It is generally accepted that one of management’s primary roles is to optimize profits by controlling costs effectively. This includes costs associated with operating the day-to-day business, such as those related to labor, materials, and administrative functions, as well as more strategic costs, such as those for research and development (R&D) and capital investments in property and equipment.

Traditionally, companies have focused on costs that they can control from within, which is known as internal cost management (ICM). But with the advent of technology capable of measuring and tracking costs along a supply chain, there is an emerging trend to manage costs associated with supply chain partners, too. As an example, a manager at a French multinational company explained that his former job description was to “manage” or “supervise” his suppliers. In his current role, however, he is expected to “collaborate with” suppliers. He further explained that one of his company’s primary goals was to work with suppliers to reduce costs. This collaborative approach is known as interorganizational cost management (IOCM), which is quite different from the more traditional model where a more powerful partner benefits at the expense of a weaker one.

How IOCM Works
Here is an example of how IOCM can benefit both parties in...
a business transaction. A chocolate company initially supplies chocolate to a customer by following these six steps: (1) Supplier produces liquid chocolate; (2) supplier solidifies chocolate into chocolate bars; (3) supplier wraps the bars and packages them on pallets; (4) supplier ships the pallets; (5) customer unwraps the packaging; (6) customer melts the bars back to liquid form. It was only after the supplier and customer began working together that they realized both companies’ costs could be reduced substantially by shipping the chocolate in liquid form.

This example leads to several specific questions regarding interorganizational cost management: In what types of IOCM activities do companies engage? What practices can firms in supply chains employ to facilitate the development of IOCM activities? What are the payoffs, if any, to companies that engage heavily in IOCM? To answer these questions, we surveyed a representative set of organizations engaged in supply chain activities. We also identified several factors that people believed would help organizations implement IOCM as well as its perceived benefits.

In this article, we present a summary of our survey results to assist management accountants in determining their organization’s potential for engaging in IOCM. The academic version of our article can be found in the April 2012 issue of Accounting, Organizations and Society. Titled “Effect of Internal Cost Management, Information Systems Integration, and Absorptive Capacity on Inter-Organizational Cost Management in Supply Chains,” that article contains the theory, references, technical analysis, and detailed results pertaining to factors that can be combined to enable IOCM.

The Survey
With the support of IMA (Institute of Management Accountants), we collected the data for this study at three IMA-sponsored events: a national meeting, a Lean accounting conference, and a regional IMA conference. IMA members in supply chain organizations were encouraged to complete the survey; 76 responded. We targeted accountants with knowledge of internal cost management (ICM) activities, supply chain activities, information systems, and their organization’s relationships with supply chain partners. More than half the respondents are in a controller or similar type of accounting position, and about one-quarter hold finance positions such as CFO or project financial director. A variety of organizational types are represented; most were from manufacturing, followed by distributors, retailers, and wholesalers.

Before we could evaluate the extent to which interorganizational cost management activities were being adopted, however, we believed it was important to first describe these practices in the context of common ICM activities because many IOCM practices are just an interorganizational application of many internal procedures. We characterize the IOCM activities this way based on the recognized resource-based view that organizational learning occurs in sequence, whereby companies develop internal resource capabilities such as cost management and then extend the capability externally to make the company more competitive. Furthermore, based on this concept, we examined the extent to which ICM influences IOCM practices in the respondent’s organization, as well as other related practices and activities that could potentially enable IOCM. We also explored a range of perceived cost savings and strategic benefits associated with IOCM.

How IOCM Is Used Today
As you can see from Table 1, organizations today employ a variety of internal and interorganizational cost management activities. ICM consists of practices and routines that allow organizations to manage internal costs and make cost management decisions within the firm’s own internal value chain. These typically include procedures such as standards and budgets, activity-based costing (ABC), target costing, quality improvement, and continuous improvement (Kaizen costing), as well as inventory management procedures.

IOCM activities, on the other hand, sometimes are described as an interorganizational extension of ICM activities, with the same planning and control capabilities fundamental to ICM being applied to IOCM. For example, the traditional focus of ABC is to identify the relevant internal activities or business processes in order to trace activity costs to the appropriate products, suppliers, distribution channels, or customers. Therefore, it is a natural evolution for companies to take what they
Another traditional IC M technique that can be applied in an interorganizational context is target costing, which is defined as a structured approach for determining the cost at which a proposed product with specified functionality and quality must be produced to generate a specific level of profitability at a specific selling price. As a result, target costing often affects a product’s design and its production process. Traditionally, target costing has been an arm’s-length cost management technique that did not actively involve a partner company. More and more companies, however, are now extending target costing to include costs outside the organization.²

A final example of an ICM technique being extended to the wider organizational context is Kaizen costing, a system of incremental or continuous improvements used to reduce the costs associated with manufacturing a product. Kaizen costing generally accepts the design of the product as fixed and seeks ways to manage or reduce manufacturing and delivery costs. Now, however, there is evidence that companies also can use Kaizen costing to identify and set cost-reduction objectives for suppliers. For example, in 1998, researchers Robin Cooper and Regine Slagmulder found that real benefits from interorganizational Kaizen costing can be realized “when the firms in the supply chain cooperate to find new low-cost solutions that they cannot identify in isolation.”³ Furthermore, a few years later, Chris Guilding and his coauthors classified Kaizen costing as a strategic management accounting practice when it focuses on an external, market-oriented approach “that is forward-looking and closely aligned to a quest for competitive advantage.”⁴

### A “Strong” vs. “Weak” IO CM Capability

From our survey of IMA members, we found that organizations engage in a wide array of internal and interorganizational cost management activities. For each cost management technique in Table 1, respondents indicated the extent to which their organization engaged in these activities using a range from 1 (strongly disagree) to 7 (strongly agree).

The most popular ICM activities were performance standards and budgets, cost information, inventory management procedures, measures of efficiency, and nonfinancial measures such as a balanced scorecard. Some organizations also are extending ICM techniques to manage their interorganizational costs. Some of the ICM techniques used most frequently include the development of common demand and sales forecasts, the joint management of quality costs, inventory management procedures, target costing, and the sharing of

**Table 1: Top 10 ICM and IOCM Activities**

<table>
<thead>
<tr>
<th>Internal Cost Management Activities</th>
<th>Mean*</th>
<th>Interorganizational Cost Management Activities</th>
<th>Mean*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance Standards and Budgets</td>
<td>5.26</td>
<td>Common Demand, Sales, or Order Forecasts</td>
<td>3.80</td>
</tr>
<tr>
<td>Cost Information</td>
<td>4.97</td>
<td>Quality Cost Management</td>
<td>3.58</td>
</tr>
<tr>
<td>Inventory Management Procedures</td>
<td>4.54</td>
<td>Inventory Management Processes</td>
<td>3.54</td>
</tr>
<tr>
<td>Process Efficiency Measures</td>
<td>4.38</td>
<td>Target Costing</td>
<td>3.34</td>
</tr>
<tr>
<td>Balanced Scorecard</td>
<td>4.09</td>
<td>Common Asset Sharing</td>
<td>3.26</td>
</tr>
<tr>
<td>Target Costing</td>
<td>3.99</td>
<td>Co-location of Employees</td>
<td>3.24</td>
</tr>
<tr>
<td>Kaizen</td>
<td>3.68</td>
<td>Business Process Redesign</td>
<td>3.11</td>
</tr>
<tr>
<td>Total Quality Management/Six Sigma</td>
<td>3.53</td>
<td>Collaboration Activities</td>
<td>3.00</td>
</tr>
<tr>
<td>Value Chain Analysis</td>
<td>3.41</td>
<td>Functionality/Price/Quality Trade-off Analysis</td>
<td>2.89</td>
</tr>
<tr>
<td>Business Process Redesign</td>
<td>3.30</td>
<td>Value Chain Analysis</td>
<td>2.89</td>
</tr>
</tbody>
</table>

*Based on a 7-point scale ranging from 1 (Strongly Disagree) to 7 (Strongly Agree)
common assets.

To gain deeper insights into the relationship between internal and interorganizational cost management, we divided companies into quartiles based on the overall extent to which they engaged in IOM activities. Those that engaged in IOM activities most extensively are in the upper quartile and are considered to have a strong IOM capability, while companies that engaged in IOM activities least extensively are in the lower quartile and have a weak IOM capability. Figure 1 compares the differences between the mean responses of firms in the upper and lower quartiles, as well as the overall (total) means.

Although the quartiles were calculated based on an average of all IOM activities listed in Figure 1, a consistent difference remains between the upper and lower quartiles across all of the individual IOM activities. In particular, the greatest differences revolve around collaboration activities, inventory management processes, and quality cost management activities. These practices represent the IOM activities most emphasized by the upper quartile (those with a strong IOM capability) relative to the lower quartile, which evidently did not place as much stock in them.

As mentioned earlier, we surmised that the development of a strong internal cost management capability may be a necessary precondition to IOM. Therefore, we next explored the differences between the upper quartile group (strong IOM) and the lower quartile group (weak IOM) for ICM activities. As shown in Figure 2, the strong IOM group tended to have implemented advanced ICM techniques such as Total Quality Management (TQM), Kaizen, and ABC. From this analysis, we concluded that firms with a strong IOM capability may have leveraged a strong ICM focus.

Figure 1: IOM Activities — Upper Quartile vs. Lower Quartile
Other Factors Affecting IOCM

Based on our literature search, we identified four additional factors in the area of information technology and communications/relationship building that could influence IOCM: (1) external electronic integration, (2) knowledge seeking of joint cost information, (3) acceptance of new ideas between firms, and (4) trust between partner firms. Now we will look at each of these in more detail.

External Electronic Integration: The relationship between internal and interorganizational cost management may be enhanced by the electronic integration of a company’s information systems with its business partner’s information systems. Interorganizational processes often require an external information system to control and transact business, provide data, coordinate activities, and communicate with supply chain partners. These systems further enable the partners to efficiently share planning, tracking, ordering, and shipping information, as well as integrate many management accounting controls that were previously internal systems. Such integrated systems include policies, procedures, and routines for processing transactions, and storing data and knowledge associated with these systems and routines. These integrated systems often are unique to supply chain partners and provide an important resource that can be used to enable them to manage their interorganizational costs so they can achieve a competitive advantage.

Knowledge Seeking: Knowledge seeking enables firms to identify and capture relevant knowledge and is potentially another important aspect of an organization’s ability to collaborate with suppliers. Specifically, knowledge seeking is the search for and exploration of new ideas that can lead to innovation and a swifter response to changing business conditions. In a supply chain, an organization may seek to learn more about its partners’
cost structures in order to improve its own business activities as well as better leverage cost management strategies between companies.

Acceptance of New Ideas: In conjunction with the knowledge seeking of new ideas is the actual acceptance and implementation of these new ideas and other innovations related to cost management. The discovery and learning associated with IOCM can occur only if new ideas from partners are accepted as worthy of being integrated into the work environment and if individuals in the organizations are appropriately motivated to implement these new ideas.

Mutual Trust: Trust is a factor associated with both knowledge seeking and the acceptance of new ideas. An environment of trust between partners is an important precursor of IOCM. Trust also is a prerequisite to sharing information, as well as a result of sharing information through repeated interactions with supply chain partners. In several case studies, trust has been found to be important in forming effective alliances and has also been shown to require time to develop.6

In Figure 3, you will see that all four of these factors are greater for those organizations with a strong IOCM capability (upper quartile) than for those firms with a weaker IOCM capability (lower quartile). Most notably, we saw a larger difference between groups in terms of knowledge seeking, external electronic integration, and the acceptance of new ideas.

Taken together, the factors of knowledge seeking, acceptance of new ideas, and trust affect relationship development. All three are key components of developing a strong, cooperative relationship between partners, and it appears that they also are important for developing a strong IOCM capability. In Figure 3, it is notable that the trust level at the lower quartile is not very different from the trust level at the upper quartile and that both are very high. This probably occurs because survey respondents were asked to consider a partner with whom they are familiar, but a potential takeaway of this finding

Figure 3: Other Factors Affecting IOCM
is that trust appears to be a necessary but insufficient condition for partners to engage in IOCM activities. We also think this finding suggests that many companies probably are in a good position to leverage their trust in supply chain partners in order to elevate their IOCM activities. The largest differences between the upper and lower quartiles in Figure 3 are with the knowledge seeking of joint cost information and the extent of external electronic integration between firms—two specific areas that companies can actively focus on in order to facilitate the development of IOCM activities.

**Figure 4: Benefits of IOCM**

![Benefits of IOCM Diagram](image)

**A Model for IOCM Development**

A common goal for companies engaging in IOCM is to achieve greater cost efficiencies. The collaborative partnerships and processes that develop around achieving this goal may have additional outcomes that are valuable to a company’s overall performance. Besides exploring the factors that influence IOCM, our survey also measured the extent that companies benefit from IOCM. Our initial analysis of both the upper (strong) and lower (weak) IOCM quartiles, based on aggregated IOCM activities, suggests that the respondents perceive...
significant benefits from engaging in IOCM practices (see Figure 4). Overall financial performance and product/service innovation are the highest-rated benefits, followed by the ability to identify new business opportunities and to increase market share.

The factors influencing the development of IOCM and the resulting benefits are shown in Figure 5. First, external electronic integration is identified as a factor influencing IOCM, where a company must be technically integrated with its partner in order for IOCM activities to flourish. Second, the internal cost management capability of the organization must be strong. By zeroing in on ICM, a company can leverage its approach to internal cost control into an external cost focus more easily. Although not highlighted in Figure 5, we found that both of these factors are likely to be higher when the company also has strongly integrated internal systems.

Finally, the organization also must engage in relationship-development activities, such as the knowledge seeking of joint cost opportunities, the acceptance of new ideas from their partners, and the continual building and reinforcement of trust. When all of these factors exist, the environment is conducive to the development of IOCM activities and the resulting payoffs.

What We Learned
This survey enriched our understanding of the emerging trend among companies in supply chain partnerships to collaborate and engage in joint cost management practices. The findings offer several recommendations for companies considering how best to strengthen their IOCM capability.

First, we found that companies in our survey varied greatly in the extent to which they engage in internal and interorganizational cost management activities. More important, it appears that some companies that use ICM techniques extensively are able to leverage their expertise to use more IOCM techniques. Thus, a first step is to focus on sound, fundamental ICM practices, which then can naturally evolve across company boundaries into IOCM practices.

Second, our survey revealed that a strong ICM focus
is not the only foundation for developing the I O C M capability. Companies with a strong I O C M capability have more mature information technology support systems to integrate cost management practices and share information between partner firms. This electronic integration is important for I O C M to develop and flourish.

Third, we found that perhaps even more important than the technical communication infrastructure is the informal or human communication/relationship infrastructure within the partner firms. In this area, the knowledge seeking of cost management ideas is important, as are the acceptance and implementation of these ideas. Moreover, trust is the glue that binds the transfer of new ideas and the sharing of information between companies.

Finally, we demonstrated that companies with strong I O C M capabilities reap more benefits. Firms in the upper I O C M quartile reported increases in financial performance, product and service innovation, identification of new business opportunities, and market share in addition to cost reductions associated with the streamlining of processes.

As you can see, interorganizational cost management represents innovative practices that companies can implement to improve their bottom line. In this article, we shared examples of specific types of I O C M practices, as well as some guidance on the complementary factors (such as electronic systems integration, internal cost management, and relationship development) that can facilitate a firm’s ability to manage interorganizational costs. We hope that this information will help your company successfully incorporate I O C M activities into your own portfolio of cost management techniques.

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Endnotes