# ORGANIZATIONAL CULTURE AND STRATEGIC COST REDUCTION

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### ABSTRAK

*Organisasi bisnis dengan kultur yang kuat menunjukkan kinerja keuangan yang lebih baik dibandingkan dengan pesaing-pesaingnya. Memperbaiki kinerja keuangan dapat dilakukan dengan dua cara, yaitu dengan meningkatkan penjualan produk/jasa yang menguntungkan, dan mengurangi beban, yang berarti perbaikan efisiensi. Pengurangan kos strategis berarti secara strategis memperbaiki efisiensi. Perusahaan dituntut untuk fokus pada kepemimpinan kos dengan sasaran menjaga keunggulan kompetitif jangka panjang. Upaya perbaikan efisiensi merupakan satu cara yang dapat dipergunakan oleh perusahaan untuk mempertahankan dan meningkatkan keunggulan kompetitifnya. Pendekatan strategis atas manajemen kos dapat membantu perusahaan menyejukkan kesulitan ekonomis jangka pendek, dan menciptakan budaya efisiensi yang permanen. Budaya kos adalah jalur bagi sistem costing organisasi yang mempengaruhi caranya bereaksi terhadap dinamika dan tantangan. Premis utama tulisan ini adalah bahwa pengurangan kos akan bermanfaat hanya bila menguntungkan perusahaan dalam jangka panjang.*

*Kata kunci: organizational culture, competitive advantage, cost culture, strategic cost reduction*

## I. INTRODUCTION

A study conducted by Massachussett Institute of Technology (MIT) found that firms with strong culture had better and more reliable financial performance than firms with weaker culture (Hitt, Black, and Porter, 2005). If this is true for most, if not all, companies it means that organizational culture has some relation with financial performance of the company. The question is how we can explain, at least theoretically,

the relationship between the organization culture and its financial performance. There are only two pathways available for a company to be able to achieve better financial performance, i.e.: (1) increases in the volume of profitable products/services; and (2) reduction in costs. Further questions that should be addressed are: (1) how can organization culture used in increasing sales volume; and (2) how can organization culture used in improving efficiency, thus reducing costs.

Managers get paid to accomplish goals with and through other people. Ultimately, managers need to thoroughly understand culture because it can help accomplish managerial responsibilities. Because culture is rooted in assumptions and values, once established, it guides peoples' behavior without overt or constant supervision. Culture can be a powerful means of directing peoples' behavior and accomplishing organizational objectives, such as outperforming competitors.

This article provides insight to the important of business culture in business organization, and how it can be considered as the driver for strategic cost reduction efforts. This is not to threat efforts for increasing the volume of profitable products/ services as not important, but rather because cost reduction efforts are mainly driven by internal aspects of the organization. The major premise is that cost reduction efforts will be useful only if these efforts benefit organizations in a long-term horizon.

## II. THEORITICAL AND CONCEPTUAL BACKGROUND

**Culture and Organization**

Numerous definitions and descriptions of culture and organizational culture can be found in the literature (Putti, 1991; Hofstede, 1997; Deresky, 2000; Elashmawi, 2001; Trompenaars&Hampden-Turner, 2004; and Ball et. al., 2004). From many definitions he quotes, Putti (1991) synthesize the definition of culture as the set of values, beliefs, norms, attitudes, habits, and generally the way of life of a group of people. Edgar Schein (Turner, 2006) describes culture as a set of shared assumptions about the world and the way it works; values about what is right and wrong; beliefs about what or should be the consequences of these values; and norms about expected behavior. According to Schein behavior is the only action observable. All the rest are inferred.

Culture is a learned set of assumptions, values, and behaviors that have been accepted as successful enough to be passed on to new comers (Hitt, Black, and Porter, 2005). As definition suggests, a culture begin when a group of people face a set of challenges. Fundamentally, culture is important because it is a strong driver of behavior. As a consequence, an understanding of culture can be helpful in understanding why people behave the way they do and in leveraging culture to help accomplish goals as well as achieve the strategic aims of the organization. Culture is critical because culture can dramatically influence important behaviors. Because culture is not an individual trait but a set of assumptions,

values, and beliefs shared by a group, people can and do identify themselves with the culture and the group. Most anthropologists also agree that (Ball et. al.): (1) culture is learned, not innate; (2) the various aspects of culture are interrelated; (3) culture is shared; and (4) culture defines the boundaries of different groups.

Culture consists of three distinct but related levels, i.e., artifacts, values, and assumptions (Hitt, Black, and Porter, 2005). The structure of these elements is like a tree. Some elements are visible and some are hidden. Artifacts are visible manifestations of a culture such as its art, clothing, food, architecture, and customs. Values are essentially enduring beliefs that specific conduct or end states are personally or socially preferred to others. Most of the components of culture lie below the surface and are hard to see unless we make an effort to uncover them. These are the assumption of culture, or the beliefs about fundamental aspects of life.

Basically, organizational culture is the personality of the organization. According to McNamara (2000), culture of organization is comprised of the assumptions, values, norms and tangible signs (artifacts) of organization members and their behaviors. Members of an organization soon come to sense the particular culture of an organization. Culture is one of those terms that are difficult to express distinctly, but everyone knows it when they sense it. McNamara (2000) explains that corporate culture can be looked at as a system (Exhibit 1),

consisting inputs, process, and outputs. Inputs include feedback from, e.g., society, professions, laws, stories, heroes, values on competition or service, etc. The process is based on assumptions, values and norms, e.g., values on money, time, facilities, space and people. Outputs or effects of culture are, e.g., organizational behaviors, technologies, strategies, image, products, services, appearance, etc. The concept of culture is particularly important when attempting to manage organization-wide change. Practitioners are coming to realize that, despite the best-laid plans, organizational change must include not only changing structures and processes, but also changing the corporate culture as well.

**Exhibit 1**
**Corporate Culture as a System**

| INPUTS | | PROCESS | | OUTPUTS |
|--------|--|---------|--|---------|
| Feedback from society, professions, laws, stories, heroes, values on competition or service, etc. | → | Assumptions, values and norms, on money, time, facilities, space and people. | → | Organizational behaviors, technologies, strategies, image, products, services, appearance, etc. |
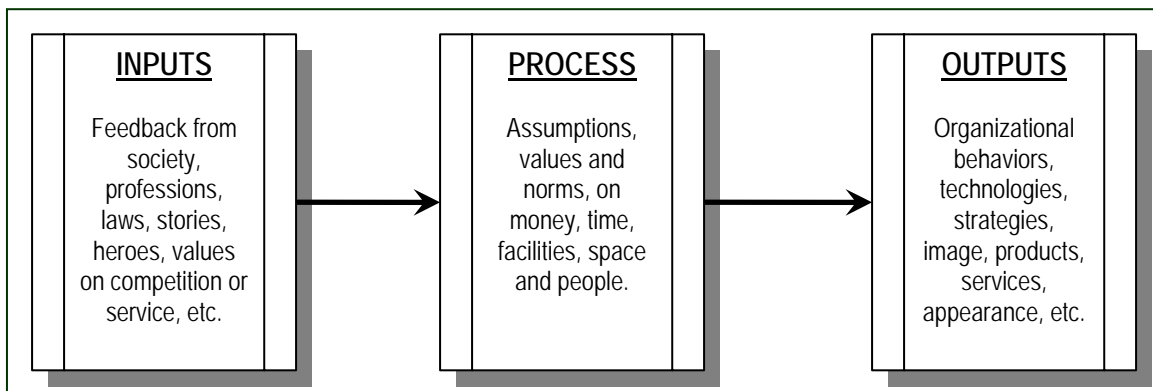
Source: McNamara (2000)

Globalization is a critical factor and brings together cultural diversity into the organizations. Even though cultural diversity has

existed among different national, ethnic, regional, and other groups, globalization of business has increasingly brought that diversity together. As companies globalize and expand operations around the world, they create an increased opportunity and demand for people from different cultures to effectively interact together. According to Stephen Robin, organizations can have a dominant culture and numerous subcultures (Turner, 2006). A dominant culture expresses values that are shared by the majority of the organization's members. One consistent theme found throughout the literature is that organizations have cultures which govern how members behave. This concept is especially evident in correctional organizations.

Multi-National Corporations (MNCs) should take into considerations the international context of culture in their organizations. Perhaps one of the most useful concepts for examining and understanding different countries cultures is cultural context. Cultural context is the degree to which a situation influences behavior or perception of appropriateness (Hitt, Black, and Porter, 2005). In high-context cultures, people pay close attention to the situation and its various elements. Key contextual variables are used to determine appropriate and inappropriate behavior. In low-context cultures, contextual variables have much less impact on the determination of appropriate behaviors. In other words, in low-context cultures, the situation may or may not make a difference in what is considered

appropriate behavior, but in high-context culture, the context makes all difference.

Cultural awareness has become important due to increased globalization. The global political structures have changed and the business culture might be entirely different. In some cultures, relationships are much more important than the actual contract and in others it is opposite. Majlergaard (2006) explains that the success of business organization depends on six interrelated factors (Exhibit 2), and culture is one of them. Majlergaard stressed the importance of culture by putting it in the center of interrelationships.

Since organization culture can be a mechanism for guiding employee behavior, it is as important as the company's compensation or performance evaluation systems. To create and reinforce a particular set of values or corporate culture, alignment between the desired values and other systems in the organization, such as the compensation system, need to exist. But what can managers do to create effective cultures or to change cultures that are ineffective to match the environment? There are at least five critical strategies for managing organizational culture (Hitt, Black, and Porter, 2005).

1) <u>Selection</u>. One way to create or change a culture is to select individuals whose assumptions, values, and behaviors already match those that you desire.

2) <u>Socialization</u>. Even if selection is not perfect, congruent cultural vales can be introduced and reinforced in new hires through socialization.

**Exhibit 2**
**Six Interrelated Factors in the Success of Business Organizations**
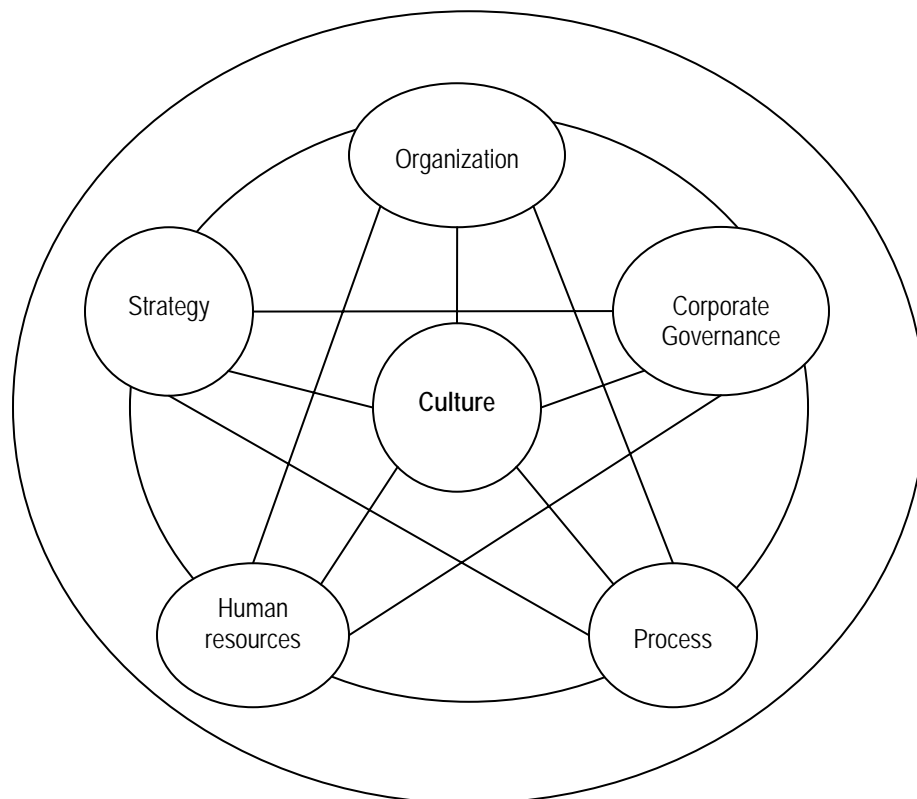


Source: Majlergaard (2006)

3) <u>Performance appraisal</u>. Few things signal what the organization values more clearly to newcomers in an organization than what it measures and evaluates.

4) <u>Reward and compensation</u>. Reward and compensation may be among the most powerful means of signaling what the organization values and reinforcing desired behavior in newcomers.

5) <u>Stories and symbols</u>. Organizational culture is also created and reinforced through a variety of symbols. Rituals play a key role in the symbolic communication of an organizational culture.

When all five are in place, the wheel of an organization's culture is much easier to push to where the managers want it to go.

The importance of the organizational culture has invited researchers to conduct studies in the area. One of the important findings from the area of study, expressed by Hofstede (1997), based on the results of a research project carried out between 1985 and 1987 under the auspices of IRIC (Institute for Research on Intercultural Cooperation). The institute made intensive use of the experience collected during the cross-national IBM studies. The study concluded that the organizational cultures can be articulated in six dimensions, i.e.: (1) process oriented vs. results oriented; (2) employee oriented vs. job oriented; (3) parochial vs. professional; (4) open system vs. closed system; (5) loose control vs. tight control; and (6) normative vs. pragmatic.

**Strategic Cost Reduction**

Business exists to create and render value to its stakeholders; hence, the main activities for a business organization are value creating

activities. Corporate managers are responsible for acquiring physical and financial resources from the firm's environment and using them to create value for the firm's investors. Value is created when the firm earns a return on its investment in excess of the cost of capital (Palepu, Bernard, & Healy, 1996). Value for the firm's investors can be achieved only by rendering value to the customers. According to Hansen and Mowen (1997) customer value is the difference between what a customer receives (customer realization) and what the customer gives up (customer sacrifice). What a customer receives is more than simply the basic level of performance provided by a product. What is received is called the total product. The total product is the complete range of tangible and intangible benefits that a customer receives from a purchased product.

In the information age, organizations engage in value creating activities face a dynamic environment, where they have to be on the lookout for avenues to sustain their competitive advantage. The growth of internet and globalization, to name a few factors, have resulted in information interchange and availability, bringing down the period for which organizations can hold on to their competitive advantage. According to Beckham (2007), in a rapidly transforming environment, no organization can afford to fall behind in the race to maintain an advantageous position. An organization's playbook for achieving such an advantageous position is its strategic plan. A strategic plan allocates scarce resources to an organization's best opportunities. One of the ways

in which organizations can sustain and improve their competitive advantage, in the current environment, is to reduce cost and thereby maximize value rendered to their customers.

Businesses become successful because they possess some advantage relative to their competitors. The two most prominent sources of competitive advantage can be found in the business's cost structure and its ability to differentiate the business from competitors (Pearce & Robinson, 1997). An organization gains competitive advantage by creating more value for its customers than its competitors, because customers demand enhanced value at reduced cost. In the present day scenario, organizations have realized the difficulty in sustaining competitive advantage over an extended period of time. They have now felt the need to look for avenues by which they could reduce costs to survive and succeed. They have realized that cost management as one of ways by which they could enhance value for its customers. Strategic cost management is an integrated approach to value management, i.e., managing value creating activities, which results in improvement of price performance ratio.

Considering the ephemeral differentiation strategy, the companies should focus on cost leadership for long-term competitiveness. Cost reduction can be achieved either by reducing capacity or drive savings by improving efficiency. Only the latter can make permanent changes in cost structure. Strategic cost reduction means strategically improving

efficiency. This is long-term considerations and consequences. Companies that reduce capacity will soon find itself washed out from the arena of competition, for 'volume' is the name of the game in the years to come.

Cost reduction could be brought about by streamlining existing processes or by introducing new processes, which are more efficient than the existing processes. Creativity plays an important role in bringing in new thinking to streamline existing processes or in creating new processes. Process streamlining involves simplification of existing processes and elimination of non-value adding steps in the process. Non-value time could be due to reworks and errors in process execution. Elimination of such non-value time results in benefits like reduced cycle time, increased quality thus leading to increased economic value. Organizations therefore have more time for creative thinking which plays an important role in generating ideas, to reduce the non-value adding time and thereby enhance value. To reduce costs, organizations have to reduce complexity. The best way to reduce complexity is to focus on the simplification of the systems themselves (Clifford, 2006).

Cost reduction efforts can be arranged along continuum of importance (Beckham, 2007). At one end is the kind of daily effort that goes into keeping cost low, and at the other end of the continuum is strategic cost reduction. Cost reduction becomes strategic when it has one or more of these key characteristics: (1) it is driven by the CEO; (2) it

has become an item of discussion on the board agenda; (3) it engages the entire organization; (4) it produces a significant shift in operating margin; and (5) it is necessary to achieve the organization's strategic plan. Strategic cost reduction requires a comprehensive and disciplined approach. It must produce significant result in the short term while establishing mechanisms that ensure the result can be sustained. The most powerful strategic cost reduction emerges from strategic planning process that indicates why cost reduction is essential to the organization's future.

Business organization requires the right strategies for substantial and sustained cost reductions in order to be competitive and gain competitive advantage. A well-conceived cost reduction strategy enables managers to capture maximum value in the form of direct savings and the installment of a culture of efficiency while minimizing the destruction of value because of cutting too much from core business activities. Wipro Infotech (2007) addresses cost reduction issues at three levels (Exhibit 3): (1) Strategic, cut out unprofitable business/operations; (2) Tactical, reorganize and reallocate resources; and (3) Operational, improve performance of processes.

**Exhibit 3**
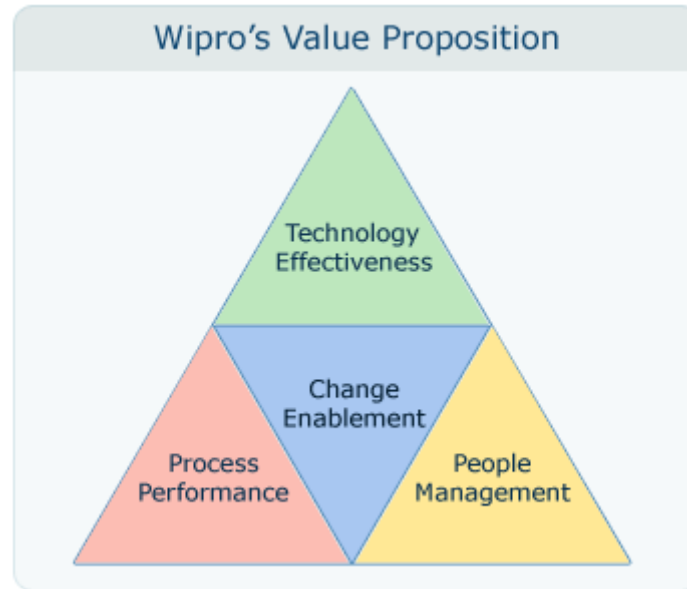
Source: Wipro Infotech (2007)

**Cost Culture and Strategic Cost Reduction**

Recall to discussion in previous section, a well-conceived cost reduction strategy enables managers to capture maximum value in the form of direct savings and the installment of a culture of efficiency. At the same time, the strategy should also enable managers to minimize the destruction of value because of cutting too much from core business activities. A strategic approach to cost management can help organization weather short-term economic hardship, and create a permanent culture of efficiency (Martin, 2001). Costs are hard facts that need to be understood in the most relevant perspective for a costing system to be effective. Costing is not cocooned within the boundaries of cost reduction and cost rationalization; rather it includes strategic issues

including capacity planning and utilization, and investment decisions in specific geographies or technologies. Cost culture is the way an organization's costing system influences its reaction to the business dynamics and challenges (Mahalingam, 2004).

Cost culture reflects core organizational issues such as cost ownership, investment related decision-making capabilities, responsibility ownership, and alignment of strategic goals with operational efficiency. Further, Mahalingam (2004) stated that a study of the cost culture can reveal whether the top management's cost related targets have permeated to the shop floor. Cost culture echoes the extent of the permeation of cost consciousness across the organization. Among the various factors that drive business leadership, cost leadership is the most significant one. A key measure in the effectiveness of cost culture would be the integration of organizational initiatives with the costing system. To achieve efficiencies, organizations have to look at key processes such as fulfillment or customer service and eliminate non-value activities. Ultimately, this approach gives a company economic endurance, installing a committed culture of efficiency in the organization (Martin, 2001).

Identifying and understanding the culture of an organization is a difficult task, requiring analytical skills, understanding of the organization, and knowledge of organizational theory combined with a great deal of effort. However, it is an even more difficult task to overcome

cultural resistance while trying to control and reduce costs. According to Turner (2006) effective leadership is essential to successful efforts at cost-containment, efforts directed toward controlling and reducing cost. Skilled leadership is necessary to successfully deal with the difficult issue of achieving cost-containment.

## III. DISCUSSION

A fundamental question raised in this article is "how can organization culture affecting firm's efforts on strategic cost reduction?" The aim of strategic cost reduction efforts is achieving better financial performance, and there are two pathways available for such efforts, i.e.: (1) increases in the volume of profitable products/services; and (2) reduction in costs. Achieving better financial performance means improving the organization's ability to render more value to its stakeholders. Corporate managers are responsible for acquiring physical and financial resources from the firm's environment and using them to create value for the firm's investors. Value is created when the firm earns a return on its investment in excess of the cost of capital. Value for the firm's investors can be achieved only by rendering value to its customers.

Cost reduction can be achieved either by reducing capacity or drive savings by improving efficiency. Only the latter can make permanent changes in cost structure. Strategic cost reduction means strategically improving efficiency, a long-term horizon regarding its considerations

and consequences. Cost reduction efforts can be arranged along continuum of importance. At one end is the kind of daily effort that goes into keeping cost low, and at the other end of the continuum is strategic cost reduction. If cost reduction comes into the concern of people at top level, it should emerge as parts of strategic planning process that indicates why cost reduction is essential to the organization's future.

Embedding cost reduction efforts into the strategic planning process implies that the organization has been adopting cost culture. Cost culture is the way an organization's costing system influences its reaction to the business dynamics and challenges. Cost culture reflects core organizational issues such as cost ownership, investment related decision-making capabilities, responsibility ownership, and alignment of strategic goals with operational efficiency. As mentioned by Mahalingam (2004), a study of the cost culture can reveal whether the top management's cost related targets have permeated to the shop floor. Cost culture echoes the extent of the permeation of cost consciousness across the organization. The signs of cost culture, or culture of efficiency, has been in place is that each member of the organization aware on the importance of strategic cost reduction in their daily activities. Building cost culture, as part of organizational culture, will create cost awareness for the members of the organization.

In order to successfully implement cost-containment, efforts directed toward controlling and reducing cost, the successful manager is

required to function on two levels. On the first level the manager acts on organizational elements that are on the surface and observable. This includes evaluating operations, implementing procedures, reducing staff, and reorganizing. This approach certainly will have an effect, but the impact will not be long lasting. The problem is that most managers stop their change efforts at this level. To achieve effective change, the efforts must go beyond the obvious and move to a second, deeper level. At the second level, action is initiated to deal with the organizational cultures which govern how the members of the organization behave. True cost-containment cannot be achieved by superficial procedural changes. It requires the changing of the underlying behavior of the organization. This change can only occur if the manager understands the culture and context of his or her organization and provides appropriate leadership which motivates organization members to change.

## IV. SUMMARY AND CONCLUSSION

This article provides insight to the important of business culture in business organization, and how it can be considered as the driver for strategic cost reduction efforts. The major premise is that cost reduction efforts will be useful only if these efforts benefit organizations in a long-term horizon. Cost reduction can be achieved either by reducing capacity or drive savings by improving efficiency. Only the latter can be considered as a strategic tool, because it makes permanent changes in

cost structure. Strategic cost reduction means strategically improving efficiency. For that reason, the companies should focus on cost leadership for long-term competitiveness.

Culture is a learned set of assumptions, values, and behaviors that have been accepted as successful enough to be passed on to new comers. A culture begins when a group of people face a set of challenges. Fundamentally, culture is important because it is a strong driver of behavior. Corporate culture can be looked at as a system, consisting inputs, process, and outputs. One consistent theme found throughout the literature is that organizations have cultures which govern how members behave. The success of business organization depends on some factors, and for sure culture is one of them.

No organization can afford to fall behind in the race to maintain an advantageous position. An organization's playbook for achieving such an advantageous position is its strategic plan. A strategic plan allocates scarce resources to an organization's best opportunities. One of the ways in which organizations can sustain and improve their competitive advantage, in the current environment, is to reduce cost and thereby maximize value rendered to their customers. Cost reduction efforts can be arranged along continuum of importance, from the kind of daily efforts that goes into keeping cost low, till the efforts of strategic cost reduction.

A well-conceived cost reduction strategy enables managers to capture maximum value in the form of direct savings and the installment of a culture of efficiency while minimizing the destruction of value because of cutting too much from core business activities. A strategic approach to cost management can help organization weather short-term economic hardship, and create a permanent culture of efficiency. Cost culture is the way an organization's costing system influences its reaction to the business dynamics and challenges. It reveals whether the top management's cost related targets have permeated to the shop floor. Cost culture echoes the extent of the permeation of cost consciousness across the organization.

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