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Accounting for new organisational forms: the case of subcontracting and outsourcing

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Overview of project
New organisational forms are brought about by globalisation and developments in technology, and are generally flatter, leaner, less hierarchical and more flexible than the traditional bureaucratic forms. This move has been spurred by the growth in subcontracting and outsourcing by organisations in order to focus on their core activities.

This research report identifies key questions which assess the use of new organisational forms in contemporary UK business, and its consequent implications for management accounting.
Key issues to be examined include:
• the influence of subcontracting on organisations’ management accounting
• the management of buyer-supplier relationships
• the impact of changing organisational forms on corporate performance.

The participants in this research were subject to observed developments in their organisational forms and their willingness to cooperate over time. The five chosen organisations included: a public sector organisation; a retail franchise operation; a major UK food retailer; an engineering manufacturer; and a food manufacturer.

In-depth face-to-face interviews provide a set of detailed case studies whilst the quantitative postal questionnaire provides a larger representative sample of responses on which more sophisticated statistical analysis can be performed.

1. Objectives
The aim of this research project is to understand management accounting (MA) practices in change situations by examining their emergence and functioning within the context of emerging supply chains.

The main issues to investigate through the case studies are the following:
1. The role of management accounting calculations in the supply chain
   a. Types of accounting calculations and practices used in the decision to outsource, new techniques or existing ones used in new ways.
   b. Role of management accounting in deciding which activities to outsource and which to perform internally.
   c. Decision to term management accounting as ‘core’ or ‘non-core’ activities.
   d. The changing role of management accounting under ‘core’ or ‘non-core’.

2. Accounting and the management of supplier-chain relations
   a. Current management accounting techniques used in new ways to manage supply chain relations or new techniques developed.
   b. Role of management accounting in writing outsourcing contracts.
   c. Role of management accounting in overseeing and revising outsourcing contracts.
   d. Impact of accounting calculations on determining length of the outsourcing contract.
   e. Role of management accounting in enforcing outsourcing contracts.
   f. Accounting metrics used to compare suppliers and their contracts.
   g. Extent to which management accounting practices underpin network relations.
   h. Knowledge transerral within and across the supply chain subjected to accounting calculation.
   i. Accounting skills transferred from the company to the supplier.
3. Management accounting and the impact of outsourcing on corporate performance
   b. Accounting input on measures of efficiency and effectiveness.
   c. Measuring value creation and value capture.
   d. The basis to continue with outsourcing.

2. Findings
   A combination of qualitative and quantitative research methods has been employed. While quantitative findings were investigated via a postal questionnaire, qualitative research employed in-depth case study analysis of various organisational form archetypes.

2.1 Questionnaire findings
   Background Information
   The representative sample includes responses from private sector companies, NHS Trusts and Local Authorities.

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Firstly, respondents were asked to indicate on the questionnaire which size grouping they fell into; private sector companies (Private) had, on average, between 5,001 and 10,000 employees; NHS Trusts (NHS) between 2,001 and 5,000; and Local Authorities (LA) the same, between 2,001 and 5,000.

Secondly, the respondents were given an opportunity to identify the factors which were most likely to have influenced changes in organisational forms, in terms of: a merger or acquisition, demerger or a divestment, strategic alliance or partnership, increase in the number of departments, reduction in the number of departments, removal of managerial layers, and the introduction of a completely new structural form or model.

Lastly, all respondents identified the extent of a specialist MA function employed within their organisations (in 95% of private sector companies), as well as the extent of outsourcing which was similarly moderate in all.

Supply chain management
   A greater use of outsourcing by private sector companies had no significant impact on the ways in which the supply chain was managed. In the NHS, where change had been introduced, respondents indicated that staff had experienced a change in the nature of their jobs since outsourcing had been started. However, they were also rather cautious in thinking it important to try out small contracts with outsourcers, before getting tied in to long-term contracts. In local authorities, a change in organisational form was associated with administrative changes, for example, through the introduction of new cost centres. Long-term contracts with outsourcers were not thought to be restrictive, but LAs kept a close eye on them through regular financial reporting.

Effects of outsourcing
   There is little evidence to suggest that changes in organisational form, of the nature we have discussed above, have any great impact upon the development of accounting systems used within organisations. We chose, therefore, to investigate whether there was any significant correlation between the extent of outsourcing and subcontracting undertaken and the level of agreement with statements about changes in MA systems.

   The least impact seemed to be in private sector companies, where they were most likely to undertake outsourcing. However, they also had developed their own new techniques for accounting for outsourced contracts, and found that there had been changes in the types of decision for which MA was used. In both types of public sector organisations, new leadership or senior management was associated with changes in organisational form, increased outsourcing and subsequent impacts on management accounting.
Changes in management accounting
Traditional management accounting methods, such as net present value, discounted cashflow, breakeven analysis, payback and, especially, cost-benefit analysis, are still considered to be amongst the most important techniques available to the modern manager when considering issues such as outsourcing decisions.

The impacts of outsourcing that we might have expected to see on management accounting were not as great as anticipated overall, with the major effect being the introduction of new cost centres to account for the organisation’s outsourced activities, and to facilitate the monitoring of the organisation’s outsourcing suppliers.

2.1 Qualitative case analysis

2.2.1 FOOD UK

Background Information
- A major subsidiary of one of the largest international food companies in the world, FoodUK began its manufacturing activities in the late 1880s and now has about 12,000 employees with a turnover of £1.6 million and many of its products being household names.
- Prior to the 1990s, FoodUK had no function core supply chain, no customer services role was set up within the company, only a stock and order management group existed within distribution. As customer stocks tended to be relatively high, a few days delay in delivery were not thought to be serious, particularly in the case of ambient products, like many of those produced by FoodUK.
- Prior to the 1990s, FoodUK had no function core supply chain, no customer services role was set up within the company, only a stock and order management group existed within distribution. As customer stocks tended to be relatively high, a few days delay in delivery were not thought to be serious, particularly in the case of ambient products, like many of those produced by FoodUK.
- Following a very large acquisition by FoodUK in the early 1990s, a new Chairman was appointed, and among the changes he introduced was the setting up of a supply chain re-engineering team in order to look into ways to improve customer services.

Supply chain management
- The new supply chain function incorporated purchasing, logistics development, distribution, finance and customer service, thereby integrating both downstream and upstream activities into one function. Also, for each of the product divisions supply chain functions were established.
- A whole new way of monitoring customers’ shelves was also sought. Previously, once orders were delivered by FoodUK to customers, it was left to the customer to check product availability on their own shelves.
- Customers, however, are still pushing for more costs to be taken out of the supply chain by asking for more frequent deliveries at much shorter time intervals than previously. Informants in FoodUK find this particularly frustrating, given that the bulk of their products are ambient products with a long shelf life.

Effects of outsourcing
- In 2002, the newly appointed Director of the supply chain initiated focus on reducing costs rather than driving growth.
- The low profitability of many of the products was made worse by incessant customer drive to push costs up the supply chain. The customers’ drive for lower supply costs by carrying lower stock levels, however, led them to demand ‘just in time’ deliveries of smaller loads which also tend to be delivered on vehicles that carry less than full loads.
- Customers’ quest for holding lower stocks through securing just in time deliveries impacted on the cost structure of FoodUK factories which, without exception, operated with over-capacity and were fiercely competing against other factories within the Group to remain open by keeping unit production costs as low as possible. Customer pressure necessitates focusing upon long production runs, which undermined high production flexibility to meet just in time customer orders.

Changes in management accounting
- Until recently, separate functions existed for accounts receivables and credit control. The problem with this arrangement was that if prices were not set up on time or were not determined correctly queries were initiated by one of these two units and then the customer came back complaining of overcharges. A decision was taken in 2001 to group these two units into one function, commercial administration, but with a reduction of staff numbers by about 25%. This new department assumed responsibility for setting up prices, agreeing bonuses/discounts, overseeing credit control, and liaising with the sales staff by organising financial awareness programmes to highlight the financial consequences of their decisions.
2.2.2 TRUSTSTAR

Background information
- A large teaching NHS Trust Hospital in England attached to a prestigious university, it has an annual budget of over £170M, employs well over 5000 staff, and provides care for nearly half a million inpatients, outpatients and accident and emergency patients.
- Truststar had a financial deficit of a few million pounds. It was also involved in a major Private Finance Initiative (PFI) which was launched just before we began our interviews.

Supply chain management
- Our interviews uncovered three main types of outsourcing activities in which Truststar was involved: (1) building maintenance and housekeeping (the PFI concession agreement); (2) recruitment of nursing staff; and (3) surgical procedures. Each of these types of outsourcing was motivated by different kinds of pressure upon Truststar.

Effects of outsourcing
- The shift from external outsourcing (the private agency) to ‘internal’ outsourcing (NHSP) was not thought by Truststar staff to offer real savings and was possibly more costly. The rates stipulated by a government directive is to pay the nurse the grade plus two percent, and the NHSP then receives 7.5% fee from Truststar.
- The NHSP is seen as a more costly alternative to the private agency. To add to the cost of Truststar, while the abolition of the back-office was calculated to save about £17K per year, new monitoring will be required to manage the relationship with the NHSP. An additional source of extra cost was calculated to result from having to pay more to private agencies whenever the NHSP fails to provide nurses from its own pool and engages private agencies.

Changes in management accounting
- Accounting provides a host of information items to ensure that the process is managed appropriately. These include ensuring that the right number of patients is being outsourced and charged for, identifying their specialities, and the specific private hospital to which the patient is sent.
- For all this focus on cost control of outsourcing procedures, the real concern for Truststar has been its ability to meet waiting time targets, particularly in light of the initial low assessment of performance. When the private hospitals failed to meet breach days, the financial savings arising from free patient treatment offered little comfort to Truststar management. The problem with meeting these waiting time targets seems to emerge for two reasons; differences in the time-frames of the private hospitals and Truststar, and the relative power of the private hospitals compared to Truststar.

2.2.3 RETAIL UK

Background information
- One of the largest UK supermarket retailers, offering a diverse range of products including financial services, internet retailing, 24-hour hypermarkets, and more recently international expansion has placed it amongst the top ten global retailers.

Supply chain management
- In 2001 the stock management function was re-introduced, but as a supply chain function. The main difference from previous systems was that new management principles i.e. responsibility, accountability, consult and inform were now brought in.
- The supply chain was described by one of Retail UK’s senior directors as the ‘lifeblood of the whole business, bespoke, and one which we would never outsource’.

Effects of outsourcing
- Major outsourcing is of peripheral functions only, such as facilities management, catering and cleaning etc.
- Contrary to perceived wisdom (both in academic and practitioners circles), certain UK Retail respondents felt that outsourcing did not add to organisational flexibility, rather it was inflexible in that the organisation ended up in permanent contractual discussions with suppliers. Structured formal contracts did not exist and if service provider suppliers do not perform to standard, then those agreements are much more difficult to rectify than if the work had been retained in house.

Changes in management accounting
- While there is a central management accounting function, the majority of the information required for reporting is generated by non-accounting staff using standardised systems co-ordinating stock and sales. Such systems include, for example, an activity based costing approach rather than a more conventional resource-based approach. This change was introduced as it relates more accurately to financial costs, such as overheads, and ‘hidden costs’ in distribution and warehousing to the processes that generate such costs. This enables decision makers with the organisation at all levels to make the necessary improvements in working processes, as well as identifying specific product costs.
### 2.2.4 CARCO

**Background information**
- A long established multi-national automotive producer, with over £9 million turnover in 2000, and over 40,000 employed.
- It revised its business strategy in the 1970s, investing in total quality management, lean production management techniques, a systematic grading system introduced for individual suppliers, and outsourcing of complex, but non-core activities.

**Supply chain management**
- There has been an increase in the number of suppliers which are experiencing financial difficulties due to the level of competition, which is of some concern for Carco finance staff, particularly in situations where the company relies on one supplier for a part. The supply base has, therefore become more volatile due to the overall volatility of the supplier, mergers and acquisitions amongst the supply base and a change in the level of work that they are doing.

**Effects of outsourcing**
- In terms of outsourcing, Carco works to a cost-benefit time adjusted rate of 35% which amounts to 100% on most projects, given that they are typically on a pay-back period of three years. Parts are ‘segmented’ into those essential areas that need to be ‘line sequenced’ (i.e. supplied on a just in time basis) and those that are not (typically smaller parts) and which are thus sourced globally. The broad philosophy is thus to get the best in quality and functionality at the lowest cost and to achieve maximum efficiency at Carco’s car manufacturing plants.

**Changes in management accounting**
- The basic fundamentals of the accounting system, in relation to suppliers, have changed little in the past twenty years. However, there have been significant changes in the mechanism of accounting systems. There has been a decline in the traditional accounting function with far fewer staff involved as it is much less labour intensive. Much is now controlled centrally, which is in keeping with the Carco organisational philosophy, which is extremely centralised.

### 2.2.5 CHOCCO

**Background information**
- A major integrated producer and retailer of luxury confectionary, publicly listed yet retains a degree of family ownership. The corporate goal is to be the UK’s leading retailer and distributor of specialist sweets and foods.
- Chocco is now selling chocolate bars to all major retail chains in UK, under a different brand name to maintain Chocco brand’s ‘specialness’. Chocco expects sales to rise, as supermarket business is not seasonal, however this does pose logistical problems of controlling storage, distribution, and handling as it gets transferred to the retailers.

**Supply chain management**
- Supply chain management is relatively simple compared to the other case study organisations, given the degree of vertical integration. The organisation regards its product recipes as its ‘crown jewels’ and would be reluctant to give a third party manufacturer access to them.
- Key Performance Indicators (KPIs) for suppliers are delivery on time, supply output and responding to changing forecasts. These are important given that Chocco tends to keep zero stocks, especially on big items.

**Effects of outsourcing**
- Chocco outsource its information technology (IT) function in its entirety. However, as Chocco cannot afford to pay Compuco for 24-hour coverage, this results in delays and expensive equipment lying idle.
- The outsourcing of IT has posed considerable problems for the accounting function as Compuco does not provide itemised bills, some items of which can be claimed back for tax purposes. Chocco finance functions’ workload has thus dramatically increased directly as a result of the outsourcing of IT. In addition, new staff has had to be employed.

**Changes in management accounting**
- In Chocco’s core management accounting entries and statements, manufacturing and distribution activities are all cost-centre controlled. A standard costing framework is employed and activity-based measures have been used for the past two years instead of gross margin as was previously used.
- Chocco uses internal historical performance indicators to seek cost cutting either by machinery investments or alternative labour deployment measures as opposed to bench-marking against other chocolate producers as these producers manufacture huge volumes of standard products. Discounting only occurs to shift surplus stock after the Christmas and Easter peaks, but strategy like this is neither the norm nor the prime driver of sales in Chocco.
3. Conclusion
Challenges to the traditional form led to advocates of change to call for flatter, more flexible and less hierarchical new organisational forms. Our research results on new organisational forms, from the questionnaire survey and case studies, point to evolutionary, or incremental change, rather than revolutionary or transformational change.

The questionnaire surveys indicate that the greatest changes are in public sector organisations and in particular the NHS. The case studies had all experienced dramatic changes, albeit fairly gradual and over a relatively extended time period.

The supply chain as well as the outsourcing functions has become increasingly important. Largely, non-core service contracts, such as cleaning, catering and maintenance, but also computing, IT, recruitment and training have been outsourced to save money by lowering costs and, to a lesser extent, to concentrate on core activities and to increase flexibility, quality and access to specialist skills.

Changes in the adoption of new management accounting techniques have been gradual, in for instance use of KPIs and the Balanced Scorecard. The majority of management accounting techniques being utilised are traditional ones e.g. cost-benefit analysis, net present value, payback, discounted cash flow, however these have changed markedly in all the organisations.

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Other literature generated from this research project
Organisational change, outsourcing and the impact on management accounting
CIMA (The Chartered Institute of Management Accountants) represents members and supports the wider financial management and business community. Its key activities relate to business strategy, information strategy and financial strategy. Its focus is to qualify students, to support both members and employers and to protect the public interest.

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