

The Target Calculation in the Context of Strategic Management of the Commercial Banks Applied Aspects

Dr. Rayna Petrova

*(Assistant Professor, Department of Finances and Accounting,
St. Cyril and St. Methodius University of Veliko Turnovo, Bulgaria)*

Abstract: *The globalization of the world economics determines the trend of merging in the banking sector, expanding the proposed banking products and their orientation to differentiate services, increase in profitability etc. Along with the maximizing shareholder benefits, the commercial banks are directed to satisfying the customers expectations and needs. To meet the modern requirements of strategic management in the commercial banks the target calculating method is offered.*

Keywords: *target costing, financial institutions, strategic management accounting, strategic management, accounting information*

I. Introduction

The current article is aimed at revealing the possibilities of applying target calculation in the practice of the commercial banks. To achieve this purpose the study is focused on the strategic aspects of the method leading to improving performance, processes and internal environment of the companies in financial institutions.

Directions for applying the "target calculation" in the strategic management of commercial banks

The globalization of the world economics determines the trend of merging in the banking sector, expanding the proposed banking products and their orientation to differentiate services, increase in profitability etc. Nowadays on one hand a more important role of the foreign economic activities of the banks and the increased number of advisory and investment services take place and on the other the bank customers requirements for improving the quality of banking services grow ever bigger. Along with the maximizing shareholder benefits, the commercial banks are directed to satisfying the customers expectations and needs.

The introduction of modern management accounting techniques in the contemporary financial institutions practice is able to respond to the increased needs of the external environment. In response to these external changes in the banking institutions the processes of development, reorganization and improvement of methods and management practices start, in order to succeed keeping their competitive advantage and cross their own interests with those of the market.

To meet the modern requirements of strategic management in the commercial banks the target calculating method is offered.

The target calculation aims to determine the acceptable level of cost of production of a certain product at a certain market prices and quality as well as the profit expected by managers. The core of this method of calculation are the consumers and a major engine is the market. This is not only a method of calculation, but also a strategic planning method.

The prerequisites for applying the "target calculation" method in the strategic management of commercial banks can be described in the following directions:

- ◆ The managers in the commercial banks are faced with the challenge to apply complex skills and flexible strategies for effective management in order to respond to the growing needs of the external environment;
- ◆ Providing a wide range of services, orientation their banking products to differentiation of services and increase the profitability as main strategic goals of the commercial banks are prerequisites to search ways to improve both the methods and management practices, in order to maintain a competitive advantage;
- ◆ Basically budgeting is drafting budgets that reflect various aspects of bank activities, which preparation is impossible without internal bank management information about costs formation, accounting and optimization. Regarding the budget management in the literature the purpose of this process as a management tool for accomplishing the annual aims of the organization is considered. In this context it should be noted that on one hand, banking institutions adhere to the widely accepted concepts of budgeting, but on the other budgeting practices vary from bank to bank: in the level of budget details; in the organizational units and products that are subject of budgeting; in the staff involved in the process;
- ◆ The target calculation is led by the cost, and the system of evaluating the profitability of banking products is part of management accounting system in the commercial banks;

- ◆ In the financial institutions through the method of target calculation reducing the cost and improving the quality of the banking products can be achieved. In this context it is considered that the combined use of the target calculation and the Balanced Scorecard (*BSC*) provides the managers with information to make grounded management decisions regarding the strategic management of the commercial banks. By *BSC* the main perspectives of management – aims, tasks and indicators for their achievement are combined into one system. The method of target calculation can be integrated within the *BSC* because the two techniques have common characteristics that unite them: the idea of achieving a competitive advantage, which ensures the efficiency of the company; their common focus on improvement of market positions; achieving a high profit is interpreted as a consequence of achieving the competitive advantages under conditions of strong competition; the aim is to provide a product of a quality level desired by consumers and a price satisfying both their needs and needs of the owners.

The activities that make up the process of target calculation – detailing in the commercial banks

In the previous article of the author on this topic the activities that make up the process of target calculation were reviewed. These are activities to establish and achieve the target calculation. They are organized at three levels:

- *at the market level;*
- *at the product level;*
- *at the component level.*

Their detailing in the commercial banks is characterized by certain specifics.

The target calculation at the level of the market of the banking sector focuses on customer needs, their desires on quality of banking product and the price they would pay. Also, using the concept of eligible costs, it transfers the competitive pressure, which the market exercises, to the product design and service. The target calculation at the level of the market is carried out by five steps; the first two are common to all products, and the next three are made separately for each banking product:

1. Determination of the long-term sales and target profits;
2. Structuring the product lines;
3. Determination of the market price;
4. Determining of the profit margin;
5. Calculation the eligible costs.

Realization of the long-term plan of the bank is of primary importance for the process of the target calculation. Because of this, such step aims to ensure that each product will contribute with its planned share of the long-term target profit of the bank. The long-term plans for sales and profit are derived from a careful analysis of all available information.

The process of determining the profit from the sale of specific banking products is associated with a long-term profit, which is planned and should be achieved. When determining the target profit margins of products' realization two things should be given: to make sure that the margins are realistic and that they are sufficient to offset the costs for the entire life cycle of the banking products.

Eligible costs are obtained as from the market price the estimated margin is deducted. There is a critical issue related to the fact that the eligible costs reflect the relative competitive position of commercial banks, because they depend on the size of the margin, which is based on realistic long-term plans for profit. Therefore, eligible costs are not a criterion on which the bank could compare to its competitors. In order to make eligible costs work as a reference value, a margin that reflects the capabilities of the most effective competitor must be established.

The target calculation at the level of the product is based on two main dependencies.

The degree of reduction in the estimated (current) value of the product directed to reach the target value of the product is called cost-reducing effect. Therefore, the target cost is calculated as from the current value of the product the value of the so-called *cost-reducing effect* is deducted.

It is possible that part of this cost-reducing effect can not be taken/reached. This part of the costs that should be reduced, but cannot be, is called *a strategic challenge to reduce costs*. This is the unattainable part of a cost-reducing effect. Along this line of thinking, the strategic challenge of reducing costs is equal to the difference between the target value of the product and the acceptable cost. In companies that are efficient in conditions of strong competition, these two values are equal or approximate, meaning that the strategic challenge to reduce costs is zero or negligible.

By the target calculation at the level of the product the best alternative, ensuring a correspondence between the needs of customers and the profit desired by the management team, is chosen. The selected team compares different versions and on this basis calculates the cost of a new product. An option to reduce the costs in the banking sector is the use of *value engineering* technology. This technique is aimed at designing and developing products, maximizing the so-called *consumer value*. Another technique which can be applied is a

„quality function deployment”. Its characteristics are supposed to provide a structured approach to ensure that the wishes of consumers are not at risk during the design process.

The above listed techniques are performed by the entire team on the method for target calculation, but the implementation would not be possible without the management accountant. He is the major figure in collecting information on the cost – calculation, summarizing and comparison. After processing the information about the cost of product taking into account different options, he gives the information into relevant for understanding form to the other members of the team on the basis of which decisions about options for developing and offering a new banking product are taken. This makes it possible to take on time and correct decisions on the design and development of a new banking product without any loss, measurable in monetary value or time.

The basic rule of this second level of applying the target calculation is that eligible expenses should never be exceeded. This rule applies in three ways:

- ✓ If the improvements in the new bank product are associated with increased costs, then look for alternatives, reducing activities without added value and increasing value adding activities;
- ✓ Do not take developing and offering a new banking product which estimated value exceeds the target;
- ✓ A monitoring is executed and a management of the transition towards offering the new product is done to ensure that the target cost is performed.

The target calculation at the level of the component is carried out after the team for implementation the target calculation process performs calculating on the level of the banking product. At this level of implementation the pressure concerning the amount of costs is transmitted from the producers, who get it from their competitors, respectively, to the suppliers. This moment is a crucial one for businesses that are horizontally and not vertically integrated. These companies buy a significant part of its materials and components from external suppliers. In this way the companies depend, to some extent, on the level of cost and quality offered by suppliers.

There are three major steps through which the process target calculation at the level of the component is carried out:

1. Fragmentation the new product to a level of main functions;
2. Determination of the target value of the individual components;
3. Supplier management.

The main functions are subsystems providing functionality which allows the product to achieve its objective. Identifying the main functions gives the opportunity to divide the design process into several independent tasks. Usually a dedicated team takes the responsibility for the design of each main function.

The main task is to determine the target price of each main function, usually through a long negotiation process with project teams. Identification of the eligible costs for each of the main functions can be obtained either on the basis of historical data or on market analysis. In practice, these two approach types do not occur in pure form.

When applying the historical data approach the logic is as follows: if in the previous periods the costs of performing given main function were reduced by a certain percentage per year, it is expected that this percentage will also be applied to the specific function this year. However more advanced approaches such as functional analysis and performance analysis can be applied.

Gradually an approach, based on market research, is entering. It includes inquiry on what price the users would pay to obtain a product of a certain quality. This approach allows a compensation between the target values of the individual basic functions. If one function is of great importance to the consumers and at the same time its target value is too low to provide the desired level of quality, then the value of this function will be increased. This increase in an individual function does not lead to a proportional increase in the target value of the entire product, but will lead to a proportional reduction in the value of another function, which is not so important to the user. The aim is despite the changes that might occur in the target values of the different functions making up the product, the total target value to remain unchanged.

Determining the eligible costs of the individual functions and eligible costs of the individual components are interrelated and overlap. By setting the costs of the separate functions, the costs of components are also determined. To identify the costs eligible for the individual components, it is necessary first to identify those for the major functions that are transmitted to the product during its production. Fixing the eligible costs for the components is a continuation of the process of determining the costs of major functions.

A comparison of permissible value for each major function and the expected costs of the components of this function, after reduction of costs shows that each major function can be produced at the defined target price.

Regarding doing the first two steps of the target calculation at the level of the component in commercial banks propose specifying component parts (elements) of the bank product type „Consumer lending bank customers”: a consumer request to obtain credit; completing the credit application; register the request in

the information system; gathering the necessary information to determine the creditworthiness of the banking customer; determine the credit worthiness of a bank customer; credit approval at the level of the credit inspector; credit approval at the level of the branch director, regional director, credit committee; notification the client for approval of the credit; review of the security; open a credit account; define and customize the rules for repayment of the credit; providing the funds in consumer payment account; tracking the repayment of the credit; closing the credit account after the full repayment; release the security after full repayment; restructuring of substandard credits; management of the staff who are involved in specifying bank services crediting; information support of the management team; support a real time information system. The banking products are complex interconnected banking services and operations, aimed at meeting customer needs of different types of banking activities, and defining the basic elements of a banking product is aimed at determining the function of each element.

We can summarize that in the target calculation at component level an important role plays the application of the functional approach, by which the product or service is seen as a set of functions. The specific functions should be implemented by the product. By using the functional approach a unity of functions, effective ways of their work and costs associated with their implementation are sought.

The third step in the implementation of target calculation at the component level, which is the management of suppliers includes choice of suppliers and rewarding those of them who find a creative way of reducing the cost of the components they supply.

The choosing of suppliers begins with analyzing which components can be provided from the inside and which ones from the outside. After that the description of each component including all the particularities, characteristics and properties, and expected production volumes is made. Then the suppliers give their price at which they can provide a particular component and the time period they can deliver it.

In the commercial banks the considered selection of suppliers is associated with design and development of combined banking products with other organizations (banks, insurance companies, financial and consulting groups, etc.).

The team carrying out the process of target calculation, compares the acceptable level of component costs and the offers of different suppliers. If there is a match between the acceptable costs and price component offer, a contractual relationship between the producer and the supplier arises.

II. Conclusion

In conclusion it have to be emphasized that by the target calculation the adequate information base for making strategic management decisions in modern commercial banks can be justified and thus the needs of strategic managemen could be met. The target calculation method gives a wide opportunity to the bank managers to assess the usefulness or the activities by which the competitiveness of the bank can be improved.

References

- [1] Lambovska, M., Budget management of the business organization, UNWE, Sofia, 2013
- [2] Lambovska, M., Rangelova, L., Budgeting in Bulgarian Commercial Banks, International Conference „Global economy as a determinant of business performance improvement”, Serbia, 2006
- [3] Petrova, R., The target calculation in the context of strategic management – a conceptual basis, IOSR Journal of Business and Management (IOSR-JBM), e-ISSN : 2278-487X, p-ISSN :2319-7668, Volume 18, Issue 9 (September. 2016), PP 77-80, www.iosrjournals.org
- [4] R. Cooper, R. Slagmulder, Target Costing and Value Engineering. Productivity Press, Portland OR, 1997
- [5] S. Anstri, Target Costing: The Next Frontier in Strategic Cost Management. Irwin Professional Pub, 1997
- [6] R. Cooper, R. Slagmulder, Develop Profitable new product with target costing. Sloan Management Review, Vol. 40, N. 4, 1999 , pp. 23-33