

Research proposal

The role of management control systems in a strategic change situation

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Abstract

The term “Strategic management accounting” (SMA) arrived into management accounting literature over 20 years ago. The debate about what SMA really is originated in the 1980s and it has been going on ever since. The accounting literature emphasizes the role of management control system as an organizational mechanism that supports strategic change but the empirical research about topic is still scarce. As Ahrens & Chapman (2007, 2) point out the organisational members know the limitations of accounting and reporting practices but they draw on them when making decisions. So accounting can potentially make significant contributions to the ways in which organisations coordinate action. The objective of this study is to examine the role of management control systems in a strategic change situation and to define the consequences of using management control systems in the strategic change situation. The study uses Simons (2000) classification of different types of control systems: diagnostic control systems and interactive control systems. The concept of strategy is based on the thoughts of the positioning school, which uses Porter’s (1996) and Kim & Mauborgne’s (2004) definition of strategy. The study will take a practice-based view using a practice theory approach and institutional theory. The empirical evidence will be collected from two to three Finnish case-companies. The researcher has gained a preliminary access to one Finnish company. The company is a global operator in the log home business.

Key words: management control systems, strategic management accounting, practice theory, institutional theory, strategic change

1. BACKGROUND

1.1 Strategic management accounting

Since the 80s a new term has arrived into management accounting literature. “Strategic management accounting” (SMA) (Simmond 1981). In the following decades a debate about what SMA comprises has been originated. It is accepted that SMA is identified as a generic approach to accounting for strategic positioning (Roslender & Hart 2003). CIMA (2002, 50) gives the definition about strategic management accounting saying that it is a form of management accounting in which emphasis is placed on information which relates to factors external to the firm, as well as non-financial information and internally generated information. Nilsson & Rapp (1999, 65) see that strategic management accounting is one of the two lines of research to study management control systems from a strategic perspective. A particular feature of this school is the emphasis on the idea that management control systems should provide information on the cost structure, product markets and strategies of a firm’s competitors.

SMA may be viewed as an attempt to integrate insights from marketing management and management accounting within a strategic management framework (Roslender & Hart 2003). The literature suggests that strategic management accounting (SMA) should incorporate strategic product costing and performance measurement, analyses of the firm’s product markets and competitive market forces, and the assessment of organisational strategies over extended periods of time. (Hornngren, Datar, Foster 2003, 790)

Bromwich (2001) sees SMA as going beyond collecting data on businesses and their competitors, to considering the benefits that products offer to customers, and how these benefits contribute to building and sustaining competitive advantage. One intent of Strategic management accounting might therefore be to determine the cost of providing product features to consumers given operating conditions which continuously seek improvement (Hornngren et al 2003, 791). Strategic management accounting is used also as an umbrella term to include various approaches (see the figure 1.)

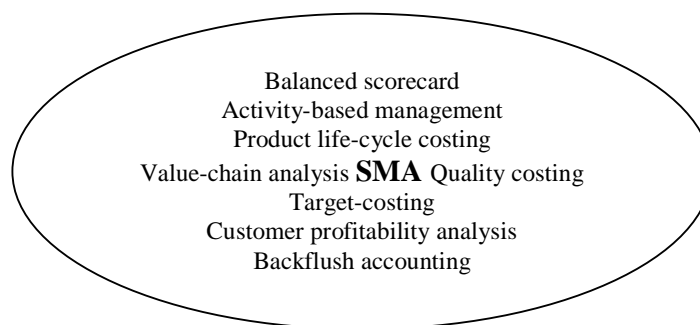


Figure 1. Dimensions of Strategic management accounting (SMA) (Hornngren 2003, 791-806).

Strategic management accounting is specific to the extent that it connotes the integration of external with internal financial and non-financial information. It includes cost management approaches such as life-cycle costing, value-chain analysis, target costing, activity-based management, quality costing and balanced scorecard among others. So it should not come as a surprise that SMA is

deployed in some organisations in ways that are highly enterprise specific. (Horngren et al 2003, 806)

It has been claimed that strategic management accounting is one of new management accounting techniques with activity-based costing and balanced scorecard which has been developed largely by practitioners within their own organisations. The role of researchers has tended to be one of reporting the techniques through case studies of innovative practices, and then refining the practices for more general use. In this refining process it is possible to discern some elements of the normative approach of management accounting's conventional wisdom. (Ryan et al 2002, 91)

1.2 The role of management control systems in the strategic change situation

The accounting literature emphasizes the role of management control system as an organizational mechanism that supports strategic change (e.g. Dent 1990, Nilsson & Rapp 1999, Simons 1995), but empirical studies have not addressed the way in which management uses the management control system to engage in strategic change directly. A notable exception is a number of interpretative case studies (e.g. Abernethy & Chua 1996, Ezzamel, Lilley & Willmott 2004) A reason for this lack of evidence is that studies on the management control system-strategy relationship have typically modelled strategy as a determinant of management accounting system, rather than as consequence of the management accounting system (Naranjo-Gil & Hartmann 2006, 2). However Luft and Shields (2003, 200) point out that management accounting is not easily classified as only a dependent or only an independent variable – it tends to be implicated in a more complex way in the unfolding of events as both cause and effect of changes.

A number of researchers (Hopwood 1987, Dent 1990, Argyris 1990, Hedberg & Jonsson 1978) have provided strong theoretical support for the idea that management accounting systems can serve an active role in shaping organizational change. There is, however, little broad-based empirical research examining the topic. Ahrens & Chapman (2007, 2) see that members in an organisation know the limitations of accounting and reporting practices but they draw on them when example pursue different objectives. So accounting can potentially make significant contributions to the ways in which organisations coordinate intentional action.

According to Simons (2000, 208) to understand how to communicate and control strategy effectively, it is important to differentiate between two different types of control systems: diagnostic control systems and interactive control systems. Managers rely on both types of systems, but for different purposes. Diagnostic control systems are used as levers to communicate critical performance variables and monitor the implementation of intended strategies. Interactive control systems are used to focus organizational attention on strategic uncertainties. The distinction between these systems is solely in the way that managers use these.

In the article "*What is Strategy?*" Porter (1996) differentiates the operational effectiveness and strategy saying that operational effectiveness is not strategy. Both are essential to superior performance but they work in very different ways. Operational effectiveness means performing similar activities better than rivals perform them. In contrast, strategic positioning means performing different activities from rivals or performing similar activities in different ways. (Porter 1996, 62) Kim & Mauborgne (2004) mean a little same when they say that the business universe consists of two distinct kinds of space, which we think of as red and blue oceans. Red oceans represent all the industries in existence today. In red oceans industry boundaries are defined and accepted, and the competitive rules of the game are well understood. Companies try to outperform

rivals in order to grab a greater share of existing demand. As the space gets more and more crowded, prospects for profits and growth are reduced. Products turn into commodities, and increasing competition turns the water bloody. In blue oceans, demand is created rather than fought over. Two ways to create blue oceans by companies are to give rise to completely new industry or to create the blue ocean within a red ocean when a company alters the boundaries of an existing industry. (Kim & Mauborgne 2004, 77)

The traditional units of strategic analysis, company and industry – have a small explanatory power when it comes to analyzing how and why blue oceans are created. The same company can be brilliant at one time and wrongheaded at another. Likewise, relative attractiveness of industry is driven largely by the creation of blue oceans from within them. The most appropriate unit of analysis for explaining the creation of blue oceans is the strategic move – the set of managerial actions and decisions involved in making a major market-creating business offering. The creation of blue oceans is a product of strategy and as such is very much a product of managerial action. (Kim & Mauborgne 2004, 81)

2. THE PURPOSE OF STUDY AND RESEARCH QUESTIONS

Research objective is the evidence of the researcher's clear sense of purpose and direction. The objective of study is likely to lead to even greater specificity than the research questions. (Saunders, Lewis & Thornhill 2003, 25)

The study examines the role of management control systems in the strategic change situation and defines the consequences of using management control systems in the strategic change situation.

The next figure (Figure 2) tries to clarify the framework of the study. The aim is to analyse the role of management control systems in the strategic change situation using Simons (2000) classification of different types of control systems: diagnostic control systems and interactive control systems. The view about strategy is based on the thoughts of the positioning school and uses Porter's (1996) and Kim & Mauborgne's (2004) definition of strategy. By answering the questions how management accounting systems are used in organizations in a strategic change situation and the consequences of that the study tries to find out the existence of strategic management accounting.

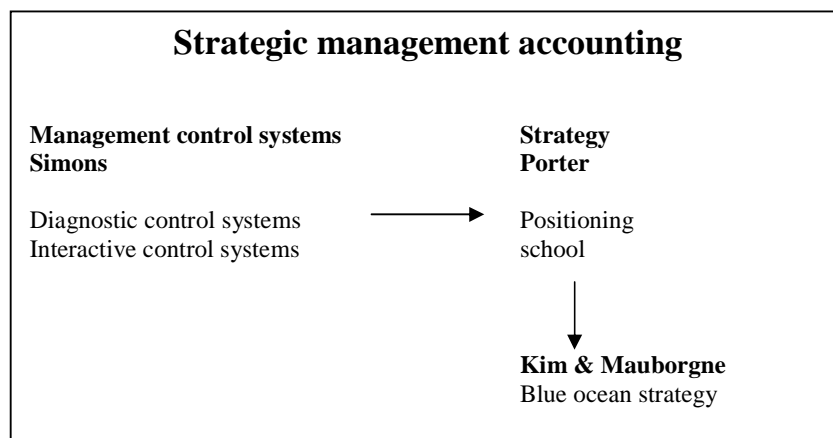


Figure 2. Framework of study

It is often a useful starting point in the writing of research questions to begin with one general focus research question that flows from the research idea (Saunders et al. 2003, 24). The aim of this research is to answer the question:

Can we say that strategic management accounting really exists?

A general research question may lead to several more detailed questions or to definition of research objectives (Saunders et al. 2003, 24). The additional research questions are:

How management accounting systems are used in organizations facing strategic change?

What are the consequences of using management accounting systems in a situation of strategic change?

Nilsson & Rapp (1999) analysed how the Swedish toolmakers, Sandvik Bacho have designed and used their management control system at the management and operational levels to implement the differentiation strategy. At the management level the effect of the control systems has been to reduce the uncertainty arising from the differentiation strategy. At operational level the effect of the control systems has been to determine the frameworks for operations without reducing the opportunities for personal initiative. They emphasize that in future control system should be able to collect more comprehensive information and be highly adaptable. Abernethy & Brownell (1999) study the performance effects of the alignment of management accounting system with strategic change. They define strategic change as the “extent to which a firm is moving along the prospector-defender continuum”, regardless of the direction of strategic change. This view seems to contradict with results in the majority of studies on the management accounting system-strategy relationship (e.g. Abernethy & Guntrie 1994, Langfield-Smith 1997, Simons 1987).

3. METHODOLOGY

3.1 Qualitative field (case) study research

Case study research is quite common in accounting research, especially in management accounting. Case studies offer the possibility to understand the nature of accounting in practice. A case study usually means a single unit of analysis. This might be a company or other form of organization, but it could also be a more aggregated unit of analysis. (Ryan et al 2002, 142) It is argued that case studies are particularly appropriate in areas where theory is not well developed (Ryan et al 2002, 149). The term “fieldwork” is often used in connection with case study research. Both are used to refer to studies of accounting in its practical settings. In the social sciences, fieldwork is usually taken to mean studies of social practices in the field of activity in which they take place. In accounting, field work can be a study of a single organization or a number of organizations. (Ryan et al 2002, 142-143) Ahrens & Chapman (2006, 821) says that qualitative field studies *collect data in the domain “field” and employ “qualitative” methodology.*

The field (or case) study research is a useful method in the study at hand because it offers the possibility to understand accounting in practice. Strategic management accounting is a highly enterprise specific concept. Field studies are also particularly appropriate in areas where theories are not well developed. Though a number of researchers have provided strong theoretical support for

the idea that management control systems can serve an active role in shaping organizational change the empirical studies have not addressed the relation directly.

Selecting the case or set of cases depends (at least partly) on the methodological perspective. The issues involved in selecting cases in the case of theoretical generalizations should reflect the needs of theory development, rather than statistical analysis. The case company can be defined as a “critical case” or an “extreme case”. The objective of critical case study is to determine whether the theory provides good explanations, or whether alternative explanations need to be developed. If the researcher wants to extend a theory to cover a wider range of circumstances, it may be appropriate to select an extreme case. (Ryan et al 2002, 151)

The multiple case studies can be used for two purposes – replication and theory development. A number of similar cases might be selected to replicate the theoretical explanations. Alternatively, dissimilar cases may be selected to extend the theory to a wider set of circumstances. The objective of multiple cases is to develop a rich theoretical framework, capable of explaining a wide range of circumstances. (Ryan et al 2002, 152) In this study the aim is to select the companies from different branches of industries. There are two reasons to this. First, the researcher wants to extend the theory to wider circumstances using companies from different industries. Second, the gaining of access will probably be easier when the companies operate in different branches of industries. In the study at hand empirical data will be collected from two to three case companies. The researcher has gained a preliminary access to one Finnish company. The company is a global operator in the log home business.

In reading case studies it is important to identify the research methodology being used because case studies are a research method, not a methodology. The role of case studies can be different in different methodologies. (Ryan et al 2002 150)

3.2 Theory building from case study research (Grounded theory)

Eisenhardt (1989, 548) see that theory building case study research is particularly useful if the phenomenon is quite new and little is known about it, current perspectives seem inadequate because they have little empirical substantiation, or they conflict with each other of common sense. Sometimes, findings in the theory-testing study suggest the need for a new perspective.

The theory building from case studies could be a useful methodology because strategic management accounting is an umbrella term that includes various approaches (eg. life-cycle costing, value-chain analysis, target costing and activity-based management). The use of these various methods is very enterprise specific, which means that the term strategic management accounting varies relative to the context.

Grounded theory is a methodology for generating theory originally developed by two sociologists, Barney Glaser and Anselm Strauss. Grounded theory is a bottom up approach such that the specifics of data produce the generalizations of theory. (Parker & Roffey 1997, 213) The typical character of grounded theory is low level of prior theorization. Avoidance of prior commitment to a particular theory before entering the field stands in marked contrast to critical theory informed research. (Parker & Roffey 1997, 216).

3.3 The research methods

Specific research methods (interview, observation or questionnaire) can be used for different methodologies. The management accounting literature contains a number of multi-method field studies combining questionnaires and interviews. (Ahrens & Chapman 2006, 822). The research interview is a general term for several types of interview. Interviews may be highly formalised and structured (structured interviews), using standardised questions or they may be informal and unstructured conversations (semi-structured or unstructured interviews). (Saunders et al 2003, 246) Semi-structured and unstructured interviews are used in qualitative research in order to conduct discussions not only to reveal and understand the “what” and the “how” but also to place more emphasis on exploring the “why”. (Saunders et al 2003, 248)

Qualitative field studies hold greater potential for open-ended interaction between the researcher and researched. The researcher has less control over the researched, but has the opportunity to learn from their unprompted actions. This means that researcher can never exclude an observer effect. (Chapman 2006, 825) Observation involves the systematic observation, recording, description, analysis and interpretation of people’s behaviour. The observation is particular useful if the research questions and objectives are concerned with what people do because it helps to discover this by watching them when they do it. Saunders et al (2003, 221) examines the two different types of observation: participant observation and structured observation. Participant observation is qualitative and emphasizes discovering the meanings that people attach to their actions. By contrast, structured observation is quantitative and is more concerned with the frequency of actions. Researcher’s aim is to use interviews and participant observation as the means of gaining information from the research sites. The use of questionnaires as a means of collecting information from the research sites is also possible. A broad literature review will be included in the research.

Qualitative field studies must achieve “fit” between theory, methodology, hypothesis, method, and domain in order to contribute to the literature. Fit indicates a successful conclusion of the process. A good study is the outcome of ongoing theoretical repositioning together with redefinitions of the concepts used within qualitative methodology, the development of new and discarding of old hypotheses, changes to the method, and redrawing of the boundaries of the field. (Ahrens & Chapman 2006, 827)

4. THEORETICAL BACKGROUND

In the case studies theories are used to explain observations (Ryan et al 2002, 149). Explanation often happens with reference to multiple theories (Ahrens & Chapman 2006, 823). Existing theory assist case study researcher to identify appropriate hypotheses from the case study. Case studies seek to apply theories in new contexts. The theory is likely to be refined and/ or modified and through this process the theory is generalized. Such a process could be described as theoretical generalization. (Ryan et al 2002, 149-150) There are two forms of theoretical generalization. In the first, case studies in new or different contexts are used to generalize the theory to a wider set of contexts. In the second, theory is used to extend the applicability of the case study findings to other contexts. (Ryan et al 2002, 149)

Llewelyn (2003) suggests five levels of theorizing in qualitative management and accounting research:

Level 1. Metaphor theorizes

Level 2. Differentiation theorizes

Level 3. Concepts theorizes

Level 4. Theorizing settings = context-bound theorizing (*practice theory, institutional theory*)

Level 5. Theorizing structures = context-free theorizing (*structuration theory as part of institutional theory Dillard et al 2004*)

Metaphor theorizes creates meaning and significance through “picturing” or “image-ing” the world. Categorization or differentiation underlies peoples understanding and experience of social life (Llewelyn 2003, 670-671). Johnson & Kaplan (1991) the relevance lost/relevance regained was pivotal in theorizing the demise and rebirth of management accounting. The introduction of new concepts and the refinement of the senses of existing ones both happen through “level three” theorizing. New concepts reflect different ways of thinking and acting in the world. The research of how people experience a sense of accountability is example from accounting field level three theorizing. (Llewelyn 2003, 672) Context-bound theories offer an understanding of the settings for experience. They create meaning and significance through explaining relationships between phenomena. Examples about context bound theories are example contingency theory, systems theory, institutional theory, agency theory and so on. Grand theory is concerned with structural, impersonal, large-scale and enduring aspects of the social realm. (Llewelyn 2003, 675-676)

4.1.1 Practice theory

Ahrens and Chapman (2007, 2) see that accounting cannot be understood simply with reference to its supposed functional properties because it is implicated in the shaping of its own context. Accounting and organisational objectives are interdependent. The emphasis on accounting as a social and not equally strategic and commercial technology has left an important gap in understanding of the interconnections between accounting and other organisational practices. (Ahrens & Chapman 2007, 3). Ahrens & Chapman (2007) introduce the practice theory in order to attempt to fill this gap. The practice theorists have been concerned to reflection the ways in which action relates to aspects of context (seen as a system political, economic, cultural or technological). When the management control is seen as practice the greater prominence is given to the construction and functioning of managerial intent and some of the ways in which they relate to the situated functionality of accounting. (Ahrens & Chapman 2007, 8-9)

In the practice theory a management control system is seen as a bundle understood as management control practices plus material and technical arrangements. According to practice theory the actions are organised around practical understandings, rules and engagements. The perceived usefulness of management control practices and systems is of paramount importance for researching management control and management accounting more generally. (Ahrens & Chapman 2007, 10)

The practice theory could be a particularly useful theory to study the existence of strategic management accounting because it recognizes the importance of organisational practices to accounting. Using the practice theory strategic management accounting can be understood as an umbrella to include various accounting practices. Strategic management accounting is developed largely by practitioners that also support the idea.

4.1.2 Institutional theory

Institutional theory is becoming one of the dominant theoretical perspectives in organization theory and is increasingly being applied in accounting research to study the practice of accounting in organizations. Institutional theory is a way of thinking about formal organization structures and the nature of the historically grounded social processes through which these structures develop. Institutional theory is primarily concerned with an organization's interaction with the institutional environment, the effects of social expectations on the organization, and the incorporation of these expectations as reflected in organizational practices and characteristics. (Dillard, Rigsby & Goodman 2004, 506-508) Dillard et al. (2004) propose a social theory based framework for grounding and expanding institutional theory to more fully articulate institutionalization processes. They incorporate institutional theory and structural theories to develop a theoretical framework useful for the better understanding of institutions, accounting practices and change processes.

The accounting literature contains institutional theory based studies addressing various accounting practices. These studies provide evidence suggesting the importance of social culture and environment on the practice of accounting (see example Burns 2000, Collier 2001, Scapens 1994). However a little consideration is given either to the processes whereby institutional practices are established, transposed and decomposed or the socio-economic and political context that constitutes the framework for these organizational processes. Another limitation of institutional theory concerns the role played by power, special interests and the political nature of organisations. (Dillard et al 2004, 507) Because of these limitations Dillard et al. (2004) propose expanding institutional theory, so that it provides a comprehensive conceptual basis for investigating the practice of accounting in organizations. The resulting framework outlines a dynamic social context within which the processes of institutionalization, transposition and deinstitutionalization take place and within which radical as well as incremental change can be addressed. As a result, changes in accounting practices and the influence of these practices on institutional and organizational change can be understood. (Dillard et al. 2004, 507)

Dillard et al. (2004) expand the idea of institutional theory to include the institutionalization processes. By incorporating institutional theory and structural theories it is possible to better understand example accounting practices and change processes. The purpose of this study is to examine the role of management control systems in the strategic change situation and to define the consequences of using management control systems in the strategic change situation. The purpose of the study supports Dillard's et al. (2004) idea to expand the institutional theory to include a dynamic social context where radical as well as incremental change can be addressed. As a result of the study the influence of accounting practices on institutional and organizational change can be understood.

4.2 The central concepts in the study

4.2.1 Management control systems

A management control system is a means of gathering and using information to aid and coordinate the process of making planning and control decisions throughout the organisation and to guide employee behaviour. (Horngren, Bhimani, Datar & Foster 2005, 639) Simons (1995, 4) says that management control systems are the formal, information-based routines and procedures managers use to maintain or alter patterns in organizational activities. Simons (1995) is concerned primarily with formal routines and procedures (plans, budgets, and market share monitoring systems).

Information-based systems become control systems when they are used to maintain or alter different patterns (eg. goal-oriented activities or patterns of unanticipated innovation) by managers (not the control systems used lower level in organization eg. quality control procedures)

According to Simons (1995, 153) the control of business strategy is achieved by integrating the forces of belief systems, boundary systems, diagnostic control systems and interactive control systems. Beliefs systems are the explicit set of organizational definitions that senior managers communicate formally and reinforce systematically to provide basic values, purpose, and direction for the organization (Simons 2000, 276) Boundary systems are explicit statement embedded in formal information systems that define and communicate specific risks to be avoided. (Simons 2000, 764) Diagnostic control systems are the formal information systems that managers use to monitor organizational outcomes and correct deviations from preset standards of performance (Simons 2000, 209) Interactive control systems are the formal information systems that managers use to personally involve themselves in the decision activities of subordinates (Simons 2000, 216).

4.2.2 Strategy

There is no single, universally accepted definition of strategy (Hornngren et al 2003, 787). Some management theorist view strategy in terms of how it is supposed to be according to them (the prescriptive or normative approach) while others prefer to explore how strategies arise in organisations (the descriptive approach). The prescriptive approach has tended to dominate writings on the design of strategic management accounting systems and techniques and it has been useful in explaining the process by which such techniques emerge and are operationalised. Porter (1996, 68) says that strategy is the creation of a unique and valuable position, involving a different set of activities. Strategy means also making trade-offs in competing because the essence of strategy is choosing what not to do (Porter 1996, 70). At last the strategy is creating fit among a company's activities. The success of a strategy depends on doing many things well – not just a few and integrating among them. (Porter 1996, 75)

The origins of the term strategy go back to ancient Greece whereby strategos signified the role of a general in command of an army. (Hornngren et al 2003, 787). Some modern management writers have maintained emphasis on militaristic notions of the term to identify essential dimensions of strategy. (Hornngren et al 2003, 787) This perspective has been particularly influential in a number of strategic management accounting writings (Shank & Govindarajan 1993, Simmonds 1981, Simmonds et al 1997) Adopting this view, strategy is described in terms of how an organisation matches its own capabilities with the opportunities in marketplace in order to accomplish its overall objectives. (Hornngren et al 2003, 787)

Kim & Mauborgne (2004, 80) gives a critic to this military based definition of strategy. They see that most companies seem becalmed in their red oceans partly because the corporate strategy is heavily influenced by its roots in military strategy. “Described this way, strategy is all about red ocean competition.” Blue ocean strategy, by contrast, is about doing business where there is no competitor. It is about creating new land, not dividing up existing land.

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