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Strategic Management Accounting

16.1 Introduction and objectives

Traditionally management accounting has been characterised as providing information to aid managers internally in a firm and as such the focus of the management accounting systems has also tended to be internally orientated. During the 1980s and 1990s a growing number of academics (Johnson and Kaplan, 1987; Bromwich and Bhimani, 1989, 1996) began to recognise that management accounting was not adapting to changes in the modern business environment and as such was not fulfilling its function to aid managers.

In a bid to improve the quality of management accounting information for managers it was necessary to focus more widely on the external environment of the firm and thus the concept of strategic management accounting evolved. Now (strategic) management accounting involves the provision of information, which is externally orientated, market-driven and customer-focused and provides managers with a range of techniques and tools to facilitate strategically-orientated decision making.

After studying this chapter you should be able to:

- Discuss the development and key elements of strategic management accounting
- Understand the difference between traditional and strategic management accounting
- Evaluate key analytical tools which link management accounting with strategy.

16.2 Why strategic management accounting? Definitions and evolution

In order to fully appreciate the development of strategic management accounting it is necessary to evaluate the changes to the external environment of organisations over the last 30 years.

The first main change has been in relation to the competitive environment of organisations. They have seen significant change from the opening of barriers to trade allowing for global competition which in turn has been possible because of advances in technology.

The increase of competition has had the effect of shortening the lifecycle of products. This means that organisations have to work harder to develop new products and services and have less opportunity to recoup costs and generate profit before the decline of the product or service.

The improvement in technology has given more information to the customer allowing the customer to make better informed decisions about which products and services they wish to buy and also to allow the customer to be more proactive in selecting products and services which are tailored specifically for them. In particular the empowerment of customers has resulted in three key challenges for businesses:

- Prices are being forced down because customers are able to find a much wider source of alternatives.
- Quality is being forced up as businesses compete to attract the customer
- Greater variety in the product/service offering is necessary to attract the customer.

Additionally a number of new management techniques have been adopted by firms in light of the above concerns, such as total quality management, just in time and other methods to rationalise the cost of production and consumption.

The above developments have forced organisations to consider their position in their markets, their prices and their costs in a different way than they had done in the past.

Definitions of strategic management accounting began to spring up the earliest pioneer of which was Simmonds (1981) whose definition has subsequently been subsumed into the CIMA definition which is:

A form of management accounting in which emphasis is placed on information which relates to factors external to the firm, as well as non-financial information and internally generated information.

CIMA official terminology, 2005, p. 54

A number of definitions have appeared over the years but no definitive definition of what it is, or what techniques it contains, have been consolidated over the last 30 years.

In their most recent work Roslender and Hart (2010) review much of the literature and contend that three distinct conceptions of strategic management accounting have appeared:

- The attempt to incorporate strategic ideas into management accounting by taking generic strategy tools and looking at what management accounting information can be used to support strategy.
- That it is designed to align management accounting with marketing management for strategic positioning. This view looks at the marketing tools used by businesses and uses management accounting within those tools.
- That it is just a name to group together many of the contemporary approaches in management accounting that have developed which have a strategic implication. There are a number of contemporary approaches to management accounting which have been marked as strategic management accounting techniques because of their external and market orientated content.

16.3 Linking strategy and accounting (strategic versus traditional accounting)

Management accounting systems have three primary purposes:

- To allow for the allocation of costs between cost of goods sold and inventory for internal and external profit reporting
- To provide relevant information to aid management decisions
- To provide information to aid in planning, control and the evaluation of performance.

Whilst these are indeed important and critical requirements of accounting systems, the traditional viewpoint has been to use internal information to achieve them and this is where the failings of traditional management accounting can be seen to be apparent.

The first purpose is in line with financial reporting requirements and a failing of traditional management accounting has been that the techniques used have been orientated to satisfying financial reporting requirements rather than on providing information to help managers make better decisions which is the second purpose. The first purpose is also achieved by using absorption costing methods to achieve the cost used and we have previously commented on the failings of such a system particularly in service industries. Additionally much of the information provided for the second and third purposes has come from internal sources and historical data which have proved to also be inflexible and have failed to consider external factors such as customers or competitors.

To make management accounting more strategic it is necessary to provide information which has an external as well as internal focus and which is orientated towards the future rather than the past. Table 16.1 summarises the key points.