How Performance Management Contributes Towards Maximizing Profits

Summary of the assignment

This essay is about how performance management techniques allow companies to achieve maximum profit. This essay contains more positive statements, which are from verified sources such as websites, books, online documents, etc. If other's work has been presented in this document, it is acknowledged and cited for.

Introduction

Profit maximization is the main objective for most of the organizations. In order to achieve profit maximization, a company will have to cut cost and improve its performance. Improvement in performance can only be seen when the right managerial techniques are applied. Managerial techniques include taking long-term and short-term decisions by looking at costing techniques, Budgets for different activities, performance evaluations (such as managers feedbacks on employees) (ACCA Paper F5, Performance Management Study Text, 2010).

According to ACCA (Association of Chartered Certified Accountants), managerial accounting includes four main broad categories. That is Costing techniques, Decision-making Techniques, Budgeting and performance evaluation (ACCA Paper F5, Performance Management Study Text, 2010). This essay will look into these four categories.

One of the companies that have great performance management is Google. They launched a project called "Project Oxygen" in 2008, which focuses on the manager's effectiveness and outlines their responsibilities. Also, in addition, they developed a system called "Objective and key results", which enables managers to track employee's performance. This improved the employee's engagement and resulted in increased overall performance (Maier, 2017).

Costing Techniques and how it contributes to profit maximization

Costing techniques are used to calculate the total cost of a product, Job or service of an organization through a process called cost accumulation (ACCA Paper F5, Performance Management Study Text, 2010). Costing techniques such as absorption and marginal costing method are now only used by a few companies because of their limitations (Tabitha, 2016). For Instance, Marginal costing only uses variable manufacturing costs into inventory and absorption costing method can only be used to take short-term decisions (Tabitha, 2016). Nowadays, many firms use costing techniques such as activity-based costing, target costing and lifecycle costing (Tabitha, 2016). This allows them to measure cost effectively, and take managerial decisions to lower the cost while increasing profit.

Activity Based Costing

Activity-based costing allocates all the indirect costs (overheads) to the cost centers (Activities)

(Tabitha, 2016). When we apply activity-based costing, firstly all the cost centers and indirect costs are identified and after that, all the Overheads are distributed (indirect costs are allocated to the cost centers using reciprocal or step-down method) (ACCA Paper F5, Performance Management Study Text, 2010). Managers can use absorption costing to find the activities that are not profitable and so they can shut down those activities to gain more profit (ACCA Paper F5, Performance Management Study Text, 2010).

According to Xu Ji Electric Co. Ltd, in 2009 they started producing ABC system reports on a monthly basis. In 2010 their sales increased by 50% and the net profit margin increased by 13% (Liu, 2011). This shows that ABC reports helped the managers to take the decision to improve the business profit.

Target Costing

Target Coting is done to eliminate all unnecessary costs which are related to the production of Product (Avis, 2008). This method helps companies which have set a price for the product and wants to sell at that price to earn a high profit. This way target costing enables firms to achieve profit in competitive markets (Tabitha, 2016). Trough target costing, a company can reduce its standard cost to earn more profit. The cost reduction is done while maintaining the customer's needs and quality. If a product doesn't meet the targeted cost it is improved and its costs are reduced until it meets the targeted costing (Tabitha, 2016).

Life cycle costing

Life cycle costing assumes that costs in different stages of the lifecycle of the product will be different. In life-cycle costing, all the costs occurred through different stages of the lifecycle of the product are taken into consideration (ACCA Paper F5, Performance Management Study Text, 2010). A products life cycle has main five stages. That is development stage, Introduction growth, Maturity, Decline, and renewal stage (Avis, 2008). These stages or phases helps us to categorize and allocate the cost to different stages of lifecycle costing. Life cycle costing accumulates profitability through the product's life cycle, so profitability for any given product can be calculated (Tabitha, 2016). This technique assumes that it is necessary to realize the costs (such as warranty, Installment cost) incurred after and before producing or selling a product (Garrett, 2019). Giving attention to these costs will help the firms to reduce their cost and take managerial decisions to reduce the cost in the future (Garrett, 2019).

Decision-making techniques and how it contributes to profit maximization

Managers of a company can use past performance data of the company to forecast future performance and take the necessary decisions to achieve a targeted objective. One of the main tools used by the managers to take decisions is cost volume profit analysis (CVP) (Cost-volume-profit analysis , 2019).

Cost volume profit analysis

Cost volume profit analysis comprises using marginal costing or contribution to see the

profitability of an activity (ACCA Paper F5, Performance Management Study Text, 2010). Then this information can be used for decision making purpose. Cost volume profit analysis is also known as break-even analysis (Avis, 2008). However, break-even analysis only implies the focus on the point of an activity where there is no profit and loss (Breakeven point). CVP covers more than this (Cost-volume-profit analysis , 2019).

The most basic formula used in CVP analysis is revenue less cost is equal to profit (Cost-volume-profit analysis , 2019). This formula can be used in many different ways, such as to calculate total cost and sales. Managers can use CVP analysis to calculate how much quantity is needed to breakeven and they can calculate the estimated revenue and break-even point. So that the managers know how profitable an activity is. Also, it allows them to minimize the waste of resources (input) in the production process, as a result, the cost will reduce (ACCA Paper F5, Performance Management Study Text, 2010).

According to Air Asia' 2008 annual report, in 2008 they have increased their profit from 1094 Million RM to 2635 Million RM. However, they made a loss of 497 Million RM in 2008. This is the result of a huge increase in expense in 2008 (Annual Reports, 2009). Managers can use this information to carry out CVP analysis and take decisions to increase profit.

Budgeting and how it contributes to profit maximization

Budget is a plan drawn based on data from past, and its main corporate objective is to reduces the risk of uncertainty and measure the estimated cost of an activity (ACCA Paper F5, Performance Management Study Text, 2010). Making a budget for an activity shows the estimated cost that will result in if the activity is carried out. When the whole process of the activity is planned out then the managers can run the operation smoothly ensuring that they have a contingency plan in case of crisis (Performance management and performance measurement, 2011). Consequently, budgeting will help managers cut unnecessary costs which will result in a favorable budget. Budgets can be prepared for different activities. So, managers can invest more in profitable activities (Performance management and performance measurement, 2011).

Furthermore, as budget sets a goal, which will motivate employees to achieve that goal and as result profitability of the organization will increase (Avis, 2008). Managers can use the budget to find activities which requires more control and compel planning and provides incentive to employees to improve performance (ACCA Paper F5, Performance Management Study Text, 2010). This will result in an increase in overall productivity and profitability of the company.

According to the WPP-owned media measurement firm, Google spent around 78% of its advertising budget on television advertisements (Taube, 2014). Their advertisements will increase revenue by a huge amount.

Performance evaluation and how it contributes to profit maximization

A company's performance must be evaluated in time. For instance, executive-level people should know how the company is doing in terms of financial and non-financial aspects, so that they can take decisions, which are profitable to the company (D.Pulakos, 2004).

Balance scorecard

The Balanced scorecard evaluates a company's performance by looking into four perspectives. That are customers, internal, innovation and learning and financial perspective. Managers can use balance scorecard to take measures to Increase market share, the profit of the business and shareholders value through shareholder direct (D.Pulakos, 2004).

Conclusion

Those are the ways or measures managers can take in order to increase the profit and profitability of an organization. Managers can make critical decisions based on cost, break-even analysis (CVP), budget and performance evaluation. These are the only main categories of management accounting and so there might be other ways to increase the profit by making managerial decisions. However, even with the right measure's managers tend to make bad decisions. So, we cannot only rely on these techniques to work all the time.

All of these positive and normative statements shows how management accounting techniques contribute to profit maximization.

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