

Management accounting in the twenty-first-century firm: a strategic view

Hassan Yazdifar*

Sheffield University Management School, UK

- *This paper proposes that conventional management accounting needs to be changed to assist management in strategic decision making.*
- *The deficiencies of conventional management accounting systems are discussed and some suggestions are made to improve their role in new organizational settings.*

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Introduction

Over the past two decades, manufacturing industries have been affected by the fast pace of change, which has been viewed as a new industrial revolution. Manufacturing firms have had to adopt new management techniques to respond effectively to changes that include the growing availability of information, the rapid development of new technologies and the globalization of markets. The departments of manufacturing firms have engaged in team efforts to be more responsive to their customers' needs (diversity and high-value products) and adopted new organizational structures and manufacturing methods to cope with the fast pace of change (Ashley, 1997). Competitive challenges are also being met by product diversity, higher quality, better delivery and increased flexibility in order to satisfy new consumer demands together with enhanced global competition (Bromwich and Bhimani, 1994). Uncertainty and continuous radical

changes are the main characteristics of the new market, and corporate survival requires the ability to identify new perspectives and to comply quickly with conditions of increased competition. As a result, many firms have been adopting innovative production systems, advanced manufacturing technologies and many new organizational and managerial techniques.

The effects of this new environmental setting continue to change not only approaches to production and the application of automated equipment and flexible technologies, but also organisational structures, business strategies and managerial philosophies. As Bromwich and Bhimani (1994: 23) argue:

Operational changes arising from technological advances are not limited to manufacturing processes but extended to post-production back-up activities and particularly to the service sector.

They also include the implementation of radically different work and organization techniques and novel approaches to the coordination, integration, control and management of organizational activities. Thus, alongside these technological changes, managers have

* Correspondence to: Hassan Yazdifar, Sheffield University Management School, The University of Sheffield, 9 Mappin Street, Sheffield S1 4DT.
E-mail: H.Yazdifar@Sheffield.ac.uk

also become increasingly interested in 'new' management practices (Ashton *et al.*, 1995). Thus the 1980s and 1990s are seen as a period in which all aspects of manufacturing needed to be rethought. New business strate-

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gies have also questioned the conventional role of management accounting. As Ashton *et al.* (1995: 192) note:

The exploration of this by industrialists, academics and management consultants has produced an ideology of crisis and transformation in manufacturing, in which the role of conventional management accounting has come under increasingly critical scrutiny.

The challenge to conventional management accounting

In the new manufacturing environment, perceptions of information requirements, the use of new communication forms and channels and an understanding of the implications of changing organisational structures are essential for the management accounting profession to understand how to react. As Peavy (1990) argues, 'the revolution in manufacturing wrought and effected by new technology, necessitates a new cost accounting model that is congruent with the phenomenon of decreased inventory levels inherent in just-in-time manufacturing philosophies'. However, the argument is that conventional management accounting has deficiencies in responding to the environmental change. Some of these criticisms will now be examined.

Deficiencies in cooperating with organizational strategic planning

The traditional management accountant instead of being a participant for strategic planning focuses on inventory valuation and external reporting. Nowadays there is a strong argument for firms to introduce a strategic dimension into accounting. The role of management accounting in overall strategy-making decisions has been marginalized, changing the consultancy role of accountants to that of bookkeepers.

Concentration on short-term measurement

Today management accounting systems provide short-term measurement, with consequent management and employees rewards focused on it. However, sustainable competitive advantage requires long-term measurement and attention, which is an important factor for motivating people and managing innovation.

Performance evaluation

Performance evaluation in traditional management accounting was based entirely on financial data, ignoring some major features of automation performance requirements such as customer satisfaction, flexibility and innovation (Bhimani, 1993, 1994).

Irrelevant and repetitious reports

Many manufacturers continue to have one-third to one-half of their production reporting schedules focusing on labour efficiency and utilisation. A half-century ago, when labour typically accounted for 30–40% of total costs, the reports were relevant. Nowadays, with adoption of the new manufacturing methods, labour is typically 5–10% of total costs and therefore labour utilization has been replaced as the main concern for managers by, among other factors, cycle time, quality, delivery, scrap and inventory. However, all too often accounting reports are not required to be placed in general circulation available to all and consequently the

production manager's information comes from his own PC (Howell and Soucy, 1988: 23). Too often managers are handed reports in a financial accounting format that contain too much data and detail. Such reports fail to communicate and make it difficult for managers to evaluate, decide and take action (Howell and Soucy, 1988: 29).

Poor job product costing

Traditional cost accounting systems often do a very poor job of product costing. In fact, many of these systems do a grave disservice to managers who do not understand their inadequacies and use the product cost information as generated (Howell and Soucy, 1987a,b; Kaplan 1983). Furthermore, while the main form of traditional accounting systems is on product cost, new manufacturing methods place the emphasis on the process of production and its impact on production costs.

Overhead planning, control and allocation

One of the major areas of dissatisfaction with management accounting methods in practice relates to the accounting for and allocating overheads (Bromwich and Bhimani, 1994: 95). Allocation of overheads based on labour hours is a significant feature of traditional cost accounting. Due to the decreasing share of labour and variable costs in overall costs based on the new manufacturing technologies, this method is no longer a good one. In many new manufacturing methods, 'labour represents only 5% to 10% of a manufacturer's total cost' (Howell and Soucy, 1988: 22). In addition, 'automation is increasing the spread between variable and full costs' (Howell and Soucy, 1988: 27). With labour and overhead costs moving in the reverse direction, allocating overheads based on labour costs or hours, and using cost accounting techniques based on a disappearing manufacturing environment is no longer appropriate.

New challenges for management accounting

According to much of the management accounting literature, existing management control practices and cost accounting procedures are unlikely to meet the management needs of the manufacturing operations of the modern firm, and fail to provide useful indicators for the decision-making process. Due to the deficiencies of traditional cost measurement systems, they do not properly reflect the dramatic increase in manufacturing efficiency and effectiveness that can occur when firms adopt new manufacturing methods such as Total Quality Control (TQC), Just-In-Time (JIT) inventory systems, and computer-integrated manufacturing processes.

Today, the value-creating activities of companies in operations, product, process development, marketing and sales must be reflected by effective managerial accounting systems. This will be achieved by applying a timely and permanent change in management accounting systems that reflect the changes which have been implemented in most manufacturing processes in order to provide relevant information for managerial decisions and controls.

Accounting systems must serve the objectives of the firm. There is no universal accounting model that works well in all circumstances. While the choice of appropriate measures, aggregations and allocations is a managerial choice, it is one that must be practised in conjunction with the strategic goals of the firm and be sympathetic to the rapid changes occurring in the manufacturing processes of many businesses. In short, this means that the choice of an internal accounting system is made explicitly and simultaneously with the choice of a firm's corporate and manufacturing strategy.

There are compelling arguments for firms to introduce a strategic dimension to accounting. This function will allow

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management accounting to concentrate on the added consumer value relative to competitors. This will also assist the firm in monitoring its performance in the market place using a whole range of strategic variables over a decision horizon long enough for strategic plans to reach fruition (Bromwich and Bhimani, 1994). Furthermore, there is a real need to determine the appropriate costs associated with strategies deployed by the firm and to monitor the cost structures of competitors. All too often, the cost of many operations which have the potential to offer added value to consumers, such as flexibility in manufacture, quality, distribution and after sales service, are rendered invisible by submerging them in the overheads pool and then adding noise by allocating them (Bromwich and Bhimani, 1944: 13). Strategic management accounting (SMA) seeks to make such costs visible to management. A major problem inhibiting the use of SMA is the perception that it makes impossible information demands (Bromwich and Bhimani, 1944: 14). It is the function and responsibility of management accounting to provide this kind of information.

Organizations that seek to compete globally are continually striving for the right balance between the advantages of economies of scale and scope, while encouraging worthwhile interrelations between organizational activities governed by different local conditions and operating in very different cultural contexts. Such processes require accountants to revise both corporate accounting information systems and local systems to reflect the changes involved (Bromwich and Bhimani, 1994).

Performance evaluation should be based not only on financial data but also on features such as customer satisfaction, flexibility and innovation. It is important in this context to recall the relegation on accounting numbers by Japanese firms in many markets. The Japanese manufacturer's concern with quality assumed paramount significance and where accounting information could not assist or clouded managerial judgement, non-financial measures gained in significance. Many Japanese firms used such measures to monitor quality (Schonberger, 1982). Many Western firms are only now beginning to appreciate the value of non-financial quantitative and qualitative data (Bhimani, 1993, 1994).

One clear message is the need for the management accountant to understand operational processes together with the need to embed management accounting systems within operational activities. This can often be achieved via informal channels of communications possibly suggesting a more significant role for non-financial measurement. 'The walls that were said to have once existed between the accountants' ivory tower and the factory are gradually crumbling' (Ezzamel *et al.*, 1997). Accounting personnel should be working much more closely with manufacturing managers and product and process engineers. When significant changes are made in manufacturing operations, existing accounting systems may well become obsolete. Rather than wait for misleading information to be produced from existing conventional accounting systems, a new set of measures, aggregations and allocations should be available simultaneously with the introduction of the new production procedures. This requires that accounting and control personnel are part of any task force responsible for developing and implementing manufacturing process changes, so that measurement systems can be developed that will be sympathetic to the new manufacturing environment.

The adoption of a new approach to management accounting requires the implementation of new methods of accounting for fixed

overheads. The aim being to reflect new and realistic technological, economic and managerial characteristics of overhead resources, and hence justify cost behaviour in decision making and control. The need to reflect such characteristics in accounting is clear, because current technology is often very different from the large-scale mass production technology implicit in conventional accounting (Howell and Soucy, 1987a,b; Kaplan, 1983). The new manufacturing environment demands effective, timely, and management user-friendly reporting systems.

Conclusion

The contemporary economic and manufacturing environment demands excellence from organization management accounting systems. Vigorous global competition, changes in technology and the management of innovation requires accurate and timely information to facilitate management decision making in fashioning competitive advantage.

An excellent management accounting system will not by itself guarantee success in today's market, success depends on products and services that meet and excel customers' needs. But an ineffective management accounting system will undermine superior product development, process improvement and marketing efforts.

Biographical note

Hassan Yazdifar is a lecturer at the University of Sheffield and in the final year of his doctorate in accounting. He has an MA (Econ.) in Social Research Methods from the University of Manchester and an MA in Accounting from Tehran University in Iran.

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