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PROS AND CONS FOR THE IMPLEMENTATION OF TARGET COSTING METHOD IN ROMANIAN ECONOMIC ENTITIES

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ABSTRACT

The article looks at the pros and cons for the implementation of Target Costing method in Romanian household appliances manufacturing entities, based on its specific principle. Based on recent results obtained by experts in this field and taking into account the specific aspects of the Romanian economic entities, among the topic's pursued objectives we enumerate the following: analysis of critical implementation or non-implementation factors related to the Target Costing method and their impact on a company's internal and competitive environment. The research has been carried out through the use of quantitative and qualitative methods, but also through the use of theoretical ideas in the making of the case study. Our research design is focused on theoretical and practical approach of implications arising from issues described in the research questions. After analyzing the critical factors of implementation or non-implementation of target costing method, the results obtained through practical case study demonstrates the possibility of adapting and implementing target costing method in the household appliances manufacturing entities in Romania. Authors' conclusions on this topic highlight the most important arguments for implementing and adapting Target Costing method in Romanian household appliances manufacturing entities, due to its long-term benefits. The benefits of the Target Costing method are reflected by the results of a practical case study conducted in a company acting in this field.

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INTRODUCTION

Domestic and international changes lead to changes in the business policies of manufacturing entities, regardless of the country or continent they belong to. In order to keep up with all changes, entities must be prepared to meet all challenges coming from competitors and clients, thus proving their flexibility in any business environment, whether turbulent or uncertain. Ensuring financial stability also requires adoption and use of an efficient management system. Based on international literature and consultations held with specialists in Romanian household appliances manufacturing companies, the research team turned its attention to the Target Costing method and its implementation. We documented ourselves in respect to the methodology for applying the principles of Target Costing method, based on the different theoretical and practical approaches of management accounting and information restatement specialists, in order to determine the target cost by specialists in the management accounting department.

In this study we started from the need for introducing a costing system that meets the current Romanian economic context and not only. Changes in the economic environment are emphasizing and therefore companies are forced to create an information management system designed to provide protection and the possibility to react to shocks generated by competition. Future managers will need the knowledge and data provided by management accounting and will have to learn its terminology and techniques, but also how to use the information provided by it and their limits. The aim of this article is to demonstrate the possibilities for deploying and organizing management accounting in Romanian household appliances manufacturing entities, according to the principles of Target Costing method.

The objectives are as follows: to analyze pros and cons for implementing Target-Costing method in Romanian household appliances manufacturing entities and to develop the proper implementation process by the deploying team. Theoretically, management is a highly addressed topic in Romania according to principles of Target Costing method, and in practice, both household appliances manufacturing companies and other companies are interested in its organization in terms of roles and information potential, as well as in changing attitude towards responsibilities set at the level of each economic entity and its structures. Costs should be given proper attention, so that managers should not be denied an important control instrument over economic and production activities. Most managerial accounting

methods used belong to the last century, and therefore the need for a modern method to meet managers' information requirements is welcome.

1. THEORETICAL BACKGROUND

The target costing method was carefully investigated by many specialists worldwide, especially by the Consortium of Advanced Management International (CAM-I), whose published results show the actual utility of this method in terms of continuous cost reduction (CAM-I, 1994). We notice remarkable contributions of American universities in cost management (Cooper & Slagmulder, 1997; Broome & Perry, 2002; Kee, 2010), but also European universities conducted advanced research in this field (Lorino, 1994; Ewert & Ernst, 1999; Everaert *et al.*, 2006; Afonso *et al.*, 2008; Tiago *et al.*, 2009; Zimina *et al.*, 2012).

The first reports on the occurrence of Target Costing method date back to the 1930s at Volkswagen, Germany and Marks-Spencer, England, but its systematic application and development is done in Japan, at Toyota, in the mid 1960s and 1990s (Monden & Hamada, 1991; Sakurai, 1992; Tanaka, 1993; Tatikonda & Tatikonda, 1994). The application of Target Costing method both in the United States of America and in Europe occurs in the late 1980s. Since 2000, the method is more extensively studied and applied in Europe, but also in Romania. An intense and well documented analysis of the managerial accounting in Romania is made by a number of specialists (Jinga *et al.*, 2010), a part of which support the use of modern methods, as well as target costing in that getting the information is very useful to the enterprise management (Cardoş & Stefan, 2011), and another part which use target costing method and the strategy based on price in assuring the company's success in the long term (Deac *et al.*, 2010; Man & Fleiser, 2008).

Many studies conducted by specialists (Dekker & Smidt, 2003) show an intense use of Target Costing Method especially in Western countries. In 2003, in the United States of America the studies conducted by the Institute of Management Accountants and Ernst & Young show that 26% of their members were using the Target Costing Method, while companies in Denmark held a share of 50%. In terms of implementation or non-implementation factors or in terms of decision-making there are very few studies. Among these factors there are the following: intensity of competition, industrial affiliation, uncertainty in the business environment or strategy perceived by managers (Ansari & Bell, 1997; Dekker & Smidt, 2003; Hibbets *et al.*, 2003; Swenson *et al.*, 1993). The studies conducted in Germany by Dekker and Smidt (2003) have shown that the adoption of Target Costing method is related to the intensity of competition, and its non-adoption is related to perception in an uncertain environment. The strongest argument for adopting Target Costing method is based on forecasting the clients' demands and

on the competitors' market behaviour. The most negative argument for not adopting Target Costing method is based on rigid targets identified when forecasting the clients' demands and the degree of perception in an uncertain environment, which suggests using the method only as a tool for maintaining competitiveness.

As defined by CAM-I, Target Costing is "a set of management tools and methods aimed to design and plan activities for new products, which provides the basis for controlling subsequent operation phases and which makes sure that the products achieve their goals in terms of profitability throughout their life cycle". (Ansari *et al.*, 1997). The aim of target costing method is to identify production costs for a certain product, so that when it is sold, it generates the desired profit margin. Target Costing focuses on reducing costs of a product through changes in its design, being applied during the stage of designing the product's life cycle. These definitions suggest that the goal of target costs is (1) driven by the market price and desired profits and (2) sought only at the beginning of the product's life cycle. Atkinson and others argue that Target Costing is a cost planning method that focuses on products with discrete manufacturing processes and short life cycles (Atkinson *et al.*, 1991). During the manufacturing of the product's life cycle such companies would gradually improve processes with the Kaizen Costing. Many companies in the USA use standard systems for controlling costs in the manufacturing phase. The emphasis on the Kaizen Costing is much different from other systems. In general, standard cost systems focus on cost control, while the Kaizen Costing focuses on continuous improvement.

The opinion that the aim of Target Costing must be applied at the beginning of the product's life cycle is based on the fact that costs become fixed after a product goes through the manufacturing process. Moreover, reducing the products' life cycle consolidates the assumption that major redesign loses on relevance when a product is manufactured. These two proposals suggest that any attempt to reduce costs in the manufacturing phase is widely unnecessary. While the aim of Target Costing can be easily applied at the beginning of the product's life cycle, there is no conceptual reason for that methodology to not be applied to existing products. In our opinion, Target Costing can also be applied in the phase of manufacturing the product's life cycle.

Due to restrictive definition of Target Costing method, managers may conclude that this methodology cannot be applied to existing products and continue with current and inefficient cost management systems. Other researchers support our view, thus saying that Target Costing can be applied throughout the product's life cycle. Horvath wrote: "Target Costing is only a part of cost management function for a product throughout its life cycle. The set target cost must be achieved, thus meeting the client's requirements, by using various methods to identify cost reduction potential" (Horváth *et al.*, 1993). The Institute of Management

Accounting also advises entities that they can apply Target Costing to new products, including those that are modified. When sufficiently motivated, an entity may change its production technique, which can lead different production and profitability costs. Should managers believe that basic change is possible only during the production phase, then entities may lose significant strategic opportunities. In fact, the introduction of Target Costing approach can rather lead to changing the product than a planned change, thus causing initiation of Target Costing.

2. RESEARCH QUESTIONS

This study explores our attempt to analyze the pros and cons of implementing in Romanian household appliances manufacturing companies the principles specific to Target Costing Method. Carrying out this study on Target Costing method implementation analysis was done at the request of the specialists and managers of home appliances producing companies in Romania, both in the private and state sectors have made available the necessary data to the research team. We tried to find answers to the following research questions:

RQ1: What are the critical factors for implementing or not implementing Target Costing Method in Romania?

Based on studies conducted by researchers in the European Union and the United States of America, but also on data collected from various Romanian companies, related to the implementation of Target Costing method, we have identified some common application problems, as follows:

2.1. Lack of understanding the concepts themselves

In the opinion of many leading international specialists, “Genka Kikaku” - an overall strategic approach for reducing costs – and “kaizen costing”, which is very present in quality literature – meaning continuous improvement of cost reduction, are of Japanese origin. By reducing the products’ life cycles, many specialists find it critical to understand development costs, planning costs and the other specific phases (Choe, 2002). According to the specialists, the Target Costing approach involves a repetition (to reduce the gap between current costs and target costs) and has a strong market orientation.

The term of “target costing” is not limited to accounting (having access to data on costs, accountants have used this approach to implement production changes) and the result is a matrix of correctly designed products that meet client needs at a certain moment, whose prices are correctly set. In opposite, the “cost plus”

approach is faster and does not involve repetition (especially for reducing the gap between current costs and target costs) and does not have a strong market orientation. The term of “cost plus” is only limited to accounting (even if they have access to data on costs, accountants have not used this approach for implementing production changes) and the result is a matrix of over designed products that do not meet client needs and whose prices are incorrectly set. In addition to costs, entities must understand what consumers really want and are willing to pay for. To better understand the target costs calculation, we advocate for the implementation of Target Costing method in early product development stages only if the changes can be done cheaper and easier.

2.2. Team and cross-functional impediments

Based on the conducted studies, we consider that the implementation team and the cross-functional impediments identified in an entity can affect a method’s correct implementation.

According to the specialists, the logical “target costing” approach is very easy, based on continuous communication and information between supply chain partners. In opposite, the “cost plus” approach is based on lack of communication between supply chain partners. The correct implementation of Target Costing employs all key functions in the entity and requires an extended time horizon and commitment. The implementation of Cost plus approach only employs part of the company’s key functions and requires reducing time horizon and commitment. The previous transfer of internal functions to partners or outsourcing may represent risks, due to inability to monitor or control the outputs of the desired function. When these functions are carried out at the manufacturer’s plant, expectations and standards are communicated and understood, but often these communications are lost when the function is transferred to one of the supply chain partners. One way to control this problem is to place one of the producer’s employees in the supplier’s plant, to monitor and assist with the supplier’s activities. Based on the above, the employees will learn faster and will understand costs better, and the company’s management will adopt Target Costing Method as a faster information flow, with more frequent reporting. Most specialists agree that the skills of all persons involved in cost management activities may lead to the development of valuable knowledge (Zsidisin *et al.*, 2003).

2.3. Fear induced by the effects of the impact of implementing the method

In practice, the terms “target costs” and “Lean” represent an attempt to achieve a similar purpose in respect to production implementation, in order to reduce added non-value and irrelevant activities that do not contribute to the value of a product. Two of the most important components of target costs are quality and waste reducing, as they are part of a continuous improvement life cycle. Several authors and specialists with great experience in this field support the use of target cost

calculation together with activity based planning, the analysis of the value chain and of the internal business processes, either combined in a single system or integrated in a management framework. With this combination or integration, all are powerful tools, thus offering a guidance and manoeuvre system in the internal and competitive environment, which can ensure the company's business success. This fear is also generated by the company's internal environment, because employees fear for their jobs due to changes and cost-cutting measures brought by the Target Costing method. This can be overcome through appropriate education and training by the team who implements the Target Costing method, whose main role is to correctly present the implementation process, its importance and to guarantee successful implementation of the method, which also generates security in terms of employees' jobs.

2.4. Details of the production process

According to the specifics of the Target Costing, the designing process must be broken down into components to the lowest level. Any producer should analyze the diagram of the entire production process to its lowest level, even to the bill for materials, in order to find areas for improvement or connections that can be made by removing certain irrelevant components for the production process and for product assembly, by complying its technical specifications, as well as other ways to save a processing stage. These details require direct involvement in the production process, product design and marketing. Theoretically, the concept of target costs is intuitive and simple, but its implementation and execution becomes difficult. The aim of the target costs concept is to make minor changes and not major innovations.

2.5. Insufficiency of accounting data

According to specialists, learning is due to the use of management accounting information systems based on advanced production technology. Thus, learning the Target Costing method and the rapid supply of information have lead to its rapid learning and expansion among companies. Most specialists even suggest adoption of Target Costing method in entities that still use widely less advanced management accounting information systems, as it is a support for learning that includes accounting information on planning, control, production, budgets, forecasts, and performance standards. In this way, the information received helps to improve existing ones, thus achieving and developing a corporate learning system. Below we have described some differences between Target Costing method and the other existing traditional cost calculation methods used worldwide:

- The Target Costing approach may be used in combination/integration with Activity-Based Costing or Balanced Scorecard or other approaches; in comparison with Target Costing there are many Romanian economic

entities which are using traditional management accounting and cost calculation methods (especially standard cost method or variable cost method).

- The new information provided by Target Costing must be tailored to meet the various information needs of managers and include non-financial measures; according to traditional approach, information is tailored to certain information needs required by managers and comprises mostly financial measures.
- According to Target Costing, an entity should know the costs of its own transactions and shares part of the cost information with entities in an open network, working directly with them based on commonly accepted accounting principles between suppliers in the supply chain; according to traditional approach, few entities know the total costs of each product and the possibility of determining the costs of new activities depends on each entity; there is no common agreement on accounting practices in terms of setting costs between suppliers in a certain supply chain.

RQ2: Is it possible to achieve a successful implementation of Target Costing Method in Romanian household appliances manufacturing companies?

Based on the analysis of the critical implementation or non-implementation factors of Target Costing method, we concluded that there are prerequisites for its successful implementation in Romanian entities. Thus, we proceed to the implementation itinerary of Target Costing method, according to its specifics. The steps followed for implementing Target Costing method are the following:

Step 1. Setting the goals of the Target Costing method. The main goals of Target Costing method include: setting the target price, considering costs and processes while designing, setting the target cost, determine the drifting cost and product feasibility, process improvement, implementation and evaluation of long-term effects. The implementation of Target Costing method in terms of integration in the company's management brings some changes as: integration of competencies of the company's various functions: forecast of the effects of current decisions on future results; environment (markets and competition); creation of closer links between planning and control of current activities. Given the specific calculation method of Target Costing, the obtained information reflects a realistic cost permanently adapted to market changes. This way, information end users are satisfied with the accuracy of data provided by the Target Costing method.

Step 2. Set the implementation team and implementation process. The implementation team is appointed by the entity's management and is made up of specialists of the management accounting department and specialists in Target

Costing method. The implementation team consists of five members and a project manager. Initially, the team analysis the following issues:

(1) *Identification of significant influences of Target Costing method on the entity.* We analysed carefully issues related to: possibility of adapting Target Costing principles to the specifics of household appliances entities; identification of possibilities for implementing Target Costing method and implicitly of a good management.

(2) *Establishing the impact on the competitive environment.* The following elements can be considered: evaluation of market needs, completion analysis or the entity's preliminary plans for providing a new or changed product, with certain functions or features. The essence is that entities use Target Costing method for setting their target price on the market based on competitive conditions and long-term prices based on market penetration goals.

(3) *Identification of specific activities and costs of Target Costing method.* According to Target Costing method, the following activities and costs were identified: setting the target price based on market context and competitive environment; setting the target profit margin; setting the estimated cost and the target cost; calculation of estimated cost for estimated products and activities; calculation of target costs, of the amount to reduce costs with; internal reporting and use of information related to target costs; supply of other information on costs in the decisions-making process, in order to adopt effective decisions.

Step 3. Identification of difficulties encountered after completing the two steps and search for future opportunities. Where the two phases were conducted as expected and there were no problems, the other phases will be conducted for the successful implementation of Target Costing method. Then, the objectives are chosen that will be a priority for the new changes required to implement Target Costing method. All set objectives will be transformed in actions aimed to achieve the desired changes in the entity's internal environment: setting much lower costs for manufactured products.

If there were problems after going through the two phases, then the causes of deviations must be discovered. Each stage is carefully analyzed in order to find the causes that have contributed to the problems by using different specific diagnoses. This stage is particularly important because it is the point that can lead to successful implementation or to failing in implementing Target Costing method. We must decide if we continue implementing the method, give up or shift to another method. There can be proposals for amending the existing accounting system, especially if the entity uses a traditional cost calculation system, less flexible to current new changes.

Step 4. Testing the implementation of Target Costing method, by using information provided by it. In this stage, we test the impact of each initiative, action or project, by accounting for all cost reductions resulted from the application of Target Costing and for all income derived from the proper application of its principles.

RQ3: What are the benefits of implementing Target Costing Method in Romania?

The strength of reasons that made us to choose this method is the advantages of Target Costing method. The adoption of decisions affecting the company's financial performance provides a set of information useful for achieving the goals in terms of continuous cost reduction, disclosed cost data required for estimating the financial impact initiatives, such as: mastering the different stages of the products' life; cost analysis starting from product design, depending on their characteristics and possible selling prices; reduction of development costs and ensuring faster amortization; better organization of relationships with suppliers and collaborators; mobilizing and motivating all skills in the company by using a cross-functional approach, which favours greater competitiveness; source of information for other routing management activities, such as: design of processes and products, cost allocation and control, procurement, pricing policies, performance valuation.

3. DATA AND METHODOLOGY

In this study, the research has been carried out through the use of quantitative and qualitative methods, but also through the use of theoretical ideas in the making of the case study. The theoretical part contains information raised from literature and books that deal with the implementation of Target Costing method in some industries. The case study was conducted on the basis of data supplied by the household appliances producing company from Romania, on the analysis of micro and macro economic environment existing in Romania. Studies based on questionnaires on the implementation of Target Costing method for cost reductions reasons have been carried out in Japan (Tani *et al.*, 1994), Germany (Dekker & Smith, 2003) or Finland (Wong, 2009). Selection's motivation and application of Target Costing method consists in orientation to those industries with economic entities producing components and their assembly (Shank & Fisher, 1999; Afonso *et al.*, 2008).

Our research design is focused on theoretical approach of implications arising from issues described in the first question and on practical implications arising from issues described in questions two and three. For the study's relevance we used

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questionnaires and two main categories of respondents to the launched questions. The first category is made up of specialists in management accounting (management accountants) and the second one of company managers (heads of departments, heads of senior management). The study sample consisted of a number of 317 persons, according to the categories listed below (Table 1). The questionnaire includes simple questions requiring answers with "Yes or Pro" and "Against or Con" to those interviewed or by indicating some answer variants. Further to collecting the questionnaires and centralizing the data, the situation is presenting in Table 1.

Table 1. Results by categories of respondents

Questions	Categories of respondents			
	Specialists		Company managers	
	Pros	Cons	Pros	Cons
1. What are the critical factors for implementing or not implementing Target Costing Method in Romania?				
a. uncertainty in the business environment	36	30	28	17
b. intensity of competition	32	28	21	12
c. strategy perceived by managers	24	31	30	28
2. Is it possible to achieve a successful implementation of Target Costing method in Romanian household appliances manufacturing entities?	187	36	82	12
3. What are the benefits of implementing Target Costing Method in Romania?				
a. focuses on close cooperation between the supply chain partners	58	20	27	6
b. focuses on the products' end users and loyal clients, gaining new customers	64	18	26	7
c. ensures satisfactory financial performances	34	6	35	16

As it can be noticed, most of the Romanian specialists and company managers (84.86%) agree with implementing Target Costing method in household appliances manufacturing companies in Romania.

4. RESULTS

For our case study we have been choosing an entity that produces annually the product Alpha Washing Machine aims to improve this product, which will be launched on the market under the name Super Alpha Washing Machine. The entity is considering a functional break down based on product analysis, by taking into account the client's repeated needs. Estimates made by the company's experts, show that the life cycle of the new product will be of three years and there will be three phases: launch, growth and maturity. Production capacities, estimated selling prices, forecasted profit margins and estimated costs for the three phases are presented below:

Table 2. The situation of production capacities, estimated selling prices, forecasted profit margins and estimated costs

Explanations	Year 1-Launch	Year 2-Growth	Year 3-Maturity
Forecasted quantity	10000 pieces	12000 pieces	15000 pieces
Target unit selling price	280\$	270\$	250\$
Target profit margin	28\$	21,6\$	15\$
Target unit cost	252\$	248,4\$	235\$
Weight of profit margin in turnover	10%	8%	6%
Weight of target cost in turnover	90%	92%	94%

Target costs on elements and phases, as well as the weight in the product's cost are presented below:

Table 3. Target costs on elements and phases

Elements	Weight in product cost	Target cost on elements launch	Target cost on elements growth	Target cost on elements maturity
Other components	5%	12,6\$	12,42\$	11,75\$
Engine	35%	88,2\$	86,94\$	82,25\$
Washing tank	20%	50,4\$	49,68\$	47\$
Machine body	25%	63\$	62,1\$	58,75\$
Control device	15%	37,8\$	37,26\$	35,25\$
Total	100%	252\$	248,4\$	235

Actual costs for the three years are 255\$, 250\$, 236\$. The company's management wants to disclose the evolution of target costs for product Super Alpha during the 3 phases, of performing engineering value to reduce costs in each phase, as well as the calculation and determination of indicators specific to the variable costs method. The company's management wants to provide such information in order to make sound judgements that will impact future production policies, competition

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policies and estimation of benefits. Based on the data above, in the first year after launch the situation is as follows in Table 4.

Table 4. The situation of target costs

Components	Weight in product cost	Target unit costs	Target costs
Other components	5%	12,6	126000
Engine	35%	88,2	882000
Washing tank	20%	50,4	504000
Machine body	25%	63	630000
Control device	15%	37,8	378000
Total	100%	252	2520000

In the first phase, deviations resulted from comparing actual unit costs with target unit costs are as follows (Table 5):

Table 5. The situation of deviations

Components	Actual unit cost	Actual cost	Target unit cost	Target cost	Unit deviations	Deviations
Other components	12,75	127500	12,6	126000	0,15	1500
Engine	89,25	892500	88,2	882000	1,05	10500
Washing tank	51	510000	50,4	504000	0,6	6000
Machine body	63,75	637500	63	630000	0,75	7500
Control device	38,25	382500	37,8	378000	0,45	4500
Total	255	2550000	252	2520000	3	30000

Based on consultations with clients, the entity decides to reduce costs per components, as follows: engine 1.25\$, machine body 1.75\$ and control device 0.40\$. The situation is as follows:

Table 6. The situation after cost reduction

Components	New actual unit cost	New actual cost	New target unit cost	New target cost	Unit deviations	Deviations
Other components	12,75	127500	11,475	114750	1,275	12750
Engine	88	880000	80,325	803250	7,675	76750
Washing tank	51	510000	45,9	459000	5,1	51000
Machine body	62	620000	57,375	573750	4,625	46250
Control device	37,85	378500	34,425	344250	3,425	34250
Total	251,6	2516000	229,5	2295000	22,1	221000

CONCLUSION

As it can be noted, Target Costing method presumes a major change in the mentality of many Romanian industrial entities, managers and accountants, who are used to operate in a business environment that accepts gradual increase of prices. Due to increasing pressure at global level, the Romanian competitive environment could respond faster to the approach and benefits of Target Costing method. To succeed the implementation of Target Costing, the implementation team must carry out a personnel training in economic producing home appliances companies in Romania and to assure the stability of their future work places, cooperation which must occur at all levels within the company, so that the chosen method to produce the desired results and to achieve the main objective, continuous reduction of costs and thus to contribute to obtaining of profit.

There are many arguments for Romanian entities to adopt and implement Target Costing method, among which:

- It identifies problems related to procurement and focus on close cooperation between the supply chain partners;
- It improves the understanding of product costs, thus allowing early identification of problems that may occur in the cost reduction process;
- It focuses on the products' end users and loyal clients, by respecting their needs and gaining new market segments and new clients;
- Staff from all departments is involved in cost analysis, thus encouraging responsibility for cost management;
- There can be performed analyses related to the impact of new products on the market and competitive environment; by considering the product's full life cycle, both the product's total costs and client's costs are significantly reduced;
- It ensures satisfactory financial performances by developing specific and real goals.

We hope that those presented and argued in this article will provide a starting point for Romanian specialists and entities but not only, for understanding and correct application of the principles of Target Costing method. Also, the advantages provided by this method represent an asset for specialists in terms of a performing management based on continuous cost reduction possibilities, especially in the current conditions where business and competitive environments become increasingly fierce.

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