but which correspond technically;
- avoiding overloading, or underutilization of equipment.

Acting, in order to reduce labor costs as a factor of production, we refer, in particular, to ways of increasing labor productivity.

An essential condition for the entity's "health" is that the rate of labor productivity growth exceeds the rate of wage growth. Wage cost reduction methods include:

- increasing the technical level of production that is achieved by introducing automation, new technologies in the manufacturing processes. In this situation a higher output is obtained with the same labor cost and with implications on the reduction of the other expenses;
- improving the training system of human resources. It is envisaged the hiring of personnel with an appropriate qualification, the permanent evaluation of the personnel, the organization of qualification courses, retraining etc.;
- promotion of a competent management whose effects are found in the improvement of the management of the economic activity, in the intensive use of working time, capital, production capacities. Improving the organization of the production also refers to the improvement of the organization of work, which involves the adoption of measures aimed at reducing the volume of work; organization of jobs; production scheduling and operational control; launching new products into manufacturing and developing existing ones; the efficiency of auxiliary and service

activities; improvement of the basic activity of the entity etc.;
- ensuring the material co-interest of the employees by creating a reward system in case of special results, on the line of exceeding the working norms, of producing quality products etc., granting bonuses for additional hours worked, in night shifts or during the rest periods allowed by the law, the granting of facilities for spending the rest leave consisting of obtaining low-fare tickets at rest and treatment stations, granting holiday bonuses etc.;
- increasing the quality of working conditions and the social climate within the entity.

The improvement of the technical-material supply activity represents a way of reducing the cost, which can be materialized by:
- resizing of stocks of raw materials, materials;
- rationalizing the activity of deposits;
- simplification of the supply program;
- shortening of distribution channels;
- establishing firm contracts with suppliers that respect the quality of the products.

The reduction of sales expenses, has contributions in minimizing costs through:
- organization of its own network for the sale of goods;
- development of service activity during the warranty and post-warranty period;
- hiring qualified personnel in the field;
- establishing a well-founded marketing policy.

The administrative-household expenses, being considered constant conventional expenses, can be reduced mainly by increasing the volume of production. Their contribution to reducing the cost of production can be determined by:
- resizing administrative staff;
- reduction of office supplies.

Considering the importance of the sources of the cost advantage, the areas of cost reduction are summarized in the table no. 1.

Table no. 1
Tools used to achieve the cost advantage

AREA OF ACTION	INSTRUMENTS/TOOLS USED	EFFECTS
Material resources used	- decrease of consumption of raw materials, materials, fuel, energy, water etc. - the use of cheaper new or unconventional resources.	- changing the ratio between material and wage resources - reducing total costs and prices; - gaining new market segments, increasing market share.
Work productivity	- the qualification, retraining and improvement of the labor force; - ensuring rhythmicity in supplying jobs with production factors; - increasing the degree of organization and discipline of the work.	- increasing productivity per worker and per unit of time; - reducing costs and implicitly increasing profit; - increasing net profit.
Production resulted	- introduction into the manufacture of new products; - redesigning and modernizing the existing production.	- improving the quality of the products; - reducing the expenses resulting from non-quality.
Production capacity	- increasing the production capacity; - increasing the degree of utilization of the production capacity.	- increasing physical production; - increasing the total costs; - reducing unit costs and costs to 1000 m.u. turnover; - lowering the costs of sub-activity.
Quality of production	- reorganization and improvement of the quality management of the material and human resources, of the processes of the	- increasing the costs of prevention and identification of defects; - reducing the costs generated by non-

AREA OF ACTION	INSTRUMENTS/TOOLS USED	EFFECTS
	scientific research	quality; - increasing the quality of the products.
Implementation of technical progress	- improving the ways of capitalizing on the company's resources.	- increasing physical production; - decrease of specific consumption; - profit growth.
Management activity	- the operative monitoring of the expenses generated by places of activity and by types of expenses, the monitoring of the deviations of the registered expenses compared to the forecast level and the identification of the causes that generated these deviations; - the use of cost information in the decision-making process based on the detection of the relevant, inevitable costs and by analyzing the opportunity and investment costs.	- identification of the factors that determine the increase of costs; - relative and absolute savings in the cost structure; - elimination or maintenance of some products.

The cost leadership strategy, besides a number of advantages, also presents some obvious disadvantages:

- exerting a pressure on the financial resources of the economic entity that plays an essential role in introducing technological innovations in order to significantly reduce production costs, abandoning existing equipment and technologies when more efficient ones appear;
- making massive investments in technologies, when the preferences of buyers are oriented towards products or services with new features offered by competitors, which implies the risk of strategic inflexibility;
- the loss of the advantages and the efficiency gains generated by the previous investments, at the moment of the technological changes made in order to reduce the costs;
- exclusive focus on ways to reduce the costs of production and neglecting the changes produced in the preferences of consumers regarding the quality of products or services, the methods of use, reducing the elasticity of demand in relation to the price etc.;
- the exclusivity of applying the strategy, given that, in the competition of acquiring the position of producer at the lowest cost in the entire market, several economic entities are involved. For this reason, the competition is very intense.

Conclusions

The profit prospects opened by the implementation of this strategy materialize only for the entity that manages to win in the competition and to become the leader in the market in terms of costs, which is likely to determine the other competing companies, to abandon the respective strategy.

In the economic practice, research undertaken, highlights some difficulties in identifying the function that express correctly the relationship between production size and the unit cost of production. Deterministic models have limitations in this regard because they do not capture the dynamic of regular production factors influence, on the cost of an activity: the variable structure of the production, different wear of the equipment, high variance of commodity prices, the different workload of the work places etc.

As an inconvenience, it highlights the fact that subordinating the activity size only to reason of cost or price it is difficult to decide on a strategy (development or collapse) in order to achieve objectives.

However, in the total of internal information necessary for decision making, cost information has a special place, because on its basis shall be taken decisions on [23, 53]:

- The estimation of production volume (and therefore its structure) to achieve a certain profit, considered realistic, or practical option of estimation of the profit for a certain volume of production considered achievable, in the analyzed period;
- Setting the selling price of products;

- Acceptance or rejection of occasional orders;
- The extent of investments or the implementation of new technologies;
- Choosing to cooperate with other organizations to manufacture a product, or manufacture the entire product by its own forces;
- Diversification of the organization activities, regarding even the vertical integration.

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