Management Accounting and Knowledge Management

Management accountants are becoming strategic resource managers.

BY W.P. BIRKETT


DENNIS NOVAK/IMAGE BANK

The imperative is to sustain a creative tension between value and time through organizational processes.

Finding a new relevance for management accounting and sustaining competitive value through strategically directed knowledge management are two central themes in contemporary discussions about organizational development. The intersection of these themes illustrates how a new role, which brings knowledge management within its scope, has been created for management accounting.

Historically, management accounting is grounded in factory accounting, budgeting, and cost accounting. By the mid-1960s, these methods were consolidated and enhanced by techniques drawn from management science, information science, and organizational science to form what is considered management accounting today.

Within organizations, management accountants provided support services to management in the areas of decision making (and planning) and control (or evaluation). These services were both advisory (tendering opinions, assisting in making evaluations, forming expectations, or developing norms or objectives) and informational (providing "neutral" information on past or present occurrences, on variations from norms, on opportunities under consideration, or alternatives being evaluated.) They also were both sporadic and recurring and were oriented either toward the future or retrospectively. Management accounting work had both analytic and operational dimensions in supporting planning, budgeting, and the design of information and control systems.

Historically, management accountants took staff roles and did not intrude on the domain of "line" management. They provided services that were financial in orientation—nonfinancial data were processed, but with the aim of providing advice or information that had financial dimensions or import. Management accounting was a distinct functional area with its own management hierarchy.

By the mid-1980s, however, the traditional roles and methods had been challenged. Many organizations were changing, for a variety of reasons. Internal operations and processes were refocusing strategically on customers and competitors. Attempts were made to integrate internal tasks and operations as part of broader business processes that incorporated suppliers and customers as components of an extended "value chain." Organizational processes were reconfigured to emphasize and facilitate change by flattening management structures, using cross-functional teams, making information available immediately by capturing it in operations, and empowering the workforce. Decision making and control still were important, but they were recreated within a new organizational dynamic.

Now the imperative is to sustain a creative tension between value and time through organizational processes. A dynamic balance between customer value and shareholder value is sustained by trading between the short run and the long run. Processes are flexible and focused unobtrusively to this end, consuming resources leanly and without waste in generating value over time.

STRATEGIC RESOURCE MANAGEMENT

Today organizations are emphasizing the relationships among strategy formation, change management, and resource management. These relationships can be referred to as strategic resource management (see Figure 1) and are highlighted by the following questions:

- How are resources to be used best in supporting strategies that will in turn generate resources?
- How are resources used in, or recovered from, change processes that support organizational strategies?
- How are the twin concerns of customer value and shareholder/owner value to be layered within organizational processes as guides to the effective use of resources?
- How are resources to be deployed and redeployed over time?

Strategic resource management is the recovered domain of a new management accounting.

Strategic resource management is concerned with the rate and timing of value generation and with the deployment and consumption of resources used to this end. It requires an endless scrutiny of the ways in which resources are transposed in and out of financial forms and an endless involvement in guiding such transpositions. It seeks value creation, the elimination of waste, and the leveraging of resource use through its effective concentration, efficient accumulation, synergistic arrangement, conservation, and speedy recovery from market use.

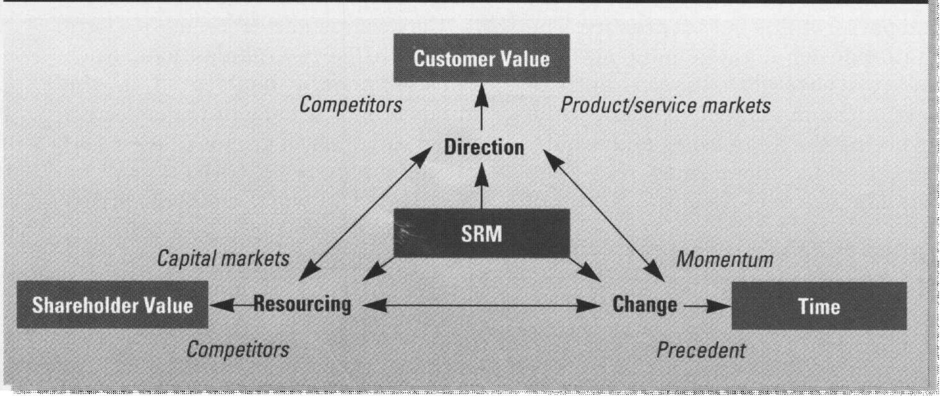
Strategic resource management is not a new issue for organizations or their leadership. It has been an enduring concern, but one that has been out of focus. It has been out of sight in the "seams" of hierarchical and functionally divided organizations. It rarely has been illuminated by management accounting systems and methods that embrace neither strategy nor change and that treat processes and time only partially and imperfectly.

Strategic resource management is the recovered domain of a new management accounting. The historical function of accounting for resources will be redirected at value creation through strategic change. In exercising this new responsibility, management accountants will:

- Participate in resource-related direction setting for an organization, for example, strategy formation, project appraisal, business planning, budgeting, and operational decision making;
- Participate in organizational change and design processes, for example, implementing process reengineering and continuous improvement initiatives, benchmarking and monitoring change processes and outcomes, establishing gainsharing/reward systems, restructuring, and the like;
- Participate in the development of performance measurement and control systems, for example, facilitating the development of performance measurement hierarchies and nonfinancial control systems, developing performance-related information systems, and establishing financial control systems consistent with organizational needs.

This reformed management accounting work will exist in organiza-

Figure 1. STRATEGIC RESOURCE MANAGEMENT



tions that aspire to be "seamless" in addressing the increasingly competitive and volatile circumstances that bear on them. Changing customer needs and demands, shortened product life cycles, aggressive and global competition, new organizational forms and alliances, advances in information technology, shifts in governmental requirements and social philosophies, and heightened ambiguity will be part and parcel of this field of practice. The challenge for management accountants will be to add value constantly as part of the management team while inventing the approaches and acquiring the skills thus needed. (See "The New Management Accounting" below.)

KNOWLEDGE MANAGEMENT IN ORGANIZATIONS

The capacity to achieve ongoing, sustainable competitive advantage has been linked to the existence or creation of "core competencies." What does this imply? First, the building blocks of corporate strategy will be business processes, not products and markets. Second, core competencies need to be identified or acquired and understood. Third, core competencies need to be embedded in key organizational processes. Fourth, these processes need to be transformed into strategic capabilities that consistently provide superior value to the customer. Fifth, core competencies and capabilities are the units of analysis in strategic resource allocation within an organization.

"Core competencies" refers to a form of knowledge in organizations. Such knowledge may be located in the minds of individuals, in the collective understandings of groups or teams, or in the company culture. It may be manifested in work methods, structures and systems, physical artifacts, modes of communication, and language patterns. It may be shared, more or less; acted out rather than articulated; tacit rather than explicit; a reservoir or a stream. It may need to be found or created—brought to the surface or consolidated.

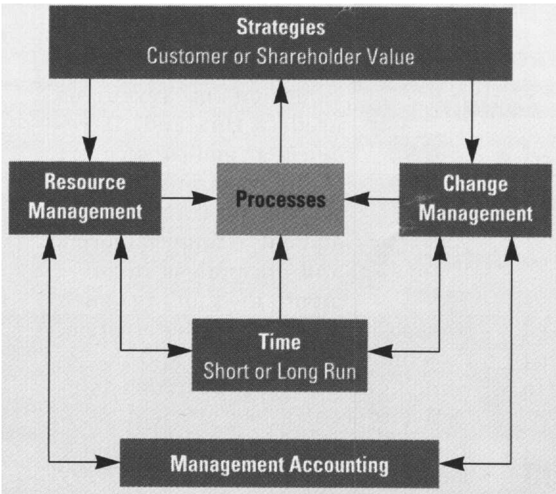
Knowledge is a resource that can be identified and managed. In its manifestation as core competencies and strategic capabilities, it can be invested in, mobilized, and recreated. Moreover, it is a site for strategic resource management in organizations where management accounting and knowledge management intersect. The following case study is illustrative (see Figure 2).

AUSTRALIS: A CASE STUDY

The Australis Corporation (fictional name) employs 1,000 people and is engaged entirely in the production and sales of a large range of branded and unbranded food products. In early 1991, it decided to undertake an activity-based costing (ABC) project as a follow-up from a factory overhead analysis exercise and as a complement to an embryonic total quality management (TQM) initiative. The project focused mainly on nonfactory costs and key factory overhead problem areas. The project was overseen by a core team consisting of the finance director, the factory controller, the marketing director, and the financial planning staff. Other relevant expertise was

The New Management Accounting

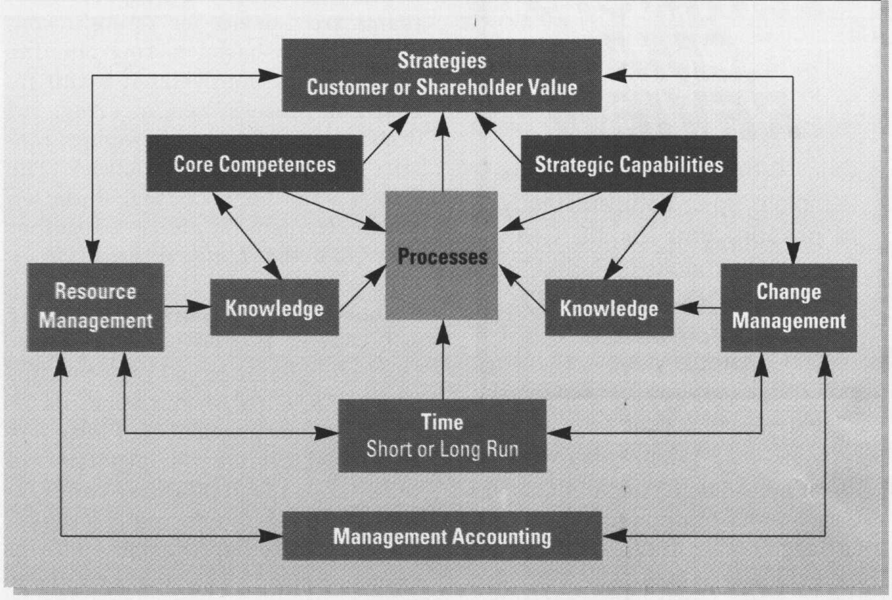
Charged with their new responsibilities, management accountants will straddle the issues of *value* and *time* in exploring the interwoven processes and resources through which organizations seek and change strategic directions.



In this connection "value" is not synonymous with dollars—lower costs, increased return on investment. Value refers to shifts in customer perceptions that are positive or shifts in the way shareholders/owners might assign value to such shifts in customer perception. Similarly, resources are not to be construed simply as financial resources—positive or negative cash flows or cash balances. Resources include the outcomes of prior or ongoing investments of cash—in people, technology, structures, cultures, and so on. The issue is how can value be extracted from these resources through various forms of leverage?

This ongoing exploration may encourage investments in technology or people, shifts in organizational structures or cultures, the refocusing of processes, adjustments to organizational or operational tempos, and so on. And it may be piecemeal or holistic—designed to extract value through the improvement of specific activities (for example, inventory levels, overhead reduction, reduction of setup times) or create value through the patterning of activities (for example, to meet customer requests with more flexibility). Holistically, for example, quality, flexibility, productivity, cycle time, innovation, competence, or *knowledge* may be the subject of inquiry as dimensions of organizational functioning where resourcing and value creation are juxtaposed.

Figure 2. KNOWLEDGE MANAGEMENT



used as necessary.

From the outset the project was seen as a means to an end. It was a diagnosis of areas that could become operational targets for performance improvement teams working within TQM philosophies. The first phase focused on cost reconstructions and took close to a year to complete, which was longer than expected. For about another year, management was diverted by a successful takeover of another company, demands from its multinational parent, and severe industrial relations problems.

The second phase focused on activity-based performance improvements and is still continuing. While the first phase reconstructed existing cost structures in terms of activities, processes, and product groups, the second phase has targeted activities and performance improvement directly, thus defining new activity/cost relationships to be sought in the future.

The first phase produced a range of fairly typical outcomes. A number of low-volume products were undercosted because high setup costs weren't recognized. A number of nonmainstream products with high packaging costs were stretching limited capacity in this area, so packaging subsequently was outsourced. The sales force spent a lot of time and effort on low performers, so sales strategies were changed. Products with high in-process inventories became problematic as a result of the company assigning imputed interest to them. In addition, certain issues relating to trade-offs between maintenance costs and equipment replacement were identified.

Surfacing of impacted knowledge. A strong subtext ran through discussions about the two phases of the project. From the perspective of the finance director, the key aspect of the project was the increased knowledge of the relationship and impact between activities and costs across the company. Because of the company's size, the finance director felt that very few people knew what was going on and that management and the factory had become separated over time. He saw the project as a way of changing to a new culture where the entire workforce shared what it knew. The project, under the guise of cost and process analysis, was a means of making that happen.

The issue was described as follows: "We are an old company (the average employee had 15 years of service) with great knowledge embedded in individuals and subunits—but this knowledge is dispersed and isolated. We have no common knowledge across the firm, and our culture has reinforced this situation."

The aim of the project was to tap into the knowledge strength of the company, draw it to a central point, and make the common knowledge a feature of a new organization culture. Obviously the pursuit of these ambitions would have to contend with the resistance built into existing structures, subcultures, and power bases—as well as with larger external distractions.

Enter management accounting. The activity-based costing project had the capacity to release impacted knowledge and promote a culture based around commonality of knowledge. First, it provided a process orientation, forcing an examination of activity relationships across the company and of relationships between processes (activity clusters) and products sold. According to the financial planner, "It had been noticeable that there were different cultures within the organization clustered around structures. For example, there were different approaches to quality in receiving, processing, dispatch, and accounting—there was no overall approach to quality, no quality culture. The ABC exercise was enlightening in this regard because it showed how structure dominated process within the organization. The project should provide a springboard for organizational change to a process perspective where structure is built up from activities."

Second, the project provided a set of diagnostic tools for employees. The first phase illuminated relationships between costs (resources consumed) and activities through driver analysis. The second phase focused on relationships between value and activities through a focus on value-adding and nonvalue-adding activities, waste, and setting priorities for performance improvements guided by customer and bottom-line impacts.

Third, the conduct of the project itself had the effect of drawing people together across functions. The financial planner felt that working across functions shifted the perspectives of senior management regarding the factory—from being a chunk of metal to a concern that also ran on knowledge and skill. It did this by bringing factory management into direct contact with finance and marketing management about manufacturing processes, issues, constraints, concerns, and solutions. It provided a mechanism for educating senior management on the job, and it began a process of sharing knowledge across departments within the factory, with the marketing and finance departments and across the organization as a whole.

Bringing knowledge to the surface was made easier because of the openness of those involved. The need for this type of focus was appreciated generally, and people welcomed the chance to voice their opinions rather than simply being blamed. The exercise uncovered tacit understandings, the opinions of individuals, and myths (opinions with status), for example, that some things are taking longer than they should, that some cost allocations are nonsense, and that some activities are of little value. It worked both ways: Some opinions/myths were validated—some were discredited. The exercise also tended to make the invisible visible. It was quite enlightening, especially in relation to maintenance costs, effort deployment in sales, and the time spent in accounting work.

The project started a process of ongoing reflection. The financial planner said, "It helped department managers reflect on and understand their own knowledge better. It structured it for them explicitly so that they were able to run their own show better. While the first phase penetrated to department head level mainly, the second phase began to probe lower down to areas of real skill and knowledge, and had the potential to generate greater value."

The project was a beginning only. The enlightenment of some had yet to be translated into action. There were obstacles in the path of change, blockers, and empires in place. The extended time of the project permitted defensive positions to be established and counteractions started.

Change management. Phase one of the project was the springboard for phase two. According to the financial planner, phase one shifted awareness—particularly in relation to how time was spent, levels of duplication, and wasted effort. It resulted in the identification of improvement opportunities, but only in general terms, and it established new interpretive frameworks as an implicit byproduct. For example, staff now were accustomed to reviewing how it uses time and was aware of duplicated effort.

Phase two shifted ownership of the process to performance improvement teams and focused on activities. It is easier to disown costs than activities. By itself, activity-based costing is not much use in producing change. To produce change it should be embedded in a more overt and powerful change philosophy/process such as TQM or product/process reengineering. Then it can be a useful tool for knowledge sharing.

The performance improvement teams are a device for acting in concert. Activity-based costing plus the performance improvement teams focused on process reengineering, but drawing from TQM philosophies constitutes the change framework. The former is the diagnostic tool; the latter, the mechanism for change. Together they guide the change process.

Resource management. In surfacing and sharing knowledge, the project has highlighted critical relationships between resource consumption and organizational functioning. Phase one suggested avenues for product and work rationalization. Phase two is focused on reengineering processes around quality improvement and value enhancement. The areas now under examination are resourcing, value, and time.

As the financial planner explained, "The project has helped the company in understanding relationships between the knowledge it possesses and its future directions. The change process we have under way, combining activity-based costing and performance improvement teams, gradually has helped us to understand our capabilities as a manufacturer: There are limits to what we can do or do well. These core capabilities set our path for us unless we want to invest in new capabilities and thus seek new directions. The process gradually makes the costs/benefits and the possibilities/risks of investing in new capabilities clearer. Thus, resourcing and strategic issues are being merged overtly for the organization overall, and in the consciousness/makeup of our staff as it does its daily jobs."

Management accounting is being reconstituted as an organizational mechanism for strategic resource management as an adjunct to the work and responsibilities of the chief executive officer. With this mandate, all types of resources can be put under the microscope, including those that are as diffuse and strategically important as "knowledge." ■

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