Implementation of Strategic Management Accounting

(Relevant to Paper II – PBE Management Accounting and Finance)

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Introduction

Modern business environments are increasingly competitive and dynamic. International competition through e-commerce and demand-based supply chain management dominate business. It is important for companies to develop coherent and consistent business strategies and to utilize management accounting tools to support strategic planning, decision-making and control.

Implementation of management accounting tools

To integrate business strategies with various management accounting tools, first companies need to identify which business they are in. It is essential to identify products and services, customer types, geographical markets, and delivery channels.

It is useful to match the strategic business unit (SBU) with the related business unit strategy. An SBU is a company department or sub-section which has a distinct external market for goods or services that differ from another SBU. Taking the example of a property agency, the property sales line on Lamma Island is one specific SBU which is different from those of other property sales lines in urban districts. Village house sales and related regulations are different from those for high-rise buildings in cities. A business unit strategy is about how to compete successfully in particular markets. It is important to focus on a certain segment, such as environmentally friendly cars in the automobile industry or Internet and phone banking in the retail banking industry. Then we ask how a specific strategy should be measured. Should this be by the additional expenditure spent for better positioning, or extra payments due to exceptional performance, such as outstanding quality, service or brand?

Let’s consider the example of Samsung. To select business strategies, the company first defines cost leadership relative to a group of competitors in consumer electronics, such as Panasonic and Sony. It measures extra promotional costs used for launching new products.

Another strategy is differentiation. This leads to unique comparison with competitors, for example, skincare lotion and multimedia games. It involves giving real or potential value to customers relative to competitors. Additional costs are tolerated if they add benefits to customers, with profit achieved through the premium price set.

Before making profit, the first concern is when we can achieve a breakeven situation. It is common to ask which type of business is hard to earn profit; where we should increase or reduce assets; what the short-term or long-term returns are, etc.

To evaluate financial performance, cost benefit analysis and performance driver analysis are used. For example, the following financial extract can be used for product or service adoption.

Product/Service	A	B	C	Total
Sales	$ 300	$ 450	$ 750	$ 1,500
Cost of sales	150	300	450	900
Operating profit	150	150	300	600
Asset employed	3,000	750	1,200	4,950
Return on assets	7.5%	30%	37.5%	12.1%

Through a comparison of data, it would appear that product/service C should be adopted if there are limited resources as the sales, operating profit, and return on assets are the best among the other options. However, we should remember that the real-life business environment is complex, and other factors need to be considered in arriving at a decision.

Comprehensive implementation and management accounting tools

In response to the modern sophisticated business environment, many new management accounting practices are being developed to emphasize the use of accounting data and related information regarding business strategies and operations. These important developments in strategic planning and control are mentioned below. Business strategies and management accounting tools are integrated as strategic management accounting. This is an integrated framework for strategic and financial decision-making and for integrating business performance which needs competitive, operational and financial analysis.

1. Balanced scorecard

There has been a proliferation of non-financial as well as financial performance measures. Examples are quality measures, delivery service measures and customer satisfaction measures. In addition, it is also often not clear to managers how the non-financial measures contribute to the whole picture of achieving organisation success. Kaplan and Norton (1996) suggested devising a balanced scorecard for an individual organisation to identify the key performance measures and to link financial and non-financial measures of performance. The balanced scorecard is a set of measures that gives senior management a comprehensive but fast view of the operation. Kaplan and Norton used "Translating Vision and Strategy: Four Perspectives" to illustrate how the balanced scorecard links performance measures. They establish a vision and strategy framework to incorporate four business perspectives of the company.

- **Learning and growth perspective** – includes human resources measures such as employee satisfaction, employee retention, skill sets, etc.
- **Business process perspective** – includes financial measures such as cost, throughput, and quality. They are for business processes like materials purchase, production, and order completion.
- **Customer perspective** – includes measures such as customer retention, customer satisfaction and market share in target segments.
- **Financial perspective** – includes financial measures such as operating profit, return on capital employed, and economic value added.

These four perspectives are not collections of independent perspectives. There is a logical connection between them – learning and growth contribute to better business processes, which in turn lead to increased value to the customers, which finally contributes to improved financial performance.

2. Profit-linked performance measurement systems

Kaplan and Norton (1996) sub-divide measures of changes in profitability over time into measures of changes in certain elements, such as productivity and price. These are systematically linked to a company's / SBU's mission and business strategy and are evaluated based on these aspects.

Profit-linked systems incorporate measures of productivity, price recovery, capacity utilization, and other relevant dimensions of performance. Practitioners initiate the development efforts, with systems which decompose measures of profitability into measures of price recovery and productivity. Academics refine and extend the systems from management accounting, business strategy and production economics perspectives. This illustrates how the systems can be used to analyze cross-sectional differences and time-series changes in performance regarding changing competitive environments and strategies.

3. Strategic variance analysis

Strategy management accounting emphasizes information which relates to factors external to the company. It examines the decision-making linked with the business operations and strategic issues of financial administration.

Where there are deviations in operation, strategic variance analysis is conducted. This refers to decomposing measures of budgeted versus actual net profit into variances. Managers can relate the profit variances to their companies' or SBU's mission and business strategy, and then analyze performance from a strategic perspective.

To implement this, profit variances are sub-divided into different types of second level variances which capture the separate impacts of key underlying factors. For example, there are deviations between actual and budgeted sales volumes and mixes, market sizes and shares, manufacturing costs, and contribution margins. For profitability, a build, hold or harvest perspective in terms of low cost leadership or product differentiation is built. By analyzing the variances with explicit reference to a company's / SBU's mission and business strategy, management accountants can determine the extent to which deviations between actual and budgeted performance are or are not consistent with the business mission and strategy. Analyzing the variances without reference to mission and strategy is misleading or uninformative.

Profit variances are classified into effectiveness variances (market size, market share, selling prices, and product volume and mix variances) and efficiency variances (materials and labour price and efficiency variances, activity-based cost variances, and committed cost spending variances). Effectiveness variances are essential to SBUs pursuing differentiation strategies. They focus on sales and product mix aspects. Efficiency variances are important to units pursuing low cost, high volume strategies. They focus on cost and efficiency aspects.

Conclusion

Strategic management accounting practices exist in different forms within companies seeking to use both financial and non-financial information as well as external market-based information. It is also subject to wider contextual influences including industry-specific effects.

Strategic management accounting systems include a wide array of techniques. The balanced scorecard, profit-linked performance measurement systems and strategic variance analysis are common and well-utilized. Their implementation and effects on companies are best considered in visionary and creative terms. Apart from cost and benefit analysis, understanding organizational context from a long-term spectrum is the key to the implementation of an effective strategic management accounting system.

References

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