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# Target costing as a role of strategic management accounting in real-estate investment industry

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**This research explored the role of strategic management accounting in target costing (TC) in real-estate investment industry. In contrast to the traditional target costing /strategic management accounting (SMA) in literatures that mainly view it as a system of cost management and profit planning, target costing in this research is seen beyond that. It is seen as the broad strategic management practices and involves more of a focus on market orientation/price dynamics in the real-estate investment industry. With the interview-based evidences on the target-costing-adopted real-estate investment firms, this research revealed that creating added value to increase prices was combined together with cost management in order to achieve expected profit margins. The findings also presented that the strategy of product price increase in this industry was not only at the level of a whole of construction batch, but also at heterogeneous products caused by the attributes of products within a batch. Finally, the research focused on the evaluations of target costing in accordance with differentiator and confrontational strategies in monopoly competition market, and then justified that target costing with more market orientation/price dynamics could support the strategies adopted by the companies under the circumstances and reached their goals.**

**Key words:** Target costing, strategic management accounting, real-estate investment industry, product price increase.

## INTRODUCTION

Nowadays, the power of the target costing (TC) is often underestimated by many managers who still assume it as a financial or accounting matter rather than a competitive marketing tool. It is clear to know that pricing strategy in the competitive market is still strongly affected by two main ideas: one is that the market prices and profit margins are variables the companies' managers try to control; the other one is that customers' expectations and financial markets drive the cost planning. For the real estate investment industry, the firms face the markets/ prices sensitive to inflation impacts and economic recession, and the high power of customers sensitive

to product price (Wu and Brown, 2011). Furthermore, the markets have strong locational differentiation for products (Ling, 1995; Yang, 1999; Ha, 1999). This situation has revealed that the concept of market-oriented product development as well as strategic cost management should be taken into account and then put into practice. Therefore, TC in this research as applied to real estate investment industry is regarded as an integrated application system in which cost management methods must be combined together with marketing campaigns, production management as well as engineering techniques.

Based on the cost management theories, TC is defined as a system of profit planning and cost management that is price-led, customer-focused, design-centred, and cross-functional (Ansari et al., 1997; Cooper and Slagmulder, 1999; Fisher, 1995; Helms et al., 2005;

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Nicolini et al., 2000). It can also be viewed as a practice of strategic management accounting (SMA) (Chenhall and Langfield-Smith, 1998; Ewert and Ernst, 1999; Guilding et al., 2000; Tani, 1995). However, it tends to focus greatly on the management accounting/engineering interface at the expense of that between management accounting and marketing in TC/SMA literatures (Roslender and Hart, 2002).

TC has been noticed to be mostly applied in assembly manufacturing industries (Monden and Hamada, 1991; Kato et al., 1995; Pierce, 2002), rarely appeared in literatures of real-estate investment industry (Wu and Brown, 2011; Wu et al., 2011; Yang, 1999). The real-estate investment industry in Taiwan, for the investment and development of real-estate, is committed to the building, and sale or rental of residence/ buildings, and may include construction companies by direct allying or indirect groups (Yang, 1999; Zhang, 1996). The products in manufacturing industry appear homogenous in competitive market (Ansari et al., 1997; Cooper and Slagmulder, 1997, 1999; Fisher, 1995; Ibusuki and Kaminski, 2007). This can justify the main role of SMA as cost management in TC in the industry. However, real-estate investment firms are sensitive to the impacts of general circumstance and face intensive competitive market with high power of buyers and land suppliers (Wu and Brown, 2011). Marketing/product pricing and cost reduction assure the attainment of integral profit increase. Furthermore, firms normally present heterogeneous products in different areas/more detailed targeted markets (Ling, 1995; Yang, 1999; Ha, 1999). It appears like monopoly competition in the market (Ha, 1999). This makes the strategy of marketing/ product price practical in the industry. Therefore, TC in real-estate investment industry is supposed to simultaneously emphasize on marketing/ product price and cost reduction to support the strategies in the circumstance.

Furthermore, the strategies adopted by real-estate investment firms mainly focus on differentiation or confrontational strategies (Wu and Brown, 2011). In the industry, how is TC acting as a role of SMA in the industry to support the strategies adopted, related goals and the circumstances becomes important to TC-based companies.

There are two main purposes of this research: the first is to determine whether TC in real-estate investment industry tends to more market orientation/ price dynamics by means of creating added value to increase product price together with cost management for achieving expected profit margins; the second is to prove that TC with more market orientation/ price dynamics can support the strategies adopted by the companies under the circumstances and their goals. The reason of selecting the companies in real-estate investment industry as the universe of the study is the belief that these companies focus more on differentiation or confrontational strategies and hence they have strong necessity for the application

of TC with more market orientation/ price dynamics and more consistent and reliable information can be derived from them. However, manufacturing industry has unique sale price for a set of homogenous products in a batch of production (Fisher, 1995; Ansari et al., 1997; Cooper and Slagmulder 1997; 1999; Ibusuki, and Kaminski, 2007), whereas the products in the same construction batch (a building) in this industry are inherently different for vertically (higher or lower floors) or horizontally differentiated (aspect view, location and layout within the same floor) (Fan, 1991; Feng and Qiu, 1993; Ling, 1995; Wu et al., 2011). Therefore, the methods of TC operations to support strategies should be explored at the level of a whole of construction batch and at level of heterogeneous products within a batch separately.

## LITERATURE REVIEW

The literature review is presented as follows: firstly, TC as a role of SMA; secondly, TC at the level of a whole batch and heterogeneous products within a batch; thirdly, the strategies adopted by TC companies; fourthly, the goal of TC implementation, and finally, general and business circumstances of TC implementation.

### Target costing as a role of strategic management accounting

TC, regarded as a tool for satisfying customers' needs in functions and quality and simultaneously reduces the product costs to earn the planned profit, is market-oriented, playing the role of strategic attendant to increase the competition of the company (Cooper and Chew, 1996; Cooper and Slagmulder, 1999; Ibusuki and Kaminski, 2006; Pierce, 2002; Shank and Fisher, 1999). It can be the part of a broader product cost management process, called target cost management (TCM) (Dekker and Smidt, 2003; Feil et al., 2004; Tani et al., 1994; Yook et al., 2005). In this research, we use TC as TCM alternatives. The characteristics of TC are viewed as relation with SMA in previous TC/SMA literatures as follows: First, market orientation/ price dynamics (Brausch, 1994; Cooper and Chew, 1996; Ewert and Ernst, 1999; Guilding et al., 2000). Second, a coordination instrument (Cooper and Chew, 1996; Ewert and Ernst, 1999), which includes cross functional teams and suppliers relations (Cooper and Chew, 1996; Helms et al., 2005; Nicolini et al., 2000; Pierce, 2002). Third, its interaction with other factors affecting long-term cost structure or management in the form of strategic learning (Chenhall and Langfield-Smith, 1998; Cooper and Slagmulder, 1999; Dekker and Smidt, 2003; Ewert and Ernst, 1999; Guilding et al., 2000; Nicolini et al., 2000; Tani, 1995; Pierce, 2002), such as specified functionality and quality (Cooper and Chew, 1996; Cooper and

Slagmulder, 1999; Nicolini et al., 2000; Pierce, 2002); forth, profit management/ long-term profit (Brausch, 1994; Cooper and Slagmulder, 1999; Feil et al., 2004; Helms et al., 2005; Kato, 1993). Guilding et al. (2000) pointed out that TC was viewed as a practice of SMA for moving costing away from a quest for accurate monitoring towards a costing philosophy that was forward-looking and closely aligned to a quest for competitive advantage as well as the external focus signifying market-led costing rather than cost-led pricing. With all of the aspects aforementioned sufficed in TC as a role of SMA in real estate-investment industry, this paper focuses on market orientation/ price dynamics to distinguish TC application in TC/ SMA from that in literatures.

### Proposition 1

TC in real-estate investment industry focuses on market orientation/price dynamics together with cost management.

With respect to SMA, it is first used by Simmonds (1981) who explored the provision of an accounting perspective on competitor appraisal (Cadez and Guilding, 2008). Roslender and Hart (2002) pointed out that SMA was used in three related meanings: First, the accounting for strategic positions. In their categories, TC was one of the families of related techniques; that is, generic approaches to strategic positioning. They also viewed TC as one phase of strategic positioning, which had strong management accounting resonances (Roslender and Hart, 2002). Second, bring together the strategy literatures and management accounting. Third, a specific form or approach to the provision of accounting information to management, and provide the strategic credentials with more focused views.

Roslender and Hart (2002) pointed out that it was this market-driven emphasis that linked TC with SMA concept. However, many of the subsequent TC literatures tend to focus on the management accounting/engineering interface at the expense of that between management accounting and marketing (Roslender and Hart, 2002). For example, Yook et al. (2005) studied construction industry in Japan, and defined TC as a comprehensive cost management system to manage the process of obtaining the target profit by setting and achieving a target cost at each step of the process, from design to construction (Yook et al., 2005). Roslender and Hart (2002) indicated that TC in previous literatures tended to the identification of profit margins, the determination of allowable costs and the successful pursuit of value engineering, and to novel accounting contributions such as functional cost analysis and the maintenance of cost tables (Roslender and Hart, 2002). As a result, the protectionist roots of traditional costs accounting were established in the context of TC (Roslender and Hart, 2002). The task of providing market information such as

identifying desirable products, acceptable prices, and probable sale volumes were taken for granted (Roslender and Hart, 2002).

### TC at the level of a whole batch and heterogeneous products within a batch

The manufacturing industry is characterized by a set of homogenous products in a batch of production (Ansari et al., 1997; Cooper and Slagmulder 1997; 1999; Fisher, 1995; Ibusuki, and Kaminski, 2007). However, the products in the same construction batch (a building) in the real-estate investment industry are vertically (higher or lower floors) or horizontally (aspect view, location and layout within the same floor) different (Fan, 1991; Feng and Qiu, 1993; Ling, 1995; Wu et al., 2011). Different from manufacturing industry discussing TC at the level of a whole batch, TC application in real-estate investment industry should also be explored in heterogeneous products within a construction batch to pursue a whole planned profit (Wu et al., 2011).

Furthermore, due to the economies of scale arising from purchasing components (leading to a higher percentage of committed costs) and maintaining customer satisfaction, different TC approaches existed for higher priced products, in contrast to lower priced products (Wu et al., 2011). Here, higher/lower-priced products (apartment) were defined as higher/lower product price rather than average price of a whole batch (Wu et al., 2011). Higher-priced products finitely corresponded with higher-priced indoor materials and facilities, whereas lower-priced products did not (Wu et al., 2011). In this way, higher-priced indoor material and facilities finitely commanded higher-priced products to increase even much higher product price (Wu et al., 2011) for the better profit margins. However, it is impossible for lower-priced products with the usage of lower-priced materials and facilities to meet customers' satisfactions (Wu et al., 2011).

### Strategies adopted by TC-adopted companies

Researchers found that TC adoption frequently had identified a link to firm strategy as a defining factor (Ansari and Bell, 1997; Cooper and Slagmulder, 1997; Tani et al., 1994). Hibbets et al. (2003) studied three corporation-level strategies, low-cost leadership, differentiation, and confrontational strategy in TC adoption. The findings showed that product differentiators were more likely to implement TC than cost leaders or confrontational strategy adopters. Confrontational strategy was posed by Cooper (1995), and defined as based on current competitive forces and the goal of this strategy choice was to produce high-quality items at the lowest possible cost (Hibbets et al., 2003). However, Kato (1993)

pointed out that there were a very limited number of Japanese companies which utilized Porter's strategy framework, but many were seen as both cost leaders and differentiators. TC was likely to be employed by lean enterprise pursuing a confrontational strategy (Cooper, 1995; Cooper and Slagmulder, 1997).

In real-estate investment industry, differentiator and confrontational strategies were two strategies adopted by TC companies (Wu and Brown, 2011).

### **The goal of TC implementation**

According to the related literatures, the goals of TC implementing are as follows: cost reduction (Dekker and Smidt, 2003; Ellram, 2000; Tani et al., 1994), profit (Monden and Hamada, 1991), quality (Dekker and Smidt, 2003; Tani et al., 1994), customer satisfaction (Dekker and Smidt, 2003; Tani et al., 1994)/ market-oriented product development (Dekker and Smidt, 2003), timely product introduction (Dekker and Smidt, 2003; Tani et al., 1994)/ time-to-market, understanding the supplier's cost structures (Ellram, 2000), improving internal cost management, improving cost monitoring and increasing cost accountability (Ellram, 2000).

In real-estate investment industry, the companies with TC framework indicated construction cost reduction and integral profit increase (Wu and Brown, 2011). Furthermore, improving internal cost management/ control, time-to-market, quality, the customer satisfaction, an increase of working capital were also included (Wu and Brown, 2011).

### **The general and business circumstance of TC implementation**

There was a strong support in the literature for a positive relationship between the intensity of competition and benefits of adopting TC (Ansari and Bell, 1997; Ax et al., 2008; Cooper, 1995; Cooper and Chew, 1996; Cooper and Slagmulder, 1997, 2002; Dekker and Smidt, 2003; Ellram, 2002; Hibbets et al., 2003; Monden and Hamada, 1991; Pierce, 2002; Swenson et al., 2003). According to Hibbets et al. (2003)'s study, using five-force model proposed by Porter (1979), the competitive forces were rated highly for rivalry and buyer's power. Supplier power was arguably a strong competitive force (Hibbets et al., 2003). The results are similar to those shown in previous literatures where the competitive forces are related to TC mainly in intensity of rivalry among competitive sellers (Ax et al., 2008; Cooper and Slagmulder, 1997; Dekker and Smidt, 2003; Hibbets et al., 2003), and the power of key buyers (Cooper and Slagmulder, 1997; Dekker and Smidt, 2003; Hibbets et al., 2003; Helms et al., 2005).

In real-estate investment industry in Taiwan, the market had higher power of buyers and lower barriers of

entrance (Yang, 1999; Zhang, 1996). The intensity of competitive circumstance in the real-estate industry was rigorous (Wu and Brown, 2011). The pressure in the industry came from two different ends; one end was the higher power of land owners, which made the large portion of construction costs hard to reduce, and the other end was the higher power of buyers and their higher sensitivity to the market price (Wu and Brown, 2011). However, the intensity of rivalry among competitive sellers was the factor claimed by most TC companies, but not by all interviewees adopting TC in the industry (Wu and Brown, 2011).

As to uncertainty environment, there were positive and negative relations between perceived environment uncertainty and TC adoption in the previous literatures (Ax et al., 2008; Cooper and Slagmulder, 1997; Dekker and Smidt, 2003; Tani, 1995). This may involve two different forms of uncertainty: technological uncertainty and market uncertainty (Ax et al., 2008). While market uncertainty which is related to product demand, understanding customer needs, pricing, and so on was not suitable for TC, technology-related uncertainty might be more suitable (Ax et al., 2008). Other factors of the circumstances, such as economic recession, caused the emphasis on cost reduction, and may result in the adoption of TC (Feil et al., 2004; Tani et al., 1994; Yook et al., 2005).

In real-estate investment industry, the impacts of external circumstances, such as the change of governmental policy, and economic depression would result in uncertainty because of long term for constructing products (Huang, 1993; Wu and Brown, 2011; Yang, 1999). The real estate investment industry in Taiwan was vulnerable to worldwide depression (Huang, 1993; Ling, 1995; Wu and Brown, 2011; Yang, 1999; Zhang, 1996). Wu and Brown (2011) indicated that the government regulation treated as the factor of technique uncertainty and attributed to political circumstance formed one of the most uncertainties.

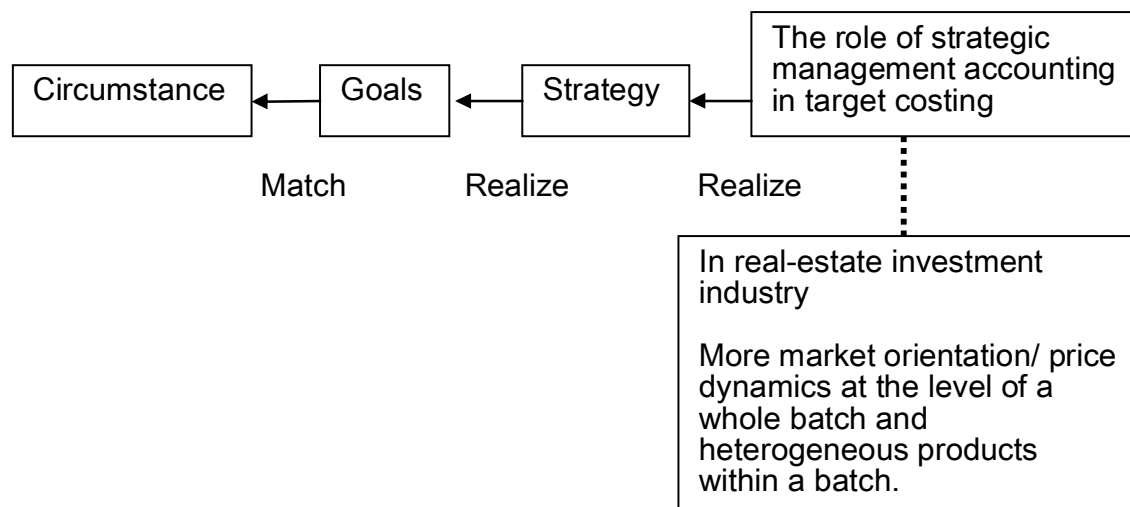
## **METHODOLOGY OF STUDY**

### **Study structure**

We structure this study into two aspects: The first aspect aims to explore whether TC in real-estate investment industry tends to more market orientation/ price dynamics. It includes how the methods of TC operate at the level of a whole of construction batch and at heterogeneous products within a batch separately. The second aspect aims to determine whether TC as a role of SMA in the industry can support the strategies adopted, related goals and circumstances. We used case study to explore the first one. Then we summarized it with previous literatures for the second one. The structure is represented in Figure 1.

### **Study method**

This case study used a method of theory refinement/ illustration in



**Figure 1.** The Role of strategic management accounting in target costing in real estate investment industry.

Keating (1995). We investigated TC as a role of SMA in a more market orientation/price dynamics way by different real-estate investment firms. Theory refinement was used where provisional definitions and working hypotheses were assessed, redefined and elaborated as the researchers modify the theory in light of the empirical data (Keating, 1995). Theory illustration case, subdivision of theory refinement in Keating (1995), was to establish the plausibility of a specific theoretical perspective by demonstrating its capacity to illustrate some previously unappreciated aspect of management accounting practice. Furthermore, Everaert et al. (2006) indicated the reasons why case study could be used as the research method in the TC studies: First, the concept of TC had not been clearly defined and meant means different things to different people. Second, the current state of knowledge on TC could be described as at the clinical knowledge stage, where researchers were trying to understand and capture the many dimensions of the phenomenon. Third, the case study enabled the direct and in-depth contact with practitioners to inform the theory.

In-depth semi-structured interviews were conducted after an explanation on the design of TC in each of the case companies. We interviewed six real-estate investment firms and four of them that adopted TC framework were qualified. In the four TC-adopted firms, three of them are listed companies, and all own allying construction firms. Two firms are located in Southern Taiwan, one in middle Taiwan and the other in South near middle of Taiwan. Two researchers conducted each of the interviews. These interviews were then transcribed and coded based on the case structure constructed. The data were then analyzed to assess the validity of the proposition.

## RESULTS AND ANALYSIS

Based on the case structure constructed, we divide the results of case study into two categories: first, whether TC in real-estate investment industry tends to more market orientation/ price dynamics, and how the methods of TC operate at the level of a whole of construction batch and at heterogeneous products within a batch separately. Second, whether TC as a role of SMA in the industry supports the strategies adopted and related goals and

circumstances.

### TC as a role of SMA tended to more market orientation/ price dynamics

The results showed that TC as a role of SMA in real-estate industry tended to more market orientation/ price dynamics by means of creating added value to increase product price together with cost management. While all of interviewees with TC framework mentioned that TC was used as a tool of cost management by cost reduction and cost control; creating added value to increase product price for achieving the planned profit was also important throughout TC adoption. Two interviewers mentioned that creating added value to increase product price decreased the extent of price curtail by customers. The other one mentioned that they competed with others in products themselves but not product prices in the markets. By creating added value to increase product price together with cost management, real-estate investment firms supported their strategies and had more resistance to general circumstance impacts and to the high power of buyers sensitive to product price. It made TC more practical in assuring the attainment of integral profit increase in the industry. Therefore, proposition 1 was supported.

### Methods of creating value to increase product price in TC conducted at level of a whole batch

All of the interviewees with TC framework emphasized on value-created to increase product price by means of branding strategy. Furthermore, the methods used by different companies to increase product price are as follows: by the fame of architect in house construction, by

**Table 1.** The methods for product price increased at different levels of target costing application.

Level of target costing	Method for product price increase	Goal
At level of whole batch	Products in different markets from other companies by the brand of company, by differentiated targeted market, by the fame of architect in house construction, by the extent of costs increase; that is, lower than the extent of increase of the product price.	To have integral profit increase for survival
At level of heterogeneous product	Higher- priced products finitely corresponded with higher-priced indoor material and facilities. Lower-priced products may use the same architectural designs, for example duplex apartments/suites on the top floor, subsidized/ granted for indoor design/ decoration, or explanation for customer's change for higher- priced facility and material.	To attain the goal of total target profit for the whole batch.

differentiated targeted markets, by the extent of costs increase; that was lower than the extent of increase with regards to the product price.

#### **Methods of creating value to increase product price in TC conducted at level of heterogeneous products within a batch**

Higher-priced products finitely corresponded with higher-priced indoor materials and facilities, whereas lower-priced products did not (Wu et al., 2011). When asked whether it is possible for lower-priced products to increase product price by higher-priced materials and facilities, the company used different methods as follows: by the same architectural designs, for example duplex apartments/suites on the top floor or different room numbers in different orientations, subsidized/ granted for indoor design/ decoration, or explanation for customer's change for higher-price facility and material. Duplex apartments/suites in Taiwan are related to the ladder in upper and lower two floors as one product.

We summarized that TC as a role of SMA tended to more market orientation/ price dynamics by means of creating added value to increase product price together with cost management at level of a whole batch as well as at the level of heterogeneous products within a batch. The results of the aforementioned are in Table 1.

#### **TC as a role of SMA supporting the strategies adopted, related goals and the circumstances**

We evaluated the results above and that of previous literatures. We could see that real-estate investment industry was vulnerable to the impacts of the external circumstances (economic depression, inflation, and change of governmental policy) (Wu and Brown, 2011). The increased profit and cost reduction to survive was important, especially on the setting of inflation or economic depression. Furthermore, due to the higher

power of land owners, and large amount for land investment in the industry (Wu and Brown, 2011), the large curtail of construction costs was hindered. The higher power of buyers and their higher sensitive sense to the market price (Wu and Brown, 2011) in monopoly-completion market drove the goals of TC implementation to emphasize on increased integral profit together with construction cost reduction to survive. The value creation for increased product price to meet the customers' needs in this monopoly competition market might provide ways to achieve the expected gross profit margins together with cost management. It might justify differentiator and confrontational strategies adopted by real-estate investment firms with TC framework to accommodate the circumstance and achieve the goals. Under the setting aforementioned, it is clear to see that TC as a role of SMA tended to more market orientation/ price dynamics in the industry (Table 2).

We might see that TC as a role of SMA tending to more market orientation/ price dynamics supported the real-estate investment firms' strategies and accommodated themselves to the general circumstance impacts (Table 1). Furthermore, by means of creating added value to increase product price at level of a whole batch as well as at the level of heterogeneous products within a batch (Table 2), TC was actively executed to tend to more market orientation/ price dynamics in the industry.

## **DISCUSSION AND CONCLUSION**

Unlike previous literatures with focus of cost management on TC, our findings showed that TC as a role of SMA in real-estate investment industry tended to more market orientation/ price dynamics. This was signified by emphasis on creating added value to increase prices together with cost management on TC operation. This findings also showed that creating added value to increase prices was conducted not only for a whole of batch, but also for heterogeneous products caused by attributes of the products (apartment floor level,

**Table 2.** The circumstance, goals, strategy, and the role of strategic management accounting in target costing literatures and in real-estate investment industry.

Parameter	Circumstance	Goals	Strategy	The role of SMA in TC
TC literatures	intensive competitive markets, intensity of rivalry among competitive sellers,	cost reduction, profit, quality, customer satisfaction/ market-oriented product development, timely product introduction, lead- time reduction (time-to-market), understanding the supplier's cost structures, improving internal cost management, improving cost monitoring and increasing cost accountability	Differentiator and confrontational strategies in competition markets	Cost control
Real estate investment Industry	Buyers have higher power and higher sensitivity on price, higher power of landlords(Supplier) Inflation impact, global economic recession, political circumstance	increase company integral profit, construction cost reduction, improving internal cost management, time-to-market, quality, the customer satisfaction, and increase the walking capital	Differentiator and confrontational strategies in monopoly competition markets	Cost control and Product price increase

orientation, layout within the same floor) in the industry. The various methods to increase product price appeared in firms. These results justified the differentiator and confrontational strategies adopted under the circumstance and goals for the firms. The real-estate investment industry, vulnerable to the impacts of the external circumstances (economic depression, inflation, and change of governmental policy) and facing business circumstances with higher power of land owners and higher power of buyers and their higher sensitive senses to the market price, had their main goals for TC implementations; cost management and increased integral profit (Wu and Brown, 2011). The value creation for increased product price together with cost management to meet the customers' needs in this monopoly competition market might provide ways to support the strategies adopted by the companies. It is clear that under the settings, TC acting the role of SMA tended to more market orientation/price dynamics in the industry.

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