

# STRATEGIC MANAGEMENT ACCOUNTING

## LECTURE WEEK 10

### THE ORIGINS OF MANAGEMENT ACCOUNTING: A REVIEW

# CLASS SCHEDULE

12:00 - 12:15

BRAINSTORMING

12:15 - 12:30

WHAT IS HISTORICAL  
ANALYSIS?

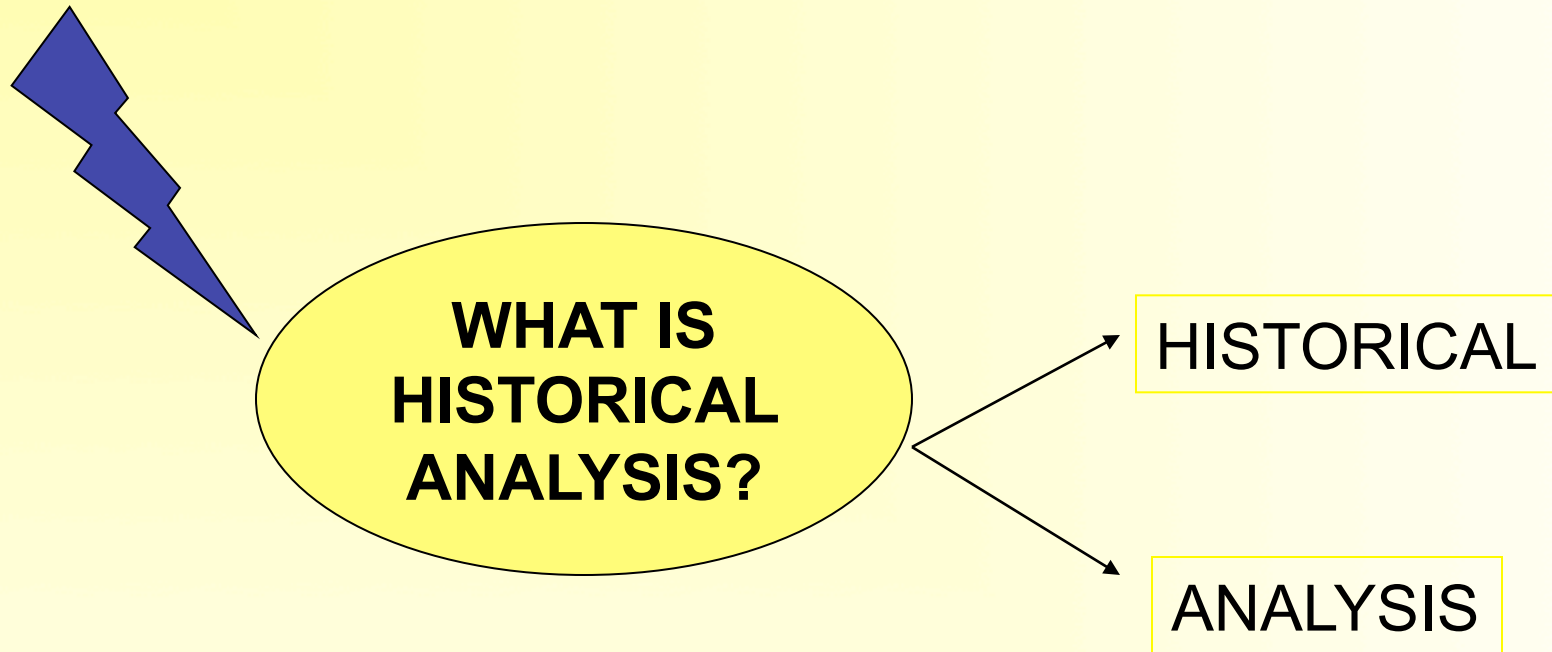
12:30 - 13:15

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)



## PROCESS

- SOMETHING THAT IS CHANGING IN NATURE
- ITERATIVE & CUMULATIVE



## CONSTRUCTION & RE-CONSTR.

- C & R: LINK TOGETHER & MAKING UP



## PAST EVENTS

- PAST SITUATIONS & FACTS: SET OF CONDITIONS THAT EXIST IN A PARTICULAR TIME PERIOD

# INTRODUCTION: A HIST. ANALYSIS (4)



## HISTORICAL SOURCES

- THE HISTORICAL ACCOUNTS FROM WHICH SOCIO-ECONOMIC EVENTS ARE COLLECTED



## UNDERSTANDING

- MORE THAN A DESCRIPTION, BUT KNOWLEDGE & COMPREHENSION
- THE AIM IS TO GATHER AN UNDERSTANDING & EXPLANATION



## THEORETICAL PERSPECTIVE

- THE ANALYSIS INFLUENCED BY THE RESEARCHER'S THEOR. FRAMEWORK

# INTRODUCTION: A HIST. ANALYSIS (5)



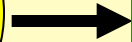
**WHY IS IT  
RELEVANT?**

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.**

# 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**