STRATEGIC MANAGEMENT ACCOUNTING
SMA

LECTURE 1_2

STRATEGIC MANAGEMENT ACCOUNTING: CONCEPTUALIZATION

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PRACTICAL ISSUES (1)

- Read all that is communicated
- Lecture notes will be available on “e-learning moodle” after the lecture.
- The lecture notes on “e-learning moodle” may differ from the lecture notes used in class
  - E.g. calculations may be incomplete on the notes and you will complete them during the lecture

PRACTICAL ISSUES (2)

- Some reading material will be made available on “E-learning Moodle” – BUT you are also required to search for additional material
- Material for the workshops/seminars will be available on “E-learning Moodle”.
- Workshops solutions will be available “E-learning Moodle” after the tutorial.
  - But, some workshops are discussion based and in these cases no “solutions” will be provided

A) INTRODUCTION: SMA (1)

SMA

WHEN

- 1980s: debate about role and future of MA.
- SMA developed within this context.
- Simmonds (1981, 1982) first coined the term.

WHY

- Traditional MA practices and theory were criticized
- New “ways” were advocated (J&K).
- SMA was considered as a “new way”.

WHAT

- There is no comprehensive framework as to what constitutes SMA.
- Many definitions exist. Each emphasize different aspects.

A) INTRODUCTION: SMA (2)

SMA: WHAT IS IT?

- Many definitions of SMA have been provided. Some of them have emphasized either an external focus or an internal one.
- Drury (2008, p. 570) defines SMA as: "*a form of management accounting in which emphasis is placed on <u>information</u> which relates to <u>factors external to the firm</u>, as well as <u>non-financial information</u> and <u>internally generated information</u>*" (CIMA, 2005, pag. 54). Innes (1998) defines SMA as the "*provision of information to support the <u>strategic decisions</u> in organizations*"

A) INTRODUCTION: SMA (3)

An omnibus definition is provided by Hosque (2006).

MANAGEMENT ACCOUNTING ⟷ **STRATEGY**

A) STRATEGIC MANAGEMENT ACCOUNTING: A DEFINITION (4)

Strategic management accounting is the process of identifying, gathering, choosing and analysing accounting data for helping the management team to make strategic decisions and to assess organisational effectiveness (Hoque, 2006)

A) INTRODUCTION: SMA (5)

SMA: SO WHAT?

Process

The term comes from the latin "*procedere*", i.e. something that is not static but in a continuous change

Identifying
Gathering
Choosing
Analysing

Accounting information could be both financial and non-financial. These have an internal or external focus.

Help
Support

Information has a function: i.e. to support management to take specific choices.

A) INTRODUCTION: SMA & BS (6)

Strategic choices

Information will be provided for the formulation, implementation and management of organization's strategy .

To stimulate behaviour that is consistent with an organization's strategy, attention is devoted to designing and implementing accounting-based techniques that can be used to identify, clarify, communicate and manage organizational strategy.

Accounting-techniques ⟷ **Strategy**

B) SMA – Background (1)

- Before 1980s, the success factor form most companies was the capability to use large-scale production methods (i.e.economy of scale)
- Today's businesses operate in a dynamic, complex environment as they are affected by sociological, technological, and political factors, internal competition and the increasing bargaining power of suppliers and customers.

B) SMA – Background (2)

- In a changing world and competitive, complex institutional environment companies need to develop their operations and adjust to the new conditions:

  i) Shorter product life cycles (e.g hi-tech);

  ii) Globalisation;

  iii) Sustainability demands.

- What is the role of management accounting in this dynamic and complex environment?

C) Strategic Management & Accounting

- STRATEGY ANALYSIS
  - Analysis of environment, relationships, organisational capabilities
- STRATEGY FORMULATION
  - Strategic positioning (Porter)
    - Cost leadership
    - Differentiation
  - Strategic typology (Miles and Snow)
    - Defender
    - Analyser
    - Prospector
  - Strategic mission (Gupta and Govindarajan)
    - Build
    - Hold
    - Harvest
- STRATEGY IMPLEMENTATION
- MONITORING & CONTROL

D) Organisational strategy (1)

- Strategy was defined by Mintzberg in 1978 as "a pattern or stream of decisions about an organisation's possible future domains"

- It has a time horizon of three to five years
  - evaluate external environmental opportunities
  - internal strengths and resources to decide on goals, and
  - sets out action plans to accomplish these goals.

- Strategy is an integrated set of actions aimed at securing a sustainable competitive advantage.
  - Focuses the firm's attention on those aspects of its products and services that it must rely on to drive the firm towards achievement of its goals.

- Strategy is the process of building defences against competitive forces or to acquire advantages.

D) Strategic goals (2)

Example of strategic goals in a multinational cereal company:

- **People:** attract, select and retain top quality people; provide training, development and growth opportunities; promote from within whenever possible; recognise achievement and reward performance.
- **Profit/growth:** grow/expand core business; strengthen global leadership; excel in the introduction of products that meet consumer needs.
- **Consumer satisfaction and quality:** strive for excellence, as defined by internal and external customers; pursue partnerships with company customers, suppliers and company employees to achieve common goals.
- **Integrity and ethics:** engage in fair and honest business practices; show respect for each other, company staks.

D) Objectives (3)

- From GOALS to OBJECTIVES
- Objectives
  - are the future results sought or the aims and expectations as to the future state desired.
  - are the end results of an organisation's planned activity.
  - are the desired targets within the scope of the vision to realise the mission.
  - state what is to be accomplished by when and should be quantified if possible.
- An organisational goal is broken down into objectives
  - Measurable accomplishments to be implemented within a specific period of time.
  - An objective for increased profitability, for example, might be to increase it by 6% within six months to one year.

E) Strategic **decisions (1)**

- In formulating an organisation's strategy three main types of strategic decisions are made:
  - What business will the organisation operate in?
  - How should the organisation compete in that business?
  - What systems should the organisation have in place to support its competitive strategies?
- Effective strategic decisions within an organisation:
  - deal with the organisation's boundaries
  - relate to the matching of the organisation’s activities with the opportunities in its substantive environment
  - require the matching of an organisation's activities with its resources
  - have major resource implications for organisations
  - are influenced by the values and expectations of those who determine the organisation's strategy
  - affect the organisation's long-term direction.

E) Strategic **decisions (2)**

- The primary stages of strategic decisions are as follows:
  - FORMULATION: Formulating strategies of the business.
  - COMM: Communicating those strategies throughout the organisation.
  - TACTICS: Developing and carrying out tactics to implement the strategy.
  - CONTROL: Developing and implementing management control systems to monitor the success of the implementation steps, and hence the success in meeting the strategic objectives.
- Cost accounting information plays a significant role at each of these stages. It is in this area that strategic management accounting systems are important.

F) Types (or levels) of strategy

- **Corporate strategy** describes how a company determines what business it wants to be in. It deals with three key issues:
  - directional strategy (growth, stability, or retrenchment);
  - portfolio strategy (industries or market for products); and
  - parenting strategy (systems of allocation of resources and coordinating activities among product lines of business units).

- **Competitive (or business unit) strategy** occurs at the business unit, division or product level.
  - Refers to how an organisation competes within each type of activity and tries to achieve competitive advantage relative to its competitors.

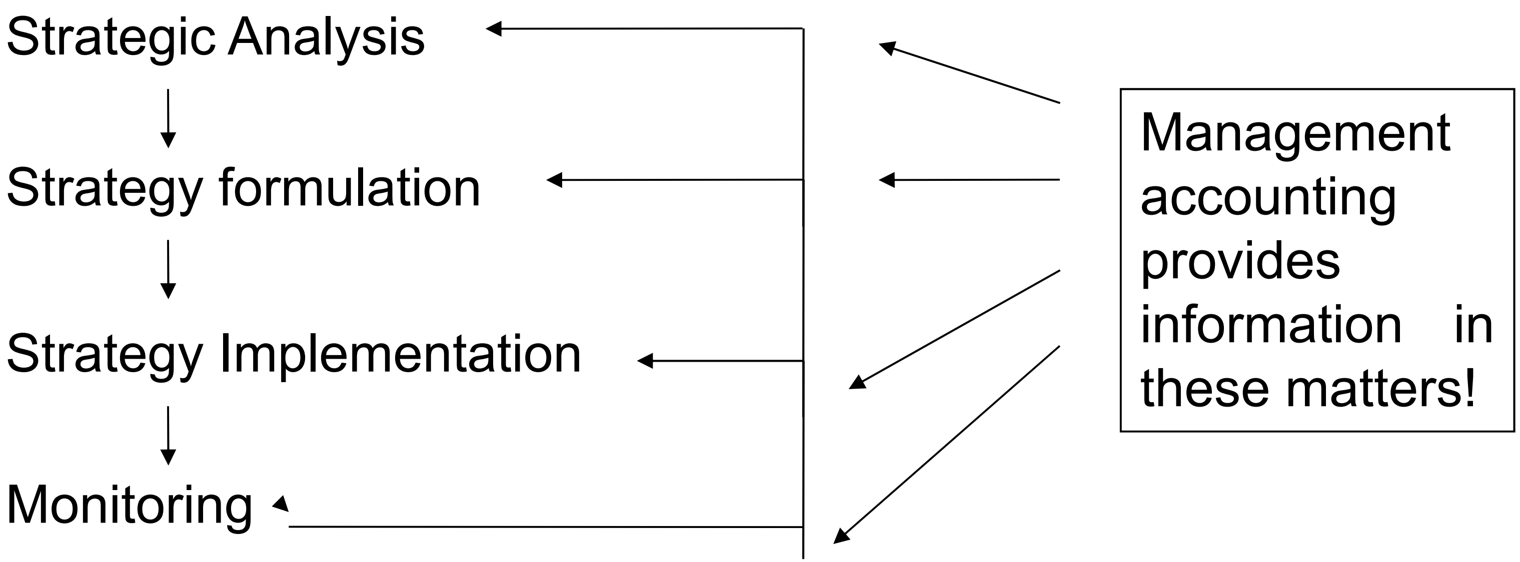
- **Functional (or operational) strategy** is the company's actions of a specific function (e.g., distribution) within particular businesses.
  - Pulls together the various activities and competencies of each function so that the organisational strategies and goals are achieved.

Porter's competitive strategy

- **Lower cost (or overall cost leadership) strategy**
  - The ability to produce and market a comparable product at lower price than its competitors.
  - Focuses on low cost, high market share, standardised products, economies of scale, and tight cost control. Firms using lower cost strategy produce no-frills products industry-wide.
- **Differentiation strategy**
  - The ability to produce and market unique and superior quality products.
  - Focuses on product uniqueness, brings brand quality, emphasises marketing and research, and has superior after-sale service.
- **Focus strategy,**
  - Concentrates on a defined buyer group, product line or geographic market, and quick response (or niche strategy)

Strategic Management

Strategic Management is the ongoing process of ensuring a competitively superior fit between an organisation and its changing environment (Kreitner)



Changing environment: Management accounting in change

- Consistent with the changing environment, management accounting is also in a process of change.
- Increasing numbers of businesses are adopting
  - activity-based costing,
  - strategically oriented performance measurement systems and
  - strategic cost analysis.
- This enables businesses to track their performance in comparison to its competitors.
- Scholars label this discipline *Strategic Management Accounting.*
- Strategic management accounting is built upon the view that a MAS should be tailored specifically to the strategies and environment of the business.

Strategic management accounting

- Over the next few weeks we will…
  - see how management accounting exists within any enterprise primarily to facilitate the development and implementation of competitive business strategy,
  - examine the process of strategy formulation, communication, implementation and control and
  - integrate conventional management accounting techniques into a strategic management accounting framework.

Management accounting & strategic management accounting (1)

- MA identifies, collects, measures, and reports information that is useful to managers in planning, controlling, and decision making.
- Technical-rational (or conventional) role of management accounting.
- Based on the basic premise that a business has
  - preset unitary goals,
  - utility/profit maximisation goals, and
  - an efficiency and effectiveness focus
- Management accounting textbooks identify the following two key points concerning managers and accounting information:
  - Managers need information, and they understand its usefulness and how to use it.
  - Management accounting information can contribute to the following management areas:
    - policy formulation,
    - planning and controlling the activities of the firm and
    - decision-taking on alternative courses of action.

Management accounting & strategic management accounting (2)

- SMA is a set of techniques and expertise available to managers to deal with the increased scale and pace of change within and outside organisations.

- Conventional MA is heavily technical and focus mainly on short-run decisions.

- Major limitations of conventional MAS:
  - **Technical-orientation** - placing heavy emphasis on technical (or computational) aspects of accounting;
  - **The ignoring of human-relations aspects** such as employee morale, attitude, perceptions, and motivation; and
  - **The ignoring of business context** such as strategy, organisational culture, management/leadership style, external environment, government regulation, politics and power.
- To deal with today's complex and uncertain business environment, conventional approaches to management accounting may no longer be sufficient for their heavy emphasis on financial, quantitative and historical information

Financial accounting, cost accounting, cost management and strategic cost management: how do they relate? (1)

- **Financial accounting** originated to fulfil the “stewardship” function of businesses.
  - It measures and records business transactions and provides financial statements.
  - Concentrates on external reporting such as income statements, balance sheets, cash flow statements and changes in equity.
- **Cost accounting** is concerned with calculationl of costs.
  - It provides information on a company's costs and may be used for both external and internal purposes:
    - external purposes - it measures the cost of production and sales in accordance with generally accepted accounting principles.
    - internal purposes, cost accounting information provides the basis for planning, controlling, and decision making.

Financial accounting, cost accounting, cost management and strategic cost management: how do they relate? (2)

- Cost accounting includes (CVP) analysis, budgeting, relevant costing, job costing, process costing, activity-based costing (ABC), activity-based management (ABM).
- **Cost management** requires a deeper understanding of the cost structure of the firm.
  - It combines elements from 3 fields: management accounting; production; and strategic planning.
  - Used to describe the activities of managers in short-run and long-run planning and control of costs.
  - Cost management not only focuses on cost reduction, but also on cost control and management.

Financial accounting, cost accounting, cost management and strategic cost management: how do they relate? (3)

- **Strategic cost management** provides costing information for strategic decisions.
  - It helps formulate and communicate strategies.
  - Long-run focus and carries out tactics that implement those strategies.
  - Develops and implements controls that monitor success at achieving strategic objectives.
- Financial accounting, cost accounting, cost management, strategic cost management, management accounting and SMA all contribute to the information (financial and non-financial) system of an organisation and increasingly in practice are totally integrated.

ASPECTS OF SMA

- Balanced scorecard
- Value chain analysis
- Activity based management & ABB
- Benchmarking
- Target costing/Kaizen Costing
- Product life cycle costing
- Competitor analysis
- Just in time and total quality management
- Accounting for sustainability