Management Accounting in the New Economy

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Abstract :

This paper aims to theoretically investigate, in order to, explore management accounting in the current business environment. This is because of phenomena that have appeared in the last few years, such as Globalisation, technological advances, deregulation and the economic transformations in the structure, function and the roles of the economy which is termed “New Economy" which creates challenges for management accounting and accountants in the future.

1- Introduction :

The discussion around Management Accounting (MA) and the New Economy has significantly intensified in the last two decades (Johnson and Kaplan, 1987; Jaruga and Ho, 2002; Laitinen, 2003; Carmona and Gutierrez, 2003; Baines and Smith, 2003). The business environment in which organisations operated has become more turbulent, uncertain (Duberley, *et. el.* 2000; Williams and Seaman, 2002), and fast-changing in the competitive circumstances. These led to fundamental changes in the competitive rules, which create radical changes in the strategies adopted by organisations (Lockamy, 1998). On the other hand, this new environment drives the strategic formulation and the methods and techniques in which the organisation operates its activates in order to achieve strategic objectives, either through anticipation of, or reaction to, major changes in the marketplace (Laitinen, 2003; Johnny and Gani, 2004).

The economic transformations in the structure, function and the roles of the economy which is termed "New Economy" (Bhimani, 2003) has influenced the role of MA (Szychta, 2002) through creating a complex business environment. In this environment the success and survival of a business is highly dependent on innovative ideas and technology; risk, uncertainty and constant change are the main features.

Since accounting is the language of business, (and language being a means of communication in society) it naturally evolves to reflect the changes that occur in our environment and adapts to the technological advances achieved. Accounting is therefore constantly developing in an endeavour to communicate business information more efficiently and effectively and to keep pace with a rapidly changing business environment.

Therefore, the rest of this paper is organized as follows. First, the definition of management accounting; then the main features of the New economy. The paper ends with summarizing the major effects of the New Economy on the MA both as an organisational practice and an academic discipline.

2 Management Accounting (MA) Definition:

MA in simple terms is the branch of accounting, which is responsible for meeting both the financial and non-financial information needs of business management; the Balanced Scorecard is an example of one MA technique that attempts to address these related needs. MA may be defined as the application of accounting techniques to provide information designed to assist all levels of management in planning, making decisions, and controlling the activities of an organisation. MA is concerned with the provision of information to people within the organisation to help them make better decisions. This is opposed to the role of financial accounting, which is concerned, with the provision of information to external parties such as investors, government agencies, regulatory bodies, and environmental groups (Drury, 2005).

The management accountant has a whole series of methods and techniques to calculate how the organisation, department, or individual is performing. Traditional MA methods such as ROI and subsidiary ratios were the backbone of most accounting systems. MA was concerned with such cost accounting issues as the determination of product cost. Johnson and Kaplan (1987: p. 6), provide a view of the first MA, as this; "accounting reports have been prepared for thousands of years. However, it was the Industrial Revolution, in the 19^{th} century, which created the demand for MA information. The objective of the first MA measures was to provide owners and managers with a picture of the efficiency by which labour and material were converted to finished products". "By 1925, virtually all MA practices used today had been developed; cost accounts per labour, material, and overhead; budgets for cash, income, and capital;

flexible budgets, sales forecasts, standards costs, variance analysis, transfer prices, and divisional performance measures" (p. 12)

The technology of Production was relatively simple, with products going through a series of distinct manufacturing processes. The speed of the manufacturing process was governed by the speed of manual operations (Ashton *et al.* 1991). According to Ashton *et al.* (1991) one of the main features of this stage (1950s-1970s) in the development of MA was the lack of academic research concerned with the development of the MA theory. The application of neoclassical economic theory was adopted as the basis for the research to deal with the problems of business decision-making and control. The business objective was the maximization of the wealth of shareholders.

3- Features of The new economy:

The features of the current environment that govern business refer to the major changes in the business environment. The economic changes entailing computer-based information exchanges and sometimes includes an array of other changes in the nature and functioning of the economy and related social structures and processes (Bhimani, 2003). This is because of phenomena that have appeared in the last few years, such as Globalisation, technological advances and deregulation which have stormed the old economic roles. Dent (1996) states that, challenges arising for MA, and in particular for planning and control, such as multiple perspectives, coordination of complexity, competitor analysis, resource allocation and the development of a clarity of strategic intent, bind managers together worldwide and reward behaviour in the corporate, as opposed to local interest.

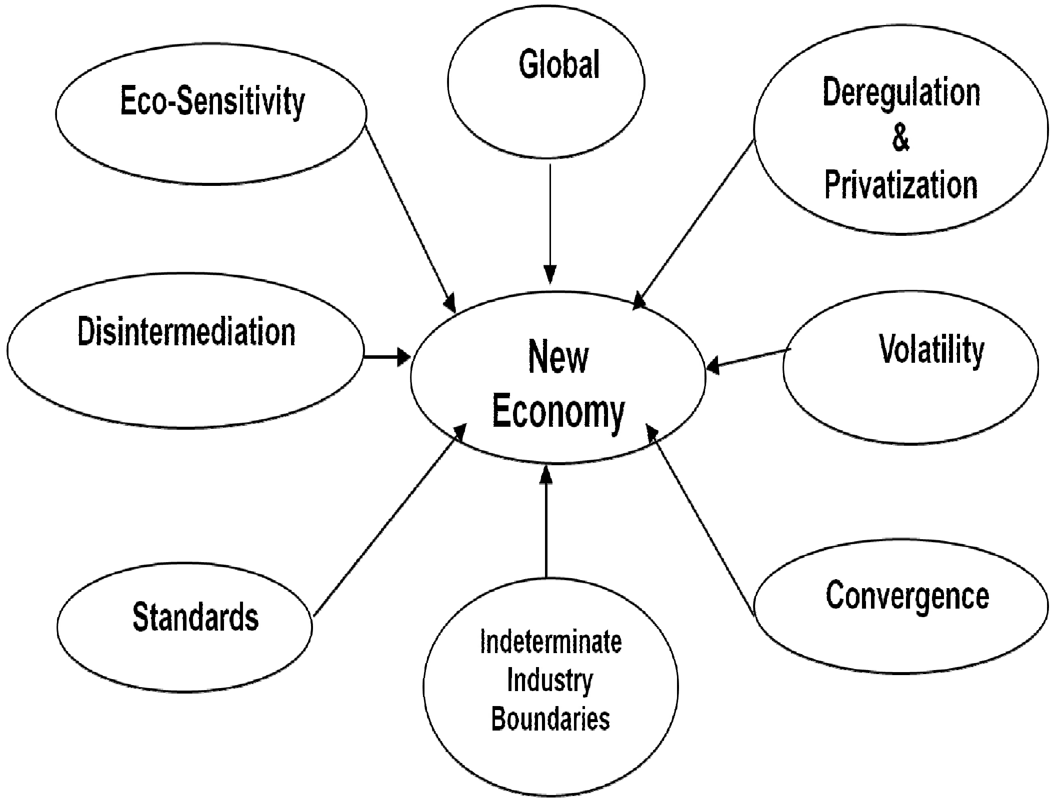
Globalisation is one of the major changes in the business environment and together with advances in technology and the telecommunications revolution, is the most powerful force effecting business now (Yip, 2000). Baylis and Smith (1997) state that " A globalized world is one in which political, economic, cultural and social events become more and more interconnected, and also one in which they have more impact". It has become easier to enter markets anywhere in the world. On the other hand, the power has transferred from sellers to buyers who have more choice, and sellers have to respond. Consequently new vocabularies have appeared in the literature, such as "Global Competition", "Global Strategy" and "Global Market" (Wit and Meyer, 1994; Yip, 2000). The majority of the world markets operate in a dynamic environment as opposed to a relatively stable environment. However, organisations at present have the advantage of the “digital economy” allowing high-speed communication, computerised trading and companies to move their operations in and out of countries at significant speed.

Deregulation is the loosening of government control over economic activities. This accelerating trend is driven by the belief that, private sectors are more efficient than the government in creating value from economic resource and have the ability to compete better than the public organisations which are excessively rule-governed and bureaucratic. Public ownership is particularly poor at forecasting demand and at adapting to changing conditions (Glaeser and Scheinkman, 1996). In many countries, the public sector has been inundated with a spate of far reaching management changes in the last few years (Broadbent *et al,* 1996). Privatisation of state-owned enterprises has been a major component of economic policy in many developed and developing countries in the last two decades (Saygili and Taymaz, 2001). This has increased opportunities and created whole new markets whilst also increasing the level of competition. This also opened up the market to competitors and meant that huge opportunities were open to organisations that had the ability to meet customer needs in this new marketplace. Organisations that are aware of regulation changes can react quickly to the opportunities that it can bring but must also be aware that competition is likely to increase as well.

Technology has changed so rapidly over the last decade that every industry has been altered by new hardware, software or communication advancements. These make it easier to find out what the market wants and quicker to design products and services based on this. The technology also opens up new distribution channels, again making organisations aware of new technologies that they must adopt, or they will find themselves left behind competitors who are quicker to seize new technological advancements and the advantages they bring (Nixon, 1995).The use of technological innovation by many of today's businesses is creating a more volatile and dynamic market place. Advances in technology, such as Computer-Aided-Design (CAD), Computer-Aided-Manufacturing (CAM) rapid prototyping and simulation are helping smaller business to be able to compete for larger market. Also share by simply reaching the market with their products or services before larger, more established businesses.

Prahalad (1998) recognises eight significant discontinuities that are shaping the New Economy. Figure (No.1) shows the main forces that shape the New Economy.

Figure (1)



Source: Prahalad, C.K., 1998, "Managing Discontinuities: The Emerging Challenges".

Management Accountants need to take on the task of managing these discontinuities by absorbing and integrating new streams of knowledge and collaborating across professional cultures. The change from the industrial enterprise (old economy) to the knowledge enterprise (New economy) can be seen in Appendix 1. In this new knowledge economy power has firmly shifted to the customer, resulting in a diminution of monopolisation.

According to Maskell (1991) as the business needs changed, the information provided by management accounting systems had lost its relevance. In particular, Maskell argued that MA information was produced too late and it was too aggregated and too distorted to be relevant for managers' decision making. Johnson and Kaplan (1987) also maintained that academics had failed to develop new MA concepts to match changes, notably in manufacturing technology and manufacturing management methods, and that MA had therefore lost its relevance.

According to Johnson and Kaplan (1987) relevance was lost between the 1950s and 1980s when management used cost accounting to drive marketing strategies and control operations. They go on to state that, "it is inconceivable that accounting systems ever can help to control operating processes in a customer-focused global enterprise". This view is backed by Dixon *et al.* (1990) who consider that "cost accounting systems are inconsistent with the new emphasis on quality, JIT and using manufacturing as a competitive weapon".

Over the last decade new MA Theory has been widely written about, with developments in concepts such as Activity based costing (ABC), total quality management (TQM) and continuous improvement methodologies among other (Suwignjo et al, 2000). However, Kaplan (1998) maintains that big companies operating in today's economy, such as Hewlett-Packard, Intel, IBM adopt new management technologies-including TQM and Just-in-time (JIT), but are still using traditional standard, direct labour focused costing systems and a monthly system of financial variance reporting designed decades earlier. He concludes by saying that these companies are using "obsolete assumptions about labour content, process efficiencies and the drivers of long-term competitive success"

The role of MA in the future is predicted to shift from activities such as activity based management, environmental accounting, enterprise solutions, balanced scorecard and shared service centre towards management cockpit, browsing the data warehouse, efficient data mining, organic periodicity, integrating data channels, 3D business models and working without budgets because they are believed to be a constraint to development (Jenkins, 1998). Another prediction is that the need for management accountants will fall while the need for MA will rise (Cooper, 1996); Cooper's point is that traditional 'second-wave management accountants have no future in the ‘New Economy’. This notion is also introduced by Anastas (1997) stating that there will be “fewer management accountants but at more senior levels”. Cooper also has similar views to that of Anastas who writes: “decentralising the MA process and empowering the workforce result in fewer management accountants but a much wider use of MA information” (Anastas, 1997). There is a shift in the role to becoming more “internal consultants”, motivating others to change, finding ways to stay profitable and ahead of competition (Jenkins, 1998) for the change in management accountants role from 1999 to 2010) can be seen in the following Figure (2).

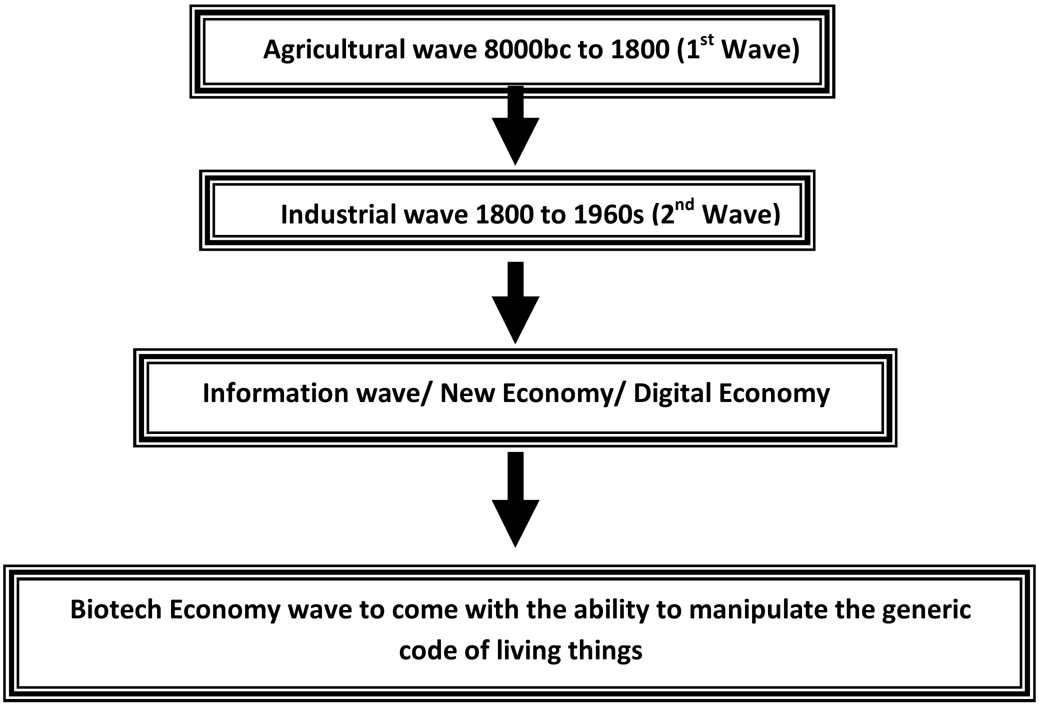
The Management Accountant’s Role from 1999 to 2010

1999	2010
Functional focus	**Holistic focus**
What?	**Why? And How?**
Inward looking	**Outward looking**
Backward looking	**Forward looking**
Alchemists/scientists	**Analysts and teachers**
Accountants	**Controllers/ information managers**
Country based	**Global**
Slaves to technology	**Masters of technology**
Separate overhead department	**Integrated specialists**

Source: Jenkins, M. (1998).

They will also be expected to have knowledge of all areas of the organisation and have commands of the latest IT software. The MA of the future will, it seems, need to be an effective and persuasive decision-marker: “MA has begun to evolve beyond historic cost data and reports designed to control results against financial plans” (Nanni et al., 1992).

Change in the future is dependent on many factors, development of technology being the main factor. “Firms will have to rethink the nature of their core competencies and acquire new ones that will shape their future” (Prahalad, 1998). According to Nixon *et al.* (2002) features of the new economy are the speed of change, hyper-competition, virtual organisations, E-Commerce, an increasing dependence on intellectual capital for competitive advantage and greater dependence on alliances and various collaborative arrangements in order to manage risk, acquire technology and gain access to markets. As Nixon, *et al* (2002) illustrate the development of New Economy phrase can be understood by the following Figure (3):



Source: Nixon, *et al.* 2002

Managing the competencies identified in a multi-cultural environment where people have different views requires management to absorb and combine new streams of knowledge and arrange competencies across business units' perimeters. The 'discontinuities' (Prahalad, 1998) identified will force firms to compete globally, focus on speed as a major issue, use temporary alliances and collaborative agreements and re-evaluate the business model.

Any one of these factors can be managed with some difficulty but survival in the New Economy requires that all of these forces are managed simultaneously.

This is the major challenge that management accountants face in the new economy and in the future. Kaplan (1994) suggests that management accountants should "become part of their organisations value-added team, participate in the formulation of strategy, translate strategic intent and capabilities into operational and managerial measures and move away from being scorekeepers of the past to becoming the designers of the organisation's critical future.

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