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May 1999

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Target Costing Best Practices Report

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The AICPA, The University of Akron and the Consortium for Advanced Manufacturing-International have funded the Target Costing Best Practices Report. This unique project brought together academics and industry practitioners to study how and why companies implement target costing.

Japanese companies have used target costing as a strategic weapon for nearly 30 years. In contrast, only a handful of U.S. companies have used target costing for any length of time. U.S. companies are increasingly interested in learning more about this powerful tool for managing costs in highly competitive market environments. The sponsors' objective in implementing this study was to help U.S. companies understand and implement target costing by documenting best practices in this area.

The best practices study has two parts: a survey sent to more than 1,500 individuals including 324 companies that were selectively targeted because of their adoption or known interest in the subject and site visits to selected U.S. and Japanese companies (one day per company).

Survey Results

The survey had three purposes. First, recognizing that very few U.S. companies use target costing, we wanted to understand factors that differentiate adopters from non-adopters. Second, we wanted to understand the reasons for non-adoption and the barriers for improvement. Finally, we wanted to identify companies that seem to be furthest along in using target costing as candidates for site visits.

The survey found that adopters and non-adopters differ on nine dimensions.

Like Japan, early target costing adopters in the U.S. tend to be in fabrication and assembly industries that rely on skilled and

trained manpower for production. Surprisingly, there are some adopters in the process and service industries at this early stage.

Adopters face customers who are significantly more sophisticated and knowledgeable about what exists in the market and what their needs are.

Adopters place more importance on beating their competitors to market with new products, providing more and better features, providing more reliable, longer-lasting products and providing the lowest-priced products.

There are cultural differences between adopters and non-adopters as well. Adopters value teamwork and continuous improvement and are more willing to solicit and implement employee suggestions. They also are more likely to use innovative, strategic management processes, activities and tools than non-adopters.

Adopters use tools theoretically associated with target costing such as Multi-year Product and Profit Planning, Design to Cost, Design for Manufacturability, Total Quality Management, Benchmarking, Value Engineering, Competitor Cost Analysis and Quality Function Deployment (in descending order).

Adopters make significant use of cross-functional teams.

Adopters have significantly closer working relationships with their internal and external value chain. The various functions within a business work together closely and adopters seek more input from dealers and resellers and coordinate product and process design with suppliers.

Adopters develop systematic and serious cost estimates during product concept and design stages more often than non-adopters and also include more of the life cycle cost elements in their estimates.

Adopters are significantly more customer-focused than non-adopters. They seek more customer input during the product design phase, collect data using formal methods, analyze customer needs and make the information available widely throughout the organization.

The most important reasons for not adopting target costing are (a) facing more pressing business problems, (b) lack of familiarity with it and (c) its perceived irrelevance. Adopters report the biggest barriers to improving target costing are insufficient resources to implement and lack of rewards for achieving targets (while missing targets is viewed negatively).

Site Visits Results

The main purpose of the site visits was to supplement survey results with an in-depth look at best practices in the U.S. and Japan. We have isolated fourteen important attributes shared by target costing best practice companies.

* Top management support is a critical success factor in implementing target costing.
* Target costing is part of a company's culture. The exception to this was at Boeing where it was part of the project team's culture, but not the overall company culture.
* Best practice companies tie target costing to strategy and profit planning. It provides the assumptions and plans for product planning and delivery and establishes a cohesive product realization process throughout the organization.
* All best practice companies have a high level of accountability and monitoring of target cost achievement. Targets are taken seriously and best practice sites have reporting structures for monitoring progress against targets. Many maintain discipline by not letting teams cross-subsidize targets.
* The process by which cost targets are set is relatively consistent among the best practice companies. The targets are heavily influenced by market conditions and some variation of the following formula: Market price + profit margin = target cost. Initially, senior management establishes high-level cost targets for its products or programs.
* Best practice companies have a systematic process for decomposing higher level targets to the various functions, processes, parts and teams. All of them set targets that are achievable at a reasonable "stretch." One company described this as setting targets that provide "equal challenge" to all participants.
* Targets are never ignored or explained away. Generally, when targets cannot be met, companies revisit material composition, customer requirements, current production processes, supply chain options, product redesign, or as a last option, product abandonment.
* When technology is a limiting factor in achieving targets, best practice sites use the capital budgeting process to invest in enabling technology that can close the gap between current and target cost.
* Best practice sites, in general, have close supplier relations. In Japan, purchasing is often where target costing begins. U.S. companies are working on supplier integration. They seem more reticent about sharing cost data or cost savings with suppliers.
* Cross-functional teams are critical to the success of target costing. They must be independent and empowered to acquire resources from functions.
* Target costing is not tied to supportive performance measures, rewards, training and information systems. Japanese companies are generally ahead of the U.S. companies in this area. The latter have paid little attention to linking target costing with the whole system architecture.
* There is no unique implementation path. In Japan, the typical implementation starts in purchasing and process Kaizen in the plant. It is later moved to product design. In the U.S., there has been greater effort to do concurrent product and process design early in the implementation.
* A key enabler of target costing is the use of sophisticated cost estimation models. These models convert the old static cost tables into a dynamic cost planning tool by using sophisticated cost analysis (CA) codes. CA codes allow companies to organize cost data by parts, units and products according to name, function, shape, size, weight, assembly method and type of raw materials. Japanese companies are ahead of their U.S. counterparts in this area.
* Another critical enabler is a solid understanding of cost concepts by all employees. Most engineers and designers are not trained in cost accounting. Best practice sites make costs visible and understandable to product designers and engineers through internal training and education.

In conclusion, target costing is relatively new to the U.S. It is adopted in response to extreme pressure on profit margins. None of the best practice site visits implemented target costing as a "must have" best practice initiative. Most U.S. companies that report doing target costing are not really following the major tenets of target costing or using many of its critical tools. Companies that have used target costing well have reaped significant benefits. In Japan, we saw target costing yielding as much as 13-17% savings per year. In the U.S. Daimler Chrysler has achieved a remarkable financial comeback. Even companies that have partial implementation of target costing report benefits such as improved profits, more customer focus, better cost planning and control and better teamwork in their value chain.

For more information, contact Peter Zampino at CAM-I, 817/860–1654 ext. 145 or Dave Schwendeman at Boeing, 425/237–5682.

NEW! 1999 AICPA Controllers Workshop

The AICPA is proud to announce its first controllers workshop. This workshop goes beyond technical instruction, preparing you to become the New Finance Professional who combines expertise in creating business development and the key competencies to implement them. The 1999 AICPA Controllers Workshop is being held from July 15-16 at Caesars Palace in Las Vegas.

You'll be in a highly interactive setting that will engage, inspire and stimulate. Energize yourself with new ways of thinking under the expert guidance of noted specialists. Revitalize your business mindset as you equip yourself with new knowledge to become an innovator and solid business leader for the 21st century.

Hear from some of the leading authorities in the field, offering their extensive business experiences and vital insights to guide you in generating new approaches for different challenges. Keynote speaker Steve Taylor, Senior VP-Finance, Paramount Pictures, will talk on mission and motivation. Paul McDonald, West Coast District Director, Robert Half International, Inc., will address career development and core competencies. Take advantage of the learning opportunities at the 100-minute mini-workshops and 200-minute in-depth workshops designed to provide you with a superb, practical learning experience.

Our total workshop package includes the perfect setting to unwind and enjoy your leisure time. Las Vegas, a premier vacation spot, has all the fun and excitement within easy reach. Ritzy shopping malls and world-class restaurants vie with the smorgasbord of entertainment in this gambler's paradise.

Receive 19 hours of CPE. Register by May 31, 1999, and save $150. Seating is limited at this interactive workshop.

For more information or a conference brochure, contact the Member Satisfaction Center.

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Y2K Critical Dates to Watch in 1999

By Wayne Harding, CPA

Y2K failures are already causing problems that are no longer simple annoyances. According to a recent study of 114 Fortune 500 companies by Cutter Information Corporation, in 1998, 40% reported technology breakdowns and 70% of those breakdowns caused financial miscalculations for the third quarter.

As January 1, 2000 draws closer, it is expected that these problems will multiply. But the question remains: Just how bad will it be? No one can say in exact terms; however, we can look ahead to anticipate possible problem times.

Here are the dates to monitor and the reasons they are important:

January 9, April 9, September 9 and December 31, 1999: These dates are known as "program trigger dates." They are significant because they contain the numeral nine or 99. Some programmers used 99 within date fields to signify something different from a date; such as end of file or end of routine. Some programs count the number of days into a year for calculations—not the month and date.

As of this writing, nothing unusual had occurred on January 9 or April 9, which could be good news for the remainder of the "program trigger dates," but don't bet on it. Continue with your contingency planning.

Not only is December 31, 1999, a programming trigger, but, if problems occur, almost all will take place on or before 12:01 a.m. January 1, 2000. Some countries will experience problems before others because they are in different time zones. Therefore, early in the morning (in US time zones), we can watch what happens in countries just to the west of the International Dateline. Trouble in New Zealand, the Philippines, Asia and Australia could indicate potential problems in Europe, Africa and in the United States, Canada, Central and South America.

Someone in your company should be assigned to monitor international ramifications. Updates can then be passed along to the head of the Y2K contingency team.

April 1, 1999: If companies are on a fiscal year, they are usually on a calendar quarter. March 31 was the first time that books were being closed and new budgets being set that incorporate the year 2000. Further, the State of New York is on a March 31 year end.

July 1, 1999: On this day, 44 states begin a new fiscal year.

August 22, 1999: Some earlier versions of the Global Positioning Satellites could fail. GPS satellites must have accurate time calibrations to function. The earlier satellites counted the number of Mondays from launch date.

January 10, 2000: This is the first date that has a nine-character date field.

February 29, 2000: The rule is that century dates are not leap years UNLESS the century is divisible as an integer by 400. Therefore, 2000 will be a leap year.

October 10, 2000: This will be the first date that has a 10-character date field.

Once we have safely passed these dates, we can take a breather and enjoy our venture into the 21st century!

Wayne E. Harding is Vice President and General Manager of Hosting Services at Great Plains Software. Mr. Harding serves on the AICPA Information Technology Practices Subcommittee and chairs the High Tech Task Force. Mr. Harding's articles are published in numerous professional journals, magazines, and newspapers. This material is adapted from a Tech Alert issued by the IT member section, 212/596–6211.

New NAICS Codes for Business

As mentioned in the April 1999 edition of *The CPA Letter*, new codes have been created under the North American Industry Classification System. This new coding system replaces the old SIC codes and was developed by a committee of U.S., Canadian and Mexican authorities to provide new comparability in statistics about business activity across North America.

The following table shows the comparison between the old SIC divisions and the new NAICS sectors:

SIC Divisions — Division Title	NAICS Sectors — Sector Title
Agriculture, Forestry and Fishing	Agriculture, Forestry, Fishing and Hunting
Mining	Mining
Construction	Construction
Manufacturing	Manufacturing
Transportation, Communications and Public Utilities	Utilities, Transportation and Warehousing
Wholesale Trade	Wholesale Trade
Retail Trade	Retail Trade, Accommodation and Food Services
Finance, Insurance and Real Estate	Finance and Insurance
	Real Estate and Rental and Leasing Services
Services	Information
	Professional, Scientific and Technical Services
	Administrative and Support and Waste
	Management and Remediation Services
	Educational Services
	Health Care and Social Assistance
	Arts, Entertainment and Recreation
	Other Services (except Public Administration)
Public Administration	Public Administration
None (previously, categories within each division)	Management of Companies and Enterprises

NAICS United States provides 1,170 detailed United States industry classifications, a 15% increase in total classifications compared to those available under the SIC. NAICS United States also replaces or revises some 60% of the previously available SIC industries. It provides 358 new industries the SIC did not identify, 390 that are revised from their SIC counterparts and 422 that continue substantially unchanged. The result is expanded and revised industry classifications that mirror businesses in our modern economy.

For more information, visit the NAICS Web site:

www.ntis.gov/naics