

Introduction to Cost and Management Accounting in a Global Business Environment



LEARNING OBJECTIVES

After completing this chapter, you should be able to answer the following questions:

1

How do financial and management accounting relate to each other?

2

How does cost accounting relate to financial and management accounting?

3

What is the role of a code of ethics in guiding the behaviors of an organization's global workforce?

4

What factors have influenced the globalization of businesses and why have these factors been significant?

5

What are the primary factors and constraints that influence an organization's strategy and why are these factors important?

6

How does an organization's competitive environment impact its strategy and how might an organization respond to competition?

7

How does the accounting function impact an organization's ability to successfully achieve its strategic goals and objectives?

8

Why is a company segment's mission affected by product life cycle?

9

What is the value chain and why is it important in managing a business?

INTRODUCING

<http://www.abnamro.com>

The Netherlands-based bank, ABN AMRO, was formed in 1990 when Algemene Bank Nederland merged with Amsterdam-Rotterdam Bank. Following the merger, ABN AMRO has established itself as a global bank with operations in 76 countries and territories including the United States, where the bank has a 16% share of the Midwest market. ABN AMRO's global expansion was driven initially by mergers but more recently by innovative web-based delivery of products and services.

By traditional measures (such as its \$505 billion in assets and its capital position), ABN AMRO is the largest bank in Holland, the fourth largest in Europe, and the eighth largest in the world. ABN AMRO's core lending business is solid. Over half of ABN AMRO's revenues come from Dutch clients—a very stable source of business that includes such companies as Royal Dutch Shell, Philips Electronics, and Unilever.

ABN AMRO formulated an identity statement in 1992 to reflect its corporate aspirations: "ABN AMRO Bank is a long-established, solid, multi-faceted bank of international reputation and standing. We will strive to fulfill the bank's ambition in being a frontrunner in value-added banking, both on a local and worldwide level. . . ." The corporate values statement was formalized in 1997, although the values have been important priorities since the bank was established in the 1800s. The four values forming the basis of the bank's activities are integrity, teamwork, respect, and professionalism. Bank managers believe that the values need to be formalized even though they are and should be self-evident. The formalization provides external parties criteria by which the bank can be assessed. ABN AMRO perceives its corporate identity and values as the underlying tenets of the organization.

SOURCE: www.abnamro.com/profile; Chris Costanzo, "ABN AMRO Says Web Will Anchor Its Expansion," *American Banker* (December 9, 1999), p. 16.

ABN AMRO is successfully pursuing a corporate identity as a "bank of international reputation and standing." ABN AMRO was ranked as the fifth largest commercial and savings bank and the seventy-third largest corporation in the 1999 Fortune Global 500. The corporation (with its foreign subsidiaries and affiliates) is comprised of over 3,500 branches and offices in 76 countries and territories across five continents. Although international trade was once confined to extremely large corporations such as ABN AMRO, the explosion of World Wide Web usage has enabled any business with the right infrastructure capabilities and the necessary funds for Web site development to market its products and services around the world.

Organizations operating globally face three primary challenges. First, managers must understand factors influencing international business markets so they can identify locations in which the company has the strengths and desire to compete. Second, managers must devise a long-term plan to achieve organizational goals. Third, the company must devise information systems that keep operations consistent with its plans and goals.

This chapter introduces cost accounting and describes the global environment of business, international market structures, trade agreements, e-commerce, and legal and ethical considerations. It addresses the importance of strategic planning and links strategy creation and implementation to the accounting information system. The chapter discussion applies equally well to large and small profit-seeking businesses, and most discussion is appropriate for not-for-profit and governmental entities.

INTRODUCTION TO COST ACCOUNTING

To manage a diverse, international banking organization, ABN AMRO's leaders need monetary and nonmonetary information that helps them to analyze and solve

problems by reducing uncertainty. Accounting, often referred to as the language of business, provides much of that necessary information. Accounting language has two primary “variations”: financial accounting and management accounting. Cost accounting is a bridge between financial and management accounting.

Accounting information addresses three different functions: (1) providing information to external parties (stockholders, creditors, and various regulatory bodies) for investment and credit decisions; (2) estimating the cost of products produced and services provided by the organization; and (3) providing information useful to internal managers who are responsible for planning, controlling, decision making, and evaluating performance. Financial accounting is designed to meet external information needs and to comply with generally accepted accounting principles. Management accounting attempts to satisfy internal information needs and to provide product costing information for external financial statements. The primary differences between these two accounting disciplines are given in Exhibit 1–1.

Financial accounting must comply with the generally accepted accounting principles (currently established by the Financial Accounting Standards Board [FASB], a private-sector body). The information used in financial accounting is typically historical, quantifiable, monetary, and verifiable. These characteristics are essential to the uniformity and consistency needed for external financial statements. Financial accounting information is usually quite aggregated and related to the organization as a whole. In some cases, a regulatory agency such as the Securities and Exchange Commission (SEC) or an industry commission (such as banking or insurance) may mandate financial accounting practices. In other cases, financial accounting information is required for obtaining loans, preparing tax returns, and understanding how well or poorly the business is performing.

By comparison, management accounting provides information for internal users. Because managers are often concerned with individual parts or segments of the business rather than the whole organization, management accounting information commonly addresses such individualized concerns rather than the “big picture” of financial accounting. Management accounting is not required to adhere to generally accepted accounting principles in providing information for managers’ internal purposes. It is, however, expected to be flexible in serving management’s needs

EXHIBIT 1-1

Financial and Management Accounting Differences

	Financial Accounting	Management Accounting
Primary users	External	Internal
Primary organizational focus	Whole (aggregated)	Parts (segmented)
Information characteristics	Must be <ul style="list-style-type: none"> • Historical • Quantitative • Monetary • Verifiable 	May be <ul style="list-style-type: none"> • Current or forecasted • Quantitative or qualitative • Monetary or nonmonetary • Timely and, at a minimum, reasonably estimated
Overriding criteria	Generally accepted accounting principles Consistency Verifiability	Situational relevance (usefulness) Benefits in excess of costs Flexibility
Recordkeeping	Formal	Combination of formal and informal

and to be useful to managers' functions. A related criterion is that information should be developed and provided only if the cost of producing that information is less than the benefit of having it. This is known as cost-benefit analysis. These two criteria, though, must be combined with the financial accounting information criteria of verifiability, uniformity, and consistency, because all accounting documents and information (whether internal or external) must be grounded in reality rather than whim.

The objectives and nature of financial and management accounting differ, but all accounting information tends to rely on the same basic data system and set of accounts. The accounting system provides management with a means by which costs are accumulated from input of materials through the production process until completion and, ultimately, to cost of goods sold. Although technology has improved to the point that a company can have different accounting systems designed for different purposes, some companies still rely on a single system to supply the basic accounting information. The single system typically focuses on providing information for financial accounting purposes, but its informational output can be adapted to meet most internal management requirements.

Relationship of Financial and Management Accounting to Cost Accounting

Cost accounting is defined as “a technique or method for determining the cost of a project, process, or thing. . . . This cost is determined by direct measurement, arbitrary assignment, or systematic and rational allocation.”¹ The appropriate method of determining cost depends on the circumstances that generate the need for information. Various costing methods are illustrated throughout the text.

Central to a cost accounting system is the process for tracing various input costs to an organization's outputs (products or services). This process uses the traditional accounting form of recordkeeping—general and subsidiary ledger accounts. Accounts containing cost and management accounting information include those dealing with sales, procurement (materials and plant assets), production and inventory, personnel, payroll, delivery, financing, and funds management.² Not all cost information is



1
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2
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cost accounting

This manufacturer of televisions must use cost accounting techniques to determine financial statement valuations for product inventory and cost of goods sold.

¹ Institute of Management Accountants (formerly National Association of Accountants), *Statements on Management Accounting Number 2: Management Accounting Terminology* (Montvale, N.J.: NAA, June 1, 1983), p. 25.

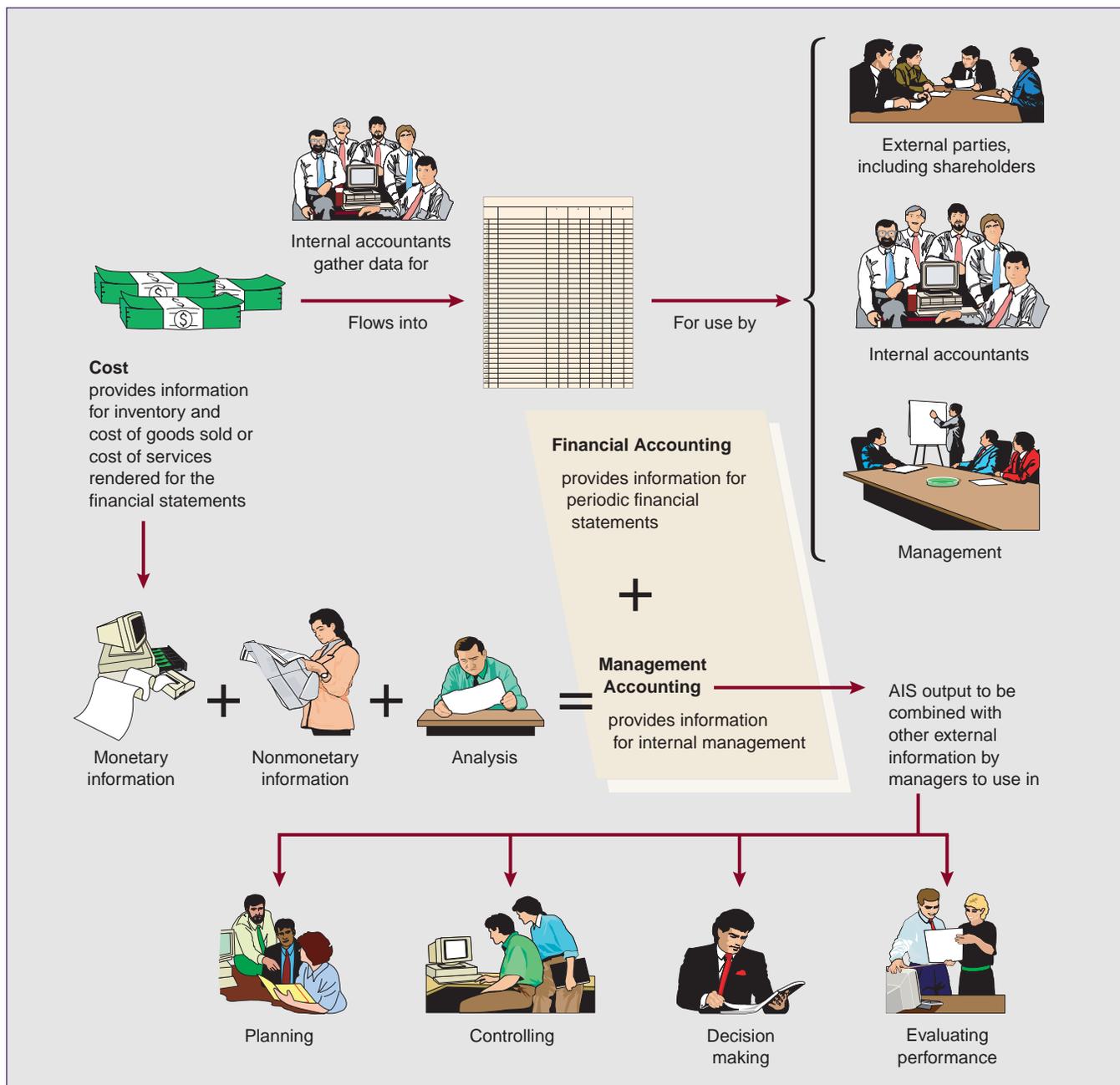
² With reference to accounts, this text will focus primarily on the set of accounts that depicts the internal flow of costs.

reproduced on the financial statements, however. Correspondingly, not all financial accounting information is useful to managers in performing their daily functions.

Cost accounting creates an overlap between financial accounting and management accounting. Cost accounting integrates with financial accounting by providing product costing information for financial statements and with management accounting by providing some of the quantitative, cost-based information managers need to perform their tasks. Exhibit 1-2 depicts the relationship of cost accounting to the larger systems of financial and management accounting. None of the three areas should be viewed as a separate and exclusive “type” of accounting. The boundaries of each are not clearly and definitively drawn and, because of changing technology and information needs, are becoming increasingly blurred.

EXHIBIT 1-2

Accounting Information System Components and Relationships



The cost accounting overlap causes the financial and management accounting systems to articulate or be joined together to form an informational network. Because these two systems articulate, accountants must understand how cost accounting provides costs for financial statements and supports management information needs. Organizations that do not manufacture products may not require elaborate cost accounting systems. However, even service companies need to understand how much their services cost so that they can determine whether it is cost-effective to be engaged in particular business activities.

Management and Cost Accounting Standards

Management accountants can use different costs and different information for different purposes, because their discipline is not required to adhere to generally accepted accounting principles when providing information for managers' internal use. In the United States, financial accounting standards are established by the Financial Accounting Standards Board (FASB), a private-sector body. No similar board exists to define universal management accounting standards. However, a public-sector board called the Cost Accounting Standards Board (CASB) was established in 1970 by the U.S. Congress to promulgate uniform cost accounting standards for defense contractors and federal agencies.

The CASB produced 20 cost accounting standards (of which one has been withdrawn) from its inception until it was terminated in 1980. The CASB was recreated in 1988 as an independent board of the Office of Federal Procurement Policy. The board's objectives are to

- Increase the degree of uniformity in cost accounting practices among government contractors in like circumstances;
- Establish consistency in cost accounting practices in like circumstances by each individual contractor over time; and
- Require contractors to disclose their cost accounting practices in writing.³

Although CASB standards do not constitute a comprehensive set of rules, compliance is required for companies bidding on or pricing cost-related contracts for the federal government.

An organization important to the practice of management and cost accounting is the Institute of Management Accountants, or the IMA. The IMA is a voluntary membership organization of accountants, finance specialists, academics, and others. It sponsors two major certification programs: Certified Management Accountant (CMA) and Certified in Financial Management (CFM). The IMA also issues directives on the practice of management and cost accounting called *Statements on Management Accounting*, or SMAs. The SMAs, unlike the pronouncements of the CASB, are not legally binding standards, but they undergo a rigorous developmental and exposure process that ensures their wide support.

An organization similar to the IMA is the Society of Management Accountants of Canada, which also issues guidelines on the practice of management accounting. These Management Accounting Guidelines (MAGs), like the SMAs, are not requirements for organizational accounting, but are merely suggestions.

Although the IMA, Cost Accounting Standards Board, and Society of Management Accountants of Canada have been instrumental in standards development, much of the body of knowledge and practice in management accounting has been provided by industry practice and economic and finance theory. Thus, no "official" agency publishes generic management accounting standards for all companies, but there is wide acceptance of (and, therefore, authority for) the methods presented in the text. The development of cost and management accounting standards and

³ Robert B. Hubbard, "Return of the Cost Accounting Standards Board," *Management Accounting* (October 1990), p. 56.

practices indicates that management accountants are interested and involved in professional recognition. Another indication of this movement is the adoption of ethics codes by both the IMA and the various provincial societies in Canada.

3

What is the role of a code of ethics in guiding the behaviors of an organization's global workforce?

Ethics for Management Accountant Professionals

Because of the pervasive nature of management accounting and the organizational level at which many management accountants work, the IMA believed that some guidelines were necessary to help its members with ethical dilemmas. Thus, *Statement on Management Accounting 1C, Standards of Ethical Conduct for Management Accountants*, was adopted in June 1983. These standards are in the areas of competence, confidentiality, integrity, and objectivity. The IMA Code of Ethics is reproduced in Exhibit 1–3.

EXHIBIT 1–3

Standards of Ethical Conduct for Management Accountants

COMPETENCE

Practitioners of management accounting and financial management have responsibility to:

- Maintain an appropriate level of professional competence by ongoing development of their knowledge and skills.
- Perform their professional duties in accordance with relevant laws, regulations, and technical standards.
- Prepare complete and clear reports and recommendations after appropriate analyses of relevant and reliable information.

CONFIDENTIALITY

Practitioners of management accounting and financial management have responsibility to:

- Refrain from disclosing confidential information acquired in the course of their work except when authorized, unless legally obligated to do so.
- Inform subordinates as appropriate regarding the confidentiality of information acquired in the course of their work and monitor their activities to assure the maintenance of that confidentiality.
- Refrain from using or appearing to use confidential information acquired in the course of their work for unethical or illegal advantage either personally or through third parties.

INTEGRITY

Practitioners of management accounting and financial management have responsibility to:

- Avoid actual or apparent conflicts of interest and advise all appropriate parties of any potential conflict.
- Refrain from engaging in any activity that would prejudice their ability to carry out their duties ethically.
- Refuse any gift, favor, or hospitality that would influence or would appear to influence their actions.
- Refrain from either actively or passively subverting the attainment of the organization's legitimate and ethical objectives.
- Recognize and communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity.
- Communicate unfavorable as well as favorable information and professional judgments or opinions.
- Refrain from engaging in or supporting any activity that would discredit the profession.

OBJECTIVITY

Practitioners of management accounting and financial management have responsibility to:

- Communicate information fairly and objectively.
- Disclose fully all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, comments, and recommendations presented.

SOURCE: http://www.imanet.org/content/About...cle_of_Ethics/Ethical-standards.htm. May 1, 2000, 10:30 a.m., *Statement on Management Accounting Number 1C: Standards of Ethical Conduct for Management Accountants* (Montvale, N.J.: NAA, June 1, 1983). Copyright by Institute of Management Accountants (formerly National Association of Accountants), Montvale, N.J.

Accountants have always been regarded as individuals of conviction, trust, and integrity. The most important of all the standards listed are those designated under integrity. These statements reflect honesty of character and embody the essence and intent of U.S. laws and moral codes. Standards of integrity should be foremost in business dealings on individual, group, and corporate levels.

To summarize, cost accounting allows organizations to determine a reliable and reasonable measurement of “costs” and “benefits.” These costs and benefits may relate to particular products, customers, divisions, or other objects. Much of this text is dedicated to discussing the various methods, tools, and techniques used in cost accounting. However, before providing that discussion, the balance of this chapter and Chapter 2 provide important descriptive information about trends in business today, as well as information about important practices widely used by managers. This descriptive information will establish a context for understanding the practice of cost accounting in the contemporary organization. One of the big influences on current business practices is globalization.

THE GLOBAL ENVIRONMENT OF BUSINESS

Most businesses participate in the **global economy**, which encompasses the international trade of goods and services, movement of labor, and flows of capital and information.⁴ The world has essentially become smaller through improved technology and communication abilities as well as trade agreements that promote the international movement of goods and services among countries. Exhibit 1–4 provides the results of a survey of Fortune 1000 executives about the primary factors that encourage the globalization of business. Currently, the evolution of Web-based technology is dramatically affecting international business.

E-Commerce

Electronic commerce (**e-commerce**) is any business activity that uses the Internet and World Wide Web to engage in financial transactions. But e-commerce had its beginnings in two important events that occurred before a computer was even developed: (1) the introduction of wireless money transfers in 1871 by Western Union and (2) the introduction in 1914 of the first consumer charge card. These inventions alone, however, were not enough to produce global opportunities for business.

4

What factors have influenced the globalization of businesses and why have these factors been significant?

global economy

e-commerce

EXHIBIT 1-4

Factors Driving Business Globalization

Factor	Percentage Indicating Factor as Primary in Globalization Trend
Technology	43%
Competition	29%
The Economy	21%
Better Communications	17%
Need for New Markets/Growth	13%
Deregulation	11%
Access to Information	9%
Legislation	7%
Ease of Entering New Market	5%

SOURCE: Deloitte & Touche LLP, *Survey of American Business Leaders: Information Technology* (November 1996), pp. 1–11. Reprinted with permission from Deloitte & Touche.

⁴ Paul Krugman, *Peddling Prosperity*, quoted by Alan Farnham in “Global—or Just Globaloney,” *Fortune* (June 27, 1994), p. 98.

Web sites of manufacturers and retailers worldwide can be accessed by potential customers 24 hours a day. Businesses and consumers can view products and the way they work or fit together on computer or television screens. Customers can access product information and order and pay for their choices without picking up the phone or leaving home or the office. In the world of banking and financial services, bills can be paid, balances accessed, loans and insurance obtained, and stocks traded.

Some of the numerous positives and negatives of having e-commerce capability are provided in Exhibit 1–5. In some cases, a seller's positive may be a buyer's negative: the ability to accumulate, use, reuse, and instantaneously transmit customer information “can, if not managed carefully, diminish personal privacy.”⁵

But the current drawbacks to e-commerce will not stop the ever-increasing usage of this sales and purchasing medium. More and more merchants will develop sites that are easy and safe to use by customers but that inhibit hackers from causing internal problems. The rapid expansion of e-commerce illustrates the success of its positives and necessitates the correction of its negatives.

Trade Agreements

Encouragement of a global economy has been fostered not only by e-commerce but also by government and business leaders worldwide who have made economic integration a paramount concern. **Economic integration** refers to creating multi-country markets by developing transnational rules that reduce the fiscal and physical barriers to trade as well as encourage greater economic cooperation among countries. Most economic integration occurs through the institution of trade agreements allowing consumers the opportunity to choose from a significantly larger selection of goods than that previously available. Many of these agreements encompass a limited number of countries in close geographic proximity, but the General Agreement on Tariffs and Trade (GATT) involves over 100 nations worldwide.

Trade agreements have created access to more markets with vast numbers of new customers, new vendor sources for materials and labor, and opportunities for new production operations. In turn, competitive pressures from the need to meet or beat prices and quality of international competitors force organizations to focus on cost control, quality improvements, rapid time-to-market, and dedicated customer service. The accompanying News Note on page 12 reveals an interesting outcome from the North American Free Trade Agreement. As companies become more globally competitive, consumers' choices are often made on the bases of price, quality, access (time of availability), and design rather than on whether the goods were made domestically or in another country.

Globalization Considerations

There is no question that globalization is occurring and at a remarkably rapid rate. But operating in foreign markets may create situations that vary dramatically from those found only in domestic markets. Considerations about risk, legal standards, and ethical behaviors can be vastly dissimilar between and among different foreign markets.

RISK CONSIDERATIONS

Numerous risks exist in any business environment. But when a business decides to enter markets outside its domicile, it needs to carefully evaluate the potential risks. Some of the risks depend on the level of economic development of the country in which operations are being considered; these risks often include political and

⁵ W. J. Clinton and A. Gore, Jr., *A Framework for Global Electronic Commerce* (<http://www.iitf.nist.gov/elecomm/ecomm.htm>, April 4, 1999), p. 12.

EXHIBIT 1-5*The Realities of E-Commerce*

	Merchant	Customer
<i>Positives:</i>		
• Convenience and efficiency	No downtime Real-time accumulation of customer and product/service data Ease of updating product/service information Ease of obtaining feedback on customer satisfaction or providing customer service Comparative ease of business start-up Ease of access to new markets Ease of instantaneous communication	Around-the-clock availability for product information and purchases Access to international merchants Ease of use Ease of comparison shopping Ease of providing feedback Ease of gaining information on products/services from other companies or individuals Ability to receive instantaneous communications from merchants
• Cost savings	Staff, paperwork, and inventory reduction No need for around-the-clock staffing to take orders Less expensive to testmarket new products Lower transaction costs, such as those related to errors or electronic data interchange Wide dissemination of information at nominal incremental cost (after start-up) Inexpensive method of document transfer Ability to use site as an employment recruiting tool	Access is local rather than long-distance Rapid access to on-line technical support
<i>Negatives:</i>		
• Privacy	Lack of standardized international privacy policies Theft of passwords or exploitation of unprotected connections to take over Web sites and corporate computers	Questionable ability to obtain redress if personal information is used improperly Theft of passwords, credit card numbers, etc., allowing unauthorized purchases
• Legality	Lack of international laws governing transactions Questionable ability to ensure intellectual property protection Difficulty of assessing compliance with tax regulations in all business jurisdictions	Questionable ability to obtain redress if decisions are made on inaccurate or incomplete information
• Costs	Cost of Web site development (including need for multiple languages), maintenance, and security (including firewalls and data encryption) Potential for internal network shutdown from e-mail complaints, such as those related to inappropriate advertising Losses due to fraudulent sales	Cost of "distraction time" from Net surfing Possibility of purchasing from a fraudulent business or a business that will not correct problems, such as damaged merchandise Possibility of purchasing counterfeit goods
• Other	Potential for sites to be accessed by improper parties (e.g., minors) Some products/services may be too complex for e-commerce (e.g., health care)	Poor customer service due to merchant's inability to manage increased e-commerce Difficulty in using site Difficulty in finding specific site, product, or service

NEWS NOTE



INTERNATIONAL

Taking Business South

Among chief executives, Phillip Martin is unique. He runs a conglomerate that does everything from making auto parts to running casinos. And he is a real chief, as in chief of the Mississippi Band of Choctaw Indians. Over the past 30 years, he has helped to bring a wealth of jobs within the border of the 25,000-acre Choctaw reservation.

The profits from Chief Martin's enterprises have given the Choctaws employment opportunities they never had before, and they have elected to send low-skilled work south and bring higher-paying jobs to their community. So, like so many other U.S. CEOs, Martin has taken business to Mexico. Chahta Enterprise is the first Native American-owned company to leave the reservation and take a giant step into the global economy.

"We started in this business competing with the Japanese, but now all our competition is coming from Mexico," says the 73-year-old chief. Mr. Martin says the North American Free Trade Agreement meant that Chahta had to join the migration south or lose its automobile industry contracts. The Choctaws opened a factory in Sonora, Mexico, in 1998, and its 1,400 employees—none Choctaws—assemble wire harnesses for

Ford Motor Co. A second Chahta plant in Mexico, making car-stereo components, is scheduled to open in late 1999.

Chahta had to invest more than \$1 million to build a factory that met Ford's price and quality demands. A typical employee at the Mexican plant makes \$6 per day for work that would cost \$7 to \$12 per hour in Mississippi. The Sonora plant manager explains how the economics of the auto industry forced the Choctaws to relocate in Mexico: a door lock electrical cluster that Ford paid \$65 to \$70 for in 1994 now sells for \$50. And car makers keep pounding away for every penny that Chahta, and all other suppliers, can reduce costs. But going south has benefited the Choctaw Nation. Chahta's 1999 Mexican operations were expected to gross over \$100 million, which will be used to fund other investments to create jobs in tribal schools and in the hotels, casinos, and golf courses that dot the reservation in Mississippi as well as an American Greetings Co. printing operation.

SOURCE: Adapted from Joel Millman, "Choctaw Chief Leads His Mississippi Tribe into the Global Market," *The Wall Street Journal* (July 23, 1999), p. B1.

currency risks. Political risks include the potential for expropriation or nationalization of assets and the potential for change in business, legal or tax treatment under new political leadership.

Currency risks can cause widely unpredictable results. For example, ABN AMRO acquired 40 percent of Banco Real, Brazil, for \$2.1 billion; Brazil's currency devaluation three months after the purchase caused two situations. First, depending on the depth of the recession, there may be a significant level of loans that "go bad." But, second, the devaluation made the acquisition much less expensive for ABN AMRO.⁶

Risks relating to cultural differences are more subtle. The business must assess whether product names and slogans will translate correctly, whether gender issues (such as female supervisors) will create labor problems, and whether products reflect the lifestyles or product preferences of different global customers. To illustrate this latter point, consider that diet cola comprises about 25 percent of all Coca-Cola and PepsiCo beverage brands sold in the United States. However, these companies, which have just begun selling diet colas in India, forecast a maximum long-term market share of only 3 percent of that country's sales. Diet foods are a new concept in a country where malnutrition was a recent phenomenon. "There is a deep-seated feeling that anything labeled 'diet' is meant for a sick person, such as a diabetic or someone with heart problems."⁷

Exhibit 1-6 provides numerous considerations in a business risk framework. These items must be evaluated whether a business is operating domestically or internationally. The difference in the evaluation process is often the greater depth of

<http://www.coca-cola.com>
<http://www.PepsiCo.com>

⁶ Deborah Orr, "Dutch Colonizers," *Forbes* (June 14, 1999), p. 119.

⁷ Miriam Jordan, "Debut of Rival Diet Colas in India Leaves a Bitter Taste," *The Wall Street Journal* (July 21, 1999), p. B1.

EXHIBIT 1-6*A Business Risk Framework*

Strategic Risks—Risks that relate to doing the wrong thing.

Environment Risks:

- Natural and manmade disasters
- Political/country
- Laws and regulations
- Industry
- Competitors
- Financial markets

Organization Risks:

- Corporate Objectives and Strategies: planning; resource allocation; monitoring; mergers, acquisitions, and divestitures; joint ventures and alliances
- Leadership: vision, judgment, succession planning, tone at the top
- Management: accountability, authority, responsibility
- Corporate Governance: ethics, reputation, values, fraud and illegal acts
- Investor/Creditor Relations
- Human Resources: performance rewards, benefits, workplace environment, diversity

Operating Risks—Risks that relate to doing the right things the wrong way.

- Workforce: hiring, knowledge and skills, development and training, size, safety
- Suppliers: outsourcing; procurement practices; availability, price, and quality of suppliers' products and services
- Physical Plant: capacity, technology/obsolescence
- Protection: physical plant and other tangible assets, knowledge and other intellectual property
- Products and Services: development, quality, pricing, cost, delivery, consumer protection, technology/obsolescence
- Customers: needs, satisfaction, credit
- Regulatory Compliance: employment, products and services, environmental, antitrust laws

Financial Risks—Risks that relate to losing financial resources or incurring unacceptable liabilities.

- Capital/Financing: availability, interest rates, creditworthiness
- Investing: cash availability, securities, receivables, inventories, derivatives
- Regulatory Compliance: securities law, taxation

Information Risks—Risks that relate to inaccurate or irrelevant information, unreliable systems, and inaccurate or misleading reports.

- Information Systems: reliability, sufficiency, protection, technology
- Strategic Information: relevance and accuracy of measurements, availability, assumptions
- Operating Information: relevance and accuracy of measurements, availability, regulatory reporting
- Financial Information: relevance and accuracy of measurements, accounting, budgets, taxation, financial reporting, regulatory reporting

SOURCE: Deloitte & Touche LLP, *Perspectives on Risk* (New York: 1997), pp. 12, 24, 25. Reprinted with permission from Deloitte & Touche.

knowledge necessary and the greater potential for change when operating in foreign markets. The corporate implications of many of these items can be minimized or exploited depending on the business's ability to respond to change and to manage uncertainty.

LEGAL CONSIDERATIONS

Domestic and international laws and treaties can significantly affect how an organization legally obtains new business, reduces costs, or conducts operating activities. Laws represent codified societal rules and can change as the society for which they are established changes. For example, Communism's fall resulted in new laws promoting for-profit businesses in the former Soviet Union. Britain, in the face of budget troubles, changed its laws to allow privatization of some utility companies. China, in pursuit of a more open international trade position, altered its laws to allow some foreign banks (including ABN AMRO) to have full-fledged branches in Beijing. These examples represent a small proportion of how laws regarding business activities change as society changes.

NEWS NOTE



INTERNATIONAL

Unacceptable Rebates

In July 1999, the European Union's executive body, the European Commission, conducted raids to examine documents and gather evidence . . . that could lead to a full-blown antitrust action against Coca-Cola. The raids focused on suspicions that Coke was illegally using rebates to enhance its market share—charges Coke denied. In Europe, the company outsells PepsiCo Inc. and other rivals in soft-drink sales by vast margins. For instance, in Germany, Coke's share of the soft-drink market is 55%, compared to Pepsi's 5%.

The raids focused on rebates to distributors. Such rebates aren't necessarily illegal in the 15-nation EU, but

EU authorities say they can be illegal in some cases if paid by companies that dominate their markets. In the Coke case, the commission is looking for evidence that the U.S. company stifled competition with several types of rebates. Among them are rebates on sales that boost Coke's market share at the expense of rivals and rebates given to distributors who agree to sell the full range of Coke products or stop buying from competitors.

SOURCE: Brandon Mitchener and Betsy McKay, "EU Raids Coca-Cola's European Offices on Suspicions of Illegal Use of Rebates," *The Wall Street Journal* (July 22, 1999), p. A4.

Most government regulations seek to encourage an environment in which businesses can succeed. As indicated in the accompanying News Note, regulatory agencies monitor business practices for activities detrimental to healthy commerce.

Many early U.S. laws relating to business were concerned with regulating certain industries on which the public depended, such as telecommunications, utilities, airlines, and trucking. With substantial deregulation, American laws are now more concerned with issues such as fair disclosure of corporate information, product safety, and environmental protection. Companies might even be held "liable for human rights abuses against indigenous people in foreign countries, even if the companies are not directly involved" if the abuses took place near company operations.⁸ Freeport-McMoRan Copper & Gold and Unocal Corp. both have been sued in the United States because of alleged military abuses in, respectively, Indonesia and Myanmar.

Organizations are becoming more active in defining responsible corporate behavior, and this trend is likely to continue. Irresponsible behavior tends to invite an increase in governmental monitoring and regulation. For example, after many American companies were found to have given bribes in connection with business activities, the United States passed the **Foreign Corrupt Practices Act (FCPA)** in 1977. This law prohibits U.S. corporations from offering or giving bribes (directly or indirectly) to foreign officials to influence those individuals (or cause them to use their influence) to help businesses obtain or retain business. The act is directed at payments that cause officials to act in a way specified by the firm rather than in a way prescribed by their official duties.

ETHICAL CONSIDERATIONS

In contrast to laws, **ethical standards** represent beliefs about moral and immoral behaviors. Because beliefs are inherently personal, some differences in moral perspectives exist among all individuals. However, the moral perspective is generally more homogeneous within a given society than it is across societies. In a business context, ethical standards are norms for individual conduct in making decisions and engaging in business transactions. Also, many professions have established ethical standards for their practitioners such as those promulgated by the IMA.

<http://www.fcx.com>

<http://www.Unocal.com>

Foreign Corrupt Practices Act (FCPA)**ethical standard**

⁸ Stewart Yerton, "World Will Watch Lawsuits' Outcome," [New Orleans] *The Times-Picayune* (May 11, 1997), p. F-1.

In general, ethical standards for business conduct are higher in most industrialized and economically developed countries than in less developed countries. But the standards and their enforcement vary greatly from one industrialized country to another. Thus, because of the tremendous variations, companies should develop internal norms for conduct (such as a code of ethics) to ensure that certain behaviors are consistent in all of its geographical operating segments. There must also be respect for local customs and traditions if they do not violate the accepted ethical and legal standards of the company and its domicile country. One cannot categorize all business practices as either ethical or unethical; there must be a *moral free space*⁹ that allows managers and employees to make decisions within the bounds of reason. The accompanying News Note about Texas Instruments (TI) addresses this issue.

<http://www.ti.com>

It is important for an organization to have and support a code of conduct that promotes integrity of behavior at all organizational levels. Companies can use a variety of methods to communicate corporate ethical values to all employees. For instance, in 1997, Lockheed Martin developed an interactive board game featuring Scott Adams' Dilbert character and a multitude of potential, practical ethical challenges to be addressed by employee teams. Texas Instruments uses an alternative method, an ethical "quick test" for its employees facing an ethical decision:

<http://www.lmco.com>

- Is the action legal?
- Does it comply with our values?
- If you do it, will you feel bad?
- How will it look in the newspaper?
- If you know it's wrong, don't do it!
- If you're not sure, ask.
- Keep asking until you get an answer.¹⁰

ETHICS



NEWS NOTE

Addressing Ethical Challenges at TI

"Ethical questions face businesspeople every day, especially when a company is involved in worldwide markets," said Carl Skooglund, former TI vice president and director of ethics. The challenge is "to provide tools to our employees so that they can make the tough, quick decisions on the fly, on the firing line. And, make them correctly. There are two elements to making decisions and taking action on behalf of an organization: (1) a clear understanding of the organization's values, principles, and ethical expectations and (2) sound personal judgment and appropriate choices."

TI has adopted a three-level approach to ethical integrity on a global level. The first level asks whether there is compliance with all legal requirements on a local level. The second level addresses whether there are local business practices or requirements that will impact interactions with other parts of the world. The third level asks

whether some business practices need to be adapted to fit local laws and customers of a specific locale. What may be believed to be proper in one country may not migrate well to another. And, on what basis can universal standards be defined that apply to TI employees everywhere?

Today, no rulebook or library of policies is going to guide ethical actions. "They must be guided by a shared understanding of basic values and principles of integrity. And they must be supported by resources that will help people to recognize when the caution lights should come on and to know where they can seek expert advice quickly. TI's reputation is completely in our hands, to be enhanced or damaged by the nature of our actions," concluded Skooglund.

SOURCE: Texas Instruments, "Ethics in the Global Market," <http://www.ti.com/corp/docs/company/citizen/ethics/market.shtml> (August 13, 1999).

⁹ Thomas Donaldson, "Values in Tension: Ethics Away from Home," *Harvard Business Review* (September–October 1996), p. 56.

¹⁰ Texas Instruments, "The TI Ethics Quick Test," <http://www.ti.com/corp/docs/company/citizen/ethics/quicktest.shtml> (August 13, 1999).

The high quality of international competition today requires managers to develop systematic, disciplined approaches to running their organizations. As shown in Exhibit 1–2, managers have four primary functions to execute in which accounting information is consumed. These functions are planning, controlling, decision making, and evaluating performance. The first function, planning, requires management to develop a road map that lays out the future course for operations. This road map also serves an important role in the design of the organization's accounting and control systems.

ORGANIZATIONAL STRATEGY

5

What are the primary factors and constraints that influence an organization's strategy and why are these factors important?

mission statement

<http://www.Hibernia.com>

planning

In responding to the challenges of e-commerce and globalization, managers must consider the organization's mission and, correspondingly, the underlying strategy that links its mission to actual activities. An organization's **mission statement** should (1) clearly state what the organization wants to accomplish and (2) express how that organization uniquely meets its targeted customers' needs with its products and services. As indicated in the following News Note, a mission statement should be an organizational road map.

The mission statement may, and most likely should, be modified over time. Not adapting the mission statement probably means the organization is stagnating and not facing the ever-changing business environment. For instance, Hibernia Corporation's mission statement in 1994 was "to be recognized by 1996 as the best provider of financial services throughout Louisiana." By 1997, the mission statement was "By 1999, we will be recognized by our customers, employees, and shareholders as the best financial services company in each of our markets."¹¹ Only three years yet a dramatic difference: the corporation had engaged in multiple bank merger opportunities outside Louisiana and was looking for more.

Translating the organization's mission into the specific activities and resources needed for achievement is called **planning**. The long-term, dynamic plan that in-

NEWS NOTE



GENERAL BUSINESS

Where Are We Going?

Imagine yourself driving down a dark road. You have no idea where you are going, let alone how you are going to get there. To your dismay, a storm crops up, rain pelting the window so hard you can barely see anything outside. You may decide to stop the car and just sit there. Moving on or parked, you are going nowhere fast.

One of the main reasons for writing a mission statement is to develop a road map showing management where the company should be going and giving general directions for how to get there. In addition to the mission statement, strategic plans should be developed that give detailed information about specific roads the company should travel to arrive at its mission destination.

When defining organization objectives, mission statements should reflect the environment in which the orga-

nization operates as well as the competencies and competitive advantages that the organization possesses. A good mission statement says clearly and exactly what an organization expects to accomplish. Many companies have eloquently stated missions, but they often neglect one of the most important characteristics of a solid mission statement: the objectives must be measurable. To know where you are on the road, you need mile markers. To know where you are going, you need signs and landmarks. Unless a company has specific measurement standards, it will not be able to determine if it has achieved its mission.

SOURCE: James A. Bailey, "Measuring Your Mission," *Management Accounting* (December 1996), pp. 44–45. Copyright Institute of Management Accountants, Montvale, N.J.

¹¹ Hibernia Corporation, 1994 and 1997 annual reports.

dicates how the organizational goals and objectives will be fulfilled through satisfaction of customer needs or wants reflects **strategy**. Strategy can also be defined as:

the art of creating value. It provides the intellectual frameworks, conceptual models, and governing ideas that allow a company's managers to identify opportunities for bringing value to customers and for delivering value at a profit. In this respect, strategy is the way a company defines its business and links together the only two resources that really matter in today's economy: knowledge and relationships or an organization's competencies and its customers.¹²

An organization's strategy tries to match its internal skills and resources to the opportunities found in the external environment.¹³ Small organizations may have a single strategy, while large organizations often have an overall entity strategy as well as individual strategies for each business unit (such as a division). The business units' strategies should flow from the overall strategy to ensure that effective and efficient resource allocations are made, an overriding corporate culture is developed, and organizational direction is enhanced. For instance, at ABN AMRO, the Netherlands Division strategy is to position the bank as a provider of integrated banking and insurance products; the strategy for Central/Eastern Europe is strong internal growth and selective acquisition; and the strategy for Asia/Pacific is to raise the profitability of core corporate banking activities.

Exhibit 1-7 provides a checklist of questions that help indicate whether an organization has a comprehensive strategy in place. Small businesses may need to substitute "product lines" for "business segments" in answering the questions.

strategy

EXHIBIT 1-7

Does Your Organization Have a Good Strategy?

1. Who are your five most important competitors?
2. Is your firm more or less profitable than these firms?
3. Do you generally have higher or lower prices than these firms, for equivalent product/service offerings? Is this difference due mainly to the mix of customers, to different costs, or to different requirements for profit?
4. Do you have higher or lower relative costs than your main competitors? Where in the cost structure (for example, cost of raw materials, cost of product, cost of selling, cost of distributing, cost of advertising and marketing) are the differences most pronounced?
5. [What are] the different business segments which account for 80 percent of your profits? [You will probably find that you are in many more segments than you thought and that their profit variability is much greater than you thought.] If you cannot define the segments that constitute 80 percent of your total profits, you need to conduct a detailed product line profitability review.
6. In each of the business segments defined above, how large are you relative to the largest of your competitors? Are you gaining or losing relative market share?
7. In each of your important business segments, what are your customers' and potential customers' most important purchase criteria?
8. How do you and your main competitors in each segment rate on these market purchase criteria?
9. What are the main strengths of the company as a whole, based on aggregating customers' views of your firm in the segments that comprise most of your profits? What other competencies do you believe the firm has, and why do they seem to be not appreciated by the market?
10. Which are your priority segments and where is it most important to the firm as a whole that you gain market share? How confident are you that you will achieve this, given that other firms may have targeted the same segments for share gain? What is your competitive advantage in these segments and how sure are you that this advantage is real rather than imagined? (If you are not gaining relative market share, the advantage is probably illusory.)

SOURCE: *The Financial Times Guide to Management and Finance* (London: Financial Times/Pearson Education Limited, 1994), p. 359. Reprinted with permission.

¹² Richard Normann and Rafael Ramirez, "From Value Chain to Value Constellation: Designing Interactive Strategy," *Harvard Business Review* (July–August 1993), p. 65.

¹³ Thomas S. Bateman and Scott A. Snell, *Management: Building Competitive Advantage* (Chicago: Irwin, 1996), p. 117.

INFLUENCES ON ORGANIZATIONAL STRATEGY

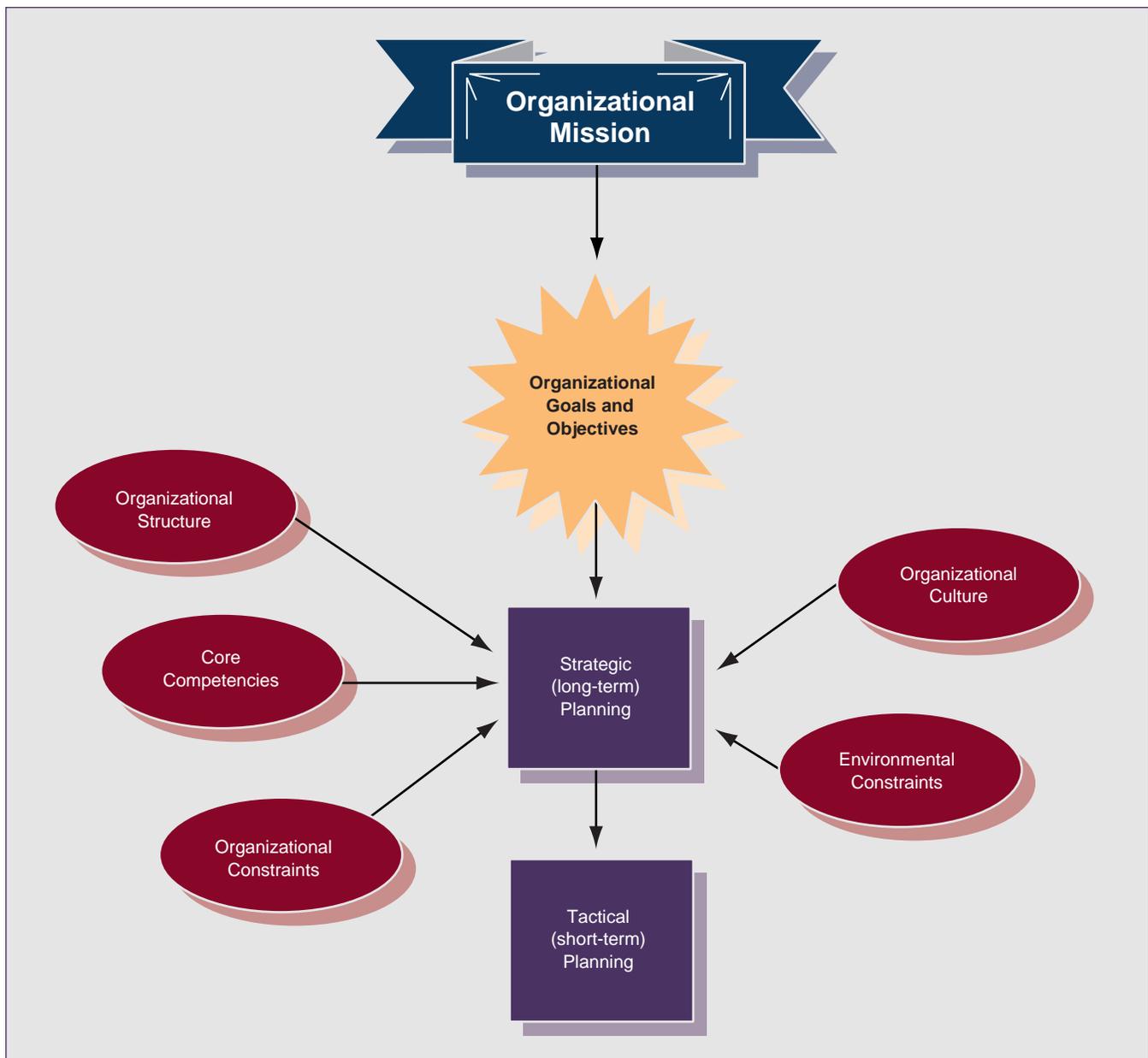
Because each organization is unique, even those in the same industries employ different strategies that are feasible and likely to be successful. Exhibit 1–8 provides a model of the major factors that influence an organization's strategy. These factors include organizational structure, core competencies, organizational constraints, organizational culture, and environmental constraints.

Organizational Structure

An organization is composed of people, resources other than people, and commitments that are acquired and arranged to achieve specified goals and objectives.

EXHIBIT 1-8

Factors Influencing
Organizational Strategy



Goals are desired results expressed in qualitative terms. For example, a typical goal of profit-oriented firms is to maximize shareholder wealth. Goals are also likely to be formulated for other major stakeholders, such as customers, employees, and suppliers. In contrast, **objectives** are quantitatively expressed results that can be achieved during a pre-established period or by a specified date. Objectives should logically be used to measure progress in achieving goals. For example, one of ABN AMRO's goals is to become a leading bank in the euro. In pursuit of that goal, the bank established an objective of having all of its systems euro-compatible by January 1, 1999, when the euro was introduced. The objective was achieved at tremendous cost, but management believes that ABN AMRO's new ability to offer harmonized banking services throughout Euroland will be worth the investment.¹⁴

An organization's structure normally evolves from its mission, goals, and managerial personalities. **Organizational structure** reflects the way in which authority and responsibility for making decisions is distributed in an organization. **Authority** refers to the right (usually by virtue of position or rank) to use resources to accomplish a task or achieve an objective. **Responsibility** is the obligation to accomplish a task or achieve an objective.

A continuum of feasible structures reflects the extent of authority and responsibility of managers and employees. At one end of the continuum is **centralization**, where top management retains all authority for making decisions. Centralized firms often have difficulty diversifying operations because top management might lack the necessary and critical industry-specific knowledge. The people who deal directly with the issues (whether problems or opportunities), have the most relevant information, and can best foresee the decision consequences are not making the decisions.

At the other end of the continuum is **decentralization**, in which the authority for making decisions is distributed to many organizational personnel, including lower-level managers and, possibly, line employees. In today's fast-changing and competitive operating environment, implementation of a decentralized organizational structure in a large firm is almost imperative and typically cost-beneficial. However, for decentralization to work effectively, there must be employee **empowerment**, which means that people are given the authority and responsibility to make their own decisions about their work. A decision to decentralize is also a decision to use responsibility accounting, which is discussed in Chapter 18.

Most organizations operate at some point on the continuum other than at either of the ends. Thus, a top management decision might be the location of a new division, while the ongoing operating decisions of that division might lie with the new division manager. Long-term strategic decisions for the division might be made by the division manager in conjunction with top management.

Core Competencies

In addition to organizational structure, an organization's strategy is influenced by its core competencies. A **core competency** is any critical function or activity in which one organization seeks a higher proficiency than its competitors, making it the root of competitiveness and competitive advantage. "Core competencies are different for every organization; they are, so to speak, part of an organization's personality."¹⁵ Technological innovation, engineering, product development, and after-sale service are some examples of core competencies. The Japanese electronics industry is viewed as having a core competency in miniaturization of electronics. MCI and Disney believe they have core competencies, respectively, in communications and entertainment. The accompanying News Note further examines core competencies.

goal

objective

organizational structure

authority

responsibility

centralization

decentralization

empowerment

core competency

<http://www.wcom.com>

<http://www.disney.go.com>

¹⁴ ABN AMRO Holding N.V., *Annual Report 1998*, pp. 18–19.

¹⁵ Peter F. Drucker, "The Information Executives Truly Need," *Harvard Business Review* (January–February 1995), p. 60.

NEWS NOTE



GENERAL BUSINESS

Finding Core Competencies

Core competencies are the combination of attributes that make an organization's products/services different and, more importantly, make customers want to buy those products/services. Organizations compete for customers, revenue, market share, etc., with products/services that meet customers' needs. Accordingly, without core competencies, organizations cannot compete.

Identifying core competencies involves research of a representative sample of customers (retailers), their customers (consumers), suppliers, and other industry experts. Ask questions about what attributes differentiate the organization's products/services over those of competitors. Follow up answers to questions with more questions; then explore for the underlying core products/services that differentiate. The unique combination of

knowledge, special skills, proprietary technologies, and/or unique operating methods will be identified.

While some organizations compete for current core competencies, smart organizations also compete for core competencies that can gain them competitive advantage in the future. How fast can the organization acquire and develop these core competencies and at what cost? A company's ability to successfully find and integrate these future core competencies will determine its ability to deliver future products/services, their future scope, the degree of differentiation, the costs, and the price the market will pay.

SOURCE: Adapted from interview with Maurice Greaver, "Strategic Outsourcing," <http://www.outsourcing.com/howandwhy/interviews/greaver/main/htm> (August 14, 1999).

<http://www.Rolls-Royce.com>

But core competencies are likely to change over time. Consider that Rolls-Royce plc, once one of the most respected names in luxury automobiles, sold its motorcar division in 1972. Company management decided its priority should be products resulting from its core gas-turbine technologies. Thus, the company began focusing on civilian and military aircraft engines and power generation and improving its service, parts, and repair business. Business boomed for Rolls-Royce: in 1987, RR engines were used on only six types of civil airframes; in 1999, they were used on 30 types, deployed in 37 of the top 50 airlines.¹⁶

Organizational Constraints

Numerous organizational constraints may affect a firm's strategy options. In almost all instances, these hindrances are short-term because they can be overcome by existing business opportunities. Two common organizational constraints involve monetary capital and intellectual capital. Decisions to minimize or eliminate each of these constraints can be analyzed using capital budgeting analysis, which is covered in Chapter 14.

MONETARY CAPITAL

Strategy implementation generally requires a monetary investment, and all organizations are constrained by the level and cost of available capital. Although companies almost always can acquire additional capital through borrowings or equity sales, management should decide whether (1) the capital could be obtained at a reasonable cost and (2) a reallocation of existing capital would be more effective and efficient.

INTELLECTUAL CAPITAL

Another potentially significant constraint on strategy is the level of the firm's intellectual capital (IC). Many definitions exist for IC, but all have a common thread of intangibility. **Intellectual capital** reflects the "invisible" assets that provide distinct intrinsic organizational value but which are not shown on balance sheets.

intellectual capital

¹⁶ Robert T. Scott, "Rolls Chief Has Profits Flying High," [New Orleans] *The Times-Picayune* (April 27, 1999), pp. C-1, 10.

One expansion of the definition is that IC encompasses human, structural, and relationship capital.¹⁷ Human capital is reflected in the knowledge and creativity of an organization's personnel and is a source of strategic innovation and renewal. Human capital may provide, at least until adopted by others, the company a core competency.

Structural capital, such as information systems and technology, allows human capital to be used. Structural capital “doesn't go home at night or quit and hire on with a rival; it puts new ideas to work; and it can be used again and again to create value, just as a die can stamp out part after part.”¹⁸ Acquiring new technology is one way to create new strategic opportunities by allowing a company to do things better or faster—assuming that the company has trained its human capital in the use of that technology.

Relationship capital reflects ongoing interactions between the organization and its customers and suppliers. These relationships should be, respectively, profitable and cost-beneficial. In many respects, the customer element of relationship capital is the most valuable part of an organization's intellectual capital: without customers to purchase products and services, an organization would have no need to employ human or structural capital.

Organizational Culture

Going global, implementing employee empowerment, and investing in new forms of capital are all decisions that require organizational change. An organization's ability to change depends heavily on its organizational culture.

Organizational culture is the set of basic assumptions about the organization, its goals, and its business practices. Culture describes an organization's norms in internal and external, as well as formal and informal, transactions.

organizational culture

Culture refers to the values, beliefs, and attitudes that permeate a business. If strategy defines where a company wants to go, culture determines how—maybe whether—it gets there. Every business has some kind of culture, just because it's an organization of human beings. But most businesses never give the topic a second thought. Their culture is to do things the way they always have or the way everybody else does them.

A few companies, by contrast, have explicit, highly distinctive cultures—strong, focused cultures that stick out from the crowd like the Grateful Dead at a marching-band convention. [For example, Southwest Airlines is] famous for its wild and woolly—not to say manic—culture. Everybody at Southwest, from CEO Herb Kelleher to the newest gate attendant, pitches in to make sure that customers have a good time and that airplanes get unloaded and reloaded and back in the air fast.”¹⁹

<http://www.iflyswa.com>

Organizational culture is heavily influenced by the culture of the nation in which the organization is domiciled, the extent of diversity in the workforce, and the personal styles and philosophies of the top management team. These variables play a significant role in determining whether the communication system tends to be formal or informal, whether authority is likely to be centralized or decentralized, whether relations with employees tend to be antagonistic or cooperative, and how control systems are designed and used. Like many of the other influences on organizational strategy, organizational culture can change over time. In most cases, however, culture is more likely to change due to new management rather than because existing managers changed their style.

¹⁷ Thomas A. Stewart, *Intellectual Capital* (New York: Currency/Doubleday, 1999), pp. 75–77.

¹⁸ Thomas A. Stewart, “Your Company's Most Valuable Asset: Intellectual Capital,” *Fortune* (October 3, 1994), pp. 71–72.

¹⁹ John Case, “Corporate Culture,” *Inc.* (November 1996), pp. 46–47.

Environmental Constraints

environmental constraint

A final factor affecting strategy is the environment in which the organization operates. An **environmental constraint** is any limitation on strategy brought about by external differences in culture, competitive market structures, fiscal policy (such as taxation structures), laws, or political situations. Because an organization's management cannot directly control environmental constraints, these factors tend to be long-run rather than short-run.

<http://www.walmart.com>

Wal-Mart provides an excellent example of the influence of environmental constraints on organizational strategy. Wal-Mart first entered Europe in 1997 by purchasing a chain of German retail stores. Germany, unfortunately, is known for high labor costs, surly employees, and a variety of arcane restrictions about zoning, pricing, and operating hours. Wal-Mart had to discontinue its "Ten-Foot Rule" requiring employees to speak to customers within ten feet of them and encouraging employees to be customer friendly. Some stores do not bag purchases because the practice is unheard of in Germany. But the company cannot refund customers the price difference on an item sold elsewhere for less because it is illegal in Germany. Nor can the associates receive Wal-Mart stock options because they are difficult and expensive to grant under German law.²⁰

RESPONSES TO COMPETITION

6

How does an organization's competitive environment impact its strategy and how might an organization respond to competition?

differentiation strategy

An organization operating in a competitive market structure may choose to avoid competition through differentiation or cost leadership.²¹ A company choosing a **differentiation strategy** distinguishes its product or service from that of competitors by adding enough value (including quality and/or features) that customers are willing to pay a higher price. Differentiation is often related to the product or service, distribution system, or advertising. The accompanying News Note illustrates a slightly different version of differentiation strategy: including substantially fewer features and charging higher prices!

NEWS NOTE



GENERAL BUSINESS

Less Costs More??

For \$675 a night, guests at the Meridian Club, on a private island in the Caribbean, get a room with no television, no radio, no telephone and no air conditioning—"almost like a motel room," says JoAnn Setzer, of Sacramento, California.

Call it downscale deluxe, and call it trendy. Ms. Setzer isn't complaining; she visits Meridian every year. And many well-heeled tourists apparently have similar tastes. These days, some of the most sought-after resorts are those that charge a whole lot but offer next to nothing in the way of amenities and nothing at all when it comes to technological innovations.

Deliberately distancing themselves from the far more numerous luxury hotels that boast every possible creature comfort and convenience, these spartan resorts proudly specialize in the experience of . . . *nada*.

Such resorts insist that simplicity is part of an industry-wide trend in travel. But travel-industry consultants warn that the tactic is risky. The demand for less-is-more luxury is small, they say, and suited for only a few, mostly older resorts rather than a chain.

SOURCE: Adapted from Lisa Miller, "Stifling Heat, No Room Service . . . and Sky-High Prices," *The Wall Street Journal* (June 27, 1997), p. B1.

²⁰ Jeremy Kahn, "Wal-Mart Goes Shopping in Europe," *Fortune* (June 7, 1999), pp. 105ff.

²¹ Michael Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Free Press, 1985), p. 17.

Competition may also be avoided by establishing a position of **cost leadership**, that is, by becoming the low-cost producer/provider and, thus, being able to charge low prices that emphasize cost efficiencies. In this strategy, competitors cannot compete on price and must differentiate their products/services from the cost leader.

In today's business environment, maintaining a competitive advantage by avoiding competition can be difficult. Within a short time, competitors are generally able to duplicate the factors that originally provided the competitive advantage. For many companies, the future key to success may be to confront competition by identifying and exploiting temporary opportunities for advantage. In a **confrontation strategy**, an organization tries to differentiate its products/services by introducing new features or tries to develop a price leadership position by dropping prices even though competitors will rapidly bring out equivalent products and match price changes.²² Although potentially necessary, a confrontation strategy is, by its very nature, less profitable for companies than differentiation or cost leadership.

To assess all of the varying internal and external factors that affect strategic planning, an organization needs to have a well-designed **business intelligence (BI) system**. This system represents the "formal process for gathering and analyzing information and producing intelligence to meet decision-making needs."²³ A BI system requires knowledge of markets, technologies, and competitors, as shown in Exhibit 1-9.

In addition to the need for information about external influences, the BI system should provide management comprehensive information about internal functions and processes, including organizational strengths and constraints.²⁴ Information provided by this system will be of great importance in helping managers perform their organizational functions, especially strategic and tactical planning.

cost leadership

confrontation strategy

business intelligence (BI) system

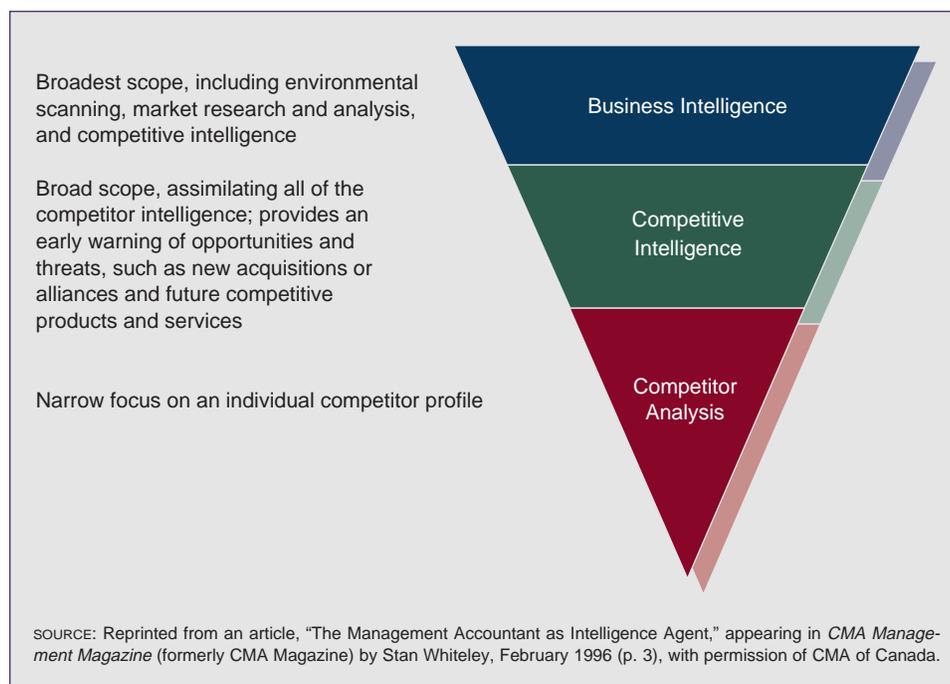


EXHIBIT 1-9

Levels of Intelligence Gathering

²² Robin Cooper, *When Lean Enterprises Collide* (Boston: Harvard Business School Press, 1995), p. 11.

²³ "U.S. Companies Slow to Develop Business Intelligence," *Deloitte & Touche Review* (October 16, 1995), p. 1.

²⁴ For more information, see the Society of Management Accountants of Canada's *Management Accounting Guideline 39: Developing Comprehensive Competitor Intelligence*.

ROLE OF ACCOUNTING IN ORGANIZATIONS

7

How does the accounting function impact an organization's ability to successfully achieve its strategic goals and objectives?

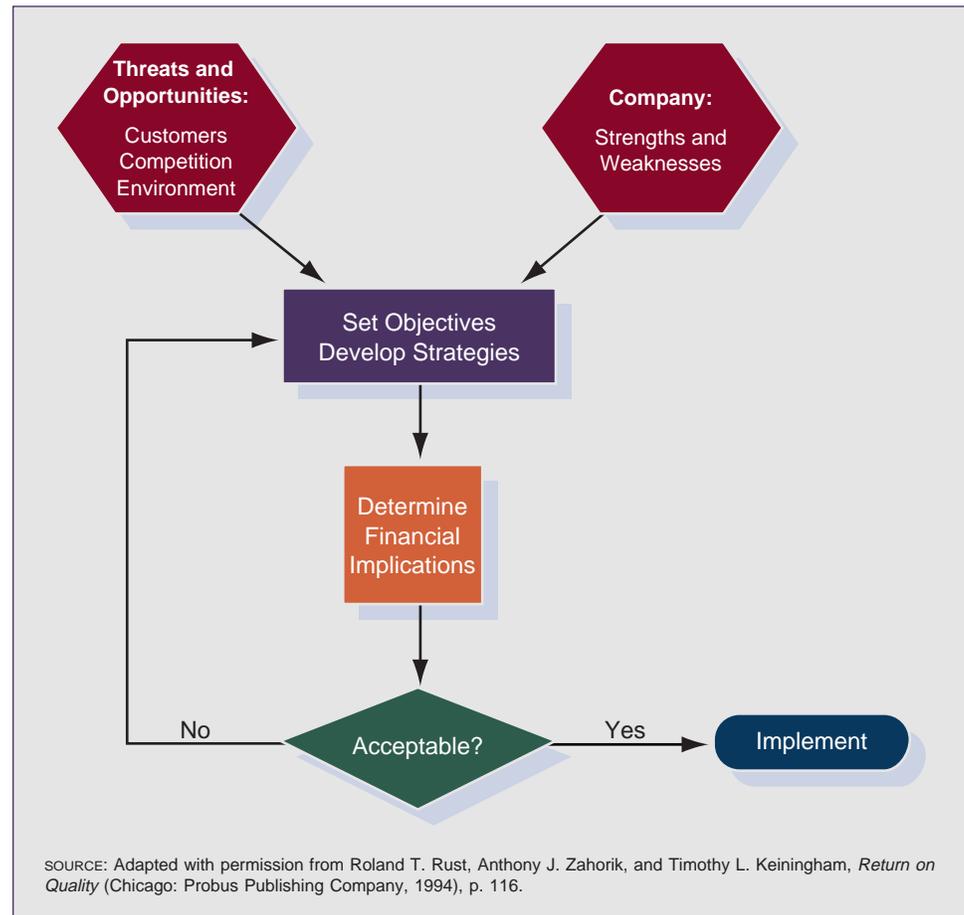
When setting strategy, managers must consider the opportunities and threats provided by the entity's customers, competition, and environment and must analyze those opportunities and threats relative to the entity's strengths and weaknesses. Such an analysis is the first part of the model shown in Exhibit 1–10. Next, management must consider the impact the selected strategies will have on organizational stakeholders. In a profit-oriented business, strategies should promote a primary goal of profit generation so that customers are served effectively, shareholders can obtain wealth maximization, employees can retain their jobs and increase their personal human capital, and creditors can be paid. Therefore, management must consider the financial implications of its chosen strategies.

Profitability is typically achieved by delivering to customers the products and services they desire, on time, and at reasonable prices. Profit measurement is one function of the accounting information system. To best assess financial implications of organizational strategies, detailed, short-term tactical plans should be prepared in the form of a budget. If the projected financial results are unacceptable, management will revise either the objectives or the strategies selected to achieve those objectives.

Although the financial accounting system is extremely important in assessing current or projected profitability, that system does not provide all the information needed by management to make decisions. "Exclusive focus on the financial results and budgets does not encourage managers to invest and build for longer-

EXHIBIT 1-10

The Planning Process



term competitive advantage.”²⁵ Also, according to noted management author Peter Drucker:

The standard concepts and tools of [traditional financial reporting] are inadequate to control operations because all they provide is a view of the skeleton of a business. What’s needed is a way to examine the soft tissue.

*Financial accounting, balance sheets, profit-and-loss statements, allocations of costs, etc., are an X-ray of the enterprise’s skeleton. But in as much as the diseases we most commonly die from—heart disease, cancer, Parkinson’s—do not show in a skeletal X-ray, a loss of market standing and failure to innovate do not register in the accountant’s figures until the damage is done.*²⁶

Organizations now have the technological capabilities to easily expand data collection activities to satisfy both external and internal information requirements. Accounting information is often a primary basis for making strategic decisions and for measuring and evaluating managerial efficiency and effectiveness. To provide the correct management incentives, accounting measurements should be tied to the established mission. In large organizations, an individual segment (or division) may pursue one of three generic organizational missions: build, hold, or harvest, as defined in Exhibit 1–11.

Segments with a build mission require the most strategic planning because they are to be operated for the long run. Segments with a harvest mission require little strategic planning; their role is to generate cash, and at some point, they will probably be sold or spun off as other company segments begin to mature.

Segment mission is directly related to the **product life cycle** or the sequential stages that a product passes through from idea conception until discontinuation of the product. The five stages of the product life cycle are design and development, introduction, growth, maturity, and decline. The build mission is appropriate for products that are in the early stages of the product life cycle, and the harvest mission is appropriate for products in the final stages of the life cycle. Accordingly, long-term performance measures are more appropriate for build missions, and shorter-term performance measures are more appropriate for harvest missions. For example, increase in market share would be a long-term measure, while annual profitability would be a short-term measure.

8

Why is a company segment’s mission affected by product life cycle?

product life cycle

EXHIBIT 1-11

Generic Strategic Missions

- **Build**—This mission implies a goal of increased market share, even at the expense of short-term earnings and cash flow. A business unit that follows this mission is expected to be a net user of cash; that is, the cash flow from its current operations would usually be insufficient to meet its capital investment needs. Business units with “low market share” in “high-growth industries” typically pursue a build mission.
- **Hold**—This mission is geared to the protection of the business unit’s market share and competitive position. The cash outflows for a business unit that follows this mission generally equal the cash inflows. Businesses with “high market share” in “high-growth industries” typically pursue a hold mission.
- **Harvest**—The harvest mission implies a goal of maximizing short-term earnings and cash flow, even at the expense of market share. A business unit that follows the harvest mission is a net supplier of cash. Businesses with “high market share” in “low-growth industries” typically pursue a harvest mission.

SOURCE: Vijay Govindarajan and John K. Shank, “Strategic Cost Management: Tailoring Controls to Strategies,” *The Journal of Cost Management* (Fall 1992). © 1992 Warren Gorham & Lamont. Reprinted with permission of RIA.

²⁵ Michael Gooldd and John Quinn, *Strategic Control: Milestones for Long-Term Performance* (London: The Economics Books Ltd/Hutchison, 1990); cited in Tony Barnes, *Kaizen Strategies for Successful Leadership* (London: Pitman Publishing, 1996), p. 135.

²⁶ “Drucker on Soft Tissue Metrics,” *Datamation* (September 1, 1994), p. 64.

Additionally, the measurement system will need to be modified when an organization begins to empower its employees and use work teams. Group (rather than individual) performance will need to be assessed, and nonfinancial measures are often more appropriate than financial ones to make this assessment. Accounting can help derive the new measurements, tie them to organizational goals and objectives, and integrate them with an organizational pay-for-performance plan.

The degree of decentralization must reflect consideration of, among other things, how rapidly decisions need to be made, the willingness of upper management to allow subordinates to make potentially poor decisions, and the level of training required so that workers can understand and evaluate the consequences of their decisions. Decisions should be made only after comparing implementation costs (such as employee training) with expected benefits (such as better communication, more rapid decisions, and higher levels of employee skills).

In evaluating core competencies, an organization must analyze its activities and compare them to internal or external benchmark measurements. Some comparison metrics will often relate to costs: how does the cost of making a product or performing a service internally compare to the price of external acquisition? To make fair comparisons, a company must be reasonably certain of the validity of its costs. Unfortunately, a recent survey of over 200 financial and operating executives in North America showed that less than half of the respondents were confident of their cost data. They wanted “more accurate, timely, and detailed information from their systems.”²⁷ To help provide such information, some companies use activity-based costing, which is discussed in Chapter 4.

In assessing alternative strategies that require substantial monetary investments (such as investing in new technology or opening a foreign production facility), managers compare the investment’s costs and benefits. Often, as with other strategic decisions, cost details may be more attainable than benefit details. Managers, aided by financial personnel, must then make quantitative estimates of the investment’s qualitative benefits (for instance, allowing the company to be the first to bring a product or service to market). The accompanying News Note addresses the significance of estimating future benefits from investments.

From an accounting standpoint, there is frequently a mismatch in the timing of costs and benefits. Costs are recorded and recognized in the early years of many strategic decisions, whereas benefits created by these decisions are either recognized in later years or possibly not at all because they are nonmonetary in nature. For example, financial accounting does not recognize the qualitative organizational benefits of faster delivery time, customer satisfaction, and more rapid development time for new products. Consequently, measurement methods other than traditional financial accounting ones are necessary to help managers better evaluate the strategic implications of organizational investments.

Strategic resource management (SRM) involves the organizational planning for deployment of resources to create value for customers and shareholders. Key attributes in the success of SRM are the management of information and of change in responding to threats and opportunities. SRM is concerned with the following issues:²⁸

- how to deploy resources to support strategies;
- how resources are used in, or recovered from, change processes;
- how customer value and shareholder value will serve as guides to the effective use of resources; and
- how resources are to be deployed and redeployed over time.

²⁷ Mary Lee Geishecker, “New Technologies Support ABC,” *Management Accounting* (March 1996), p. 44.

²⁸ Adapted from W. P. Birkett, “Management Accounting and Knowledge Management,” *Management Accounting* (November 1995), pp. 44–48.

<http://www.gm.com>

**strategic resource
management (SRM)**

GENERAL BUSINESS

NEWS NOTE

**Less Time Means More Profits**

General Motors Corp. said sophisticated new computer and digital-imaging tools are expected to cut product-development costs as much as \$200 million for a given global car or truck program. Because of these tools, GM is making substantial progress in one of the core arenas of competition in the auto industry. An auto maker's capacity to develop new cars and trucks quickly can give it an edge in responding to swings in customer demand. In the 1990s, for example, GM's inability to move quickly left it way behind in various high-profit truck segments. And savings on engineering and tooling costs translate directly into profit.

Central to GM's transformation is the adoption of "an integrated portfolio of computer math-based tools." This means that all of the various design and manufacturing activities use the same software package, which turns

every aspect of a vehicle into digital and mathematical models. GM is spending about \$1 billion a year on this sort of computing.

GM uses these tools to take a vehicle design from a designer's initial computer-screen pen strokes all the way into production. This saves money by eliminating the need for physical models, cutting down engineering changes, reducing lead times 50 percent for ordering production tooling, and making it possible to solve manufacturing problems in "virtual" factories instead of real ones. GM now takes about 24 months from design until the start of production, down from 42 months in 1994.

SOURCE: Adapted from Robert L. Simison, "GM Turns to Computers to Cut Development Costs," *The Wall Street Journal* (October 12, 1998), p. B4.

These areas cannot be measured by financial accounting because they often relate to nonmonetary benefits. Thus, management accounting provides the necessary estimates to help managers address these issues and focus on strategic objectives.

The foundation of SRM is the **value chain** (supply chain), or the set of processes that convert inputs into products and services for the firm's customers. As shown in Exhibit 1–12, the value chain includes both internal and supplier processes. Managers can use the value chain to determine which activities create customer value as reflected in product/service prices and, thus, revenues earned. By reducing or eliminating activities that add no value within the value chain, firms can become more efficient and effective.

For their contributions to the value chain, employees earn compensation and suppliers earn revenues. Successful firms will gain the cooperation of everyone in the value chain and communicate a perspective that today's competition is between value chains more so than between individual businesses. Once this concept is accepted, members of the value chain become aware that information must be shared among all entities in the value chain.

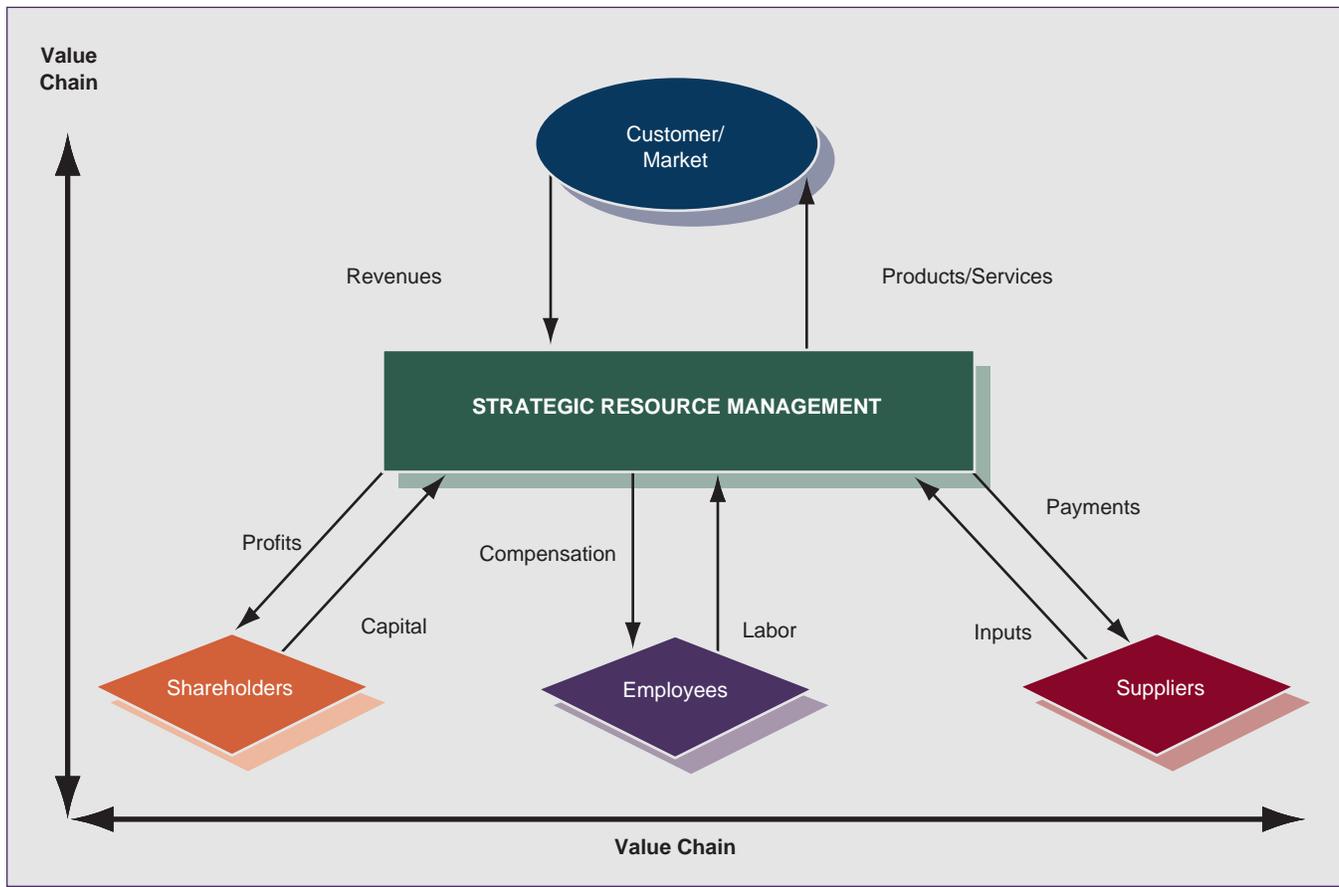
The arrows in Exhibit 1–12 indicate information flows that provide the key linkages between managing resources and managing change in a business. Managers, as the agents of change, must understand internal organizational processes, external markets (customers), available and visionary technologies, current and future competitors, and operating environments. This knowledge helps managers to respond proactively to new market opportunities and to competitors' actions. Much of the information required by managers comes from the business intelligence system (which includes the accounting information system) discussed earlier in this chapter.

One of the most significant challenges of managing an organization is balancing the short-run and long-run demands for resources. Resources include all organizational assets, including people. In the contemporary business environment, managers must be able to balance short-term and long-term considerations as well as recognize and prioritize strategic resource needs. In addition, managers must be careful to structure strategic initiatives such that they allow flexibility in day-to-day

9

What is the value chain and why is it important in managing a business?

value chain

**EXHIBIT 1-12**

The Value Chain and Strategic Resource Management

management. Stated another way, in making long-term commitments of resources, managers must consider how those commitments affect short-term management of resources. Information is the key to successfully analyzing and resolving all of these decision situations—and much of that information is provided by an organization's accounting system.

REVISITING

ABN AMRO
Bank

<http://www.abnamro.com>

ABN AMRO sees itself as a prominent universal banking group with a strong international focus. Its strength lies on the one hand in its extensive, worldwide network of branches and subsidiaries with highly qualified staff and, on the other hand, in the integrated delivery of banking services to all customer segments through every available channel of distribution. Embedded in the organization is a corporate culture based on the four corporate values (integrity, teamwork, respect, and professionalism) that guide daily activities.

In its quest to provide value-added services to clients, the bank has a virtual product for corporations willing to outsource their accounts receivables operations. In effect, the bank's service would start by generating the invoice for the client and end with dunning its customers, if it came to that.

Other new cash management products include IntelliTracs, an interactive, automated payments tracking system, and Facet, a global system that enables correspondent banks to initiate faster and more accurate payment

transactions from anywhere in the world. Both products use cutting-edge technology, keeping the bank abreast of other leading global banks.

Three important policy support divisions at ABN AMRO are Planning & Control, Financial Accounting, and Management Accounting. The P&C area is responsible for formulating corporate strategy and objectives, translating these into financial plans, and engaging in investor relations. Financial Accounting compiles, analyzes, and provides financial information to group management in respect to domestic and international operations as well as preparing financial statements. Management Accounting responsibilities include developing and implementing instruments for analyzing product, customer and distribution channel profitability, engaging in medium- and long-range planning and budgeting, offering organizational advice, supporting

strategic planning, conducting operations research, and providing policy support advice.

ABN AMRO has retail banking operations in 23 countries. The bank intends to expand in these markets using the Internet. In Europe, web-based expansion will be more important than in other markets because defensive governments have frequently blocked the bank's merger-based expansion strategy. To ensure the Internet gets deployed effectively throughout its markets, ABN AMRO has formed a team with responsibility for examining Web plans on a case-by-case basis. The approach offers "a disconnect from the yearly budget approval process," said a senior executive of the bank. The disconnect ensures the Internet expansion strategy will not wither on the vine for want of resources.

SOURCE: www.abnamro.com/profile; ABN AMRO Holding N.V., *Annual Report 1998*; Chris Costanzo, "ABN AMRO Says Web Will Anchor Its Expansion," *American Banker* (December 9, 1999), p. 16.

CHAPTER SUMMARY

Accounting information addresses three different functions: (1) providing information to external parties (stockholders, creditors, and various regulatory bodies) for investment and credit decisions; (2) estimating the cost of products produced and services provided by the organization; and (3) providing information useful to internal managers who are responsible for planning, controlling, decision making, and evaluating performance. Financial accounting is designed to meet external information needs and to comply with generally accepted accounting principles. Management accounting attempts to satisfy internal information needs and to provide product costing information for external financial statements.

Cost accounting creates an overlap between financial accounting and management accounting. Cost accounting integrates with financial accounting by providing product costing information for financial statements and with management accounting by providing some of the quantitative, cost-based information managers need to perform their tasks.

Most companies must now adapt to operating in a globally competitive environment. E-commerce is taking hold and is certain to be the norm of the future. Governments have established trade arrangements (including the General Agreement on Tariffs and Trade, European Union, and North American Free Trade Agreement) to reduce tariff barriers and foster global competition. Although an open global business environment provides new opportunities, it often creates greater risks (strategic, operating, financial, and information) and requires knowledge of and adherence to differing legal requirements. Additionally, the ethical norms may vary by location, but a solid corporate code of ethics should help a company operate in a consistent, moral way throughout the world.

Organizational strategy should be based on a mission statement that indicates what the organization wants to accomplish and how it will meet customer needs. Goals and objectives should flow from that statement. Strategy options may be constrained by numerous factors. How the organization is structured provides some constraints on who within the entity has authority and responsibility for tasks. The core competencies of an organization dictate internal strengths and capabilities and, thus, help indicate appropriate business functions to outsource. Strategy may also

be constrained by the level of capital (monetary or intellectual) available to the organization. Organizational culture provides a foundation for normal business practices and protocol for interactions among employees, managers, customers, suppliers, and the public. Lastly, environmental factors such as market structures, government regulations, and national cultures may help or hinder strategic options. A business intelligence system can help management understand the factors that influence the organization's choice of strategies.

Accounting provides important information for an organization's management. Strategic resource management links organizational strategy to resource deployment. SRM's key focus is the value chain, or the string of activities that convert organizational inputs into outputs. The accounting information system is comprised of the cost, financial, and management accounting functions—all of which provide essential information that supports strategic resource management.

KEY TERMS

authority (p. 19)	global economy (p. 9)
business intelligence (BI) system (p. 23)	goals (p. 19)
centralization (p. 19)	intellectual capital (p. 20)
confrontation strategy (p. 23)	mission statement (p. 16)
core competency (p. 19)	objectives (p. 19)
cost accounting (p. 5)	organizational culture (p. 21)
cost leadership strategy (p. 23)	organizational structure (p. 19)
decentralization (p. 19)	planning (p. 16)
differentiation strategy (p. 22)	product life cycle (p. 25)
e-commerce (p. 9)	responsibility (p. 19)
economic integration (p. 10)	strategic resource management (SRM)
empowerment (p. 19)	(p. 26)
environmental constraint (p. 22)	strategy (p. 17)
ethical standards (p. 14)	value chain (p. 27)
Foreign Corrupt Practices Act (FCPA)	
(p. 14)	

QUESTIONS

1. Discuss how financial, cost, and managerial accounting interface. Is one more important than another? Discuss the rationale for your answer.
2. Flexibility is said to be the hallmark of modern management accounting, whereas standardization and consistency describe financial accounting. Explain why the focus of these two accounting systems differs.
3. Is cost accounting a subset of management accounting or is management accounting a subset of cost accounting? Why?
4. Why would operating in a global (rather than a strictly domestic) marketplace create a need for additional information for management? Discuss some of the additional information you think managers would need and why such information would be valuable.
5. Discuss the validity of the following statement, "Only large companies (such as those that are publicly held and listed on a major stock exchange) have the opportunity to operate in a global marketplace."

6. Would you purchase products from Internet sources? Why or why not? If you have purchased from the Internet, did you experience any problems? If so, what were they and were they easily eliminated?
7. The AICPA has introduced CPA WebTrust to reduce or eliminate some problems related to engaging in e-commerce. Use the Internet to prepare a short discussion about WebTrust. What organizations are included in the WebTrust index?
8. Why are economic trade agreements so important to the globalization of business?
9. Use the Internet to find two businesses that have benefited and two businesses that have been disadvantaged by NAFTA. Briefly discuss the situations of each of these four businesses.
10. Use the Internet to find how the euro has impacted businesses in the last six months.
11. What political and cultural issues might affect an American (or a Canadian) company considering opening a business in Russia?
12. Use the Internet to find five domestic companies that have introduced in foreign countries what you would consider “radically” different products than those sold domestically. Discuss why these differences might exist. (*Hint: Food and drink companies are good candidates for this question.*)
13. Select a category of risk from Exhibit 1–6. Briefly explain some differences in the risks that would be experienced for the listed factors between your country and another selected country.
14. How do government regulations affect planning processes in the business organizations in your country?
15. Why should businesses concern themselves with a clean environment when it might be substantially less expensive to pollute, thus making their products cheaper for consumers?
16. Compare and contrast legal and ethical standards.
17. Use the Internet to find three companies that have been indicted for or convicted of violating the Foreign Corrupt Practices Act. In what countries were these companies offering bribes? Do you think the American companies believed that, without bribery, they could not have operated on a “level playing field?” Discuss your response.
18. What factors impede the development of an international code of ethics for profit-oriented businesses? Do you believe these factors can be overcome through the passage of laws? Discuss the rationale for your answer.
19. Why is a code of ethics a necessity in any organization?
20. Use the Internet to find the ethics codes for three businesses. How do these codes differ? Which do you think is better and why?
21. Why is a mission statement important to an organization?
22. Select three large, publicly held companies in the same industry. Use the Internet to access their Web sites and find a mission statement for each. How do these mission statements differ and how are they similar? Assuming that you are the president of a new company in this industry, write a mission statement for your company.
23. What is organizational strategy? Why would each organization have a unique strategy or set of strategies?
24. Are the financial implications of strategic planning more important in a business than in a not-for-profit organization? Why or why not?
25. Distinguish between goals and objectives. What goals do you hope to achieve by taking this course? What objectives can you establish to measure the degree to which you achieve these stated goals?
26. Differentiate between authority and responsibility. Can you have one without the other? Explain.

27. In what types of organizations or under what organizational conditions would centralization be a more useful structure than decentralization? Would decentralization be more useful than centralization?
28. Use the Internet to find three companies that have recently changed their organizational structures. How were the companies restructured and what reasons were given for the change?
29. If you were Dean of your College, how would you more fully empower your students relative to their college studies?
30. What is a core competency and how do core competencies impact the feasible set of alternative organizational strategies?
31. "If an organization can borrow money or sell stock, it does not have a capital constraint." Is this statement true or false? Discuss the rationale for your answer.
32. Differentiate between human, structural, and relationship forms of intellectual capital. Which do you believe is more important in each of the following organizations: a start-up software development company, a car dealership, a university, a hospital, and Coca-Cola? Provide reasons for your answers.
33. How can a change in governmental laws or regulations create a strategic opportunity for an organization? Give an example.
34. Define each of the strategies an organization may pursue to avoid competition, and discuss the benefits of each type of strategy.
35. Why would a useful business intelligence system contain substantial information about an organization's competitors?
36. What are the three generic segment missions and how are these missions related to the concept of product life cycle?
37. What is strategic resource management? Why is financial accounting an insufficient information source for strategic resource management?
38. What is the value chain of an organization and how does it interface with strategic resource management?

EXERCISES

39. (*Terminology*) Match the following lettered items on the left with the appropriate numbered description on the right.

<ol style="list-style-type: none"> a. Authority b. Centralization c. Core competency d. Decentralization e. Empowerment f. Goal g. Mission h. Objective i. Planning j. Responsibility 	<ol style="list-style-type: none"> 1. A target expressed in quantitative terms 2. The right to use resources to accomplish something 3. An expression of an organization's future path 4. A process that an organization does better than other organizations 5. A desired result, expressed qualitatively 6. A situation in which all decisions are made by top management 7. The obligation to accomplish something 8. A situation in which employees are allowed to make decisions about their work 9. The process of determining long-term and short-term strategies 10. A situation in which many decisions are made by subordinate managers
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40. (*Terminology*) Match the following lettered items on the left with the appropriate numbered description on the right.
- | | |
|---------------------------------|--|
| a. Business intelligence system | 1. An organization's intangible assets of skill, knowledge, and information |
| b. Differentiation | 2. A belief about moral and immoral behavior |
| c. E-commerce | 3. The long-term plan related to organizational goals and objectives |
| d. Economic integration | 4. The way in which authority and responsibility are distributed in an organization |
| e. Ethical standard | 5. The basic assumptions about an organization, its goals, and its practices |
| f. Intellectual capital | 6. A strategy based on differentiating products or services from those of competitors |
| g. Organizational culture | 7. The source of information about external competitors and markets |
| h. Organizational structure | 8. The processes of an organization and its suppliers to convert inputs into products and services structure |
| i. Strategy | 9. The process of using the Internet to buy and sell goods |
| j. Value chain | 10. The process of creating multi-country markets |
41. (*Accounting information*) You are the owner and manager of a small auto repair shop that does routine maintenance, major repairs, and body work. Business is good, and your monthly financial statements show that your shop is consistently profitable. Cash flow is becoming a small problem, however, and you may need to take out a loan from the bank. You have also been receiving customer complaints about time delays and price increases.
- What accounting information do you think is most important to take with you to discuss a possible loan with your banker?
 - What accounting information do you think is most important in ascertaining the business activities of your repair shop in regard to addressing time delays and price increases? What about nonaccounting information?
 - Can the various information in parts (a) and (b) be gathered from the accounting records directly? Indirectly? If not at all, where would you need to look for such information?
42. (*Globalization*) The 1996 annual report of Callaway Golf Company (headquartered in California) was slightly untraditional in that the opening "letter" to shareholders was given not only in English, but also in German, French, Spanish, Japanese, and Chinese.
- Discuss the costs and benefits of a U.S.-based company taking the time to provide such translations.
 - What additional information would you want to have to assess how such translations are related to Callaway's strategic plans?
43. (*E-commerce*) A new aspect of e-commerce is home management services. Andersen Consulting predicts that "the market for on-line orders of food, household goods, and services will mushroom from \$100 million in 1997 to \$57 billion or more by 2007."²⁹

<http://www.Callaway.com>



<http://andersenconsulting.com>

²⁹ Jane Hodges, "On the Web, It's Slow Food," *Fortune* (October 26, 1998), p. 262.

You own a grocery store in downtown San Francisco and have decided to allow on-line customer orders and provide delivery.

- a. What problems could arise from the on-line ordering? How would you and your staff solve these issues?
- b. What problems could arise from the delivery process? How would you and your staff solve these issues?



44. (*E-commerce*) It is predicted that e-commerce will help speed the process of a single European market by forming “eZones” or “regions of Internet commerce between cross-border constituencies.”³⁰ Use library and Internet resources to gather information and write a short description on how e-commerce has affected European market harmonization.

45. (*Trade agreements*) You have been appointed to a business advisory group in your country to consider the implementation of the NAFTA. What issues relative to implementation concern you and why?

46. (*Business risks*) You have just been promoted to manage a branch location of a regional bank.

- a. Provide three examples of the strategic, operating, financial, and information risks that your organization faces.
- b. What might you do to minimize the impacts of each of these risks?

47. (*Mission*) Obtain a copy of your college’s mission statement. Draft a mission statement for this class that supports the college’s mission statement.

- a. How does your mission statement reflect the goals and objectives of the college’s mission statement?
- b. How can you measure the successful accomplishment of your college’s objectives?

48. (*Strategy*) You are the manager of the local Home Depot store. What are the five factors that you believe to be most critical to the success of your organization? How would these factors influence your store’s strategy?

49. (*Strategy*) You are the manager of a small restaurant in your hometown.

- a. What information would you want to have in making the decision whether to add chicken fajitas and Boston clam chowder to your menu?
- b. Why would each of the above information items be significant?

50. (*Empowerment*) Early this year, you started a house-cleaning service and now have 20 customers. Because of other obligations (including classes), you have had to hire three employees.

- a. What types of business activities would you empower these employees to handle and why?
- b. What types of business activities would you keep for yourself and why?

51. (*Core competencies*) As a team, make a list of the core competencies of your college or university and explain why you believe these items to be core competencies. Make appointments with the dean, one vice president, and, if possible, the president of your college or university, and without sharing your list, ask these individuals what they believe the core competencies to be and why. Prepare a written or video presentation that summarizes, compares, and contrasts all the lists. Share copies of your presentation with all the individuals you contacted.

52. (*Intellectual capital*) Use library and Internet resources to research the inclusion of intellectual capital measurement at Skandia, a Swedish financial services company. Write a short paper describing the company’s IC measurement process.



<http://www.homedepot.com>

<http://www.Skandia.com>

³⁰ Robert F. Randall, “Internet Will Speed Europe Market Harmonization,” *Strategic Finance* (May 1999), p. 20.

53. (*Organizational culture*) Southwest Airlines is known for its “wacky” organizational culture. Use library and Internet resources to research this culture and write a brief paper about how you believe the culture has impacted Southwest’s strategy and organizational profitability.
54. (*Competition strategy*) Choose a company that might utilize each of the following strategies relative to its competitors and discuss the benefits that might be realized from that strategy. Indicate the industry in which the company does business and the company’s primary competitors.
- Differentiation
 - Cost leadership
 - Confrontation
55. (*Value chain*) You are the management accountant for a manufacturer of breakfast cereals. You’ve been asked to prepare a presentation that will illustrate the company’s value chain.
- What activities or types of companies would you include in the upstream (supplier) part of the value chain?
 - What internal activities would you include in the value chain?
 - What activities or types of companies would you include in the downstream (distribution and retailing) part of the value chain?
56. (*Organizational accountants*) Use library and Internet resources to find how the jobs of management accountants have changed in the last 10 years.
- Prepare a “then vs. now” comparison.
 - What five skills do you believe are the most important for management accountants to possess? Discuss the rationale for your choices.



<http://www.iflyswa.com>



CASES

57. (*E-commerce*) Competition in your industry is becoming fierce and you decide to begin selling on-line. Select one of the following industries and research the benefits and problems of e-commerce by a company in that industry. One article is suggested as a starting point for each industry.
- Banking [Paul Beckett, “American Express Starts Online Bank, An Increasingly Competitive Business,” *The Wall Street Journal* (July 23, 1999)].
 - Brokerage [Shawn Tully, “Will the Web Eat Wall Street?” *Fortune* (August 2, 1999)].
 - Automobile sales [Fara Warner, “Priceline.com, AutoNations Team Up to Offer Online Car-Buying Service,” *The Wall Street Journal* (July 28, 1999)].
58. (*Mission statement*) You have owned Lee Construction for 15 years and employ 100 employees. Business has been profitable, but you are concerned that the locale in which your business is based may soon experience a downturn in growth. One way you have decided to help prepare for such an event is to engage in a higher level of strategic planning, beginning with a mission statement for your company. (*Note:* The December 1996 *Management Accounting* article “Measuring Your Mission” may provide a useful starting point.)
- How does a mission statement add strength to the strategic planning process?
 - Who should be involved in developing a mission statement and why?
 - What factors should be considered in the development of a mission statement? Why are these factors important?
 - Prepare a mission statement for Lee Construction and discuss how your mission statement will provide benefits to tactical (in addition to strategic) planning.



<http://www.dell.com>



59. (*Benefits of successful planning*) Successful business organizations appear to be those that have clearly defined long-range goals and a well-planned strategy to reach those goals. These successful organizations understand their markets as well as the internal strengths and weaknesses of the organizations. These organizations take advantage of this knowledge to grow (through internal development or acquisitions) in a consistent and disciplined manner.
- Discuss the need for long-range goals for business organizations.
 - Discuss how long-range goals are set.
 - Define the concepts of strategic planning and management control. Discuss how they relate to each other and contribute to progress toward the attainment of long-range goals. *(CMA adapted)*
60. (*Strategy*) Dell Computer Co. has a straightforward business strategy: “Eliminate middlemen and don’t build PCs until you have firm orders in hand.”³¹
- Dell is gaining a large European market share using its uniquely American strategy. Provide some reasons why a U.S. strategy might *not* be accepted by overseas customers.
 - Dell once tried to enter the retail sales market instead of relying on direct sales. Research Dell’s attempt at a different strategic approach and discuss its outcome.
61. (*Strategy*) Select a major company in a well-known industry. Use library, Internet, and other resources to answer as completely as possible the questions in Exhibit 1–7 about the company you have chosen.
62. (*Organizational constraints*) Four common organizational constraints involve monetary capital, intellectual capital, technology, and organizational structure. Additionally, the environment in which the organization operates may present one or more types of constraints (cultural, fiscal, legal/regulatory, or political).
- Discuss whether each of these constraints might or might not be influential in the following types of organizations:
 - City Hall in a major metropolitan city
 - a franchised quick-copy business
 - a newly opened firm of attorneys, all of whom recently graduated from law school
 - an international oil exploration and production company
 Explain the rationale for each of your answers.
 - For each of the previously listed organizations, discuss your perceptions of which of the constraints would be most critical and why.
 - For each of the previously listed organizations, discuss your perceptions of whether human or structural capital would be most important and why.
63. (*Organizational culture*) The United States provides an ethnically, racially, and culturally diverse workplace. It has been argued that this plurality may be a competitive handicap for U.S. businesses. For example, communicating may be difficult because some workers do not speak English, motivating workers may be complicated because workers have diverse work ethics, and work scheduling may be difficult because of differing religions and ethnic holidays. It has been argued that Japan has a competitive advantage because its population is much more homogeneous.
- What are the advantages of a pluralistic society in the global marketplace?
 - On balance, does America’s plurality give it a competitive advantage or place it at a competitive disadvantage? Discuss.
64. (*Competition*) You recently received a very large inheritance and have decided to buy an existing business or open a new business. Given your interests, you have narrowed your choices to the following:

³¹ Silvia Ascarelli, “Dell Finds U.S. Strategy Works in Europe,” *The Wall Street Journal* (February 3, 1997).

- Purchase the existing cable company in your regional area.
 - Purchase an airline that operates in most areas of the country.
 - Open a plant to manufacture and sell hot-sauce domestically and in Central and South America.
 - Buy franchises for and open 15 locations of a fast-food restaurant in areas of the former Soviet Union.
- a. Discuss the competitive influences that will impact each of your potential businesses.
 - b. How would the tactics of product/service differentiation, cost leadership, or confrontation work in each of your potential businesses?
 - c. What would be the most critical factors for each of your potential businesses?
 - d. Which business would you open and why?
65. (*Value chain*) Strategic alliances are important parts of the value chain. In many organizations, suppliers are beginning to provide more and more input into customer activities.
- a. In the United States, when would a strategic alliance be considered illegal?
 - b. What would you perceive to be the primary reasons for pursuing a strategic alliance?
 - c. You are the manager of a catalog company that sells flowers and plants. With whom would you want to establish strategic alliances? What issues might you want to specify prior to engaging in the alliance?

REALITY CHECK

66. Many individuals do not shop on-line because of the risk of theft of passwords, credit card numbers, and so forth. Do you believe that this risk is a significant one? Discuss the rationale for your answer.
67. You are a senior manager at a large domestic firm. All senior managers and the board of directors are scheduled for a meeting next week to discuss the opportunities for e-business. The CEO has asked you to be prepared to start the discussion by developing questions that should be addressed before embarking on such a strategy. Categorize your questions as follows:
- a. executive focus on strategy and risks
 - b. customers
 - c. products and services
 - d. value chain
 - e. competition
 - f. business processes and technology
 - g. regulatory and tax environment
68. The Foreign Corrupt Practices Act (FCPA) prohibits U.S. firms from giving bribes in foreign countries, although giving bribes is customary in some countries and non-U.S. companies operating in foreign countries may not be similarly restricted. Thus, adherence to the FCPA could make competing with non-U.S. firms more difficult in foreign countries.
- Do you think that bribery should be considered so ethically repugnant to Americans that companies are asked to forego a foreign custom and, hence, the profits that could be obtained through observance of the custom? Prepare both a pro and a con position for your answer, assuming you will be asked to defend one position or the other.
69. As chief legal officer in a well-respected company making lifesaving drugs, Alistair had been asked by his board of directors to look into rumors of price-fixing in the firm's European offices. His board has a very strong ethics



policy and especially wary of price-fixing, bribery, kick-backs, and other unethical activities that can plague overseas operations.

After conducting detailed interviews in Europe for several months, Alistair was satisfied that the rumors were groundless. As one of the European managers said, “There’s no issue here.” But, he added, “if you really want something to investigate, look into the Bosnia contract.”

Over the months, Alistair kept hearing about “the Bosnia contract.” So when he had finished his report on the price-fixing rumors, he decided to delve into the other matter. The contract, he discovered, had been ordinary in almost every respect: A major relief organization had contracted with his company to supply one million inexpensive kits of medicine for delivery into the war-torn regions of Bosnia. Like most such contracts with charitable organizations, it contained hardly any profit for his firm.

What he found strange, however, was the payment of an extraordinarily large commission to a Romanian distributor to deliver the kits deep into Bosnia. Seeking out the executive in his own firm who had negotiated the contract, he had one question in mind: Was this a bribe?

Yes and no, said the executive. According to the Romanian distributor, the backs of the delivery trucks were loaded with the kits—and the glove compartments were stuffed with cash. That way, when the drivers were stopped at roadblocks set up by local militia units operating all across Bosnia, they could pay whatever was demanded and continue their journey. In the past, he noted, drivers without cash had been taken from their trucks and shot. For the kits to be delivered, this was a cost of doing business.

Alistair felt sure that none of the money had flowed back to the executive, whose only motive was to get the kits delivered. And by this time, the deliveries had already been made. Yet Alistair still faced a dilemma. Should he draft a separate report to the board on this most unorthodox contract—possibly causing great harm to the executive who had negotiated it or embarrassment to the relief organization, which was aware of the commission? Or should he keep silent? Everything in Alistair’s background with his company told him that this contract was not the way to do business. Bribery, he knew, was simply unacceptable to the board, who felt strongly that once that barrier was breached, there would be no stopping the shakedowns in the future.

But everything in his makeup as a compassionate being told him that providing medicine for the wounded was of overriding importance and that the normal ethics of commerce didn’t apply in a war zone.

What should Alistair do?

70. “Few trends could so thoroughly undermine the very foundation of our free society,” writes Milton Friedman in *Capitalism and Freedom*, “as the acceptance by corporate officials of a social responsibility other than to make as much money for their shareholders as possible.”
 - a. Discuss your reactions to this quote from a legal standpoint.
 - b. Discuss your reactions to this quote from an ethical standpoint.
 - c. How would you resolve any conflicts that exist between your two answers?
71. Mission statements are supposed to indicate what an organization does and why it exists. Some of them, however, are simply empty words, with little or no substance and with few people using them to guide activities.
 - a. Why does an organization need a mission statement? Or does it?
 - b. How might a mission statement help an organization in its pursuit of ethical behavior from employees?
 - c. How might a mission statement help an organization in its pursuit of production of high-quality products and provision of high levels of customer service?

72. Intellectual capital is extremely important to the longevity of an organization. There are, however, “intellectual capital pirates” who make their livings from stealing.
- a. Assume that you have made several popular recordings. These recordings are being pirated overseas. Discuss how you view these intellectual capital pirates and what (if anything) should be done to them.
 - b. Copying a computer software program is also intellectual capital piracy. Do you perceive any difference between this type of copying and the copying of recordings? Discuss the rationale for your answer.
73. Accounting has a long history of being an ethical profession. In recent years, however, some companies have asked their accountants to help “manage earnings.”
- a. What does it mean to “manage earnings”?
 - b. List several companies that have been accused of “managing earnings.”
 - c. Who is more likely to be involved in such a situation: the financial accountant or the management accountant? Why?
 - d. Do you believe that “managing earnings” is ethical? Discuss the rationale for your answer.