MANAGEMENT CONTROL - A PRE-REQUISITE FOR SURVIVAL

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Recent years have witnessed major changes in business structure. In general, today's businesses are far more complex in terms of both structure and operation. Increasing recognition is given to satisfying the needs of different stakeholders who include customers, suppliers, employees, local communities, investors, lenders and national governments.

We live in a world of change. Organisational success is hugely dependent on how well an organisation is able to predict and respond to changes in technology and the requirements of industrial and consumer-buyers alike. Those organisations that are able to accommodate such changes are likely to continue to prosper. Organisations that fail to recognise or respond in an appropriate manner to changes that occur in both technology and the marketplace may well lose a large share of their sales volumes and in the worst case scenario may be forced out of business.

Business units are larger and more complex, often spread over several territories. The growth of multinational organisations and increased globalisation is widely acknowledged and the business environment itself is subject to rapid change. Therefore it is of paramount importance that organisations have effective control mechanisms that will enable management to ensure the survival of the organisation. Management need to be able to focus on adopting the right tactics and actions in order to achieve the goals and objectives of the organisation.

While the need for effective management control has never been greater, one should acknowledge how critical the design and operation of effective management control systems are and their interface with accounting information systems. One should also be aware that accounting is one of the many control tools available to management. While it may assume a central position in a control structure it will need to be supplemented by other initiatives.

Many accountants subscribe to the view that cash is the lifeblood of an organisation and marketeers are often quick to point out that innovation is essential in order to ensure organisational longevity. However, while one must acknowledge the truth attached to these propositions, from an organisational control viewpoint, the importance of appropriate information to facilitate the control of the sphere of operations must also be recognised. Without a constant supply of relevant information an organisation would inevitably flounder. An organisation's management information system lies at the heart of the information gathering process and the management accounting system will invariably be an important part of this. The management accounting system produces pertinent information for use by management since it measures activities in terms of its base and (often) other currencies. The multi-currency capability of today's management accounting systems enables management to maintain more effective control relating to what are very often geographically disparate operations.

Although many commentators argue that the fundamental nature of management accounting systems and practices remains unchanged, in today's business world management tends to use the accounting systems at its disposal in a far more flexible manner than previously and also uses financial reports to an increasing extent in conjunction with a range of financial and non-financial performance measures.

Contingency theory of management accounting

The question arises as to whether or not there is an appropriate accounting-based control system which will suit all organisations in all situations. The answer to this question must be 'no', as organisations vary in size, structure and complexity. What constitutes an effective management control system therefore depends on the circumstances surrounding its use.

The question that management accountants need to answer is 'which is the most appropriate accounting-based control system that will best fit the circumstances of our organisation?' In order to answer this question they need to give consideration to the identification of the most important contingent variables and undertake an assessment of their impact on the design of a management accounting control system. These considerations are encapsulated in what has become known as 'the contingency theory of management accounting'.

Otley has provided the following widely-used definition of contingency theory:

'The contingency theory of management accounting is based on the premise that there is no universally appropriate accounting system applicable to all organisations in all circumstances. Rather a contingency theory attempts to identify specific aspects of an accounting system that are associated with certain defined circumstances and to demonstrate an appropriate matching.'

Otley drew attention to the fact that management accountants, in acknowledgement of changing circumstances, have always attempted to adapt systems in order to make them more useful. However, adoption of a contingency approach was novel because it required management accountants to identify and assess the impact of contingent variables on the design of a management accounting control system. Otley concluded that the theory was more successful in identifying contingent variables than it was in assessing their impact on the design of a management accounting control system. He suggested that this could be partially explained by the fact that the theory focused exclusively on management accounting controls whereas, in fact, organisations use a much wider range of overall controls.

Many studies have been undertaken and these have concluded that the following are considered to be the major classes of contingent variable:

- environment
- technology
- size
- strategy
- culture.

Environment

Features within the external environment of an organisation that affect the design of an accounting-based control system include its degree of predictability, the degree of competition faced in the marketplace, the number of different product-markets faced, and the degree of hostility exhibited.

Technology

The nature of a manufacturing process determines the type of costing system that is required and the extent to which costs can be traced to products. The growth in the number of service organisations is also significant since a large proportion of the total cost of the services provided is in the nature of overheads. This, together with the fact that services are often consumed at the time of purchase, will influence the type of costing system used and the extent to which costs can be traced to services.

Size and complexity

Organisational size is an important variable which affects both structure and control. It can be frequently observed that as an organisation starts to grow it will initially be organised on a functional basis. As further growth is achieved via diversification, and the organisation becomes exposed to a greater number of product markets, many organisations then choose to re-organise activities into semi-autonomous units. Top management is then able to utilise the accounting control system to measure and compare the performance of its divisions using similar performance measures as those employed to assess the overall performance of the firm.

Increasing structural complexity will also lead to an increase in the number of accounting tools used by an organisation, while environmental discontinuity may require new tools to replace those which have become obsolete.

Strategy

More recently, attention has been focused on the intervention of corporate strategy as a contingent variable. Much research relating to corporate strategy has centred on classifications proposed by Porter. The majority of contingency theory research focused on the strategy variables cited by Porter has concentrated on the differences between business units pursuing differentiation and low-cost production strategies. A control system is aimed at ensuring that corporate objectives are obtained and thus management attention needs to be placed on the nature of those objectives which are embodied in the overall corporate strategy. Moreover, in any contingency theory, the appropriate matching of controls to circumstances requires the assessment of 'effectiveness' which can only be measured by reference to corporate objectives.

Culture

It is essential that a management accounting control system is consistent with the value system of the organisation or with the language and symbols that comprise its culture. If not, resistance may well arise and the management control system will lose its raison d'etre as people direct their attention to finding 'work-arounds' in order to 'buck the system'. In much the same vein, new control systems which are perceived as likely to threaten existing power relationships may be resisted by affected personnel.

In order to maximise the effectiveness of the management control system, management should always attempt to maintain a corporate culture which is totally supportive of organisational aims, objectives and methods of working and is consistent with the demands of the organisation's business environment.

Institutional theory

During recent years, accounting has come to be regarded as a social and institutional practice which reflects social relations. Much attention has been focused on the ways in which management accounting practices influence and can be influenced by agencies, institutions and processes. Institutional theory explains the change and stability of institutions by the way the formal organisation structure reflects internally the institutionalised rules of the wider state and society.

There is no universally applicable definition of what constitutes an 'institution'. However, one might regard an organisation as comprising the taken for granted assumptions which inform and influence the actions of individual members of an organisation. Habits and customs are very important in this context. It is accepted that organisations do not exist in a vacuum. Indeed, organisations and the management accounting practices within them are dynamic in nature. Thus an organisation may be viewed as a social entity which has two-way links with many interested parties.

Miller observed that institutional theorists have argued that formal organisations are driven to incorporate the practices and procedures defined by prevailing concepts of what is rational. The conventions of modern accounting have been identified as a key mechanism for isomorphism between environmental institutions and organisational practices. It is the contention of many institutional theorists that the legitimacy and indeed, survival prospects of an organisation are increased by the incorporation of such 'rational' practices and procedures.

Perhaps at this juncture it is useful to try and demonstrate how institutional theory may provide a framework for changes in management accounting. If we take the example of the acquisition of a new subsidiary by a conglomerate, it is quite probable that the board of directors of the acquiring company will require different forms of information in order to monitor the activities of the newly-acquired subsidiary.

Practices and procedures will change and this will necessitate changes in the form of the management accounting system. As these rules are introduced and implemented within the newly-acquired subsidiary, new management accounting routines will inevitably evolve. New procedures will be developed and reproduced by those personnel who have been given the responsibility for their implementation. New procedures must work in parallel with many other organisational routines which are already in place and they will be shaped by the existing institutions, ie those taken for granted assumptions about the nature of organisational activities and the relationships between the various members of the organisation.

These new management accounting routines may gain widespread acceptance within the organisation to such an extent that they are regarded as essential features of the management control process. In circumstances where this is so, they can be said to have become 'institutionalised' and assume far greater significance than being just another set of management accounting procedures that the board of directors of the acquiring company require to be implemented.

Further reading

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