Accounting, Finance and Manufacturing Strategy

Two common denominators are used in manufacturing businesses as the basis for control and performance measurement. The first is the time base on which manufacturing principally works. Product mix and volumes, capacity, efficiency, utilization and productivity are all normally measured by time. The second common denominator is that of money. At the corporate level, forecast activity levels, performance measures, levels of investment and similar activities use the money base. The importance of getting the correct links between the time-based and money-based measures is self-evident – correct not only in terms of being accurate, but also in reflecting the key perspectives associated with the business itself.

The money-based denominator issues addressed in this chapter are controlled by what, in many companies, is frequently one of the least developed functions: accounting and finance. Based on approaches established when business activities were very different, this area has not really faced up to resolving many of the important changes in business with appropriate developments. This chapter highlights a number of areas that need to be addressed from the point of view of both manufacturing and overall strategy. It will link the areas of manufacturing and corporate strategy with accounting and finance and illustrate some of the key issues that need to be developed and the essential direction these improvements need to take. In addition, it will show the ways in which manufacturing strategy will influence and, in some cases, facilitate some of these changes, while also drawing attention to the essential nature of manufacturing’s needs and the accounting and financial information provision.

The purpose of this chapter is to make a number of critical observations about the impact on manufacturing of finance and accounting practices. The observations are made from a manufacturing executive’s perspective, hence they may well be provocative when examined by the professional accountant. If this causes debate between manufacturing and finance executives, the purpose of this chapter has been achieved. Solutions to the issues addressed must be worked out in the context of a company’s own corporate and manufacturing strategies. Since the financial systems in a business can, and do, have a major impact on manufacturing’s ability to develop and maintain effective competitive strategies, one essential objective of the finance function must be to give manufacturing the ability to measure and assess its performance accurately in relation to major competitors, the relative contribution of
products, customers and manufacturing activity to overall profits and the competitive value of investment proposals. The chapter deals with two broad areas of interaction between finance and manufacturing: first, the effect on manufacturing strategy of investment appraisal methods; second, how management accounting systems critically affect the control and performance measurement of manufacturing operations.

**Investment Decisions**

The approach to developing a manufacturing strategy was explained in some detail in earlier chapters. One important consideration highlighted in those explanations was the level of alternative investments associated with different decisions (see Exhibit 11.1). Many organizations, bounded by cash limitations, need to commit their scarce resources wisely. However, the criteria for assessing the level or nature of this critical corporate decision have rarely been arrived at with the care and in-depth analysis that is warranted. In many companies, investment decisions initially chosen or stimulated by corporate competitive requirements are finally evaluated solely by accounting measures and methods of appraisal. The effect of these financial measures on both strategy and the consequent investment decisions is illustrated by the framework introduced in Chapter 2. Accounting methods of investment appraisal are generally based on one important premise – the relative return on capital associated with each investment proposal under review. With capital investment in limited supply and capital rationing a widespread consequence, the argument to invest predominantly on the basis of return is not only built into the appraisal system itself, but invariably is reinforced by the discussion and argument that will take place. In this way, the figures will unwittingly support investment return as the predominant or even exclusive measure on which to assess these key corporate strategy decisions.

The consequences of this undue weighting have been felt by many companies, and the ramifications within manufacturing industry have been widespread. The necessity to question this view of investment decisions has stimulated a series of well-argued articles and papers that illustrate the simplistic nature of the accounting

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**Exhibit 11.1** Restrictions imposed at both ends of the manufacturing strategy process