

Modern Management Strategies and Business Networks

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Abstract

Popular management accounting strategies stress that firms should choose between value adding and non-value adding activities. This message may seem obvious, but is not only straightforward. The separating of activities is explicated in management accounting methods such as Activity Based Costing (ABC) and Target Cost Management (TCM). When firms are following ABC and TCM they mainly stimulate routine activities. According to network theory, firms operating in industrial markets develop long term and complex business relationships to a few important counterparts. The aim of the research is to show how these kinds of long term business relationships not are supported and developed by implementing ABC and/or TCM since the concentration on routine activities, is precisely what development in business networks is not.

Key words: Business networks, management accounting, target cost management, activity based costing.

Introduction

A common message in modern management literature is that firms are focusing too much on non-value adding activities. This idea is expressed in management strategies such as Business Process Reengineering, Just in Time, Lean Production, Time Based Management, Total Quality Management, and World Class Manufacturing (Hammer and Champy, 1993; Schonberger, 1986; Womack et al., 1990; Stalk and Hout, 1990; Juran and Gryna, 1993). The main question here concerns which activities firms should keep as value adding and which should be abandoned as non-value adding.

Parallel to these management strategies several corresponding management accounting methods such as Activity Based Costing (ABC) and Target Cost Management (TCM) have also been introduced in the accounting literature. A key question within these concepts is also the concern about which activities a firm should keep as value adding and which it should abandon as non-value adding.

Altogether, these management strategies and accounting methods offer solutions to the delicate problem of determining which activities a firm should focus on. This paper aims to uncover some consequences firms will face when choosing between value adding and non-value adding activities based on the solutions delivered by ABC and TCM.

The analysis focuses on firms acting in industrial markets, which are characterised by firms engaging in long-term business relationships with a few other firms (Håkansson, 1982). A business relationship is understood as an exchange process and not as specific business transactions separated in time and space (Forsgren et al., 1995). The long-term business relationships are interconnected with other relationships and together they make up a business network (Håkansson and Snehota, 1995).

The paper is organised as follows. Section 2 discusses a perspective on firms in business networks. The following section deals with some of the modern management strategies. Section 4 focuses on the accounting methods ABC and TCM. Hereafter the consequences of ABC and TCM are outlined. The paper rounds up with conclusions and some suggestions for future research.

Firms in business networks

Empirical studies during the last twenty years have shown that firms acting on industrial markets have long-term business relationships with customers and suppliers (Håkansson, 1982; Tumbull and Valla, 1986; Ford, 1990). Long lasting relationships are often created in order to manage some certain dependencies, but over time the relationships create new forms of dependen-

cies (Forsgren et al., 1995). According to Håkansson and Snehota (1995) the companies are connected through several layers, namely activity links, resource ties, and actor bonds. The firms become tied together since their activities are embedded. The activity structures of the firms are linked together in order to make the operations of each firm operate more smoothly. These activity structures can consist of technical aspects such as production and development, but they may also be characterised by administrative and commercial components. The way these activities are linked will influence the productivity and effectiveness of the firms.

Another aspect of the relationships is the matching of recourse structures between firms and hence the creation of ties. Recourses may be machines, information systems, labour, knowledge, image, and financial ability. The firm may, via the relationship, get access to and also use recourses owned by other firms. A third aspect is the creating of social bonds to other firms, which affect the degree of commitment. Social bonds also influence the identity of the firm and trust between firms. The identity of a firm is to a large extent determined by its counterparts, which in turn means that the identity will be viewed differently by different firms. One firm may be seen as having an identity of progress and success by its environment, which could result in other firms viewing it as an advantage being associated with it. Håkansson (1989) showed in a study of more than 100 small and medium sized Swedish companies that most of the firms gain the larger part of their turnover from the ten biggest customers. Furthermore, Hallén (1980) has showed that the ten most important customers are mainly the same that dominates one set of relationships over many years.

An important function of relationships is that they create stability and therefore conditions for development. Stability in a relationship does not implicate counterparts expressing lesser demands on each other. On the contrary, the stability is a prerequisite for change. When actors are aware of each other's capabilities and weaknesses it also becomes easier to impose pressure. Empirical research has shown that relationships are important for technical development and a crucial part of a firm's development is the active interaction with other firms in large networks (Laage-Hellman, 1989; Biemans, 1990; Håkansson, 1990; Lundgren, 1991). The studies show that the most important counterparts within the development activities are the companies' customers and suppliers. Thus, the business relationships are characterised by mutual learning over time. The discussion shows that firms acting in industrial markets are strongly dependent on their most important relationships, both for short-run profits and also for the long-term development and survival of the company.

Management strategies

During the 1990s many books advocating very similar management strategies have gained in popularity. The strategies expressed in concepts such as Business Process Reengineering, Just in Time, Lean Production, Time Based Management, Total Quality Management, and World Class Manufacturing have at least one common ground. All activities and recourses that do not add to the value of the customer should be reduced or preferably eliminated. These strategies are focusing on the processes whereby products and services are produced. Hammer and Champy (1993, p. 25) even state:

It is not the products but the processes that create products that bring companies long-term success.

With the point of departure in customer value the firm should minimise the activities and recourses used in matter of time, space and workforce not only in the production but also in administration. Womack et al. (1990, p. 13) are arguing:

Lean Production [...] is "lean" because it uses less of everything [...] 1 - half the human effort in the factory, half the manufacturing space, half the investments in tools, half the engineering hours to develop a new product in half the time.

There is also another side found in this literature, which stresses the importance of the employees as a crucial asset to the firm. This message is often announced with the concept of empowerment, which means that employees should be given recourses and be accountable, in order to actively contribute to the development of the firm. Womack et al. (1990) argue that lean pro-

duction is leading to new more challenging jobs characterized by new paths of careers, development, creativity and learning. Juran and Gryna (1993, p. 171) claim that:

Empowerment goes beyond delegating authority and providing additional training. It means encouraging people to take the initiative and broaden their scope.

Altogether, these strategies of management have a somewhat fuzzy message. On the one side the resources used in the firm should be cut down dramatically, and on the other side the firm should invest in the employees and let them develop. There seems to be some difficulties in combining these two messages, i.e. which recourses (among human recourses are just but one) should be maintained and developed and which should be eliminated. It seems rather difficult for management to find time and space for development of the few employees left in e.g. the lean firm. A guide to this problem can be found in the literature on management accounting since it claims to offer methods that provide the decision maker with information on which recourses to keep and which to eliminate. The discussion is hereby entering the modern management accounting methods.

Activity based costing (ABC)

In the mid- 1980s there was an American debate concerning fixed costs in US firms. Many American authors claimed that the share of indirect costs had been rising dramatically since the turn of the century (Miller and Wollman, 1985; Johnson and Kaplan, 1987). The increasing share of fixed costs was seen as one of the reasons behind the weakened competitiveness of US firms. Furthermore, the authors argued that fixed costs were not so fixed, quite on the contrary, they were increasing in scope. The previously viewed fixed costs were the most variable costs in the firms. At the end of the 1980s the ABC-method was presented as a means for solving the fixed costs problem (Cooper, 1988).

The proponents of ABC argue that the method is able to trace the indirect costs to the objects of calculation in a better way compared to traditional methods of calculation (Cooper, 1988). Another advantage subscribed to ABC is its ability to control the use of indirect recourses. According to an LK survey many firms use ABC primarily as a method for rationalisation and thereby for decreasing the use of indirect recourses (Innes and Mitchell, 1995).

The four basis concepts within the ABC-concept are activities, recourses, cost drivers and calculation objects (Cooper et al., 1992). Activities describe what is being done in the firm and the activities consume recourses. The recourses can be personnel, machines, constructions, material, etc. The cost drivers are a quantification of the relationship between the activities and the consumption of recourses. The calculation object is the target of the costs and it should be something adding value to the customer, e.g. products or services. Consequently, the ABC is based on the following relationship: the calculation object consumes activities and the activities consume the recourses of the firm. The cost drivers describe what is influencing the use of activities.

The first step in an ABC-implementation consists of a deep analysis of the activities. This analysis is normally based on interviews with managers and employees, which are reporting on their work tasks. These interviews will end up in a detailed account of the activities and in an identification of the cost drivers causing the activities. According to the ABC-messengers the activity analysis can also be used for identification of activities creating value for the customer. It is, in other words, possible to differentiate the value adding activities from the non-value adding ones (Berliner and Brimson, 1988; Cooper et al., 1992).

In order to deepen the analysis of value creating and non-value creating activities and also to show how ABC could be used for controlling indirect units it is convenient to take an example of how activities could be mapped and how cost drivers are identified and determined. Cooper et al. (1992) present the implementation of ABC in eight different firms. The authors claim that one of the advantages with ABC is the tracing of recourse usage to activities within the firm regardless of organisational boundaries. This means that all recourses related to customer adaptation are connected to the activity regardless of the use of recourses taking place at the department of research and development or in the production function.

Another argument delivered by Cooper et al. (1992) is that it is not enough only to reduce the use of recourses, because this will only result in excess capacity. According to the authors it is

necessary for management to decide on a reduction of the excess capacity in order to decrease the costs. Some of the activities and cost drivers identified by Cooper and associates (1992) in the Farrall Corporation are shown in Table 1.

Table 1

Activities and cost drivers at Farrall corporation

Activities/Business Process	Cost Drivers
Product development	Number of customer
ECNs Procurement	Number of line items per vendor order
Scheduling	Number of production orders
Materials handling	Number of moves (operations)
Inventory management	Average inventory value

Source: Cooper et al., 1992, p. 75.

As shown in Table 1 the cost drivers are oriented towards various measurements of quantities. The authors are making the assumption that the use of recourses increases proportionally in relation to an increase of a specific cost driver. Another, perhaps more important, notion is the authors advocating cost drivers connected to routine activities. This notion needs to be further explored, which is done by studying a more detailed ABC-analysis provided by Innes and Mitchell (1990). According to Table 2 these authors have divided a purchasing department's process of purchasing into six activities, as compared to Cooper et al. (1992), which considered purchase to be only one activity.

Table 2

Activities and cost drivers in a purchasing department

Activity	Cost drivers
Receive purchase requests	No. of requests
Vet alternative suppliers	No. of suppliers orders
	No. of suppliers
	No. of new parts
Order items	No. of supplier orders
	No. of items
	No. of suppliers
Expedite delivery	No. of deliveries
Approve payment	No. of deliveries
Supervise departmental work	All of above drivers

Source: Innes and Mitchell, 1990, p. 9.

As obvious from Table 2 it is no principal difference from the activities and cost drivers in Table 1. This implies that both analyses stress routine activities and that the use of recourses is increasing at a proportional rate in relation to the chosen cost driver.

It was earlier pointed out that, perhaps the biggest, advantage of the ABC- analysis is the possibility of controlling the costs of indirect units (such as service departments), which are seen as fixed in traditional cost accounting. The point of departure was ABC, through the identified cost drivers, could measure the performance of indirect functions and therefore making it possible to set various types of standards. It should therefore be possible to use the same type of control philosophy in indirect units as in manufacturing units. It would hereby be possible to get indication of an indirect units performance from the system of accounting.

In the case of Innes and Mitchell (Table 2) an analysis and evaluation of the purchasing department would be based on the outcome of the cost drivers. This could be illustrated by the

following example. If this department faced a 20% decrease in the number of orders by suppliers, it would have to reduce its resources committed to that particular activity also by 20 %, in order not to decrease the cost efficiency. The firm is, in other words, evaluating the efficiency of the department. Further, this logic implies that those activities not captured by the identified cost drivers will be considered as non-value creating, and should therefore be reduced or eliminated.

At the same time, it is rather obvious, that this purchasing department is conducting activities, which could not be considered as routine. Research on purchasing behaviour has shown such departments are involved in activities such as developing strategies of purchasing, co-ordination with other departments, planning, and developing long term relationships with its suppliers (Gadde and Hakansson, 1993). Ford and Saren (1996) show that the purchasing department within Massey Ferguson has an important role in managing critical supplier relationships. As a result of Massey Ferguson's outsourcing activities components such as fuel injection systems are bought from external suppliers. Consequently, it is necessary for Massey Ferguson to persuade the supplier to meet its particular need of adaptations. A specific important issue for the purchasing department is to influence the development activities within the supplier. Altogether, Innes and Mitchell's (1990) analysis of activities is based on a traditional view on purchasing functions only chasing low prices, switching between suppliers and trying to minimize the costs of purchase. Additionally, the purchasing department as described by Innes and Mitchell (1990) is treated as a mass-producing unit of manufacturing, where the most important things are to standardise the jobs and to minimise the costs on short term. Even in manufacturing units this kind of strategy is hardly advocated anymore (Lind, 2001).

Target Cost Management (TCM)

TCM is an accounting method focused on the stage of design of the product or the service, in other words, on the stage before manufacturing or processing. The rationale behind this is that a large proportion of the costs emerges in the process of product development and design activities. It has been argued that almost 85 % of the costs of a product is determined long before it is put into production (Berliner and Brimson, 1988).

The target cost is defined as "Target Cost (Allowable Cost)=Expected Sales Price - Target Profit" (Kato, 1993, p. 38). The sales price is based on the customers' level of willingness to pay. The customer is constantly the focus of the analysis. In order to obtain information on the product's possible sales price, the product is, in a first step, divided into functions. With the starting point in the functions a judgement is made on how much the customer is willing to pay for the specific functions. After the sales price being settled, the second step is to estimate the target profit of the specific product. This profit is based partly on the firm's long-term business plan, and partly on the short-term profit demand. This means that the short run profit claim for different products may differ quite strongly depending on the product's position in the firm's general business strategy. A new product may be considered as important in the long run and therefore be allocated a lower target profit at short-term.

The third step is to decide on the target cost of manufacturing the new product. The analysis is based on the existent methods of manufacturing delivering a certain cost, which is compared with the expected sales price and the target profit. At this stage it is normal that the cost level of existent methods of manufacturing is far too high in order to reach the desired target profit. This means the firm has to decrease its costs. The size of this decrease is the difference between the actual cost and the target cost.

The next step is to identify how to decrease the costs. Questions raised are as follows: Within which functions is it possible to cut costs? Is it possible to simplify the content of the product, without decreasing the customer's value? Could the manufacturing be made in a simpler way? An often reached conclusion is the costs not being able to be reduced only within the firm, but rather a large share of the body of costs are created at the suppliers. Carr and Ng (1995) studied a Japanese auto plant in UK finding more than 80% of the costs emerged at the suppliers. With this knowledge the auto-company engaged actively in an effort making the suppliers to reach their target costs. The auto-company did hereby intervene in the suppliers' efforts to cut costs.

Another example of how firms use the TCM, has been presented by Mouritsen et al. (2000). A firm developing and manufacturing alarm systems with advanced technology decided, strangely enough, to almost close down the research and development (R&D) department. Moreover, this was done in order to offer the customers the latest in alarm technology. The rationale behind the decision was to, instead of creating new technology "in house", continuously buy it from the firm offering the latest innovations at a given time.

The R&D department was therefore considerably down sized. Previously this department had been considered the core activity or recourse in creating customer value. In the new situation the firm concentrated on developing relations with its suppliers, which became much more involved in the projects of the studied firm. The new strategy created a demand for a new system of controlling, which was the reason why an inter-organisational system was created on the basis of TCM.

The firm although, had problems adopting the strong control of suppliers' cost structures as proposed by the TCM. The strength of the relationships with suppliers was instead considered as more of a co-operative kind. The firm also considered it hard to estimate the cost level of the suppliers. Hereby, the firm did not establish any direct demands on level of the suppliers' target costs, even if they had to continuously pursue decreasing costs. The financial control was made instead of the establishment of a purchasing budget with fixed prices of purchase.

The functional analysis was to become an efficient tool in controlling development projects with the suppliers. Through this analysis the firm was able to specify which functions a new component delivered from a supplier should consist of. Among the functions were e.g. the ability of a new product to be connected to a central surveillance centre, the degree of fitness into existing manufacturing processes, and service friendliness. Furthermore, the components should have a certain design, a specified finish and a unified outlook. All these demands on functions secured a new product having the corresponding identity as the rest of the firm's products had.

This analysis of functions could be used in the interaction with any supplier. The firm could choose the supplier, which at the moment was at the front of technological development. By controlling through the concept of functions combined with demands on constraints on costs, the firm became a technology co-ordinator in its field. The employees left on the down sized R&D department worked with strategic search and development of new projects of development. As evident from this case the firm became a leading actor with ambitions to work in the forefront of technological development. The relationships to its suppliers could hardly be characterised by mutual learning over time, as discussed in the firms in network perspective. Instead, the firm could, via the controlling system, shop around among suppliers and establish a relationship for a shorter period of time and then choose some other supplier. The firm had also reduced the personnel by almost an entire department. The remaining personnel were handling mainly the co-ordination of suppliers, which became the new core strategic function of the firm.

Analysis of ABC and TCM

The main question dealt with in the following analysis is the consequences of which activities and recourses that should be eliminated as non-value adding respectively kept by the firm as value adding. In the business network perspective the consequences are shown to be not as obvious as first expected. In the following section the Activity Based Costing is discussed followed by an analysis of Target Cost Management.

Some Consequences of ABC

ABC may be analysed as having at least the following consequences, which may be viewed as both negative and positive in a network perspective.

- A concentration on standardisation and routine activities
- A questioning of traditional areas of responsibility
- A visualisation of dependencies to other firms
- A revitalisation of external processes of exchange

In the earlier presentation of the ABC-concept it was mentioned that an analysis of the activities of the firm was to be carried out (corresponding to the analysis of functions in the TCM-

concept). The quest was to identify and map activities creating value for the customer. In the ABC-analysis, the activities were quantified (preferably in terms of "numbers of"). With this focus a concentration on the easy-measure is evident and therefore, of course, a too strong simplifying of the causes of the scope of the activity. The use of cost drivers in controlling indirect activities means a focus on standardisation and routine activities, which may cause the firm to eliminate the activities not quantified by the identified cost drivers. The problem is the ABC-concept trying to quantify activities that are not at all easy to quantify.

The firm that completely implements ABC in its management control system will hardly have any deep cross-functional contacts, as these are difficult to capture by the analysis. For the same reason, it is not plausible the firm having structures of relationships to other firms characterised by depth and breadth, even if the interaction between different functions of the firms are crucial according to the network perspective. When the firm is more or less protecting the technological core from the environment there are some evident risks of path dependence, i.e. "doing things the way they have always been done". There are obviously some problems connected to a focusing on standard and routine activities, which may follow from an ABC-analysis. The problem is the ABC-concept trying to transform the logic of manufacturing with mainly standardised activities to other functions of the firm, which could be characterised by another logic stressing non-standardised activities.

In previous sections it was concluded that firms on industrial markets do not create long-term development by concentrating on routine activities. A purchasing department where the employees mainly are carrying out routine activities such as purchasing from standard suppliers to the lowest price possible and handling customer complaints by standard operating procedures will hardly contribute to the long run ties with other firms. With this logic prevalent, there are small opportunities for conducting active strategies of purchasing such as managing long-term relationships with reliable and co-operative suppliers. With a concentration on routine activities the potential of developing the employees, as considered most important in the modern management strategies, will also be unexplored.

As earlier was discussed, an ABC-analysis starts with the firm mapping its processes and activities. This analysis may contribute to another conception of the firm's operations, where the processes become visualised in new way. The analysis may also reveal overlapping areas of responsibility, overlapping processes, and therefore bring forward necessary changes of processes. Traditional functional areas of responsibility contradicting the processes of the firm may also be revealed by the analysis. Furthermore the analysis may reach to the external processes of the firm by showing how the various functions of the firm are dealing with each other and towards customers and suppliers. However, the analysis should not end up trying to quantify these findings into simple "number of" cost drivers, which would be the likely result of a completely implementation of the ABC in the management control system.

The research about development in industrial networks has shown that it is not at all evident that development projects are carried out within the traditional legal borders of a firm (Håkansson, 1990; Biemans, 1990). Quite on the contrary, this research stresses the complex ties between firms and the case being the close connections to other firms creating development and success. The ABC-analysis may identify, reveal and visualise a firm's ties to other firms in order to support the development of these further on, but there seems to be an obvious danger in an implementation of the concept.

Some Consequences of TCM

The consequences of TCM may be summarised in the following way:

- A focus on increasing standardisation
- Traditional one way control of technological development
- Opening up of the firm's technological core towards other firms
- Stimulating dialogue concerning activity dependencies

In the earlier discussion of TCM it was shown that the firm should split up their products into functions in order to decide on acceptable level of costs for the various components. The func-

tion analysis and the following implications to reduce costs may be argued to force the firm into focusing on routine activities. Since one firm is deciding on what function a certain product will have and also how much it should cost, the risk for path dependence may also in this case be present. This is due to the fact that other firms have to follow the dictating firm's function analysis as was evident in the earlier discussed case.

One of the strengths with TCM, according to the literature, is that the method by focusing on routine activities enables the firm to use the same function analysis in many relationships and therefore to force many other firms into the standards set by the focal firm. With this strategy the firm should also be able to reduce its costs, at least on short-term. From a network perspective this kind of behaviour is hardly beneficial for the long-run development. In a situation where one firm is dictating the conditions to other firms there will be little of mutual development and learning by giving and taking, which is one of the corner stones in the network perspective. TCM has therefore limited possibilities as an accounting method to enhance development of firms in networks, since it is more concerned with the traditional discussion whether a certain activity should be kept inside the firm or outsourced.

In the TCM-case, which was presented above, the firm had eliminated most of its R&D department. Instead it chose to stick with a strategy, which implied taking advantage of other firms' technological innovations by continuously shopping around. In this way a new structure concerning technological development emerged in the field. By the firm developing a function analysis in line with the TCM-concept it opened up its technological core to other firms in the environment. Hereby a dialogue between the firms begun, even if the dialogue was more of a monologue in the form of direct control from a network perspective.

Both the activity analysis of ABC and the function analysis of TCM seem to open up new possibilities for development of the firm. But when both analyses are completely implemented in the management control system they become quite opposing to the firms in network perspective

Conclusions

On the basis of the analysis of the consequences of ABC and TCM two main scenarios may be outlined. First, there may emerge a scenario where a far too strong concentration on routine activities in the longer run drains the firm's ability to develop. In this case it is also likely that the potential of the personnel is not used. In the process towards standardisation of easy measurable activities the discretion for trying new alternative ways of conducting business is also minimised. In this scenario it is also easy to identify "excess personnel", which are those not performing the standardised activities. The excess personnel should be lay off or preferably be replaced by personnel with lower qualifications. This scenario could be characterised as a negative development spiral. The spiral is characterised by a continuous elimination of activities and resources vital for long run development in networks.

Second, there could emerge a scenario where the reduced use of activities and resources lead to an enrichment of vital development or a positive development spiral. In this scenario the analyses of functions and activities offered by ABC and TCM are used as tools in order to open up the firm towards other firms and thereby creating new possibilities and opportunities for development. For the personnel this may follow new tasks. In the case concerning TCM the personnel at the former R&D department had to switch from traditional R&D tasks to handling, co-ordinating and developing business relationships to a variety of other firms. This kind of job tasks can hardly be characterised by routine, instead it is demanded enlarged discretion and creativity to constantly develop new solutions. As evident from the analysis in this paper it is quite hard to draw definite conclusions of the consequences of the modern management accounting. The modern strategies and methods may implicate both positive and negative spirals of development. The main problem lies in the decision choosing which activities and resources being value creating for the customer and which are not. A decision that is hard in the short run, and even harder in the long run.

Still a critical issue remains. This concerns whether slack resources are demanded in order to facilitate development in the long run or not. It would be convenient to argue firms need slack resources to a great extent in contrast to the concept of the lean firm characterised by routine

activities performed by as less recourses as possible. It is also quite appealing arguing slack recourses implicate more possibilities and discretion in finding new ways of conducting business. However, it is not evident that the mere presence of slack recourses automatically will lead to development of a business. It is possible that the lack of slack recourses will force the firm to find new solutions. In the case of the firm developing and assembling advanced alarm equipment it was the lack of resources for keeping up to stiff competition on technological development in the field, that forced the management to find the new solution. Instead of having an R&D department of its own the firm started to create relationships to other firms, which were anticipated to have a competitive advantage. It is quite hard to imagine how this firm, without the acknowledgement of lack of developmental recourses, would have initiated the new strategy. The mere lack of recourses resulted, in this case, in the firm developing on new long-run strategy.

Earlier research on management strategies and accounting methods has to a greater extent focused on the consequences within the traditional legal border of the firm. However, there is a lack of research covering what the consequences are in larger networks of firms. It is then needed more empirical studies of the modern management strategies and accounting methods in this setting as well as the consequences.

Finally, we would like to stress that both ABC and TCM could be strong tools in supporting firms in networks. It is, however, important to note that a rightful implementation may be risky for the long-run survival of the firm. In other words the consequences are dependent on how the modern management strategies and accounting techniques are used in practice.

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