Kanthal – accounting

[Business](), [Accounting]()

Kanthal, the largest of six divisions of Kanthal-Hoganas, specializes in the production and sales of electric resistance heating elements. Kanthal has over 10, 000 customers and produces over 15, 000 items. The company consists of three divisions. Kanthal HeatingTechnology, world leader, with 25% market share in supplying heating alloys. Kanthal Furnace Products, a dominant player, with 40% market share in supplying a wide range of heating elements for electric industrial furnaces. And, Kanthal Bimetals, one of the few companies in the world with fully integrated manufacturing capabilities of thermo-bimetals for temperature control devices.

Despite the company's steady sales and performance, the President, Mr. Ridderstrale, felt that a new accounting system was needed to help Kanthal extract accurate information regarding its manufacturing cost structure and the cost of supplying individual customers. The primarymotivationbehind developing a new system was driven by the company's strategy to achieve higher growth and profitability without having to acquire additional sales and administration (S&A) resources to handle the growth in volume.

Mr. Ridderstrale wanted to achieve profitability by division, product line, market and customer. He believed that there was an opportunity to increase the bottom line by redeploying current resources to increase profits such that return on capital in excess of 20% was maintained. With access to detailed cost information Mr. Ridderstrale hoped to reallocate the company's resources to customers with hidden profits and reduce efforts for customers with hidden losses.

Given Kanthal's current accounting system, it is clear to understand why Mr. Ridderstrale recognized the opportunity to increase bottom line profits without acquiring additional resources. A more accurate and proportionate allocation of overhead costs would help company determine which customers were profitable and which were not. Hisgoalsare reasonable and sensible, assuming that the new system will accurately capture profits/losses per customer and product order. The major obstacle in achieving this goal would be to get his employees to recognize the importance of a new costing system and to subsequently acceptresponsibilityfor promoting high-margin products to high-profit customers instead of focusing on just top line growth targets.

Previous System

Kanthal's previous costing system was inefficient in allocating resource costs to products and customers in the proportions they were being consumed. The indirect costs were either manufacturing costs that were allocated to products based on direct labour, or S; A costs which were treated as period expenses and allocated to a particular order on a fixed percentage of total revenues basis. Other costs such as materials, wages, and variable and fixed processing were also allocated based on a fixed percentage of sales.

It was clear that the old system did not have the sophistication to measure the profitability of individual customers or the real cost of an order. Thus more emphasis was placed on volume of sales rather than on order profitability. As a result, all products for which the price was higher than the sum of all costs appeared profitable. Furthermore, since the S; A expenses were left unanalyzed and most costs were based on percentage of sales allocations, the real cost of an order for a given customer was not properly captured. These methods of cost treatment lead to the merging of costs and revenues across all orders and sales, despite their profitability or unpredictability.

Appendix 'A' shows that under the old system, two products- one stocked (customer #33514 - case exhibit 7) and another non-stocked (customer #33528 - case exhibit 7) - appeared to be equally profitable at 7. 5% profit margin. Under the new system, it becomes clear that customer #33514 is actually much more profitable and that overall profitability is being driven down by customer #33528. Further analysis of these two orders reveals the significant hidden costs and profits. As illustrated in Appendix 'A', orders that required non-stock inventory lead to higher overall costs which often made an order unprofitable. Under the old system these additional costs associated with non-stocked inventory, were being diluted in 'total' reported figures.

For Kanthal to achieve its new strategy of higher growth and profitability without having to acquire additional S; A resources, changes to the current system were necessary. The management team required a system that would enable them to not only identify profitable versus unprofitable orders, but to also enable them to prioritize and allocate the company's scare resources based on customer profitability.