The impact of firm characteristics on management accounting practices: A UK-based empirical analysis

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Abstract


We examine the impact of a range of potentially contingent variables on a broad set of MAPs in a sample of companies selected from the UK’s largest industry sector. The variables relate to external characteristics, organisational characteristics, and manufacturing or processing characteristics. The method differs from prior studies in not testing association between contingency factors and a single, or a limited number of, accounting practice(s) but in looking for relationships with aggregate levels of sophistication based on the emphasis that respondents place on 38 practices and techniques. Furthermore, the 10 contingency factors considered in this study include two constructs (product perishability and customer power) not previously explored.

The results, derived from a large scale questionnaire survey, indicate that differences in MA sophistication are significantly explained by environmental uncertainty, customer power, decentralisation, size, AMT, TQM and JIT. The data confirm that customer power should be considered as an added external variable in the contingency theory paradigm. Expectations of relationships between competitive strategy, processing system complexity and product perishability, and MA sophistication were not, however, supported by the data.

The improved understanding of the relationships between 10 contingency factors and MA techniques employed contributes to the further development of an integrated contingency framework explaining variations in the investment in MA.

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1. Introduction

Over the last three decades a number of innovative management accounting (MA) techniques have been developed across a range of industries. Notable contributions include activity-based techniques, strategic MA and the balanced scorecard. Many scholars argue that the ‘new’ techniques have affected the whole process of MA (planning, controlling, decision-making, and communication) and have shifted its focus from a ‘simple’ or ‘naive’ role of cost determination and financial control (CDFC), to a ‘sophisticated’ role of creating value through improved deployment of resources. For example, Ittner and Larcker (2001) argue that “companies increasingly are integrating various [innovative] practices using a comprehensive ‘value-based management’ … framework” (p. 350). It has been argued that these ‘new’ accounting techniques have been designed to support modern technologies and new management processes, such as total quality management (TQM) and just-in-time (JIT) production systems, and the search for a competitive advantage to meet the challenge of global competition. As firms adapt to these technological and management developments, they must design a management accounting system (MAS) congruent with the new requirements (Gerdin, 2005). However, Tillema (2005) reports that many organisations have not adopted the ‘advanced’ techniques. She explains that “the appropriateness of using sophisticated techniques may depend on the circumstances in which these techniques are being used (and this) … gives rise to the need to adopt a contingency theory perspective” (p. 102).

The contingency theory literature indicates that factors such as technology and environment affect the design and functioning of organisations (Covaleski et al., 1996). Its central theme is that there is no unique best structure to all organisations under all circumstances; instead each organisational structure is a response to a set of contingencies. A company’s accounting system is a significant element of its organisational structure and the particular features of an appropriate system will depend upon the circumstances that the company faces (Otley, 1980). The literature shows that important characteristics (contingencies) affecting organisational structure include size, environmental uncertainty, production technology, corporate strategy and market environment (Otley, 1995; Covaleski et al., 1996; Mitchell, 2002; Reid and Smith, 2000).

In this paper, we follow this tradition arguing that MASs evolve partly in response to the firm-specific and environmental contingencies confronted by individual firms. Our central aim is to determine which characteristics are helpful in explaining the variation between firms adopting different levels of advancement of MA techniques and practices. In particular, we empirically investigate whether ‘sophistication’ levels of management accounting practices (MAPs) are significantly influenced by firm characteristics. In this context, and to be consistent with previous use of the concept (e.g. Chenhall and Morris, 1986; Tillema, 2005; Guilding et al., 2005), sophistication refers to the capability of an MAS to provide a broad spectrum of information relevant for planning, controlling, and decision-making all in the aim of creating or enhancing value. In an innovation to previous research we locate the sophistication of firms’ MAPs by reference to four levels derived from the IFAC (1998) statement on Management Accounting Concepts. Our paper further contributes to the tradition of contingency theory research by, unusually, considering a broad range (38) of MA techniques rather than concentrating on narrow issues such as activity-based costing, and by incorporating a number of contingent variables rather than considering, for instance, simply strategy, decentralisation, or environmental uncertainty. Furthermore (in contrast to a high proportion of empirical contingency studies) the research is prosecuted on a large sample of UK companies—the sample size and the respondents’ location convey greater British relevance than previous smaller studies or those based on data from other countries.

Three categories of firm characteristics are examined in this study. These are: external characteristics (environmental uncertainty, customers’ power); organisational characteristics (competitive strategy, structure, size); and processing characteristics (system complexity, extent of implementation of advanced manufacturing technology (AMT), implementation of TQM techniques, implementation of JIT techniques, and product perishability). Fig. 1 depicts these variables and their potential relationships with the sophistication of individual companies’ MAPs.

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