

## Chapter 25

# Business strategy and management accounting

### REAL WORLD CASE

This case study shows a typical situation in which management accounting can be helpful. Read the case study now but only attempt the discussion points after you have finished studying the chapter.

*This news item shows how strategic management is helped by surveys that evaluate relative competition.*

Research and Markets (<http://www.researchandmarkets.com/reports/c11963>) has announced the addition of Chocolate Confectionery Industry Insights: Future Profit Opportunities And Growth Indicators to their offering.

Companies that fail to innovate, look ahead or anticipate customers' needs will not be successful in the current, competitive and highly saturated chocolate marketplace.

In general, NPD [new product development] is viewed as holding the most exceptional importance out of the seven main issues addressed in the survey, with 71% of the vote.

*Chocolate Confectionery Industry Insights: Future profit opportunities and growth indicators* is a *strategic management report* that analyses the chocolate market by sub-categories of 'boxed', 'Moulded bars', 'Seasonal', 'Countlines', 'Straightlines' and 'other' chocolate in each of the following countries: Belgium, Spain, Germany, France, Italy, Hungary, Poland, Czech Republic, United Kingdom and the United States.

The report analyses the chocolate confectionery market between 1998 and 2003 and forecasts the next generation of chocolate confectionery products to 2008 as manufacturers increase innovation levels. The report will enable you to increase your market share and turnover by identifying the sectors and countries that provide the best profit opportunities for your specific chocolate confectionery product.

Source: *Business Wire*, 21 February 2005, Research and Markets: Opportunities for New Chocolate Confectionery Products Examined, Research and Markets ([www.researchandmarkets.com/reports/c11963](http://www.researchandmarkets.com/reports/c11963)).



### Discussion points

- 1 Why is market share so important in strategic management for this industry?
- 2 How could any one company within the industry improve its profit performance compared to the others?

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## Learning outcomes

After studying this chapter you should be able to:

- Define 'business strategy'.
- Explain how strategic management accounting is a feature of business strategy.
- Explain 'just-in-time' management.
- Explain value chain analysis and the role of management accounting.
- Explain total quality management and the cost of quality.
- Explain business process re-engineering.
- Explain e-business and e-commerce and outline ways in which management accounting may help in developing business strategies that use e-business methods in general and e-commerce in particular.

## 25.1 Introduction

In this chapter we take the theme of business strategy and the role of management accounting. A strategy may be defined as 'an integrated set of actions aimed at securing a sustainable competitive advantage'.<sup>1</sup>

Using this definition a strategy is something more than a long-term plan. It is a statement of how the business intends to reach some preferred state in the future by changing its competitive position to meet changing circumstances.

This chapter explains and illustrates some of the approaches that have been proposed to developing business strategy, where management accounting has a contributory role to play. You have already encountered activity-based costing (Chapter 18), benchmarking (Chapter 23), the Balanced Scorecard (Chapter 23) and investment appraisal for Advanced Manufacturing Technologies (Chapter 24), all of which are techniques developed to support strategic change. They have become an established part of the management accountant's contribution to ensuring that a business stays vigilant to competitive forces.

## 25.2 Strategic management accounting

The successful management of a business depends on having a successful business strategy. It has been argued that if the business strategy gives the organisation its competitive edge, then the management accounting should reflect that strategy as closely as possible. The traditional emphasis on costs and revenues may not achieve this aim. What really matters is the influence of the external environment.

Strategy usually includes planning to achieve a better performance than competitors. It is argued that management accounting should show the extent to which the organisation is beating its competitors. Market share, market prospects and the impact of product mix would all be useful information to include in a management accounting report as factors contributing to sales, profits and cash flows.

Another way of looking at the influence of the external environment is to consider competitive advantage in costs. If the business has an influential position as a purchaser of goods and services, then its strategy may include an aggressive policy of negotiating contracts for those goods and services. The **just-in-time** strategy of ordering goods from suppliers to arrive exactly when they are needed may put strains on the suppliers and force up their costs, increasing the price of the goods. The concept of a **value chain** has been proposed to describe how the corporate strategy affects the entire chain of value-creating activities. Strategic management accounting might show that £1 saved at one point in the chain has been offset by an extra £2 incurred at another stage.

Advocates of **strategic management accounting** seek to provide financial and other related information on competitors' costs and cost structures so that the company's strategies may be monitored against those of its competitors over a period of time. Furthermore there is a need for new forms of internal analysis and accounting processes that will help management devise better strategies. There is strong support for this general direction of strategic management accounting but less agreement on how it may be achieved.

It is not necessary to abandon all that has been learned in the earlier chapters of this book. Advocates of strategic management accounting would relate the accounting technique to the strategic aims of the business. Take the example of two companies, one of which is aiming to achieve cost leadership (carrying out activities in a more cost-effective manner than competitors) while the other is focusing on product differentiation (persuading customers that there is a unique aspect of the company's products). The use of standard costing in assessing performance is very important to the cost leadership company but relatively unimportant to the product differentiation company. Analysis of marketing costs may not be so important in a cost leadership setting but is absolutely essential to the product differentiation situation.

You have already seen the **Balanced Scorecard** approach which requires an organisation to translate its vision and strategy into four perspectives: financial focus, customer focus, internal business processes, and learning and growth. Companies are encouraged to develop performance indicators under each of these headings which provide a complete view of the company's performance.

Fiona McTaggart describes her experience of a situation where a strategic approach helped a business to achieve improved performance.



**FIONA:** *One of my clients was a telephone utility company. It was in a competitive market where the customer base was growing fast. Costs had been reduced to the limit and competition focused on delivering a good quality of service to the customer.*

The first action taken by management was to change the attitude of employees, moving away from an organisation based on functions and towards an organisation based on process. As an example, the sales ledger department was disbanded. Some of the staff joined a customer enquiry unit which allowed one point of contact for matters ranging from sales orders through repairs to accounts enquiries. Others moved to the information technology unit which concentrated on providing information within the organisation. This move recognised internal 'customers' as well as external customers.

The next move was to invest in a training programme to encourage customer focus. Staff joining the customer enquiry unit were all trained in customer focus but were also made aware of the way in which their activities drive the costs of the organisation. Their training included a course provided by benchmarking experts who had information about the standards achieved by leading competitors. The company was quite surprised to find how much other companies will share through benchmarking.

You might be thinking that this does not sound much like management accounting but the focus on activities driving costs led to a rearrangement of management accounting information to use cost drivers and activity-based costing. That approach was used to evaluate type of customer, geographical area of sales and types of product promotion.

The result was continued growth in sales and profit for the company and an expansion in employment opportunities for staff.

### 25.3 The just-in-time approach

**Just-in-time** manufacturing is a methodical approach to reducing machine set-up times, accepting only perfect incoming resources, allowing no deviation from standards and matching output exactly to the demands of the customer. Every activity occurs exactly at the time needed for effective execution, and the activity always happens exactly as planned. It reduces stockholding costs, minimises idle time for production resources and creates a demand-driven business.

Fiona McTaggart describes her experience of a just-in-time management system.



**FIONA:** I recently participated in a pilot project involving a leading company manufacturing car engines. There were two shifts planned, one using manual labour and one entirely operated by robots. A just-in-time (JIT) philosophy applied throughout. Each item required for the manufacture of an engine was planned to arrive on the production line at exactly the right time. Delivery from suppliers was similarly timed with care. The computer recording system was designed so that the arrival of the component was recorded and bar coding allowed the cost to be recorded at the same time. There was no need to wait for an invoice to arrive before the cost of the component could be ascertained. Reports on direct costs could therefore be generated simultaneously with reports on physical activity. Dealing with overhead costs was more difficult, but a system was proposed where overhead costs were applied to activities using an activity-based approach and a focus on machine hours as the main measure of use of an activity.

The JIT approach emphasises elimination of waste. The management accounting report for the two shifts had a waste exception report section which allowed rapid identification of departure from accepted waste levels on each shift. Linking the accounting records to the physical activity meant that each shift could be identified separately.

The pilot project was receiving a cautious welcome by the technical managers. They had regarded traditional management accounting as an unavoidable nuisance but they could see that the pilot scheme was bringing the accounting information closer to their perspective of the operation.

## 25.4 Value chain analysis

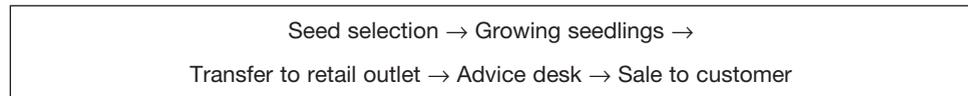
The idea of the **value chain** was popularised by Porter (1985) as a way of describing and analysing the sequence of activities that bring a product or service from its initial stage of production to the final stage of delivery to the customer.

In a competitive environment the business manager should ask: 'What is our competitive advantage; what do we do well?' That requires questions about competition – where are the threats? There could be new entrants seeking to join the sector; there could be substitute products or services. There may be strong rivalry within the industry or there may be little interest in competing. Suppliers may have a strong bargaining position; customers may have a strong bargaining position. The manager considers the kind of competition that exists and then plans to deal with that position. Perhaps this business can reduce costs below those of competitors; perhaps it can find a way of differentiating its product to make it attractive to consumers. Porter took the view that a business should choose either a cost focus or a differentiation focus, rather than try to do too much at the same time.

The value chain for any business is a description of the key processes, starting with inputs. Take the example of a plant nursery which grows plants from seedlings and sells them to customers in a garden centre. The managers have identified the competitive advantage as their reputation for growing plants that are hardy to the climate of this region. The value chain is shown in Exhibit 25.1.

### Exhibit 25.1

#### Value chain for nursery and garden centre



Each stage of the value chain adds value for the business. It is focused on product differentiation. The price may be marginally higher than the prices that would be charged by national chains selling plants as part of home improvement stores, but the customer is less likely to find the plant has wilted and died within weeks of planting. Advice is given to any enquirers coming into the garden centre, and the advice is based on local knowledge.

Fiona McTaggart has been advising the business on the steps required for value chain analysis. She explains here how she worked with management.



**FIONA:** *First we identified the value chain and assigned costs and assets to each stage. Seed selection involves labour cost and storage for seeds taken from the nursery's own plants. The nursery also buys in new varieties to strengthen the existing strains. Growing seedlings involves further labour cost, greenhouse maintenance, security and plant care materials. There is also a wastage rate to be built in. Transfer to the retail outlet involves transport costs and a risk of loss through inadequate handling. The advice desk is a heavy labour cost specific to this business. The retail sales outlet carries costs similar to those of any retail operation.*

*Next we considered the cost drivers of each value activity and the interaction of cost drivers. Then we considered the value chains of competitors who can undercut the business on price but compete less well on product durability. We worked out the relative costs and looked at ways for this business to cut its costs. For example, transferring plants to the garden centre on a just-in-time basis would reduce wastage but requires customer surveys to know when the peaks of demand will arise. We were able to identify some areas for cost control that would enable the business to remain competitive on price without eroding the product differentiation. The managers are pleased that they have this approach to focusing on how they add value at each stage of the chain.*

## 25.5 Total quality management and cost of quality

The success of Japanese companies in recent years has caused intense interest in Japanese styles of management. One aspect of Japanese management is the approach of 'get it right first time'. In this spirit, *total quality management (TQM)* has the customer as its focal point.

Quality is defined as fully satisfying agreed customer requirements at the lowest internal price. TQM is therefore a management function which could be added to those explained in Chapter 16. It straddles the traditional management functions of planning and control. The use of the TQM approach is seen as the key to improving profitability because there is a cost associated with failing to meet quality standards in products and services. Such costs could arise through loss of customers, claims for refunds in respect of defective supplies, and the work of putting right mistakes. If costs can be controlled through TQM, then profits will increase.

Those who are enthusiastic for TQM believe that it is possible to obtain defect-free work first time on a consistent basis. That may be an idealistic target but to have such a target encourages a culture where prevention of error is a key feature of the operations.

This activity of improving quality to improve profits will itself cause cost to be incurred. The term **cost of quality** is a collective name for all costs incurred in achieving a quality product or service.

Cost of quality may be defined by the 'prevention–appraisal–failure' model.

*Prevention costs* are the costs of designing, implementing and maintaining the TQM system. They include: quality planning, quality assurance, training and determining specifications for incoming materials, for processes carried out in the operations of the business and for finished products.

*Appraisal costs* are the costs of evaluating suppliers and obtaining an evaluation by customers. They include checking incoming materials and supplies, inspecting equipment and collecting information from customers on satisfaction with goods and services.

*Failure costs* are of two main types: *internal failure costs* are the costs incurred when it is found, before delivery to customers, that the work does not reach the desired specification; *external failure costs* are the costs incurred when poor quality work is discovered after the supply to the customer has taken place. Examples of internal failure costs are: waste, scrap, rectification, re-inspection of rectified work and analysis of the causes of failure. External failure costs include: repairs, warranty claims, complaints, returns, product liability litigation and loss of customer goodwill.

The traditional picture of quality control is that in the absence of quality control, failures occur which create failure costs. Detection of failure relies on checking after the failure has occurred. The checking process involves further checking costs. With quality controls in place, as prevention work is undertaken, the costs of failure should begin to fall. At the outset, the prevention costs will be additional to the costs of checking for failures, but as confidence grows, and the frequency of failure decreases, the need for checking should diminish. The quality exercise will be successful in cost terms if there is a reduction in total cost over the three headings of prevention, appraisal and failure costs.

TQM ideas are widely practised and there are many non-financial performance measures being used in business organisations. Measuring the cost of quality is a relatively undeveloped area although a few businesses have a well-developed approach. The management accountant as scorekeeper is ideally placed to record and monitor cost of quality, but many of the initiatives emerging are in special units within an organisation which are separate from the 'traditional' management accounting functions. Management accountants may need to be proactive in seeking out new ways of applying their generic skills.

## 25.6 Business process re-engineering

Business process re-engineering involves a dramatic redesign of business processes, organisation structures and use of technology to achieve breakthroughs in business competitiveness. The benefits claimed are that operations can be streamlined, and consequently costs can be cut, while creating process excellence in all key aspects of the organisation.

The phrase 'breaking the china' has been used by those who describe the technique. They are looking for a quantum leap into being a world leader. They draw the analogy of passing a treasured set of family china from one generation to the next. One day the entire collection falls to the floor in pieces. Putting it together again produces a totally different pattern in the china. In a similar way, if the whole business process is broken up and then restructured with the aim of being a world leader, an entirely new policy will emerge.

The advocates of business process re-engineering explain that, while concentrating on innovations such as TQM and JIT, businesses were retaining the traditional ways of working in functional groups. Quality teams were given the task of creating new ways of working within their specific areas or functions. In contrast, business process re-engineering concentrates on the process rather than the function.

Take an example of a company manufacturing engines for heavy goods vehicles. The castings provided by the supplier did not align exactly with the machine which carried them to the assembly line. This had always been accepted as a function of the business operation despite the fact that it caused a pause in production at regular intervals to allow maintenance work necessitated by wear and tear. As a re-engineering of the business process, the supplier was asked to manufacture the castings to a different specification which would align with the machine. This allowed the process to speed up by 30% on previous activity levels and quickly recovered the extra costs charged by the supplier due to the redesign of the castings.

Take as a second example the processing of customer orders. In the traditional approach a sales representative visited the customer and took an order. The sales representative initiated the order documentation, giving it an order number and setting up a file on the computer. The product manager received the order, checked that the resources were available for implementation and rewrote the order so that the customer's description of what was required could be specified in terms of the operations carried out by the business. The customer's credit rating was checked by the credit controller. This process all took a considerable amount of time because it was not well co-ordinated and there were gaps of time between the stages. As a re-engineering move, the business process was shortened by giving the sales representative a portable computer and a modem to be taken out on visits to clients. This allowed credit rating to be checked on-line even while the job specification was being discussed with the customer. The computer also included a data sheet on which the sales representative could enter the customer's order in such a way as to match the specification required by the production department. The information passed directly to the manufacturing premises by way of the modem and the confirmed specification was returned by fax to the customer. The entire operation of specifying and confirming the order could be completed within one hour, while the sales representative was still on hand at the customer's premises.

The advocates of business process re-engineering emphasise three goals: customer satisfaction, market domination and increased profitability. To win the claim to be a world leader requires success in all three. The business therefore has to identify the core business processes which drive it and to think in terms of process enhancement. Identifying the core business process and 'reading the market' helps the company to find a 'break point' where a change in the business process can cause a significant positive reaction in the market and take the company into a leadership position.

For some business, re-engineering may be too drastic, especially when new products are being introduced. Continuous quality improvement may be a more achievable target, where analysis of strengths and weaknesses is used to identify short-term achievable improvements on an incremental basis.

## 25.7 E-business and e-commerce

This section gives a very brief summary of some aspects of e-business and shows how management accounting has a role to play in e-business. You can learn more about e-business by using the 'Further reading' listed at the end of the chapter.

Electronic business, usually described as **e-business**, uses technology to automate and to change existing business practices. It affects product development, marketing, sales and the ways in which goods and services are delivered to customers.

Electronic commerce, usually described as **e-commerce**, is one part of e-business. It relates to all transactions between the company and its customers or suppliers, where electronic media are involved. The customer may wish to inspect a catalogue advertising products. The supplier may wish to draw the company's attention to changes in prices or products. The acts of buying and selling may take place electronically. E-commerce involves aspects of sharing business information about products and services, together with carrying out business transactions.

The theme throughout this book has been that management accounting has a role in:

- planning
- decision making
- control.

Now we consider each aspect of the role of management accounting in e-business and e-commerce.

### 25.7.1 Planning

The first question that might be asked is: 'Should we start an e-business venture?' The entrepreneur may have a vision of a new product or a new market but for any business the key accounting-related questions are: 'Can we make a profit?' and 'Will there be adequate cash flow?'

#### Revenue and cash inflow

There are examples of e-commerce where businesses sell existing products or services over the internet rather than through shops and offices or by postal mail. From the management accounting point of view there are new challenges in ensuring that the recording of revenue matches the delivery of goods and services. New control procedures must be devised, with particular attention to the security of electronic data and cash transmission. The accounting records for revenue earned and cash received will be broadly similar to those used in any business. Cash flow may speed up if customers make electronic payment ahead of delivery. Revenue may be lost if the internet-based system is difficult to use, or is not available throughout the day.

Greater challenges arise for management accounting where new forms of revenue are earned by a company through the nature of e-business. These may be described generally as 'digital services'. Examples include:

- selling banner advertising space on the company's website;
- earning commission on sales of goods by other business that have a hyperlink from the company's website;
- fees charged for allowing another business to have a 'shop-front' on the company's website.

These create accounting problems where two businesses 'swap' advertising space. 'I will let you advertise on my website if you will let me advertise on yours.' No cash changes hands but each business is gaining a benefit. This is called 'barter', a system of trading which starts in the school playground and extends around the world in places where cash is not readily available. Clearly there is no cash flow. Should each business estimate 'revenue' earned from the sale of advertising? There are costs of creating the advertisements so it seems a reasonable idea to estimate a figure for revenue. However there is no transaction for the sale of advertising and it is far from clear that the advertiser would actually pay a fee if asked. If that is the case then the estimated value of revenue is zero. There are no easy answers on how to record the value gained from barter transactions.

### Costs and cash outflow

For the business selling products and services electronically there remain the costs of producing the product or service. Beyond that, the e-business approach may reduce some costs and increase or create others. The costs that involve cash outflows may be subdivided into (a) set-up costs and (b) operating costs. The role of management accounting in planning is to estimate these costs for comparison with expected revenues.

*Set-up costs* include the costs of hardware and software, including internal networks and external links to suppliers and customers. The set-up costs also include the costs of managing the introduction of the project, developing and testing software, transferring data from the conventional business records to the new electronic system and training staff in using the new technology.

*Operating costs* include all staff costs relating to operating the new system, plus maintenance costs for the electronic system.

Cost savings may be set against these new operating costs. The business may be able to reduce the costs of staffing branch outlets, or having more staff time available to deal with problematic incoming telephone enquiries because the routine enquiries are dealt with through the website.

## 25.7.2 Decision making

Chapter 24 has explained various approaches to decision making related to long-term investments. Payback, accounting rate of return, discounted cash flow and internal rate of return have been explained and the calculations illustrated. At the end of that chapter the problems of appraising advanced manufacturing technologies were discussed. They require a different approach to investment appraisal and decision making. E-business offers similar challenges to management accounting for investment appraisal.

Typical questions that might be asked in an e-business decision are:

- Should we make the proposed investment in hardware, software and staff training for information systems to support e-commerce?
- Which of our existing business operations will give the highest return if converted to e-commerce methods?

The difficult task for the management accountant is to identify the incremental cash flows. The questions to be asked are: How much additional revenue can be generated by this new way of working? How much additional cost will be incurred after taking into consideration any planned cost saving? The uncertainties relating to e-business and e-commerce are such that discounted cash flow techniques may be of limited relevance. Payback focuses on how quickly the original outlay can be recovered through cash flows generated.

### 25.7.3 Control

Management accounting helps managers in their control activities through comparing actual costs and revenues with budgeted estimates and through quantifying and highlighting variances. The management accountant is also involved in systems design and the processing controls necessary to protect the assets and the accuracy of accounting records. Non-financial performance measures are a significant element of controlling the e-business activity.

The business receiving cash from e-commerce transactions must have adequate security measures in place. Secure connections are necessary to set up secure links between supplier and customer. Encryption (a coded message) is used for information that is being transferred and for the records held at either end of the link. The customer must be given confidence in the security controls of the supplier. The supplier must be sure that the customer has a good reputation and that the transaction will be honoured.

*Data migration* is one important aspect of moving to e-commerce where the management accountant may have a particularly useful role. Data migration means transferring data from the existing system to the new system. Sometimes this activity is called populating the database. Whatever it is called, the activity requires careful control and testing to ensure that no data are lost or corrupted in the process.

Indicators of success that evaluate the relative effectiveness of an e-business activity must include a mixture of financial and non-financial measures (sometimes called *metrics*). Two questions to be asked about effectiveness might be:

- 1 Is the marketing effective?
- 2 Is the business outcome effective?

Effective marketing requires attracting the attention of the potential customer. *Visitor activity* on the site can be measured by *hits* or by *site visits*. A 'hit' is recorded every time a piece of information is downloaded, so one visit to the site might result in several hits. Intending customers may be asked to register an email address or to give information about themselves. This is all part of the marketing information that will be analysed by the organisation to reflect activity.

Effective business outcomes are assessed using accounting information on revenues and costs. The business might set a target proportion of revenues to be achieved by internet selling. The management accountant will report on achievement of the target. Analysts often enquire about marketing costs because these are effectively an investment for the future. The ratio of marketing costs to revenues for internet business might be compared with the ratio for conventional business.

Non-financial indicators of effective business outcomes might include customer satisfaction surveys, delivery response times, complaints received or frequency of errors in delivery and invoicing.

### 25.7.4 Advising small businesses

Fiona has found that her work advising small and medium-sized enterprises (SMEs) is requiring her to develop an expertise in e-business and e-commerce.



**FIONA:** *I read a survey recently which found that most British SMEs prefer to maintain their own website and run their own e-business. That means they have to cover the cost of designing the website and they pay an in-house webperson to maintain it, involving a salary and other costs of employment. More than 80% of UK businesses have a website. Some 500,000 companies are trading online but many more companies, including most of the 1.9m SMEs, use the internet as a shop window. Many UK companies are saying that the internet has transformed sales and marketing, delivery, operations and processing.*

*However it seems to me, as a management accountant, that cost planning and control do not appear to rank highly in the decision to move to e-business activity. There is perhaps too strong a focus on revenue and lack of attention to costs and cash flow. As a result we have seen the failure of some 'dot.com' businesses where the cash resources have become exhausted. Another survey that I came across found there was little emphasis on budgets or management in the development of e-commerce strategies.*

Is e-commerce suited to all SMEs? A decision to move to e-commerce must be related to the overall business strategy and the sales strategy. The business should ask itself:

- Will e-commerce contribute to the competitive advantage of the business?
- Will it add value?
- Will the benefits outweigh the costs?

Take the example of a family business which has built its reputation for selling specialist hand tools to tradespersons and do-it-yourself enthusiasts. It has shops in several large towns but its reputation extends beyond those towns and customers will travel considerable distances to buy specialist tools. The business would be well placed to enter into e-commerce selling because its name is well known, its reputation is established in the retail outlets, which will continue to operate, and the internet can widen the market through direct customer order and delivery to the door.

Take another example of an antiquarian bookseller who buys and sells rare books. Again the bookseller has an established reputation in trade journals and has been using catalogue-based mail order sales for some years. The business would be well placed to enter into e-commerce by adding a website reference to existing advertising material. It may also improve the bookseller's ability to find sources of rare books well beyond the local sources traditionally used. Furthermore, since competitors have already established e-commerce outlets, the bookseller may lose market share if it does not move to internet buying and selling.

## 25.8 Summary

You might ask, having read this chapter, why it is necessary to pay any attention to the previous ten chapters. The answer is that the ideas described in this chapter are exciting and forward-looking but they are being used primarily by a selection of the market leaders and the innovators. There is a vast range of businesses which are still using traditional management accounting techniques. That will necessitate an understanding of the traditional approach for some time yet, in a spirit of evolution rather than revolution. So while you should read and think about the new ideas, you will also find it necessary to understand and apply the aspects of management accounting which have been taught traditionally. If you have a strong command of the approach to management accounting set out in the chapters of this book, then you will have the basis on which to build an understanding of the present practice in most business organisations. You will also be in a position to move on to an in-depth study of developments in management accounting in both the academic and the practical spheres.

### Further reading

- Chaffey, D. (2002) *E-Business and E-Commerce Management*, Financial Times Prentice Hall.
- Porter, M. E. (1985) *Competitive Advantage: Creating and Sustaining Superior Performance*, New York: Free Press.
- PricewaterhouseCoopers, *Fifth International Benchmarking Study*. This survey is published by the Department of Trade and Industry on [www.dti.gov.uk](http://www.dti.gov.uk).

## QUESTIONS

The Questions section of each chapter has three types of question. 'Test your understanding' questions to help you review your reading are in the 'A' series of questions. You will find the answers to these by reading and thinking about the material in the book. 'Application' questions to test your ability to apply technical skills are in the 'B' series of questions. Questions requiring you to show skills in problem solving and evaluation are in the 'C' series of questions. A letter **[S]** indicates that there is a solution at the end of the book.

### A Test your understanding

- A25.1** Define 'business strategy'. (Section 25.2)
- A25.2** How does strategic management accounting make use of information about competitors? (Section 25.2)
- A25.3** How does just-in-time management reduce costs of control of an inventory of raw materials? (Section 25.3)
- A25.4** What is meant by a cost-reduction approach to value chain analysis? How does it differ from product differentiation? (Section 25.4)
- A25.5** What is the management philosophy represented by total quality management? (Section 25.5)
- A25.6** What are the main components of the cost of quality? (Section 25.5)
- A25.7** What is the stated purpose of 'business process re-engineering'? (Section 25.6)
- A25.8** What are the three goals of business process re-engineering? (Section 25.6)
- A25.9** What is e-business? (Section 25.7)
- A25.10** What is e-commerce? (Section 25.7)
- A25.11** How can management accounting contribute to planning, decision making and control in e-business and e-commerce? (Section 25.7)

### B Application

#### B25.1

The directors of Craigielaw plc have decided that specialist paints for use on buses and lorries should become the focus of a new e-business strategy. 'All we have at present is a call centre where our customers phone in orders', said the sales manager. 'Our two main competitors are improving their business-to-business activities by linking to internet providers. Our strengths lie in customer loyalty and the reputation of our product for quality.'

Explain how value chain analysis can be combined with the development of an e-business strategy (300 words).

#### B25.2

A company manufacturing specialised medical equipment and supplies is currently having a debate internally about developing an e-business strategy. The sales manager wants to develop an e-commerce website. The managing director thinks that electronic methods are not necessary; what really matters is intensive marketing and offering good technical support for the products.

Explain how the management accountant could provide useful information to help this debate come to a conclusion (300 words).

#### B25.3

Explain how a low-cost airline can use strategic management accounting in developing a business strategy for competing with the traditional airlines (300 words).

## C Problem solving and evaluation

### C25.1

A company is reviewing its total quality management programme, which does not appear to be making the progress expected. Problems have been identified in:

- fear of exposing weaknesses in the organisation;
- lack of commitment from senior executives;
- seeing it as someone else's problem.

How could the management accountant help in addressing these problems (300 words)?

### C25.2

How could planning of business strategy be useful to a public sector organisation such as a public library service? Does the idea of competition have any meaning? How can the management accountant help in planning a business strategy for a public library service (300 words)?

## Cases for study groups

### Case 25.1

A company selling life insurance policies is planning to implement the Balanced Scorecard approach. The board of directors is aware that it should consider four aspects of vision and goals:

- financial perspective
- customer perspective
- internal business processes
- innovation and learning.

Prepare a short introduction for a meeting of administrative staff which is intended to ask them to suggest items for inclusion under these four headings. Make your own list of three items for each heading so that you can help the discussion if it needs some prompting.

### Case 25.2

A manufacturer of toothpaste has estimated the price at which the product will sell, making use of market surveys and consumer analysis. A profit margin has been set. Finally a target cost has been established by subtracting the target cost from the estimated selling price. The plant manager and the research and development unit have been asked to design the product in such a way that it can be produced within the target cost.

A rival manufacturer of toothpaste takes a different approach. Here the selling price is again estimated from market surveys and consumer analysis and a profit margin is set. However, the product design is then accepted on the recommendation of the research and development unit and the plant manager then focuses on a programme of continuous improvement which will keep costs within acceptable limits.

Is there a role for management accounting in either of these situations?

### Case 25.3

Search the management feature pages of a business newspaper such as the *Financial Times* for a period of one month. Find articles about management which have a management accounting angle. Select one of the articles and write a response setting out the ways in which management accounting will contribute to the management purposes described in the article.

## Note and reference

1. Wilson, R. M. S. (1995) 'Strategic Management Accounting', Ashton, D., Hopper, T. and Scapens, R. W. (eds) *Issues in Management Accounting*, Prentice Hall, ch. 8.