

# A Critical Analysis About Strategic Management Accounting

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**Abstract:** Strategic Management Accounting (SMA) is important when operating a business. In most cases, SMA can facilitate a company's business and operations. Unlike traditional methods, SMA monitors the internal, external, financial and non-financial factors of the company, which is beneficial to the short and long term development of the company.

**Keywords:** Strategic Management Accounting

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## 1. Introduction

Management accounting places an important role in the operation of a business through measuring, analyzing, and interpreting financial information to management. Strategic management accounting (SMA) is a form of management accounting focusing on company's external information (e.g. competitor analysis) and non-financial information (e.g. social and environmental impact) in order to develop and monitor business strategy (Lord, 2007). SMA attempts to integrate management accounting with other business functions (e.g., marketing) to improve the performance of a company. It indicates that accountants begin to pay attention to broader business issues rather than purely financial issues with the purpose of maintaining the accountant role as a key position in the modern business.

There are a lot of arguments for and against whether SMA makes contributions to strategy formulation and implementation. For example, Otley (2001) stated that SMA had a significant influence on the thinking of management accountants and managers, while Nixon & Burns (2012) argued that SMA has little impact on managerial discourse and practice. This report will analyze whether SMA has role to play when strategy is planned in a deliberate and rational way or in a non-deliberate and irrational way.

## 2. Conceptions of SMA

There are many conceptions of SMA. First, SMA attempts to connect management accounting with marketing management for strategic positioning (Roslender, 1995). This concept focuses on marketing tools used by companies and management accounting information utilized within those tools. Second, SMA integrates strategic ideas into management accounting. Companies utilize strategic tools and look for management accounting information that provides support for strategy. Third, SMA combine many contemporary management accounting approaches and technologies. A number of contemporary approaches to management accounting (e.g. Balanced Scorecard and value chain) are considered as strategic management accounting techniques because they consist of external and market orientated content (Kaplan and Norton, 2004). By now, there is no single and agreed definition of SMA (Langfield-Smith, 2008).

SMA has the following unique characteristics. First, it cares about external information about competitors so that it can evaluate a company's performance relative to peers in the industry. Second, SMA integrates accounting with strategic positioning. Third, it exploits linkages in the value chain, which includes a set of activities that a company takes to transform a product from idea to final product so that it can help the company to gain competitive advantages.

## 3. Strategy planned in a deliberate and rational way

### 3.1. Classic model

Classical model considers strategist as a rational economic man who seeks to get the highest satisfaction or pleasure from their economic decisions. In this case, managers behave in a rational and logical way during their thought processes. Classical model depends on two major assumptions that there is a stable and predictable external environment is and that key objective of the company is to maximize shareholder value. SMA plays a key role in strategic implementation because SMA cannot only help the company to reduce cost and generate more revenue, but also set up management controls and performance strategy.

In addition, SMA can help companies to value strategic options. Investment appraisal is the process that a company utilizes to determine which project it should accept. The most common investment appraisals include NPV, IRR, ARR, payback period and so on, all of which rely on management accounting data. In addition, companies also need to consider non-financial factors in making the investment decision, such as whether the project will make pollution to the environment or whether the project complies with social ethnicity. As SMA involves both financial and non-financial information, it can help the company to choose the best strategic option.

Moreover, SMA provides a support system at 'Strategic Analysis' level. From the classical perspective, SMA is long-term oriented and contain broad dimension. SMA enables a company to have a better understanding of the external environment it belongs to, internal resources it owns and growth potential it has, which is beneficial to the development of the company in the long run.

### **3.2. Systemic model**

Under systemic model, SMA is still a support to 'rational planning'. However, what needs attention is that people are rooted in interwoven social systems and culture with specific values and rules. As cultural context affects planning choices, accounting focus changes under different culture. Western countries (e.g. the UK and the US) focuses on profit maximum, while the Japanese emphasize on 'market share'. Nowadays, as public pay more and more attention to Corporate Social Responsibilities, accounting begins to focus on long-run sustainability, including political & social influence and brand recognition. In addition, competition is complemented by alliances. For example, Guanxi, which is defined as a strong connection with someone involving moral obligations and favour exchange, is important in Chinese business culture. In most cases, a Chinese company with a strong Guanxi is able to overperform competitors.

Granovetter (1995) argued that the content of strategy and the process of making process is embedded in a network of social relations involving an extended company and wider community. SMA enables an organization to build and maintain good relationships with government, business partners and other parties so that they will provide helps to the organization. SMA makes a company to pay more attention to external factors, it will help the company to understand the culture and value of the society deeply and thus develop the most appropriate strategy to suit the society.

## **4. Strategy planned in a non-deliberate and irrational way**

### **4.1. Processual Model**

Processual model assumes that strategists have 'bounded rationality'. It means that when they make decisions, their rationality is limited by circumstances, events, personal biases, etc. Under processual model, strategies are emerged rather than deliberately planned. A series of decisions form a 'pattern' which gets more precise over time and may become 'formalized' as a strategy. There is no clear line between planning and implementation so that everyone can become a strategist. As strategy becomes a messy process, 'resource-based view' of strategy (RBV) becomes effective. Leaders decide how they can utilize their people and resources in order to catch market opportunities or handle different kinds of problems.

Emergent strategizing requires accounting to calculate contributions from short-term opportunities. For example, SMA can be used to calculate NPVs of different investment options, so that company can evaluate which investment project will produce maximum economic value. The resource-based strategy works as 'skill-building marathon', focusing on critical resources, such as PPE, intangible assets, knowledge capital. SMA is an essential way to 'win the marathon'. SMA can help a company not only utilize these resources effectively and efficiently to promote its business operation, but also develop and build skills based on new performance measurement systems.

### **4.2. Evolutionary Model**

Under evolutionary model, there is too much uncertainty in life so that a formal, deliberate strategy cannot work. Evolutionists consider the environment as unpredictable, and thus they believe the company should make efforts on increasing both strategic and organizational 'clock speed' in order to respond quickly to emerging situations (Nadler and Tushman, 1999). As maximizing profit is considered to be the most crucial objective of a business, a significant competitive advantage is relatively efficient. The short-term strategy focuses on how to re-

duce costs and earn high profit. Therefore, accounting becomes central to cost control, and SMA plays a significant role.

SMA can help the company get a high profit in short-term through cost control and optimal use of resources. For example, activity-based management (ABM) can help a company allocate production cost to different activities. Therefore, the company can find out what activities is cost-consuming and thus make an improvement to reduce cost and increase profit. Besides, variance analysis is also practical. The unfavourable efficiency and price variance can tell companies the problems in their operations, and thus they can find the related solution. If the labour efficiency variance is unfavourable, it shows that the employees do not work efficiently in the production process so that the company should provide more training to employees to improve their production skills. Moreover, SMA can help a company make rapid decisions based on given information therefore to survive in the uncertainty environment.

## 5. Limitations of SMA

Under processual model and evolutionary model, when strategists are irrational, and strategy is planned non-deliberately, the effectiveness of management accounting technique or SMA system relies a lot on how it is utilized and on the extent to which it is a part of the organizational system and strategic process. If SMA doesn't integrate with other management systems, SMA cannot work effectively. Some researchers argue that strategic decisions not always based on financial considerations – intuition, judgment, etc. and value chain & cost analysis can be made without SMA. In addition, Pavlatos & Kostakis (2018) found that the manager's education and background have an impact on the effectiveness of SMA. If managers lack sufficient education and don't realize the importance of SMA, SMA doesn't have a role to play in the company.

## 6. Conclusion

Under processual and evolutionary model, when strategist is an irrational man and strategy is not deliberately planned, SMA might be unable to work effectively if SMA doesn't fully integrate with other management systems. However, in most of the case, SMA can promote the business and operation of a company. Different from the traditional approach, SMA provides oversight of the internal, external, financial and non-financial factors of a company, which is beneficial to its development both in the short-term and long term.

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