2 Emerging Issues

CHAPTER CONTENTS

INTRODUCTION

Robert Kaplan's tongue-in-cheek comment on the evolution of management accounting from the early years of the twentieth century suggests that nothing has changed much, especially where teaching and textbooks are concerned:

> **Despite considerable changes in the nature of organisations and the dimensions of competition during the past 60 years, there has been little innovation in the design and implementation of cost accounting and management control systems. Virtually all of the practices employed by firms today had been developed by 1925. (Kaplan, 1984: 390)**

Like most rash generalizations, the statement contains an element of truth, and in this chapter we examine both what has, and has not, changed, together with the developments in management accounting research. We conclude by speculating on the future direction of such activity.

HISTORICAL DEVELOPMENT

The traditional basis of management accounting was firmly established by the 1920s, as Table 2.1 demonstrates. The industrial revolution, particularly in the UK and USA, drove the implementation of managerial controls in the 1890s, and generated scientific approaches to optimizing the use of physical and material resources. Thus, internal administrative processes were established to co-ordinate multiple production activities; operating statistics were generated to evaluate performance, and elaborate cost reporting mechanisms were devised, particularly for the use of direct labour and raw materials.

By the 1920s, normal managerial practice embraced both a centralized accounting system on the one hand and a decentralized functional organization on the other. Such a distinction allows management to finance

TABLE 2.1

The historical development of management accounting

Development	Date
Cost and management control information	1890
Scientific management	1901
Break-even charts	1903
Standard costing and variance analysis	1908
Centralized accounting systems with decentralized functional organization	1900
Capital and operating budgets	1910
Centralized control and decentralized responsibility	1920
Separation of financial and cost accounting	1923

capital requirements and allocate investments appropriately between competing activities while allowing time for the development of specialist managers and freeing senior management from operational responsibilities sufficiently to allow them to adopt strategic and planning roles.

The decentralization of responsibilities into divisional entities necessitates annual forecasting to co-ordinate operations and performance monitoring for the early detection of budget variances. The efficient allocation of resources demands uniform performance criteria embracing the use of sophisticated, market-based transfer pricing mechanisms.

The recognition of the importance of non-accounting disciplines – notably mathematics, statistics, sociology, psychology, management and marketing – in the identification and modelling of factors influencing information processing and decision-making has changed the direction of management accounting practice and research. Table 2.2 details the major developments in management accounting since 1940, many of them the result of the adaptation of methods already established in other disciplines.

As Lothian (1987) observes, the factors critical to corporate success now bear little resemblance to those applicable in the 1920s . Neely et al. (2003: 8) echo the remark by emphasizing the extent to which globalization has changed the nature of business. Changes in technology and the manufacturing environment mean that world-class manufacturers must now focus on:

- quality of output;
- zero defects in supplies;
- minimum inventory levels made possible by just-in-time deliveries;
- flexible manufacturing systems; and
- goal-oriented programmes for the workforce.

The investigation of the role of management accounting information in complex operations has focused on the interaction of disciplines in actual practice and the formalization and correction of deficiencies. This is particularly applicable to the pioneering work of Cooper, Johnson and Kaplan in the development of activity-based costing (ABC) since the mid-1980s, and of Kaplan and Norton in the development of the balanced scorecard since the mid-1990s. Although the great majority of published examples have so far been based on production and assembly operations, there is

TABLE 2.2

Post-1925 developments

Development	Date
Residual income method	1940
Simplex method for linear programming	1944
Discounted cash flows	1950
Total quality management	1950s
Cusum charts	1954
Optimum transfer pricing	1957
Computer technology	1960
Opportunity cost budgeting	1966
Zero-base budgeting	1969
Information economics and agency theory	1970s
Just-in-time scheduling	1970s
Activity-based costing	1980s
Target costing	1980s
Value-added management	1980s
Theory of constraints	1980s
Business process re-engineering	1990s
Balanced scorecard	1990s
Economic value added	1990s

now sufficient evidence to suggest that the basic principles will also apply to the small business and service sectors.

MANAGEMENT ACCOUNTING RESEARCH

The published findings of academic research in management accounting have frequently been criticized for lacking both relevance and timeliness. Both characteristics remain important issues:

- The most recent survey evidence suggests that there is still a sizeable gap between the topics that academics write about and those that managers want to hear about.
- The rigorous refereeing requirements of the top academic journals mean that the time lags prior to publication are excessive – perhaps three years from project to publication for the 'best' journals – so we must still look to the professional and practitioner literature, and to the *Harvard Business Review*, for the latest ideas.

The requirement for relevance has seen a trend towards field studies and the use of case study research, reflecting both internal and market requirements in determining the development of management accounting information systems, but difficulties remain. Over 15 years ago, Bromwich and Bhimani (1989) identifed five persistent weaknesses in management accounting practice that required further research:

- the subservience of management accounting to external financial accounting requirements;
- the lack of strategic considerations in management accounting and project appraisal;
- the reliance of management accounting on redundant assumptions concerning manufacturing processes;
- the maintenance of traditional assumptions in performance evaluation; and
- the continued short-term orientation of performance measurement.

Their research findings were instructive in providing indications of the likely direction of research. In particular, they identifed:

- the overwhelming need to identify *cost drivers* which link processes to the costs of output;
- the need to measure *activity-based costs* where these are meaningful and can lead to significant benefits;
- the benefits of *non-financial* accounting information in different manufacturing environments;
- the opportunity to incorporate both *qualitative* and non-financial, quantitative information into management accounting information systems; and
- the increasing relevance of a *strategic* approach to management accounting.

Each of these areas provided fruitful research avenues: ABC issues dominated the literature for the next decade, and cost allocations and capacity considerations remain at the forefront of concern and have generated renewed, and welcome, interest in operations management issues. More recently, cost drivers and activity-based costing have lost their prominence, initially to a fleeting flirtation with the theory of constraints and throughput issues, but latterly through the balanced scorecard, which has become a focus for the study of non-financial measures. However, it would be fair to say that 'strategic' approaches and 'qualitative' measures have remained under-researched.

A number of subsequent studies report the conduct of up-to-date literature views and speculate on the future direction of management accounting research. It is instructive to compare these 'expectations' with outcomes over the period to identify those topics which remain under-researched, from both an academic and a practitioner perspective.

Atkinson et al. (1997a), in a study that included contributors from around the world, established three broad areas which might attract management accounting researchers:

- the role of management accounting in organizational change;
- the interaction between accounting and organizational structure; and
- the role of accounting information in supporting decision-making.

They (like Shields, 1997) recommended the adoption of a multi-method approach to research in these three broad areas, and provide more specific guidance with the following structure.

1 Change:
   - the effect of management accounting on organizational change;

  - organizational change as an impetus for management accounting change; and
  - the process of change.

2 Structure:
  - at the micro level – for example, the impact of empowered work groups on decision-making and performance evaluation;
  - at the macro level – for example, the adaptability of management accounting to both centralized and decentralized organizational structures; and
  - linkages within control systems in, for example, the balanced scorecard.

3 Decision-making:
  - strategic decisions and the design of management control systems;
  - resource-based views of the organization;
  - non-profit organizations; and
  - tactical decision-making.

Two important literature reviews, by Shields (1997) in the USA, and by Scapens and Bromwich (2001) in the UK, detail what was being published in the top tier of academic literature in management accounting in the final years of the twentieth century. Management accounting practice, management accounting change and cost accounting techniques (including ABC) dominate the lists. Shields (1997) identified six key areas for future research:

- management accounting change;
- supply and value chains;
- strategy accounting;
- virtual accounting; and
- multiple research methods.

Foster and Young (1997), in another US study, argue that an important source of research topics is the view of management, often gleaned from the press or from practitioner journals. But such topics might be deemed to be too 'new' or too 'different' for them to be published in the most prestigious academic journals. Foster and Young (1997) identified five topic areas of relevance to organizations which they deem to be 'under-researched':

- customer profitability and satisfaction;
- cost management and cost control;
- quality;
- growth; and
- profitability.

Otley (2001) suggests that management accounting research has become misdirected: too focused on 'accounting' and consequently with too little attention directed towards 'management' issues. He suggests that as a result we see a widening gap between academic research and management accounting practice. Jazayeri and Cuthbert (2004) investigate the nature and extent of this 'gap' by comparing practitioner requirements with the output of the leading academic journals in the field. They note some change in publishing practices since the Shields (1997) and Scapens and Bromwich (2001) papers, with an observed movement from 'cost reporting and analysis' towards a more future-oriented approach to cost management. More important, they detail what is *not* being published, especially where there is a clear difference with the requirements of decision-makers. High on the list of manager preferences in the Jazayeri and Cuthbert study were 'change management', 'technological impact', 'regulatory impact' and, most importantly, 'staff-related issues'. Indeed, research into human resources aspects of management was consistently the top requirement of decision-makers in organizations of all sizes – while such studies rarely, if ever, grace the pages of the top management accounting journals.

Interestingly, some of the topics identified by Shields (1997) and Foster and Young (1997) in the USA, and by Atkinson et al. (1997a), did not rate highly in the preferences apparent in the UK survey conducted by Jazayeri and Cuthbert (2004). While 'cost control' accounted for 12.6% of responses, 'customer retention' was responsible for a miserly 1.1%! However, there is some common ground and the highest-rated issues in the manager survey have clear implications for management accounting research. These issues are:

1 Staff-related (HRM) issues. While the major concerns might embrace the mainstream management/psychology literature (e.g., leadership, motivation, staff and customer retention) the accounting implications revolve around our ability to create value from these attributes. The focus therefore moves to intangible assets and our ability to link these to financial performance. The issues of customer relationship management, for example, are examined in more detail in Chapter 4; there we see the conflicting nature of the existing empirical evidence, very little of which has appeared in the accounting literature.
2 Impact of legislation on competitiveness. For the UK this would embrace issues concerned with the enlargement of the European Union, for example, including currency issues, transfer pricing and cross-border performance comparisons. It would also include globalization and cultural issues, particularly where these impact on issues of costs and managerial control.
3 Change management. The key issue in Shields' (1997) listing and a prominent topic, particularly in the practitioner literature.
4 Value and supply chain management. Second in the Shields (1997) list but still highly under-researched, perhaps because of its association with lengthy and expensive in-depth field studies.
5 New product development. A topic which reflects the relative neglect in the academic management accounting literature of start-up issues, and of issues related to small and medium-sized enterprises generally.

It is perhaps appropriate to finish this section with mention of the balanced scorecard from a research perspective. We will return to the scorecard and its implications for practice at several other points in this volume. Despite the numerous criticisms of the balanced scorecard (e.g., Atkinson et al., 1997b; Norreklit, 2000; Otley, 2001), it remains the management accounting innovation that has had the biggest impact on practice in the last decade. It is therefore deserving of more research attention than it has had to date. Otley (2001) identifies five specific areas where research into the balanced scorecard and its implementation would make a notable contribution:

- the benefits of a scorecard *per se*, rather than of its constituent measures;
- procedures for the mapping of the causal relationships implicit in the scorecard;

- the role of target setting;
- links with reward structures; and
- the establishment of information systems and feedback loops.

Empirical evidence in some of these areas is already beginning to emerge – for example, Ittner et al. (2003b), in suggesting that the existence of a scorecard in its own right has no positive impact on financial performance. We might anticipate progress in each of these five areas.

The words of Hayes and Abernathy (1980) have become sadly prophetic in that the outcomes they suggested were likely from financial accounting manipulation, and reward structures to match, have indeed come to fruition with the likes of Enron, Worldcom (in the USA), Parmalat (in Europe), and no doubt others. What Maltz et al. (2003) describe as 'asset restructuring and balance sheet wizardry in lieu of key investments' have serious implications for management accounting if they are to ensure that appropriate internal control procedures are in place. Wallin (2004) emphasizes the role of the finance professional in providing the reliable internal governance systems required by the Sarbannes–Oxley Act (2002). She draws parallels with total quality management systems in that quality has to be designed and built up from the *inside*, rather than inspected (or audited) from the outside. We might therefore anticipate future research that will highlight the role of the *accountant*, rather than accounting, so that the focus is more on the ethics, values and motivations of the individual, and the way in which these interact with the incidence of internal control.

SUMMARY

Recognition of the expanded scope of management accounting has yielded, and will continue to yield, great benefits. A strategic approach, recognition of the importance of the market and the impact of other disciplines has been paramount. The focus on value-added management and the use of shareholder value-type measures have highlighted weaknesses in our traditional financial accounting measures and have provided useful additions to the management accountant's armoury. Perhaps the greatest current opportunity lies in the recognition of the importance of a global approach. Globalization has changed the nature of business over the last ten years, increasing the levels of both complexity and uncertainty. We now have more external competitors, many of them 'virtual', and an expanded number of stakeholders (many of them with conflicting interests). Awareness of international trends and recognition of inter-country approaches and cross-cultural differences should all foster research into differences between individual management decision-makers associated with culture, gender and information processing styles. The implications for performance measurement and management control will be similarly pervasive.