

Do the right thing

Cost management accounting can give companies a competitive advantage, writes *Andrea Pawlyna*

Using the right management techniques can often mean the difference between success and failure for a company. While multinational companies often employ these methods, several Hong Kong based operations choose not to. However, with global trends moving towards the application of management techniques, Hong Kong accountants have to be aware of the latest tools.

Known by an alphabet soup of acronyms and abbreviations, Lean, BSC (balanced score card), ABC (activity-based costing), TOC (theory of constraints) and Six Sigma represent the ultimate in modern management methodology.

The Hong Kong Productivity Council (HKPC), a non-profit organization that promotes productivity and the use of more efficient business methods, stresses that many local companies and accountants are losing out by neglecting these management techniques.

HKPC's general manager of finance Sam Law says: "SMEs are more focused on sales but when they get to a certain stage where their operations become more mature and they are competing internationally, that is when they would use these tools.

"Any company operating in a competitive and complex environment should have a tool that focuses on how well or badly the company is doing as a whole and whether it is heading in the right direction provided by their strategy."

Each methodology has a formula for improving a company's performance, profit or efficiency and each relies on accountants to supply the required data and translate those numbers into dollars and cents. As good corporate governance is regarded as a public sign of a company's business practices, these systems may provide a similar signal about a firm's overall quality.

"They can be seen as a kind of quality endorsement," says Jackson Yeung, chief executive officer of process consulting firm CFO Solutions Ltd.

While a growing number of companies in Hong Kong are embracing the use of management tools and techniques, many other companies are unfamiliar with what these systems can offer, with different methods focusing on alternative ways to business success.

BSC has a broader scope than the rest and provides managers with a comprehensive overview of how their business is performing. Developed in 1992 by Robert Kaplan, of Harvard Business School, and his colleague David

Norton, it builds upon key concepts of previous management ideas such as Total Quality Management.

Balanced score card

BSC is the management tool of choice at the HKPC and looks at a business from financial, business process, efficiency and learning and growth perspectives. "Because of our unique situation as a non-profit organization, we have added a fifth element – public mission which is indirectly reflected in terms of satisfaction of services provided," says Law.

BSC is among the techniques that HKPC uses for corporate performance appraisals because it can measure down to the lowest level of corporate performance, which in HKPC's case are units that can consist of several people. Financial figures and non-financial data, such as project completion statistics and customer satisfaction surveys, are input into a computerized programme.

"We run the programme every month and we have a score for each unit, which is used to calculate its performance. This score partly affects the performance of staff, who are appraised annually," Law says.

With BSC, the HKPC functions in a focused way. "We are not financially driven so the traditional P&L doesn't



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help us. We have a public mission role which is difficult to measure, but BSC allows us to measure our financial as well as our non-financial performance.”

Other techniques are more specifically aimed at improvements in efficiency and quality. In its training courses, HKPC advocates, among other tools, both BSC and Six Sigma.

Six Sigma and TOC

A measure of quality, Six Sigma is a disciplined, data-driven approach that can be applied to any process - from manufacturing of products to provision of services.

Six Sigma focuses on errors or defects. “If you reduce those errors (for example, returns on defective products), theoretically you would be able to improve the bottom line,” says Edmund Lee, associate director of the performance improvement practice at PricewaterhouseCoopers (PwC).

By comparison, TOC, developed by Israeli physicist Dr Eliyahu Goldratt, is a management philosophy based on the premise that a company is only as sound as its weakest link, or constraint.

TOC seeks to identify bottlenecks and to find ways to eliminate them to generate more throughput, says William Law, Hong Kong-based

regional director of the Goldratt Group, which is a consultancy and distributor of TOC-based learning materials.

Identifying the weakest link is a never-ending process. “Once you eliminate one constraint, you find the next weakest link and so on. The beauty of this is that you are focused on one link at a time. Before you eliminate one constraint, there’s no point in spending time, energy and money on the next one as such actions do not generate any throughput at all,” Law notes.

An extension of TOC is its “Viable Vision” concept, which offers a set of strategies and tactics for an enterprise to achieve within four years a net profit that equals its total current sales. “Viable Vision is the joint application of all TOC components like operations, distribution, finance, measurements, marketing and sales,” says Law.

Lean and ABC

Inspired by the Japanese concept of continuous improvement, the Lean technique refers to “manufacturing without waste.” With its systematic commitment to ending waste, simplifying procedures and speeding up production, the idea behind the concept is doing more with less.

Meanwhile, ABC, a type of cost accounting, was developed in the U.S. manufacturing sector in the 1970s. This accounting technique allows an organization to objectively determine the actual costs of production and related services. By so doing, management can identify high overhead costs and then find ways either to reduce costs or to charge more for products.

The three most commonly employed management tools in Hong Kong are Lean, TOC and Six Sigma, according to Yeung. “What companies need to do is match the tools to their business,” he says. “It doesn’t matter how big or small a company is for it to benefit,” he adds. Some firms rely on a single system, while others may combine two or more.

As for which system stands out the most, no one is willing to hazard a guess. The consensus is that each method has useful applications for businesses. “We don’t want to score these systems. From an accounting point of view, each one has different strengths to help companies manage themselves better,” says Yeung.

“It’s all about awareness. A client may say they want to increase their profits by using TOC. Accountants should know what to say about that,” he says. **A+**