

STUDY GUIDE A1: INTRODUCTION TO STRATEGIC MANAGEMENT ACCOUNTING

Get Through Intro

Strategy seems to be a buzz word – but what does it actually mean? How can it help a business? How does one implement strategy?

Corporate or strategic planning is a step-by-step, systematised procedure involving

- identification of the mission of the organisation and its objectives;
- corporate appraisal (SWOT analysis); and
- analysis of the gap between corporate objectives and envisaged ability.

The strategic plan of an organisation is the bridge which tries to connect the available resources with the corporate objectives. It states how the organisation will allocate its resources to attain its objectives.

Strategic management accounting is a set of tools which provides the planners with all-important inputs - facts, figures and documents on which to base their plans. The distinguishing feature of strategic management accounting (SMA) is that it focuses on the organisation's external business environment.

This Study Guide explains the role of strategic management accounting in planning and control, which happens to be a favourite topic of the examiner as well! By understanding this Study Guide, you will be able to apply strategic management accounting to your business and see how you can improve profits!

Learning Outcomes

- a) Explain the role of strategic performance management in strategic planning and control.
- b) Discuss the role of corporate planning in clarifying corporate objectives, making strategic decisions and checking progress towards the objectives.
- c) Compare planning and control between the strategic and operational levels within a business entity.
- d) Assess the use of strategic management accounting in the context of multinational companies.
- e) Discuss the scope for potential conflict between strategic business plans and short- term localised decisions.
- f) Evaluate how SWOT analysis may assist in the performance management process.
- g) Evaluate the methods of benchmarking performance.

Introduction**Case Study**

The usage of strategic management accounting in the hospitality services sector in Australia was investigated in a recent market survey.

The study considered strategic management accounting to involve collecting and analysing management accounting data relating to business strategy.

The findings of the survey were that strategic management accounting is gaining popularity in the hospitality services sector, particularly in the planning and research of other areas such as competitor analysis.

This case study shows the importance of strategic management accounting in today's world. This Study Guide, which deals with the role and technique of strategic management accounting, will help you decide the correct inputs to be given to the strategy planners of your organisation.

**1. Explain the role of strategic performance management in strategic planning and control.^[2]
[Learning Outcome a]**

Management accounting can add value to strategic decisions, if it is appropriately linked to the strategic objectives of the firm at the corporate and business unit levels. Financial analysis, planning and control processes can be integrated into the competitive and corporate strategies of the business. Financial information systems and performance measures can be adapted in order to facilitate this.

1.1 Strategic management accounting

The fundamental objective of strategic management accounting is to use management accounting information for **strategy implementation, management planning and control** in organisations. The distinguishing feature of **strategic management accounting (SMA)** is that it considers the **relationship of the organisation with its external business environment**. It focuses attention on suppliers, customers and competitive rivals. Information may be quantitative or qualitative in nature, and some information will be of a non-financial nature.

The basic features of strategic management accounting include external orientation (i.e. competitor information, suppliers and customers) and long-term process.

1. Features of SMA**a) External orientation**

- i. **Competitor information:** (related to cost, prices, market share etc.) in developing and monitoring the business strategy.
- ii. **Suppliers and customers:** they should be considered from a value chain perspective. Several authors have widely demonstrated that external information is useful in that it enables organisations to develop a relationship with suppliers as well as customers that can be exploited in the business's interest.

Ultimately "external" refers to the "market"; it means focusing on the product's on offer to satisfy customers' needs while taking into account the cost of adding new product features.

Example

A renowned watch manufacturer observes that due to changes in customer preferences, a simple watch that can keep time accurately may not fetch the desired price. According to its market research, either a sports watch or a designer watch with gold plating may fetch a good price on the market.

The company accordingly will consider the costs of adding new product features and the differential price that it can fetch by adding new product features.

b) Long-term process

SMA is a long-term process only which focuses on utilising qualitative and quantitative information (both internal and external to an organisation) in the strategy formulation of a business.

c) Forward-looking

SMA provides information about potential changes in the market, competition, consumer preference, supplier profile etc.

d) Holistic approach

SMA does not confine itself to collecting external information. Rather, it involves collecting any relevant information that may have an impact on the business from all spheres of the business, including the internal sources of the organisation.

Example

SMA collects information not only about customer preferences, their tastes, the target customer age group, affordability, etc. but also about internal information such as the cost of an additional feature, machinery requirements and the expertise needed to incorporate a new feature into the product in order to decide on incorporating new product features.

2. Techniques used in strategic management accounting (SMA)

- a) **Activity-based costing:** based on the activities performed by the company. The activities are considered the ultimate causes of indirect costs. You have studied activity-based costing in F5 (Performance management).
- b) **Attribute costing:** considers products as a package of different features e.g. a mobile phone may have a built-in FM radio and a camera. The costing of the product will consider all the features incorporated in the mobile phone as a package.
- c) **Benchmarking:** involves identifying the best practices and comparing the organisation's performance to those practices with the goal of improvement. The concept of benchmarking will be discussed in detail later in this chapter.
- d) **Competitive position monitoring:** provides competitor information. It identifies where the organisation stands compared to its competitors in market penetration, product features, cost of the products, product pricing and so on.
- e) **Competitor cost assessment:** concentrates uniquely on the cost structures of competitors. It provides an insight into the cost components which are higher than those of competitors.
- f) **Competitor performance appraisal based on public financial statements:** public financial statements provide a relevant source of competitor evaluation.
- g) **Customer accounting:** considers customers or groups of customers as units of accounting analysis (divides them into segments – e.g. industrial, commercial, domestic or profitable and not-profitable and so on).

Example

A bank reveals that 20 per cent of its customers generated 120 per cent of its profits. To put it in a different way, 80 per cent of its customers are unprofitable and reducing its profits by 20 per cent. **Customer accounting analysis** would reveal which customers are part of the unprofitable 80 per cent (and which are part of the profitable 20 per cent).

- h) **Integrated performance measurement:** considers both financial and non-financial measures.
- i) **Life cycle costing:** aims to calculate the total cost of a product throughout its life cycle. The concept has been explained at length later in the Study Guide E2.
- j) **Quality costing:** classifies & monitors costs as deriving from maintenance of quality, appraisal, internal and external failures.
- k) **Strategic costing:** costing systems are progressively being incorporated into the strategic management process and analyses costs according to strategic management requirements.
- l) **Strategic pricing:** entails product pricing in a competitive business environment. Focuses strictly on competitors' products, their attributes, prices and moreover the pricing strategies adopted by competitors.

- m) **Target costing:** the target cost is the difference between the product price the customer is willing to pay and the desired target profit. You have studied 'target costing' in F5 (performance management).
- n) **Value chain costing:** an approach to accounting that considers all the activities performed from the design to the distribution of the product. Note that a value chain analysis is a way of analysing a firm in terms of the processes it uses to serve its customers. By looking cross-functionally, it can spot places where departmental processes, friction and self-interest reduce the quality of the service to the customer or increase costs.

1.2 Strategic planning and control

1. Strategic planning

Strategic planning is an organisation's process of defining its strategy, or direction, and making decisions on how to allocate its resources to achieve its corporate objectives, including its capital and people. Various business analysis techniques can be used in strategic planning including SWOT analysis (discussed in Learning Outcome f) and PEST analysis (analysis of the influence of political, economic, social and technological components of the organisation's external environment).

Strategic planning determines the **future course of action** of an organisation. The **focus** of a strategic plan is usually on the **entire organisation**, while the focus of a business plan is usually on a particular product, service or programme. There are a variety of perspectives, models and approaches used in strategic planning. The way that a strategic plan is developed depends on the nature of the organisation's leadership, the culture of the organisation, the complexity of the organisation's environment, the size of the organisation, and the expertise of planners and so on.

Example

The strategic planning of a multinational corporation (engaged in steel manufacturing) operating in different continents will be quite different from the strategic planning of a medium-sized organisation engaged in providing software solutions and operating only in the UK.

The strategic planning of the steel manufacturer will cover issues such as transfer pricing, cultural changes in the different countries in which it operates, issues relating to foreign currency related risks, maintaining global standard in product quality, usage of latest technology and so on.

On the other hand, the software solution provider will consider work culture and work-related rules in the UK, policies that can best address the problems of employee turnover, expanding the business to provide ITES (information technology enabled services such as providing outsourcing services to clients for their business processes) and so on.

There are a variety of strategic planning models, including **goal-based** and **issue-based** planning. Goal-based planning is probably the most common and starts by focusing on the organisation's mission (and vision), goals to work towards the mission, strategies to achieve the goals and action planning (who is to do what and when). Issue-based strategic planning, on the other hand, starts by examining the impending issues facing the organisation, strategies to address those issues and action plans. Some plans are for one year, many are for three years and some are even for five years.

2. Strategic control

Strategic control is concerned with **tracking the strategy** as it is being implemented, **detecting any problem areas** or potential problem areas and **making necessary adjustments**. A significant time span occurs between the initial implementation of a strategy and the achievement of its intended results. During that period, numerous projects may be undertaken, investments made and actions undertaken to implement the new strategy.

Moreover, the external and the internal situation of an organisation is developing and evolving. Strategic controls are necessary to steer the firm through these events. They must provide some means of correcting the directions on the basis of intermediate performance and new information.

Strategic control recognises the number of different ways that intended and realised strategies (no matter how well an organisation plans its strategy, a different strategy may emerge in reality) may differ. A firm needs evaluation and control systems in order to monitor its performance and take corrective action if the actual performance differs from the intended performance.