Strategic Management Accounting – A Strategic Role for Accountancy

Dr. Sean Stein Smith
Rutgers University
School of Business-Camden
United States

Abstract

As the business environment and competitive landscape continue to evolve at an accelerating rate the importance of developing and executing a strategic plan continues to increase. Effected by changes in the competitive and regulatory environments, organizations face a dual challenge. First, increased competition and scrutiny from both financial and non-financial stakeholders have dramatically increased both the type and the volume of information that organizations must produce to satisfy market requirements. Second, and arguably more important for organizations, is the growing importance corporate governance and sustainability, specifically the need for reporting and quantification standards. Addressing these challenges is the responsibility of the management accounting function; developing reports and communicating results is a traditional strength that must be expanded and leveraged to address the challenges of this new business environment. Accounting professionals, increasingly tasked with broader responsibilities and an increased scope of organizational duties, must embrace the challenging nature of the profession into that of strategic partner. Adopting a strategic headset, and aligning professional and organizational initiatives with strategic thinking and analysis presents both an opportunity and a challenge. Individuals in the accounting and finance professions must exercise creativity, innovative thinking, and grow as the profession transitions from reporting experts to strategic business partner.

Keywords: Strategic management accounting, stakeholder, integrated financial reporting, corporate governance, sustainability

Introduction

As business goes global, it is increasingly clear that the business landscape is rapidly changing and evolving at an increasing pace that requires both organizational leadership and employees at all levels to adapt to this evolving environment. Ranging from issues related to corporate governance, environmental issues, external reporting matters, to opportunities for operational efficiency improvements, it is increasingly important for organizations to quantify virtually every aspect of operations. Reporting and communicating information to both internal and external stakeholders is a responsibility of the management team, i.e., users of information must understand the narrative and the story behind the results of the organization. Analytics, interactions between different departments of the organization as well as with external users of information, are essential in the modern business environment. Situations that have occurred at organizations ranging from Volkswagen to Yahoo starkly illustrate the importance of this fact, and organizations must have control and mastery over data in order to successfully compete. Building on this fact, accounting professionals are uniquely well positioned to leverage existing skills in order to become the data experts in such demand by organizations.

In addition to, and perhaps more importantly than communicating and disseminating information, is the linkage between organizational data and strategic decision making. Management professionals in every aspect of the organization rely on data, both quantitative and qualitative, in order to develop and execute the decisions that guide the entity forward in a strategic fashion. Corporate strategy, as a concept and managerial area of focus, has evolved from a static plan that is periodically updated to a more fluid concept that must react to changes in competitive forces. That said, it is imperative that strategic initiatives be both grounded in quantitative information as well as supported by qualitative information to effectively convey the reasoning behind the decision making process. Whether the specific focus is related to capital expenditures, entering new markets, introducing new products or services, or divesting from different areas, the fact remains that strategic decisions must be supported by organizationally generated data.

The current gap in the marketplace, however, exists as it pertains the role of the accounting function in this rapidly changing and developing competitive landscape. Traditionally focused on compiling quantitative information for equity holders and creditors, financial information and thinking is relatively narrow in focus, based on historical information, and updated only periodically.

Bridging the Gap

In order to play a more prominent role in the managerial process finance and accounting professionals must be willing to embrace the changes occurring in the overall business landscape. Accounting professionals are trained in the science and technique of analyzing and reporting information in ways that are understandable and relevant to end-users. To facilitate this, processes and procedures must be instituted to accurately and efficiently collect, quantify, and report on the necessary information at hand most relevant for the decision under consideration. In addition to this relatively logical step, it is important that accounting professionals seeking the role they themselves play within the organization, as well as the profession at large, be aware of what key questions to ask, and at what junctions to ask these questions. Organizations across industry lines face increasing volatile environments and continue to realize that current financial and reporting systems and not sufficient to meet the growing demands of the marketplace (Endenich, 2014). In essence, the rapidly changing, and often chaotic, business environment that management teams must operate within is forcing change upon the accounting and finance profession, and practitioners must be able and willing to embrace the opportunities that accompany such change.

Facing a rapidly changing business environment, it appears unusual, at first glance, that the accounting profession, by and large, has not evolved to keep pace. Remaining relevant in such a rapidly evolving competitive landscape, however, requires that accounting professionals embrace change, the new opportunities embedded within this change, and the ramifications of these changes to the profession as a whole. It is this concept in mind, bridging the gap between the value currently delivered by the accounting profession and the requirements of the marketplace that forms the core of this discussion. Moving upward along the organizational hierarchy and decision-making structure requires not only a mastery of technical and financial concepts, but of strategic implications as well. In essence, what is necessary is a new role for accountancy, that of the strategic management accountant.

The Strategic Headset

Corporate strategy, strategic planning, and the longer-term direction for the organization represent, in virtually every instance, the highest level of management decision. Relying on the information produced by day to day operations and managerial support, the upper levels of management interpret both internal data as well as signals from the marketplace. Integrating both sets of information, decisions and calculations are made about how the entity should move forward, and resources are allocated in order to accomplish these objectives. In light of recent organizational blunders and miscalculations, including the declines of Kodak and Blackberry, as well as the product flops of both the Amazon and Facebook phone, and the routine occurrence of financial wrong-doing and malfeasance, it is clear that much work remains to improve the strategic decision making process. One such ongoing challenge can pertain to a relatively traditional perspective and role for accounting professionals – regulation. Innovation in the accounting field, specifically financial and business reporting regulation, provides both a challenge and opportunity for accounting professionals to interpret changes and add value to organizations (Chahed, 2013). As organizations increasingly do business with partners located both domestically as well as overseas, and contend with an ever-increasing amount of regulation and, the need for real-time information continues to increase. Financial and operational information systems as presently constituted, are, in many cases, simply not up to the challenge.

Implementing specific accounting techniques and systems, and mapping these techniques to profitability, is an ongoing challenge that continues to persist within both the profession and industry at large. Linking together the concept of a more strategic accounting function with profitability goals and measurement is a logical and business-oriented way to introduce the concept of the strategic management accountant (SMA). Combining an array of profitability measurements, in the case of Mohamed and Jones (2014), revenues, costs, and assets, provides a more comprehensive and robust picture of organizational performance than using just one measure. Creating such a multi-faceted approach to business performance requires that management accountants become more involved in the decision and appraisal process while still leveraging existing strengths to enter new areas.

That said, it is important to acknowledge that while strategy is certainly dependent on organizational data, the supporting information systems, and reporting of information, it also requires a qualitative lens to be applied as well. Understanding and obtaining the capability to quantify traditionally qualitative information, specifically as it relates to sustainability and corporate governance, represent areas of increasing strategic importance. As CFOs have become increasingly involved in operational aspects of the organization, including the management of supply chains, inventory, and supplier risk, these areas are not to be taken lightly. During Q4 of 2015, Chipotle, a highly regarded quick service restaurant chain (QSR) known for its organic product sourcing, suffered several very high profile incidents of E.coli related illness at branches across the country. Analysts commenting on the incident focused on one area more frequently than others, the fact that by relying on locally sourced ingredients, the organization was inherently exposed to more risk in its supply chain than an organization with a more vertically integrated model. Assessing, quantifying, and continuously reporting on this risk, including both the potential operational and financial ramifications of such an incident, would logically be included in the financial reporting of the Chipotle going forward. In order to gather and report on such information, in a format that is digestible for users of such information, it makes sense to include the management accounting function in this process.

Process Improvement & Accountancy

Linking the concept of a more strategic accounting concept to everyday activities, and not simply managerial theory, it is important to analyze the processes and methods that generate information. Developing metrics, reporting dashboards and financial reporting frameworks is an existing strength within the accounting profession that can be leveraged to address these growing areas of strategic importance for organizations. Integrating such information, presently available within organizations, is a process of layering correct cost drivers on top of more visible and high-profile business processes, i.e., transitioning from cost analytics to predictive analytics (Pickard & Cokins, 2015). In order for this transition to occur, however, appropriate systems and data collection procedures must be constructed and tested to ensure the integrity of information generated by the organization. Analyzing customer profitability, assessing real-time options related to capital investments, and having the capability to run multiple scenarios related to product or service expansion is informational needs that are not uncommon. That said, due to incompatible systems, legacy investments, and a lack of awareness of the changes occurring in the profession, these reporting needs often take much longer to comply with than optimal, and are not as accurate as needed.

The increased integration of technology within organizational processes and the decision-making process provides opportunities for management accountants to assume increased leadership roles within organizations. Drilling down specifically, and linking back to the discussion on corporate governance, there is evidence confirming that such process improvements and internal mechanisms have a definitive effect on the capital structure of organizations (Goel & Sapra, 2015). What this means, is that, in addition to a conversation about technical tools and concepts, strategic decisions linked to capital allocation might very well be influenced by the same process improvements made possible through increased leveraging of technology. Digitization of information, particularly in consumer facing industries, utilities, and healthcare, is positioning professionals within these industries for a paradigm shift. Financial decisions at every level are dependent on information, and as information becomes increasingly available to organizational decision makers, it is imperative that accounting professionals elevate their professional scope and responsibilities to that of data experts. It is important, however, to integrated flexibility and adaptability simultaneously with an increased reliance and review of organizational data. Without such flexibility and adaptability, individuals and entire organizations risk becoming sluggish to respond to opportunities, i.e. waiting for perfect data or another analysis to make a final decision. While embracing the role of strategic business partner, by definition, requires a broadening of scope and topics considered, it is imperative that accounting professionals focus efforts on areas in which the most value can be conveyed in a time and cost efficient manner.

How Accounting Can Deliver Value – Market-Driven Definitions

Linking together these disparate trends to comprehensive examples for accountants to use for practitioner application within organizations is an integral step in the evolution of the accounting function to that of strategic business decision maker.

Embedded within various functional areas of the organization, and currently accustomed with working with virtually every level of decision makers, accounting professionals are uniquely positioned to leverage existing skills to capitalize on emerging areas. Drilling specifically into the areas of data-driven decision making, sustainability, and corporate governance, there are specific examples of how an increasingly involved accounting function adds quantitative value to organizations in a wide variety of industries. While every industry and organization is unique there are themes and strategic initiatives that can be applied to a range of industries to improve performance, responsiveness, and relations with stakeholder groups.

Encapsulated within the innovative concept of integrated financial reporting is a shift in the field of financial reporting as well as in how organizational information is communicated to external users. Integrating the requirements of stakeholders pertaining to more timely and relevant information, integrated reporting requires more current information related to both financial information as well as non-financial information. Linking together aspects of corporate governance, sustainability reporting, risk management, as well as the strategic headset of senior leadership, such a reporting framework provides more information and requires organizations to change how internal processes and procedures are developed and executed. In order to produce such information and generate the data at the quality necessary to satisfy stakeholders, practitioners may use one of several varying approaches to efficiently and effectively accomplish this goal.

Strategic Accounting Tools

In order for a more strategic role for accountancy to effectively develop and expand, there need to be areas of focus, and specific tools available to management accountants. Specifically, strategic decision making is based, in large part,on quantitative information and a more comprehensive view of how organizations are actually performing. Issues related to multiple capitals, corporate governance, sustainability, and how employee engagement can affect an organization are increasingly important to internal and external stakeholders. While the bottom line of an organization will always remain the financial results achieved through operations, these results are achieved as a result of other organizational data. Using technology, and adopting a more strategic headset, allows management accounting professionals to translate data into action-oriented business information. Specifically, the concept of a multiple capital model provides a quantitative framework for accounting professionals to validate and support more strategic positions. Embedded within integrated reporting, it is essential to understand the underlying foundation of a multiple capital model to most effectively utilize this idea in the marketplace.

Multiple Capital Model

The multiple capital model, in essence, provides the quantitative and accounting-based underpinning for an integrated financial report. As stakeholder, shareholder, and consumer requirements continue to expand, and include different types of organizational data, a process must exist to report such data in in meaningful way. The six types of capital, as defined by the IIRC, and discussed below, demonstrate the importance of organizational data to both the decision-making process and financial performance of organizations. (Illustration credited to the IIRC and accessible through this link - http://integratedreporting.org/what-the-tool-for-better-reporting/get-to-grips-with-the-six-capitals/.

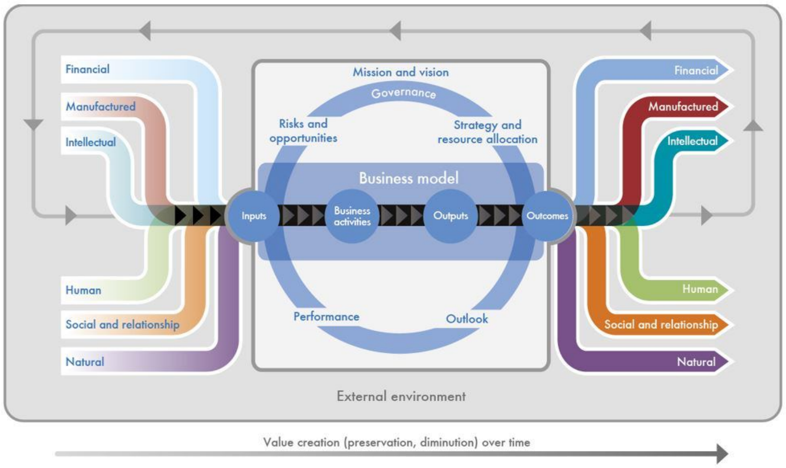

Figure 1: The Multiple Capital Value Creation Cycle(credit IIRC)

The information contained within the six capitals – financial, manufactured, intellectual, human, social and relational, and natural –does not represent new information or insights into how organizations operate. Instead, the strategic importance of this data is increasingly coming to light, and is expected to be discussed among the various stakeholders with a vested interest in how the company performs. Since, akin to the financial information, these other types of organizational data must be processed through the information technology systems of the company, management accountants are uniquely well positioned to leverage existing competencies. Analytic abilities, familiarity with organizational systems and other functional personnel, and the authority to discuss such issues with the management team provide the necessary platform for higher level conversations. Strategies, and strategic planning, which fuel the long term success of the organization, are dependent on the very information that accounting professionals have long exhibited mastery over. Integrated reporting, and a multiple capital model, creates a platform for an increased strategic role within the business decision-making process.

Integrated Financial Reporting

Integrated financial reporting, (IR) represents a paradigm shift related to how information is created, disseminated, and communicated with financial and non-financial stakeholders. Linking together, and expressing alongside financial information, information and discussion related to aspects of sustainability, corporate governance, and the risk management approach of the organization, IR is a step toward more real-time and data-driven stakeholder engagement. Organizations that have adopted such a framework include Clorox, Pfizer, Eaton, Ingersoll-Rand, among many others, and this adoption is in addition to the implementation of sustainability reporting and other similar measures at organization such as Coca-Cola, which began tracking and issuing a water stewardship report since 2008. Reporting concepts such as those mentioned above, while an improvement over traditional financial reporting in the sense that more operational data is included, do not represent the totality of influences upon an organization.

Financial activities and processes should, in general, be instituted only if they add or create economic value to the organization (Smith, 2015). Based purely on the market performance of these organizations, it appears that embracing such an approach to management and financial operations does indeed add value to existing businesses. Successfully launching such an initiative, and generating the information necessary to create and successfully communicate such data, virtually by default, requires a more a strategic and integrated accounting function. As organizations look to find efficiencies and opportunities for both cost reduction and top line revenue growth it is imperative that accounting professionals clearly and consistently advocate and demonstrate the value that they bring to the organization. Drilling down specifically in how accounting professionals can add value to this process, and assist management teams desiring to produce more varied and relevant information, it becomes apparent that while this is underway it remains in its earliest stages of development. Put another way, the opportunity for value creation and value delivery is there, it remains with the accounting professionals within industry to seize and leverage this opportunity.

Corporate Governance

Corporate governance, in essence, represents how the management team of an organization interacts with internal constituents and external partners, suppliers, regulators, and other interested parties. Traditionally, governance and the associated dialogue was limited to qualitative discussion held infrequently by the most senior levels of organizational management. In light of events during 2014 and 2015, however, this dynamic and relationship has begun to shift. Alibaba, for example, was not allowed to list shares during its IPO process on the Hong Kong stock exchange, due to issues regulators with the governance structure of the organization. Mark and Priscilla Zuckerberg, after grabbing headlines with the donation of 99% of Mark's Facebook stock to charitable work, generated additional headlines when it was discovered that instead of charitable foundation the funds would be structured as a limited liability corporation (LLC). This unique structure drew some criticism, as analysts speculated on whether or not this charitable gift was, in fact, charitable in reality. Addressing such concerns, Zuckerberg issued a statement clarifying the selection of an LLC corporate structure; such a structure would allow the organization to engage in joint ventures, for-profit partnerships, and other business activities with greater flexibility than if it were structured and operated as a traditional charitable foundation.

Additional examples of communication and disclosure issues related to corporate governance continued to make headlines as 2015 rolled into 2016; Volkswagen and Yahoo were both subjected to intense scrutiny over managerial missteps as well as weak governance and oversight. While the specifics of both situations are unique, obviously, it remains clear that a clearer and more consistent governance function, complete with quantitative information with which to evaluate developing situations, would have served both organizations well. Management at Yahoo, specifically, under fire for both a string of acquisitions, a lack of direction regarding the future of the stake owned in Alibaba, and activist shareholder pressure to turn around the core business, would have certainly benefited from a more engaged finance presence in these discussions. Corporate governance, it appears, should be linked together with existing financial systems, and subjected to similar rigor that accompanies financial, compliance, and operational data. Accounting professionals, increasing tasked with systems and information technology initiatives, are a logical partner to both design and implement enterprise improvements. Volkswagen, continuing to be plagued by the ongoing emissions scandal, simply did not have the controls or policies in place to safeguard the integrity of compliance related information. The subsequent financial blowback to both organizations has been significant, and relations with stakeholders damaged; governance clearly matters to the bottom line.

Accounting professionals, in an attempt to grow beyond traditional roles as reporters of historical financial information, must be aware of the large effect governance is having on business and financial results. Quantifying governance measures, both for the organization as well as versus competitors, is an important step in meeting this market need (Wang & Huynh, 2014). Governance and governance related issues alone, however, are not sufficient for organization competing in a multi-faceted competitive environment. Corporate governance underpins how the organization interacts with both internal and external stakeholders, but the senior leadership must still proactively execute initiatives on both a tactical and strategic level.

Sustainability

Sustainability, traditionally an issue relegated to extractive industries or utility based entities, appears to be increasingly a concern for organizations in every industry. Technology and service companies in particular, were traditionally excluded from the conversation related to sustainability matters, but as the economic clout of such organization has increased the conversation has evolved. Entities such as Google, Amazon, IBM, Microsoft, and other large technological companies, in order to meet the demands placed on them by consumers, have constructed massive data warehouses, logistics and package sorting facilities, drone facilities, and same day services. Such an increase in the physical presence of technology companies, as well the massive amounts of power user in operations have resulted in a situation where sustainability has now emerged as key issue. In fact, the issue of power consumption and the effect that such an increase in usage has on the environment has become of such importance that Alphabet (formerly Google) has invested in renewable sources of energy through its subsidiary Google Capital. Such a direct approach to finding solutions to this problem, by a market leading organization, clearly indicates the importance of such matters to senior management.

An area in which accounting professionals are uniquely positioned to enable more consistent reporting and communication related to sustainability information is the area of industry metrics and assurance standards. In a 2015 interview with Robert Eccles by Harvard Business Review Eccles argued that, despite good intentions and increased awareness regarding sustainability matters, a critical step will be development of reporting, assurance, and auditing standards. Echoing the development of common financial reporting standards, Eccles argues that an established reporting and communication framework will assist with both the refinement of end user expectations as well as how end-users interpret and use the data produced by organizations. Accounting professionals already have virtually every tool and technical skill necessary to develop and implement such metrics and reporting tools; the only real decision remaining is whether to make such standards industry specific or more all-encompassing.

Yet another area in which sustainability and environmental issues are playing a larger role is with regards to emissions and other environmentally related compliance mandates. Volkswagen, although certainly the most high profile example toward in the end of 2015, was certainly not the only organization of industry under scrutiny for environmental practices. Oil companies engaged in fracking, traditional utility organizations, retailers, logistics companies, and an assorted host of other field are increasingly under scrutiny to explain and justify the effect that operations have on the surround business and environmental eco-systems. The financial ramifications of environmental non-compliance represent a strategic risk to the organization and must be accounted for as such. Interpreting operational data into financial information for business decision making represent the essence of accounting information systems; this is of particular importance as it relates to sustainability.

Outlined below the challenge facing the accounting and financial profession as a whole can be summarized into a relatively simple statement. Organizations must be able to asses, quantify, and report on a much broader range and types of information that previously required. Governance related, sustainability items, as well as customer profitability metrics are of increasingly importance encapsulated within a broader assessment of risk management and strategic initiatives. At the risk of being demoted to less value-additive roles, accounting professionals must embrace the role of strategic management accountant, and assist with the development of systems, metrics, and reporting templates required for senior lever decision makers to make accurate decisions.

Strategic Management Accounting – Becoming the Partner

Data is increasing important in a business environment rapidly approaching digitization in virtually every industry, and accountants and financial professionals must evolve and keep abreast of change within business at large to remain relevant and to continue to add value to both the profession and their individual organizations. Leveraging advances in technology in order to extract the necessary data from internal processes and enterprise programs provides accountants with virtually of the information necessary to develop a strategic headset. Extracting information from existing processes and data flows, coordinating the information generated among a number of internal departments, and making sure that the information then reported to third party users is accurate, represent a core area in which accounting professionals can add value. That said, it is critical that in the process of creating reports and quantifying information, accountants do not lose sight of the broader issues impacting the organization. Bridging the gap, and communicating the transition from accounting's current organizational role to that of strategic partner and leader is a multi-faceted challenge. The challenge, however, lies well within existing competencies of the accounting profession, and these competencies can be leveraged, as described below, to generate increased value for the organization.

Strategy and strategic thinking involve assessing current situations as well as planning for future occurrences, and both aspects require that the correct questions be asked. Key performance indicators (KPI) are a mainstay of management and strategic planning, but the underlying questions and requirements leading to the development and reporting of KPIs are arguably more important in a rapidly changing business environment. In order to ask the correct questions, it is imperative that the organization understand the different types of information that are being distributed to stakeholders, and accounting professionals should play a prominent role in this assessment. After reviewing and assessing the information currently distributed to stakeholders as well the feedback to information presently provided, integrating systems, processes, and reporting procedures, and building new systems are logical next steps. Linked together with asking the right questions as well as understanding the response of stakeholders to current levels of information, organizations are increasingly facing pressure to both update ERP systems and standardize the information generated via these systems.

Investing in internal resources and capabilities to improve the quality of the information produced by the organization is a clear strategic initiative in many organizations, and Amazon, Facebook, and Tesla have built entire businesses and industries around the effective use of internal and customer related data. As business in general becomes increasingly data driven and fast moving it is imperative that management leaders have the necessary information to make informed decisions. Arguably more important than simply having the information, however, is whether or not the information is presented in a format that is comparative, useful, and understandable. Accounting professionals, trained the analyzing and reporting information, are well positioned to apply existing skills to emerging areas. Lastly, and connecting most directly to the existing strengths of the accounting function, management accountants can assist with developing appropriate tests and methods for addressing and correcting shortcomings that are identified, and these are direct ways that accountants can highlight and quantify emerging areas for growth.

Business leaders require timely information that reflects the performance of the organization on a holistic basis, i.e., information related to financial performance, operational performance, and factors that drive how the business performs. Drilling specifically into the emerging areas of sustainability, corporate governance, and the concept of integrated financial reporting at large, it is evident that market participants require more than what is currently being provided in terms of information. Market realities have demonstrated that, far from being academic or hypothetical concerns, governance and sustainability issues are rapidly becoming drivers of bottom-line financial performance. Additionally, and in the face of increasing competition, organizations must be able to react more quickly and embrace a changing business landscape. Accounting professionals, as illustrated throughout, are well positioned and possess the necessary skills to transition to a role as strategic business partner. Business needs strategic thinkers and leaders as globalization and competition increase, and accountants can, and should, embrace the mantle of strategic management accounting and help lead organizations forward.

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