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Strategic cost management and performance: The case of environmental costs

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ABSTRACT

Despite recent developments in the stream of research devoted to strategic cost management (SCM), there are limitations found with this research, notably the overemphasis on one component of SCM (executional cost management), the underemphasis on the other component (structural cost management), the insufficiency of links between those two components, and the absence of evidence supporting their link with performance. The aim of this study is to examine the relationship between both components of SCM, and financial performance. Two main research questions are investigated: (i) To what extent do executional and structural cost management influence financial performance? (ii) To what extent does structural cost management mediate the link between executional cost management and financial performance? In order to examine the link between SCM and performance, one specific context is investigated, namely environmental costs. The environmental costs reflect an 'executional' aspect aimed at managing, controlling and optimizing costs for a given environmental strategy, but also a 'structural' aspect based on their influence on the firm's cost structure notably in terms of product design, raw materials used and operational process design. Survey data have been collected on a sample of 319 Canadian manufacturing firms to examine the link between SCM and financial performance.

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1. Introduction

In the current business environment characterized by intense competitive pressures, organizations need to implement strategies to manage costs and reduce these costs not only on a short-term basis, but also over the long term (Nimocks, Rosiello, & Wright, 2005). Strategic cost management (SCM) is the deliberate alignment of firms' resources and associated cost structure with long-term strategy and short-term tactics (Anderson & Dekker, 2009a). It represents one aspect of a larger stream of research devoted to strategic management accounting (i.e., Bromwich, 1990; Cadez & Guilding, 2008; Lord, 1996; Roslender & Hart, 2003). Drawing on the work of Shank and Govindarajan (1992, 1994) and Tomkins and Carr (1996), Anderson (2007) describes two forms of SCM: (i) structural cost management, and (ii) executional cost management. Both have always been central to profitable firms (Anderson & Dekker, 2009b).

Structural cost management refers to the cost management activities aimed at changing the cost structure of the firm. It includes organizational tools, products and processes designed to build a cost structure that is coherent with strategy. It

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basically refers to the strategic decisions that typically define the gross parameters of the firm's cost structure. *Executional cost management* refers to the cost management activities aimed at improving performance for a given strategy. It is based on common management accounting tools used to measure cost performance in relation with competitive benchmarking used to identify improvement opportunities. It basically refers to the analysis of performance following strategic decisions. In other words, the purpose of SCM is to align a firm's resources and associated cost structure with: (i) short-term tactics through cost reductions (executional cost management), and (ii) long-term strategy through the re-engineering of the value chain and production of a different cost structure (structural cost management).

Despite the recent development in the stream of research devoted to SCM (Cugini, Caru, & Zerbini, 2007; Hsu & Qu, 2012; Nicolaou, 2003), there are three significant limitations associated with this research. First, this stream is narrowly focused on executional cost management whereas the structural cost management knowledge is developed mainly outside the scope of accounting research (Anderson, 2007). Most accounting studies address issues related to executional cost management, such as cost allocation (e.g., allocation of overhead and joint cost, cost driver analysis, activity-based costing, etc.) and cost accounting (cost variance, use of cost information for decision-making, etc.) (Hesford, Lee, Van der Stede, & Young, 2007). On the other hand, few studies address issues related to structural cost management, notable exceptions include recent studies examining target costing (e.g., Dekker & Smidt, 2003; Kee & Matherly, 2006; Yasukata, Yoshida, Yamada, & Oura, 2013) and interorganizational cost management (e.g., Agndal & Nilsson, 2009; Fayard, Lee, Leitch, & Kettinger, 2012).

Secondly, the stream of research devoted to SCM does not establish a sufficient number of links between the executional and structural cost management dimensions, and thus fails to create a unified body of knowledge (Anderson, 2007). Hence, although there is a need to examine structural cost management more intensively, this examination should not neglect executional cost management in order to prevent the results from being incomplete or spurious effects. Hence, there is a need to examine simultaneously both components of SCM to shed light on their mutual dependencies.

Thirdly, although various claims have been made promoting the benefits of SCM (Aluko, Mayhall, Wauquiez, & Vercio, 2010; Cooper & Slagmulder, 2003; Freeman, 1998; Wong, 1996), and despite the empirical investigation of the impact of executional cost management activities on the effectiveness of cost management systems (Cohen & Kaimenaki, 2011; Hughes & Paulson Gjerde, 2003; Nicolaou, 2003; Schoute, 2009), limited empirical evidence has been provided to support the impact of SCM on financial performance. More specifically, in the executional cost management literature, the empirical evidence supporting the link between cost-system design and financial performance is limited and conflicting (Lee, 2003; Pizzini, 2006). For instance, past research related to activity-based costing have provided mixed empirical results (Gosselin, 2007; Maiga, Nilsson, & Jacobs, 2014). One possible explanation is the absence of structural cost management within the model developed and tested in past studies. Not only does structural cost management have the potential to influence financial performance (Anderson & Dekker, 2009b; Cooper & Slagmulder, 2004), it could also potentially intervene in the relationship between executional cost management and financial performance. In fact, the basic management accounting tools used to measure cost performance (executional cost management) might provide the necessary cost knowledge in order to proceed to the re-engineering of the value-chain and the production of different cost structures (structural cost management) leading to financial performance.

Our goal is to contribute to the growing SCM stream of research and we specifically intend to address these three limitations. More specifically, the aim of this study is to examine the relationship between SCM, in terms of both executional and structural cost management, and financial performance. Two main research questions are investigated: (i) To what extent do executional and structural cost management influence financial performance? (ii) To what extent does structural cost management mediate the link between executional cost management and financial performance? In order to provide answers to those questions, a conceptual model has been developed and survey data have been collected on a sample of 319 Canadian manufacturing firms. Structural equation modeling (SEM) is used to provide empirical support and test the conceptual model.

To examine the link between SCM and financial performance, one specific context is investigated, namely the environmental costs. Typically, environmental costs represent an important portion of the operating and manufacturing costs, notably for manufacturing firms (Parker, 1999). For instance, Canadian firms invest approximately nine billion dollars each year on the protection of the environment (Statistics Canada, 2010). For the European Union, the total environmental costs represent more than forty-five billion Euros (Roewer, 2008). Considering the importance of environmental costs for organizations, it is not surprising to observe that CEOs worldwide consider the reduction of these costs to be an important sustainability driver (Aschaiek, 2012).

The environmental costs have been chosen to examine the strategic cost management approach for three main purposes. First, it is now commonly recognized that environmental issues are an important part of a firm's strategy (Hart, 1995; Porter & Van der Linde, 1995b; Russo & Fouts, 1997). Therefore, there is a need to examine environmental costs at the strategic level and not only at the operational level. Second, environmental costs reflect an 'executional' aspect aimed at managing, controlling and optimizing costs for a given business and environmental strategy, but also a 'structural' aspect based on their influence on the firm's cost structure notably in terms of product design, raw materials used and operational process design. Third, past research devoted to environmental cost accounting is predominately comprised of descriptive or prescriptive studies (e.g., Cortez & Penacerrada, 2010; Epstein & Birchard, 2000; Letmathe & Doost, 2000; Rannou & Henri, 2010) and suffers from a lack of empirical evidence (Bouma & Van der Veen, 2002; Burritt, 2004).

In sum, this study contributes specifically to three accounting streams of research, namely (i) strategic cost management, (ii) environmental management accounting, and (iii) cost accounting. First, as previously mentioned, the strategic cost

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