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CENTRE FOR SOCIAL AND ENVIRONMENTAL ACCOUNTING RESEARCH

THE ORIGINS OF MANAGEMENT ACCOUNTING

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INTRODUCTION

In literature several authors have analysed the origins Management Accounting (MA): e.g. Chandler, 1977; Johnson, 1972; Loft, 1995; Kaplan, 1984; Johnson & Kaplan, 1987.

These studies provide a renewed interest 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.

INTRODUCTION

An historical analysis of MA is relevant because provides a conceptual framework (Loft, 1995):

To better understand today's MA practices;

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.

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?

GENESIS (1850-1900)

Kaplan (1984) traces the origins of cost accounting 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 number of cash transactions (summary of financial reports).

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)

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.

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 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).

GENESIS (1850-1900)

For Kaplan (1984) COST ACCOUNTING emerged between 1850s-1880s & developed in early 1900s.

COST ACCOUNTING INFORMATION was used to:

Assess operating efficiency (EFFICIENCY);

Aid determination of price (PRICING);

To coordinate activities (COORDINATION);

Control/MOTIVATE workers performance.

COST ACCOUNTING INFO was USEFUL.

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.

DEVELOPMENT (1900-1925)

One of these INNOVATIONS was the development of the functional/unitary form of organizing activities: this led to DECENTRALIZATION of firms into separate Deptartments (sales, manufacturing, etc).

iv. DECENTRALIZATION & FUNCTIONAL organization required ad hoc performance measurement systems & indicators for evaluation: Return on Investment (ROI)

v. But RECESSION after WWI calls for re-innovations: DP/GM adopted “**multidivisional**” form of organizing.

DEVELOPMENT (1900-1925)

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

DEVELOPMENT (1900-1925)

The Management Accounting System & 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;

An incentive and profit sharing plan for senior managers (The Bonus Plan);

Market-based transfer price system between divisions

DEVELOPMENT (1900-1925)

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.

(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

(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.

(UN)DEVELOPMENT SINCE 1925

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.

RE-GAIN RELEVANCE?

Kaplan (1984) identifies what were the new & essential directions in order to "**re-gain**" the relevance lost of MA:

Extension of the indicators that are necessary to evaluate the organizational performance beyond financial aspects: INCLUSION OF NON FINAN.

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?

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 only "ONE" history of WHY & HOW Management Accounting developed.

THE ORIGINS OF MA: APPROACHES

A) TRADITIONALISTS (Garner, 1954);

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

C) JOHNSON & KAPLAN's APPROACH

D) LABOUR PROCESS APPROACH;

E) FOUCAULTIAN APPROACH.

*«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)

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

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 it 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.

JOHNSON & KAPLAN

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*.

FOUCAULTIAN APPROACH* (1)

- The philosopher Michel Foucual inspired a different school of thought in the history of MA, by focusing on ‘disciplinary institutions’.
- In these institutions, individuals are organised in such a way as to be watched & disciplined if rules/standards are not respected (SURVEILLANCE & DISCIPLINE).
- In factories, the organisation of work allows for the SURVEILLANCE of workers the via the creation of records about their work and/or managerial performance.
- From such a perspective, management systems and accounting could be seen as means of “surveillance”, and “discipline” and of labour

FOUCAULTIAN APPROACH* (2)

- Foucault’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)

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