

Case study simens

Business



One of the key factors in this success was a change in the costing system.

Activity based elements were introduced which identified the number of customer orders and number of types of specialized components as key cost drivers. Siemens' transformation is a classic case study in process costing.

Strategic reorientation

1 Competition: the Need for Changed SEEM commenced in 1937 in Bad Nauheim in the western German state of Bavaria.

Most of Siemens' electric motor factories were destroyed in the Second World War or fell under the control of Eastern Bloc countries after the war.

Despite major expansion and automation in the 1950s, Siemens was struggling to compete in the production of standard A/C (alternating current) motors. Characterized by long runs of single types of motors which were inventoried and shipped on receipt of orders to a wide range of customers, Siemens' low margins left SEEM unable to compete on price. By the 1950s labor costs were a major competitive advantage for Eastern Bloc manufacturers.

Due to strong economic recovery in West Germany during the late 1950s and the 1960s, input costs, inclusiveness, increased.

The Eastern European cost-war experience had been very different, with wages and salaries, and standard of living, falling well behind that of West Germany.

In this environment, Siemens' managers saw that they needed to reduce costs.

SEEM considered its options, and management decided to transform the operation into a specialized customized electric motor manufacturer.

Siemens's move to a specialist customized motor manufacturer SEEM refocused their operations toward low-volume, customized A/C motors. Due to the higher margins compared to standard A/C motors, the customized A/C motors lead to increased profitability. In order to cater for a wider range of applications, SEEM produced a wide range of customized motors with power ratings from 0.

0.6 to 18.5 kilowatts. This change in strategy required a transformation of Siemens's production environment. In order to produce a much wider variety of motor types in small runs required, Siemens invested 1.5 billion DM each year from 1985 to 1988 to retool, replacing the majority of machines. This strategic reorientation had proved itself by 1987. A total of 630,000 motors were sold with 10,000 different types of motors.

Of the 65,625 orders, 90% were for custom motors.

In order to better understand the cost structures of the new production environment, a process-oriented cost system was introduced. Day management. In the new cost system, management decided which custom orders to take by providing more accurate information on which products were cost effective. Despite running production at 115% of rated capacity, SEEM only accepted 1.5 billion DM of the 2 billion DM in orders received.

Transformation of the manufacturing process SEEM needed to come up with ways to reduce costs the production of custom motors.

This affected the manufacture process due to a higher proportion of low-volume components being required for production compared to standard

motors. Customized motors were produced by making modifications in the base motors used in standard motor production. Each custom motor was modified using a range of custom components to meet the specific requirements for low volume orders. The strategy SEEM implemented was to increase automation of component manufacturing, allowing special components to be produced as required.

In 1987, a total of 325, 000 production orders and requisitions were prepared for special monuments.

High volume components were manufactured using highly automated processes, while very low volume parts were sometimes made by hand. In addition, flexible manufacturing was utilized, with some components having up to 10, 000 custom variations. This reduced costs associated with holding components in inventory, including handling and storage costs as well as the opportunity cost of unused inventory. . 4 Inadequacies of the ' TRAditional' costing systems SEEM has employed a costing system since 1926. In the traditional cost system, material and labor cost was assigned directly to the products.

Production related overheads were allocated to products using direct labor hours or machine hours as the allocation base. This lead to the use of 600 different cost pools, one for each machine class. Support related overheads were allocated based on the total pre- support related manufacturing costs.

This treatment of support related overheads was unable to adequately capture the relationship between increased support costs and the change in product mix. The result was that high-volume, standardized products being

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overcooked and subsidizing a subsequently under coated, low-illumination, relatively complex products in Semi's customized motors. This in turn led to inaccurate unit cost and sub-optimal product-line pricing decisions.

3. THE Introduction of PROCESS costing 3.1 A new costing system for a new process By 1987, 74% of orders received by SEEM were for less than five motors.

The move to smaller orders of highly customized motors led to increase in the number of orders, each of which had roughly similar support related costs regardless of how many motors in an order. Actual costs related to order processing showed that same amount of resources was required for orders of one custom motor or 100 standard motors. Another key cost driver for support related overheads was the number of types of specialized components in each customized motor.

This was because each special component was manufactured on an as required basis.

Therefore, a new process oriented costing system called PROPOSAL was applied to the company, in which two new overhead costs are identified and separated out from support-related cost: order-processing cost and special component costs. 8 3.2 Order processing and special components handling under the new systems Under the PROPOSAL system, support related overheads were restructured to create two new cost pools for order processing and support costs related to special components. In 1987, these two new activity based cost pools accounted for 9% of total costs, out of a

total support related costs of 26%, resulting in the transfer of DAMS. Million in costs from engineering related support costs and administrative costs.

The remaining support related costs still being allocated under the traditional system (representing 17% of total costs in 1987) combined with the pre-support costs to represent the pre-PROPOSAL costs. 10 Order processing costs were allocated based on the number of orders accepted, which was 65,625 in 1987, and the cost pool consisted of: Order Receiving Product Costing and Bidding Shipping Billing The rate per order is calculated using the following formula: 1 .

Support costs related to special components was driven by the number of different types of special components used in each motor, and included the following costs: Technical Examination of Incoming Orders Scheduling and Production Control Inventory Handling Product Development Purchasing Receiving Each production order and requisition was able to list the special component by stock number and the quantities of each number of stocks required. In 1987, the Production orders and requisitions were prepared 325,000 times to call special components from inventory or initiate special component production.