

STRATEGIC MANAGEMENT ACCOUNTING

LECTURE 9_1

THE ORIGINS OF MANAGEMENT ACCOUNTING: A REVIEW

CLASS SCHEDULE

12:30 - 12:45

BRAINSTORMING

12:45 - 13:00

WHAT IS HISTORICAL
ANALYSIS?

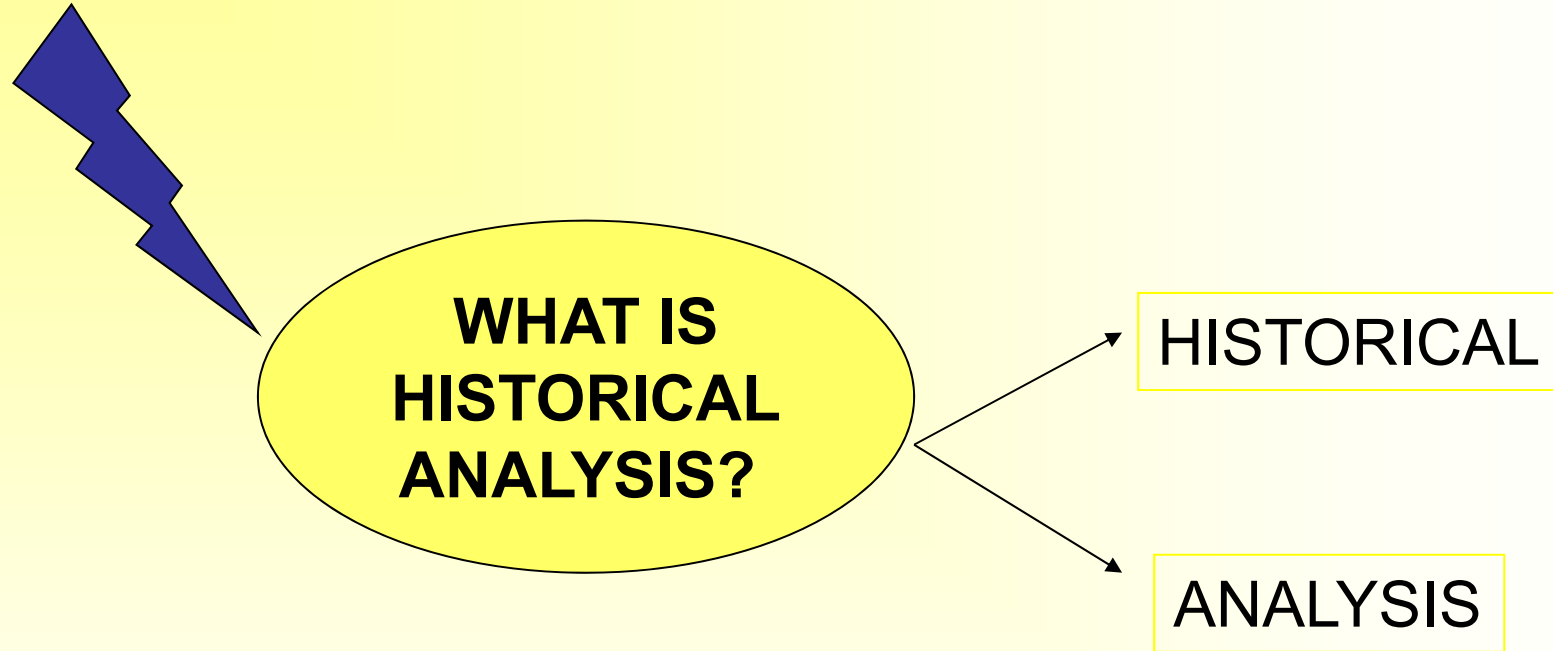
13:00 - 14:30

THE ORIGINS OF MA

BRAINSTORMING

1. WHAT IS THE HISTORICAL ANALYSIS?
2. WHY IS THIS RELEVANT, IF AT ALL?
3. WHAT DOES IT MEAN TO CONDUCT A HISTORICAL ANALYSIS OF (MAN) ACCOUNTING?

INTRODUCTION: A HIST. ANALYSIS (1)



**Analysis of '*how & why*'
something developed as it did.**

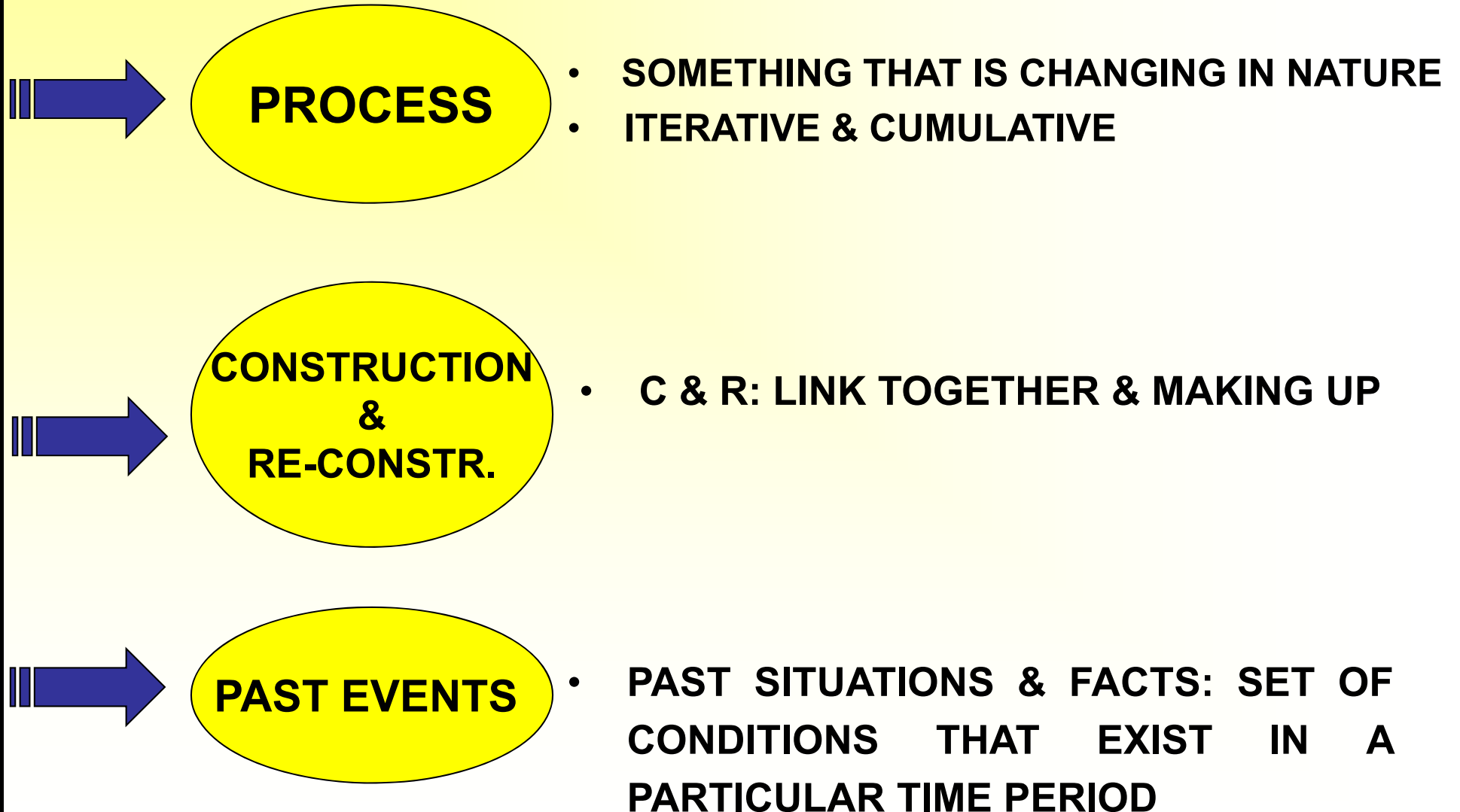
INTRODUCTION: A HIST. ANALYSIS (2)

**“Those who don’t remember the past are condemned to relive it”
(Santayana)**

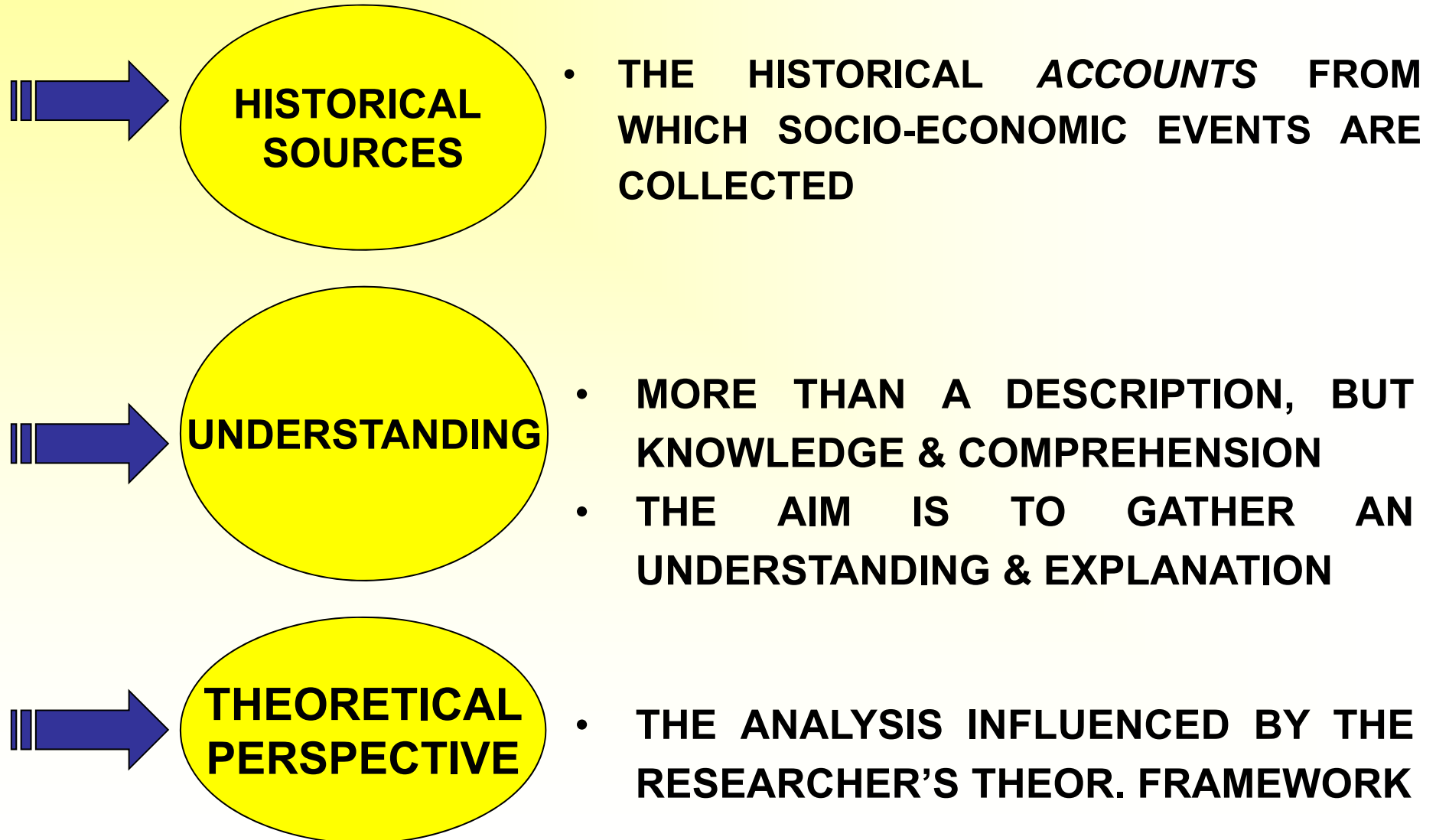
WHAT IS IT?

It is something more than a simple description of past events and facts. It is a complex **process** of “**construction** and **reconstruction** of **past situations**” through the use of appropriate **historical sources**.

INTRODUCTION: A HIST. ANALYSIS (3)

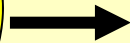


INTRODUCTION: A HIST. ANALYSIS (4)



INTRODUCTION: A HIST. ANALYSIS (5)

**WHY IS IT
RELEVANT?**

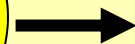


As noted by Le Geoff the historical analysis is essential because it provides answers to the following questions: i) What are we? ii) Where do we come from? iii) Where are we going to?

**It provides an «explanatory»
framework**

INTRODUCTION: A HIST. ANALYSIS (6)

SO WHAT?



The historical analysis provides any researcher with a moral and intellectual framework through which to understand, make sense and explain the «origins and prospects» of any socio-economic phenomenon.

The following historical analysis should be considered as a conceptual framework for interpreting and understanding the origins of MA

THE ORIGINS OF MANAGEMENT ACCOUNTING (1)

- In literature several authors have analysed the origins MA: e.g. Chandler, 1977; Johnson, 1972; Loft, 1995; Kaplan, 1984; Johnson & Kaplan, 1987.
- These studies show a renovated attention to the study of the «history» of MA: «how» and «why» MA developed as it did during the 20th century.
- Different historical accounts used to construct an explanation of the origins of MA: firms' archives, manuals, textbooks, articles.

THE ORIGINS OF MANAGEMENT ACCOUNTING (2)

- **An historical analysis of MA is relevant because provides a conceptual framework (Loft, 1995):**
 - i. To better understand today's MA practices;**
 - ii. To investigate the institutional contexts within which MA developed as it did.**
- **We drawn on the works of Kaplan, 1984, J&K 1987, Loft 1995, to analyse «how & why» MA developed.**
- **Focus on two Qns: 1) What MA practices developed?**
2) How & why did MA emerge?

THE ORIGINS OF MA: INTRODUCTION

- A) *GENESIS* OF COST ACCOUNTING: 1850-1900;**
- B) *DEVELOPMENT* OF COST ACCOUNTING AND
MANAGEMENT CONTROL: 1900-1925;**
- C) *STATIONARY* STATUS/ROLE OF MA: 1925-1980s;**
- D) *REGAINING* RELEVANCE: SINCE 1990s**
- E) SO WHAT? DIFFERENT APPROACHES?**

THE ORIGINS OF MA: GENESIS (1850-1900)

- Kaplan (1984) traces the origins of cost acc. to 1850s when the first big *textile* & railroads firms emerged (drawing on Chandler, 1977; Johnson, 1972).
- Demands for information for planning & control.
- Information generated to *coordinate & record*:
 - i. Textile to coordinate the multiple processes involved in the production;
 - ii. Railroads to summarize an enormous No of cash transactions (summary of financ. reports).

THE ORIGINS OF MA: GENESIS (1850-1900)

- In the late 1880s these emerging accounting systems were adopted by the first giant mass production & distribution firms (e.g. Carnegie).
- Similarly, these cost accounting systems used to «*coordinate*» but also *to* «*control*» activities.
- «Control» through «calculation of costs».
 - «Costs were the obsession of Carnegie.. The men felt and often remarked that the eyes of company were always on them through the books» (Chandler, 1977; pp. 267-268)
- Control as «detecting» activities & costs.

THE ORIGINS OF MA: GENESIS (1850-1900)

- **In particular, cost accounting systems used to monitor and control costs (i.e. prime cost). This allowed price-cutting initiatives during economic recession.**
- **Thus, cost accounting as a «lever» for gaining competitive advantage through cost reduction.**
- **Scientific Management Approach, promoted by engineers, gave an impetus to development of cost account. & management control systems.**

THE ORIGINS OF MA: GENESIS (1850-1900)

- **SMA was a managerial approach through which to manage, organize and control firms.**
- **SMA based on the idea of providing a «scientific» (mathematical-based) measure of the STDs of the manufacturing factors (e.g. labour/materials) required to produce a given unit of output.**
- **SMA stimulated several innovations in terms of ways of organizing, managing & control (e.g. burden cost; development of standard costing).**

THE ORIGINS OF MA: GENESIS (1850-1900)

- For Kaplan (1984) **COST ACCOUNTING** emerged between 1850s-1880s & developed in early 1900s.
- The **COST ACCOUNTING INFORMATION** used to:
 - i. Assess operating efficiency (**EFFICIENCY**);
 - ii. Aid determination of price (**PRICING**);
 - iii. To coordinate activities (**COORDINATION**);
 - iv. Control/motivate workers performance.
- **COST ACCOUNTING INFO was USEFUL.**

THE GENESIS OF COST ACCOUNTING

THE ORIGINS OF MA: DEVELOPMENT (1900-1925)

- The first **giant & vertically integrated enterprises** emerged: e.g. Du Pont (DP) & General Motors (GM).
- **DP** considered by Chandler & Johnson as an «**innovator**» of management and control practices.
- **BUT WHY?** We need to consider that:
 - i. **DP** developed a **vertically integrated & multi-activities form of organization**: complexity/diversity;
 - ii. **Managerial innovations** required to cope with new complexity & diversity.

THE ORIGINS OF MA: DEVELOPMENT (1900-1925)

- iii. One of these **INNOVATIONS** was the development of the functional/unitary form of organizing activities: this led to **DECENTRALIZATION** of firms into separate Depts (sales, manufacturing, etc).
- iv. **DECENTRALIZATION & FUNCTIONAL** organization required *ad hoc* performance **measurement systems & indicators** for evaluation: **ROI***
- v. But RECESSION after WWI calls for **re-innovations**: DP/GM adopted «**multidivisional**» form of organizing.

THE ORIGINS OF MA: DEVELOPMENT (1900-1925)

- vi. In GM this **NEW form of organizing** involved the adoption of a new approach «**centralized control with decentralized responsibility**».
- vii. The **problem** was the «**control**» & «**coordination**» of the separate multidivisions: **new cost accounting & management control systems** required.
- **SO WHAT?** In GM & DP new *ad hoc* accounting & management control systems emerged & developed as they were a **SINE QUA NON** for their survival.

THE ORIGINS OF MA: DEVELOPMENT (1900-1925)

- The MAS & practices adopted in GM did provide:
 - i. An annual operating forecast to monitor divisions' performance;
 - ii. Flexible budgeting and sales reports to measure the actual results of each division;
 - iii. Pricing formula to determine the standard price;
 - iv. An incentive and profit sharing plan for senior managers (The Bonus Plan);
 - v. Market-based transfer price system btw divisions

THE ORIGINS OF MA: DEVELOPMENT (1900-1925)

SO WHAT?



The emergence of modern corporations between 1900-1925 provided the stimulus for the development of innovative managerial, organizational and control practices (ROI, Flexible BDG, etc.). According to Kaplan, by 1925 DP & GM have adopted many of today's (i.e. '80s) management control practices.

THE RISE OF MANAGEMENT ACCOUNTING

ORIGINS OF MA: (UN)DEVELOPMENT SINCE 1925

- Kaplan sustains that between 1925- 1980s there have not been **MAJOR** innovations in MA by practicing managers & management accountants.
- The only developments regard:
 - i. Modern treatment of capital budgeting;
 - ii. The Residual Income extension to ROI;
 - iii. Discounted Cash Flow analysis;
 - iv. Applications of quantitative models;
 - v. More recently theoretical contributions from Agency theory & Transaction cost theory

ORIGINS OF MA: (UN) DEVELOPMENT SINCE 1925

- **So WHY did it occur?** Kaplan sustains that:
 - i. Innovations that emerged in the «RISE ERA» were the result of the activities of managers who devised and adopted these innovations in practice.
 - ii. In contrast, innovations developed since 1925 were detached from the real life of the organization. These are devoid of reference to actual organizational life.
 - iii. As a result MA became «irrelevant» to the challenges deriving from changes in the business environment.

ORIGINS OF MA: (UN) DEVELOPMENT SINCE 1925

SO WHAT?



The MA practices and knowledge which developed in the period after 1925 till 1980s were not based on investigating decisions/procedures of actual organizations in their specific context but based on stylized models of firms' behaviour developed by economists.

THE FALL OF MANAGEMENT ACCOUNTING

ORIGINS OF MA: RE-GAIN RELEVANCE?

- Kaplan (1984) identifies what were the new & essential directions in order to «re-gain» the relevance lost of MA:
 - i. Extension of the indicators that are necessary to evaluate the organizational performance beyond financial aspects: INCLUSION OF NON FINAN.
 - ii. Adoption of a multiple indicators perspective for performance evaluation: e.g. BSC;
 - iii. Links with planning & strategy control of firms: VAC; TQM (Johnson, 1994)

THE ORIGINS OF MA: SO WHAT?

WHAT IS IT?

Historical Analysis of MA is more than a description of MA practices that emerged in the past. It is a complex **process** of “**re-construction** of **how & why** MA developed, through the analysis of historical **sources**.”

There is NOT «ONE» history of WHY & HOW MA developed.

THE ORIGINS OF MA: APPROACHES

«There is not a single, simple, history of MA which can honestly claim to be the History. All histories are inevitably partial and depend on the assumptions of theories of the author»(Loft, 1995)

A) TRADITIONALISTS (Garner, 1954);

B) NEO-CLASSICISM (Fleischman et al.);

C) JOHNSON & KAPLAN's APPROACH

D) LABOUR PROCESS APPROACH;

E) FOUCAULTIAN APPROACH.

THE ORIGINS OF MA: TRADITIONALISTS

- **Traditional historians (Garner) argue that cost accounting systems emerged at the end of 19th C.**
- **‘Crude’ costing to determine ‘prime cost’ of a product.**
- **Great Depression (1873-1896) caused a drastic reduction in the demand: price-cutting initiatives.**
- **This is a ‘linear’ explanation of origins of MA.**
- **This approach was criticized due to limited sources used: firms’ manuals & articles**

Cost accounting USEFUL to respond to changes

THE ORIGINS OF MA: NEO CLASSICISTS

- **Neo Classicists (e.g. Fleischman, Parker & Tyson) share with traditionalists a rather 'passive' view of the origins of cost accounting.**
- **CA/MA developed because «served» the firms' needs related to the changes in the business environment.**
- **In contrast, neo-classicists used different historical sources such as detailed case studies & concluded that MA developed much earlier than thought before.**

Cost accounting SERVED to respond to changes

THE ORIGINS OF MA: J&K* VIEW (1)

- **J&K argue that Cost Accounting developed earlier than thought by traditionalists (agree with Neo-Class).**
- **CA developed when, as result of industrial capitalism that led merchants to adopt a factory system where employers were paid by wage contract, the labour cost per unit of output needed to be calculated for assessing the efficiency (J& K, 1987, p. 42):**

MA practices in manufacturing, rail transportation and distribution firms had one common purpose: to evaluate a company's internalized process...this new accounting information focused on the efficiency».

THE ORIGINS OF MA: J&K* VIEW (2)

- MA developed over 1920s with the growth of the giant firms (DP & GM). MA played an important role in coordinating, managing and controlling these firms.
- MA **strategic instrument** for responding to the changes in the environment and ensure efficiency.
- BUT after 1925, MA lost its relevance, when firms shifted from cost *management* to cost *accounting*.
- MA had a golden age in early 1900, but over the years it *lost its relevance*.

MA NEEDS TO REGAIN ITS RELEVANCE

THE ORIGINS OF MA: LABOUR APPROACH (Hopper & Armstrong)

- **MA & control systems are not neutral mechanisms for decision making but means through which to «control» labour processes and workers.**
- **H&A argue that developments in MA over the 19th/20th directed to exercise power on labour (e.g. increasing impersonality) rather than to improve efficiency.**
- **H&A *reinterpret* the events described by J&K by providing a different explanation of HOW & WHY.**

**CA/MA ASSOCIATED WITH DESIRE TO CONTROL &
MANIPULATE LABOUR PROCESS IN THE FACTORY**

THE ORIGINS OF MA: FOUCAULTIAN APPROACH* (1)

- **F. encouraged a different school of thought in the history of MA, by focusing on ‘disciplinary institutions’.**
- **In these instit. individuals are grouped to be watched & punished if rules are not respected (SURVEILLANCE & DISCIPLINE).**
- **Similarly in factories workers are set up to allow SURVEILLANCE via creation of records about their work.**
- **From such a perspective, management systems and accounting could be seen as means of «surveillance», «discipline» and «punishment» of labour and workers.**

THE ORIGINS OF MA: FOUCAULTIAN APPROACH* (2)

- F.'s view is that knowledge & power are intrinsically connected. The role of supervisors & knowledge (e.g. costs) allows them to exercise this power on others.
- Hoskin & Macve adopted this approach to study origins of MA, by looking at experience of Springfield Armory.
- The introduction of the principles of «discipline» and «control» to measure human performance were the first step through which to make workforce a «set of *calculable* & thus *governable* persons» (Miller & O'Leary)

MA EMERGED TO GOVERN HUMAN PERFORMANCE

MANAGEMENT ACCOUNTING AN INTRODUCTION:

Further suggested readings

- **A. Ashton, T. Hopper, R. Scapens, “*Issues in Management Accounting*”, Second Edition, Prentice Hall, 1995, Chapter 1;**
- **H.T, Johnson, R. Kaplan, “*Relevance Lost: the Rise and Fall of Management Accounting*”, Harward Business School Press, 1987, First part**
- **Ezzamel M., Hoskin K. and Macve R., (1990) “ Managing It All By numbers: A Review of Johnson & Kaplan’s ‘ Relevance Lost’”, Accounting and Business Research, Vo. 20, N° 78, pp.153-166 .**
- **Fleischman R. and Tyson T,(2000) “ Parallels between US and UK cost accountancy in the World War I era”, Accounting Business and Financial History, Vol. 10, N° 2, pp 191-212**