

Value chain analysis and traditional management accounting



Along with the development of world economic integration, the modern enterprises are facing the competitions and challenges not only from the domestic market, but also from the international markets. The companies are confront with the different economic environment, so that the social environment of accounting may also undergo some major changes(Pierce and

O'Dea, 2003). The first one is the research and development of science and technology become an important foundation. Then the ability of access to information and communication become the crucial point of success. Third, the human resources as a prerequisite for firm's development and expansion. The final one is an unprecedented development of services, the corporate should have global awareness. The modern enterprise management concept is strategic, long-term and global development, therefore the traditional management accounting may be difficult to adapt this new environment. The cost systems, cost control systems and performance reporting systems of traditional management accounting may be no longer meet the new manufacturing environment. The competition among enterprises is no longer limited to the price of products and services, cost or quality, but rather be reflected in the inter-enterprise value chain. Since the 80s of last century, Professor Michael Porter set the value chain theory has been widely applied to the practice of business management and become the most important management ideas and methods

Based on such situation, this assignment will investigate how the value chain analysis challenge and improve the traditional management accounting.

First, It will illustrate the weakness of traditional management accounting.

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Then it will go on to demonstrate the value chain theory. Third, it will consider the difference between traditional management accounting and value chain analysis.

The limitation of traditional management accounting

There exist five major limitation for traditional management accounting. The first one is the traditional management accounting may treat the firm as a single part. It only provided information for a single enterprise management decision and control, ignoring the external environment and other relevant information also can reflect the firm's position in the market(Williamson, 1975). Second, the traditional management accounting limited to the collection and analysis of internal financial information, the information break away from the requirements of corporate strategic management and weakened the role of management accounting(Granlund and Lukka, 1998). Third, the concept of traditional management accounting just focus on solving the relevant and individual internal issues. It can not form a sound management system with the market and long-term interests, so that the composition of the budget system just only concentrate on the enterprise's internal planning and operations. The forth is the traditional management accounting adopted financial indicators mainly such as profit and cost to assess and measure the performance of corporate. But the calculation of these indicators do not consider the cost of capital and risk premium, therefore, the report of business performance by these indicators are not accurate. In addition, the measurement of enterprise performance should include monetary and non monetary factors. However, the measurement of indicators by traditional management accounting only include monetary

indicators. The final one is the investment decision is an important part for traditional management accounting. The economic evaluation of investment projects mainly through the cash inflows and outflows of entire construction and operation period. This approach chiefly considers the financial benefits, focusing on saving direct materials and labor. However, when facing the global international market, in order to improve and enhance the competitiveness of business, the firm can not only appraise the financial profit, but also should take a variety of non-financial benefits into account (Bhimani and Langfield-Smith. 2007).

Because of the limitation of traditional management accounting, the appearance of “ Strategic Management Accounting” expands the perspective of the management accounting (Roslender and Hart, 2003). It clearly explain that the MA should concern about the overall function of the company. It is servicing for developing and controlling the company’s strategy. Based on this, the value chain analysis as an crucial method of SMA is the breakthrough. In the following chapter, I will focus on to state the value chain theory.

The value chain theory

The concept of value chain is firstly proposed by Professor Michael Porter(1985), he demonstrated that if taking the enterprise as a whole it can not discover the firm’s competitive advantage. The competitive advantage should come from the various mutual separate activities, such as design, production, marketing, delivery and supporting process. Each company is the aggregation of such kinds of activities, all these activities can be expressed with the value chain. After that Shank and Gowindarajan(1993) believe that <https://assignbuster.com/value-chain-analysis-and-traditional-management-accounting/>

any corporate value chain should contain the whole process from the raw materials which get from the initial suppliers to the final products which will be delivered to the users. Their greatest contribution is combined the value chain analysis method with the accounting information to make the strategic management become reality. With the development of information technology, Rayport and Sviolda(1995) proposed the “ virtual value chain”, they further enrich the value chain theory.

Dynamically, the value chain analysis is actually a process which around the value-added, continue to coordinate and optimize the value chain. The Value chain as an important management tool should be first an information system which services to its target - business management. It have to provide useful information to optimize the business processes, realizing the value-added process and can be utilized for decision-making. The value chain analysis takes all forms of business activities into the value chain and then forecast, decide, analysis, control and evaluate any increased or decreased value which on the value chain. Compared with the traditional management accounting, the value chain analysis expands the range of accounting object and extending the business from the internal core to the entire value chain. If treating the enterprise as a whole, it may be unable to distinguish which is the effective value-added part. But the value chain analysis can decompose the business activities, by examining each activities and their relationship with other segments of the value chain to determine the company's added value. Also the concept of value chain vividly summed up the organic links of the firm's value creation activities, but the company's value chain is not a single part, it is a crisscross value chain network(Collins

and Belcher 1999; Hinterhuber 2002). Therefore, the control of the value chain can not be isolated and dispersed, but should be based on real-time evaluation and multi-dimensional of the full range of control.

The differences between value chain and traditional management accounting

There may exist three main difference between value chain analysis and traditional management accounting. The first one is the typical character of traditional management accounting is its inward-oriented services, subordinate and serve the enterprise's internal organization and management. And the traditional management accounting use the firm itself and its internal units as object, only concerned the enterprise itself and ignored the external factors, so the aims of corporate may lack of long-term competitiveness. In contrast, the value chain analysis tends to extroversion, mainly because enterprises strategy is outward character. The enterprise development strategies should consider the uncertainty of external operating environment as premise, it must pay attention to the changes of the external environment to ensure that the business can survive and develop in such turbulent environment. So the researched scope of value chain is breakthrough the enterprise itself, involved both upstream and downstream enterprises, also including the competitors. The goals is to maintain a competitive advantage as a starting point, based on system optimization and the long-term competitiveness.

The second one is the traditional management accounting focus on the maximization of short-term interests of the enterprise and only concerned about the production process, analyzing the associated cost of three stages

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of project: supply, production and marketing, never in-depth consideration of the management operating. However the value chain management is directly analysis of to the operating level. It includes five basic operations and four auxiliary operations. The five primary activities is: inbound logistics, operations, outbound logistics, marketing and sales, and service. And the procurement, technology development, human resources management and enterprise infrastructure as four support activities. On this basis, the value chain analysis can be divide into three levels, one is aimed at the operating management of the basic operations and support operations. The second is the enterprise value chain management. The third one is the firm's outside value chain management. These three levels will cooperate with each other and making the management become more objective. In fact, when the competition of firms become the overall strategic competition, the pursuit of long-term goals, market share has become a business imperative goal. Therefore, the value chain analysis follow the long-term and overall interests and maximizing the profit as its main characters

The third one is the traditional management accounting based on the enterprise itself and only regarding the firm as a whole or using the internal units as object, the analysis is rather limited. But the value chain analysis not only take the business itself into account, but also consider the rival , suppliers, sales channels and even entire industries, the analysis of subjects is quite diversity.

Conclusion

To conclude, because of only focusing on the internal management and

short-term effect, the traditional management accounting exposed it's

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limitations and can not meet the requirements of business. However, the strategic management accounting is more able to adapt to today's more complex competitive environment and global market, it both concerns the long-term interest and the coordination of internal resources and external environment. In this assignment, the article emphasis on analyzing how the value chain analysis better than the traditional management accounting and stating the main difference between value chain analysis and traditional management accounting. The value chain theory is an important achievement in recent years and it provides a new perspective for the business management.