Management control systems have evolved to address the need for innovation

Innovation is the adoption of an idea or behaviour pertaining to a product, service device system, policy or programme that is new to the adopting organisation. Innovation has been recognised as a significant aspect of corporate survival. This has become particularly apparent in recent years as firms are increasingly operating in highly competitive markets where technologies are constantly developing, providing novel products and services that add a competitive advantage.

Traditional accounting control systems, such as budgets and standard costs, are designed to help implement organisational strategies and as such have typically not been seen as useful in formulating strategic innovation. However, more contemporary approaches that incorporate newer management control techniques provide a more comprehensive view of organisational and people concerns that relate to innovation. These approaches help managers in forming, articulating, legitimising and making visible the role of innovation to the firm.

While the traditional use of accounting controls is usually seen as inappropriate for innovation, there is evidence that a more inclusive approach can assist in that task. Traditional controls can help by identifying possible areas of the business that are likely to produce innovation through planning techniques that identify external opportunities and examine internal capabilities. Formal cost management such as target costing has been effective in profitable product development. Traditional controls can also assist in motivating managers by developing reward systems targeted on manager effectiveness in generating innovation.

An important breakthrough finding shifted thinking about the efficacy of traditional controls: the type of strategy followed by organisations is related to the way these controls are used. In more entrepreneurial firms facing dynamic business settings, traditional controls can be important but they are used in an interactive way to set agendas for debate and discussion around ways of developing innovation. However, firms following low-cost conservative strategies, within more stable settings, used formal controls in more traditional, or diagnostic, ways.
Recent research has shown that for many organisations traditional controls operate most effectively when they are combined with more informal, organic controls. Organic systems provide a supportive culture to develop innovation and flexibility to identify opportunities in uncertain settings. Formal systems curb excessive attention to potentially unviable innovations. The conclusion that combinations of formal and informal controls are beneficial has encouraged thinking about management control system design in a way that accommodates multiple approaches, with interdependencies capturing the dynamic tension between the contrasting types of procedure.

An important area of management control is performance evaluation. Again, strategy appears to have an effect on the suitability of different performance evaluation systems. Pressure to meet financial targets can induce a short-term focus and discouragement of new ideas. Evidence suggests that in innovative settings we find a de-emphasis on rigid budgetary controls. Also, more suitable controls in innovative settings include subjective evaluations. What is important to the innovative firm are non-financial measures that are seen as leading indicators, which makes them especially useful for incentivising innovative, long-term oriented efforts.

Perhaps the most pervasive development in performance measurement has been the balanced scorecard (BSC). The approach combines financial and non-financial indicators and associates them with a business model that incorporates outcomes related to financials, customers, internal process and learning and growth. These models provide strategic maps to integrate the interdependencies of business operations.

It may be expected that the control imperatives employed in BSC-type approaches will continue to be refined. Advances have particular relevance for how BSCs help achieve innovation. Concern with modelling causality within BSC strategic maps may be addressed by applying more dynamic methodologies involving advanced statistical techniques. BSCs can provide a focus on stakeholders other than shareholders and provide a primary focus on concerns other than financial matters, which is particularly pertinent in the not-for-profit sectors.

Attention will likely be directed at ensuring that the measures used in BSCs are valid and reliable, and strategy maps are comprehensible to managers. Concerns with human resources will help focus on intangible assets. Implementation issues will draw attention to the need for strong and focused leadership. It will be important to ensure that IT is developed to support efficient communications. Structural issues will be debated concerning matters such as the appropriate roles of senior and operational management, and there will be concerns about the role of empowerment particularly in flatter organizational structures.

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Notes:

- This post is based on the authors’ paper The role of innovation in the evolution of management accounting and its integration into management control, in Accounting, Organizations and Society, Volume 47, November 2015, Pages 1–13.
- The post gives the views of its authors, not the position of LSE Business Review or the London School of Economics.
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