Accounting Forum xxx (2014) xxx–xxx

Contents lists available at ScienceDirect

Accounting Forum

journal homepage: www.elsevier.com/locate/accfor

# Management accounting and decision making: Two case studies of outsourcing

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ARTICLE INFO

*Article history:*
Received 24 June 2014
Received in revised form 8 October 2014
Accepted 22 October 2014
Available online xxx

*Keywords:*
Outsourcing
Decision-making
Management accounting
Strategy
Methods
Theory
Practice

ABSTRACT

Studying the outsourcing decision in two substantial manufacturing companies, the paper explores the use of management accounting information in a complex and strategically significant decision-making setting. The setting involves multiple decision participants with potentially conflicting preferences, constrained information provision capabilities and uncertainties in respect of the financial outcomes of alternative decision options. The two case studies reveal two different methodological approaches to decision-making: analytical and actor-based. These approaches incorporate substantially different ways of managing information uncertainty, fostering interaction among the coalition of decision-participants and making use of management accounting. The findings show that management accounting information and techniques do play an important role in relation to organisationally complex and strategic decision situations. The revealed methods provide potentially educational examples from which other organisations can learn. The findings address the simplistic nature of the conventional management accounting literature on decision-making (e.g. outsourcing and "make or buy").

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## 1. Introduction

This paper is concerned with the role of management accounting in the making of important organisational decisions. It is based on two comparative and contrasting case studies of how management accounting contributes to outsourcing decisions. The aim is to explore the inadequacies of rational and quasi-rational models of organisational decision-making as a representation for understanding not only the form of management accounting but also how it is deployed in this contemporarily important organisational decision-making setting. Exploring how practice has developed provides a first step towards explaining and understanding how decisions of this type are made and how management accounting supports those making the decisions.

Decision-making is well established as one of the key rationales for management accounting (e.g. Simon, 1955, 1956, 1959, 1976; Horngren, Foster, & Datar, 2005; Hall, 2010). The conventional wisdom of management accounting practice in this respect has traditionally been heavily based on the calculated rationality approach (March, 1978; Scapens, 1991). This suggests that intelligence in decision-making involves, "intelligent individuals making calculations of the consequences of actions for objectives, and acting sensibly to achieve these objectives" (p. 592). Within this calculative genre, management

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http://dx.doi.org/10.1016/j.accfor.2014.10.005
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accounting has been particularly influenced by the normative standard of rational choice rooted in microeconomics (e.g. Keen & Morton, 1978; Demski, 1980; Sprague & Carlson, 1982; Scapens, 1991). The decision maker is assumed to act rationally by making choices that maximise his utility function. This requires knowledge of all alternative courses of action and information on their consequences (March, 1978, p. 587). The implicitly assumed role of information (including management accounting information) is to support the attainment of optimal decision outputs and to this end management accounting has been complemented and supplemented in practice by economic, statistical and operational techniques (Simon et al., 1986; Scapens, 1991).

However, many aspects of this calculative approach to rational choice decision-making have been challenged (e.g. Simon, 1955, 1956, 1959, 1976; March & Simon, 1958; Simon & Newell, 1971; Cyert & March, 1963; Kahneman, Slavic, & Tversky, 1982; Leibenstein, 1976). The quality of information accessible to decision makers does not allow for optimisation, nor do decision makers hold the innate information processing capability to leverage information to optimise their decisions (Simon, 1976). To overcome these limitations decision makers operate with bounded rationality involving that they "isolate from the rest of the world a closed system containing a limited number of variables and a limited range of alternatives" (, p. 82). Compounding this criticism is the fact that much of the calculative rational economic analysis (and indeed the bounded rationality approach as well) is founded on analysis of individual decision-making (Cummings, 1982; Simon, 1976). Claims have been made that this is not a sufficient basis for identifying how decisions are arrived at within organisations (Pfeffer & Salancik, 1974; Kleindorfer, Kunreuther, & Schoemaker, 1993). An organisation is a coalition of decision makers who hold different and conflicting values, subjective preferences and goals which can be fuzzy and change over time (March, 1962; Cyert & March, 1963). Consequently, more realistic models of organisational decision-making have to address, "how collections of individuals make complex choices in the face of ambiguity not only of information but even in objectives" (Pondy, 1982). Subscribing to the stakeholder view, some researchers have advocated the systemic rationality approach as an alternative form of intelligent decision-making. They assume that there is intelligence in decision-making, based on principles such as balancing the stakeholders' interests, sensible adaption or reaction to changes in the environment and selecting the rules and routines of the fittest (March, 1978, p. 593; Pfeffer & Salancik, 1977; Dane & Pratt, 2007; Hall, 2010). However, the organisational context of the decision maker may be complex, problematic and challenging to the point of having decision makers operating in an anarchic and chaotic context (Cohen, March, & Olsen, 1972; March & Olsen, 1984). While research on the role of management accounting for specific decision-making is limited, the studies undertaken demonstrate that management accounting in organisations is often compromised by the internal politics following managerial power groupings. Additionally, these studies testify how the innate behavioural constraints and technical limitations prevent economic rationality as a convincing explanation for the organisational decision-making process (King, 1975; Cooper, 1975; Berry et al., 1985; Lueg & Nørreklit, 2012).

These issues accentuate the need for the development of decision models that can address the limitations of calculative rational choice models. The first step is to find out what is currently done in practice (as attaining the full rationality objective is not possible in the real world). This can be achieved by empirical decision-making studies on the integration of accounting information in decisions related to complex organisational tasks that involve multiple decision participants with potentially conflicting preferences, constrained information provision capabilities and uncertainties in respect of the financial outcomes of alternative decision options. Specifically, we raise the following research question:

> Confronted with a complex, strategic decision situation involving information uncertainty and a coalition of decision-participants, how do companies structure their decision analyses and incorporate management accounting information into it?

This study is designed to answer this question. Consequently it is inductive in nature. Rich data from the two case companies is used to establish models of how coalitions of decision makers structure the analysis of complex decision problems and embed management accounting[1] into their outsourcing decisions. The induced models are, therefore, designed to identify how management accounting can play different roles in guiding organisational action (March, 1978) as opposed to predicting decision behaviour and decision consequences. The study reveals two methodological approaches to decision-making that have substantially different ways of handling information uncertainty about decision alternatives and of interacting with the organisational coalition of decision-participants. These methodological findings advance the decision-making theory of management accounting beyond the taken-for-granted models of microeconomics and conventional organisational theory. They illustrate how the 'make or buy' decision can be strategically contextualised. To our knowledge the conceptualisation of methods for decision-making is novel within the field of management accounting research[2].

[1] In this paper it is assumed that the management accounting function exists to assist management attain organisational objectives. This is achieved by the provision and interpretation of information, mainly financial, designed to support the profit objective and facilitate sustainable management. It thus involves a broader range of information than financial accounting as it covers both the financial implications of managerial decisions (strategic and operational). As management accounting is created and used by people and impacts on organisational participants, philosophy and social sciences such as economics, organisational studies, psychology and sociology have all contributed theories which have provided a cross disciplinary base for explaining and understanding the practices of management accounting.

[2] Empirical studies on decision-making within management accounting research have been concerned about such issues as how contextual factors shape accounting information for decision-making (Carr et al., 2010), how various types of accounting information relate to decision-makers' behaviour (Hopwood, 1972: Otley 1978), and how decision-makers use accounting to legitimate decisions (Covaleski and Dirsmith, 1991) Normative research drawing on agency

Please cite this article in press as: Nielsen, L. B., et al. Management accounting and decision making: Two case studies of outsourcing. *Accounting Forum* (2014), http://dx.doi.org/10.1016/j.accfor.2014.10.005

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