The Role of Management Accounting in Adding Value to Organisations

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ABSTRACT

The rapid development of digital world has provided modern organisations with challenges and opportunities at the same time. Especially, the use of advanced technology such as internet well improves transparency of many organisations. However, this also brings volatility and uncertainty to an organisation’s business environment, thereby leading to a more complex and time-consuming decision-making process. To solve this problem, two management accounting techniques, ABC System and BSC, have accordingly been adopted by many managers. In this article, the purpose is to briefly discuss some of the challenges faced by organisations; and then, the two initiative management methods are well explained individually with reference to appropriate examples.

1. Introduction

Over the last decades, the whole world has experienced dramatic changes as a result of rapid technology development. It is argued that a new digital era has come and evolved. The advanced technology development plays a key role in effectiveness improvements and costs reductions within organisations. Meanwhile, it also brings challenges and uncertainties to businesses all over the world. For instance, BBC News has just reported that half of jobs worldwide will be replaced by machines by 2025, and “robot revolution” would create a large number of new work tasks in the world but also destroy many jobs at the same time [1]. Some routine jobs and professions such as accountants are at risk of automation and elimination. In consequence, it is urgent for organisations to adopt new technologies and customised transformations in order to survive and obtain sustainable development in the fierce competition.

An important part of the transformation mentioned above involves financial departments. According to white paper published by CGMA, the future function of the finance department will shift from cost evaluation to value added evaluation [2]. That is to say, the evaluation of the finance function will not merely focus on how much it costs to the organisation, but also how much values it brings to the organisation. This article aims to discuss how to measure and the effectiveness of management accounting towards adding value to the organisation. It is structured as follows: it will firstly discuss several challenges faced by companies; and then, it will explain different accounting techniques adopted by management accounting to create value within the organisation; finally, it will provide conclusions and insights for future shifting.

2. Challenges Faced by Modern Organisations

In a digital world, a major challenge for organisations

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is how they keep the pace of the rapid development of technology. Certain new technology even has an ability to make significant changes towards the industry as a whole. The wide adoption of internet and social media are typical examples that bring changes to customer behaviours and organisational operation. The traditional business models are challenged by the implications of digital technology, and digital transformation is called for by the world economy. In the past, the maximisation of shareholders’ value has been treated at the heart of all business activities since their weights of power can be exercised upon the organisations in comparison with other stakeholders. Nevertheless, digital channels such as internet and social media make the organisations become more transparent than before and allow the public to gather information related to organisations much easier, like, products, services and financial performance. As Mori claims in his paper, the influence of other stakeholders such as consumers, suppliers and regulators has become stronger upon the daily management of companies, and they even can affect the decision making process to some extent. In other words, each step and decision made by companies is easily to be monitored and examined by the public due to the implementation of internet and social media.

In addition, it is relatively simple for companies to make decisions internally and reach conclusions with all information available within the organisations in the past decades, especially when there are no significant changes of external business environment. Since organisations have full control over all key data and information, they can decide what information to disclose and what to conceal to the public based on their own interests. Nevertheless, the increasing transparency of organisations to the whole society enables the power possessed by other stakeholders to be enhanced, and then allow them to affect the decision making process in certain levels. In consequence, to take into consideration the opinions of stakeholders and communicate with each other to reach a final decision, the decision making process becomes more time-consuming and costly within the organisations. The efficiency and effectiveness of decision making process has been reduced, as companies should make efforts to solve disagreements between stakeholders and coordinate with them. It seems that the future of organisations becomes more uncertain and complex. Thus, it is extremely important for organisations to develop and improve the abilities of decision making and problem solving.

3. The Adoption of Activity Based Cost System (ABC System)

An effective solution for organisations to improve the decision making process is the adoption of management accounting systems. These systems provide effective approaches for organisations to make decisions effectively by offering valuable information. A typical example of these management systems is Activity Based Cost system (also referred to as ABC System) which is widely considered as an alternative method to traditional costing system. An increasing number of academic researchers and management teams have started to claim the traditional cost technique cannot satisfy the urgent demands of organisations to adapt to the digital world. In order to be prepared for the digital challenges, a majority of companies have adopted the ABC accounting technique and abandoned the traditional cost system. This phenomenon has been confirmed by the analysis conducted by Cagwin and Bouwman who state that many organisations in both developing countries and developed countries have implemented ABC system.

The traditional costing was created and developed in the industrial era which allocates factory overhead to products based on the amount of resources cost such as direct labour hours or machine hours. The industrial era emphasises the labour as a key factor in the production which assumes all costs including overhead are directly linked to production. However, this is usually not the case in real business scenario especially in highly automated industries where the direct labour costs are extremely low meanwhile factory overhead is quite large. Consequently, inaccurate financial figures are obtained due to the cost allocation problems related to the traditional costing accounting technique. It will be extremely hard for organisations to sustain competitive advantages if they cannot calculate their costs correctly. On the contrast, an ABC system allocates costs to activities by utilising a group of cost drivers, and then assign costs to products based on related activities. This methodology can satisfy the needs of organisations to be more flexible and automated with the aim of improving productivity and reducing costs. Since ABC system recognises cost drivers via multiple activities, it can offer more accurate and relevant information for management team to make decisions. This lowers the risk of information being distorted from inappropriate cost systems.

Moreover, the implementation of ABC system is especially beneficial to manufacturing organisations to enhance their abilities of decision making. Two-step approach can be adopted by them to make investment decisions by analysing whether it is profitable to invest in automated systems for material processing and whether value is added by this activity investment. The ABC system initially recognises the material handling process, and
then it is required to determine the activity related costs and collect the activity data to compute the product costs. The relevant benefits are also calculated to measure how many benefits are brought by the application of new automation system for material handling. After that, Economic Value Analysis (also known as EVA) is utilised to analyse the figures generated from previous steps, and then an appropriate investment appraisal method is chosen to decide which automation system to invest in.

Besides, ABC system can also be utilised to figure out where organisations can improve further. For instance, this technique can separate activities into value added and non-value added activities. It even can help organisations to rank different activities by the volume of value added. As a consequence, it enables organisations to allocate resources effectively and abandon non-value added activities to improve performances. That is to say, ABC system can be utilised as a way to measure the performances of different activities. However, ABC system seems little effective for organisations with small proportion of overhead, and traditional method is also used to calculate certain costs required for ABC system. Cost drivers should be carefully selected to maximise the effectiveness of ABC system, yet this process seems time-consuming and costly.

4. The Adoption of Balanced Scorecard (BSC)

Another popular management methodology is called Balanced Scorecard (also referred to as BSC), introduced by Kaplan and Norton in 1992 and aiming to measure the organisation’s performances from four perspectives. BSC has become well-known and widely utilised among global firms after its inception. It also has been described as the most influential management framework since the 20th century. According to an empirical research conducted by Bain, the overall satisfaction rate over BSC remains nearly 80% among the survey samples during the period from 1996 to 2017. Except for the measurement of traditional financial accounting performance, BSC also initially considers non-financial aspects of a business to evaluate performance. This has been recognised as the main strength of BSC as a strategic management tool. In addition, BSC provides a valuable tool to enable organisations to translate their strategic objectives into daily operational terms. It is effectively linked an organisation’s pre-defined missions and vision statements with a set of measurable and quantifiable performance elements. And then, organisations can utilise these measures to obtain feedback for overall performances.

Evaluating an organisation’s performance only based on financial measures is a common problem existing among a majority of companies. Since it seems a little biased to believe that a company with outstanding profitability performance will definitely perform well in the future and be worth to be invested in. To tackle down this problem, BSC introduces a methodology to measure organisational performances from balanced four aspects. For each perspective, BSC asks firms to identify several strategic objectives, and then it defines how to measure them and set targets for each objective. Finally, it asks firms to consider how these targets can be achieved and initiate related projects in line with the organisation’s objectives. In addition, BSC can be used as a model for a self-monitoring purpose and a managerial evaluation. The management can evaluate business performance against each criterion and identify rooms for improvements. They can also obtain feedback from different stakeholders under each perspective. As a result, BSC does create value to organisations through providing a framework to map business strategy, then improve performances and achieve desired results.

However, there are also some critiques of BSC arisen from academic researches. A key logic within BSC is the cause-and-effect relationship which assumes that performances in non-financial elements can predict the future performance of financial element. Yet, as Narreklit claims, this causal relationship may be idealised of the real businesses scenario, and it even does not exist among these four elements of BSC. For instance, close relationships with customers do not equal to great financial performances. Moreover, there is no clear guidance provided by BSC towards how to build the cause-and-effect relationship among these four perspectives, which lead to the failure of organisations to maximise the functions.

5. Conclusions

To conclude, the emerging digital world has brought both opportunities and challenges to organisations across the world. The widespread of internet and social media has increased the level of transparency of business. This adds more uncertainty and volatility to external business environment, which makes the decision making process of organisations more complex and time-consuming. In order to survive in the fierce competition, it is crucial for organisations to adopt effective approaches to improve the efficiency and effectiveness of decision making. Two initiative management methods including ABC System and BSC are introduced to offer valuable information and add values to companies in the face of digital challenges. These two have already been adopted by an increasing number of organisations. Yet, their limitations should also be taken into consideration during the implementation.
and they are still needed to adapt to the actual circumstances of businesses in order to satisfy the specific requirements.

References


