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Accounting measurement tools and their impact on managerial decision making

By Yuval Millo, Emily Barman and Matthew Hall

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The rise of Shareholder Value has received attention from sociologists (e.g. Zorn 2004), but in the last few years, there has been growing concern in the public sphere about the presence and visibility of stakeholders. This shift calls for a more sociologically-informed look at dynamics related to stakeholders. According to stakeholder theory, a key task of managers is to manage the relations between the firm and its various stakeholders, such as customers, employees, suppliers, shareholders, government, and local communities, in ways that improve matters for all salient stakeholders (Crilly and Sloan, 2013; Donaldson and Preston, 1995; Freeman, 1984; Freeman et al, 2007; 2010; Jawahar and McLaughlin, 2001). In spite of the centrality of this process, little is known about how the voices of salient stakeholders are incorporated into a firm’s accounting and reporting system. This gap in the literature is critical because the goal of managing the firm to create value for salient stakeholders cannot be realized without translating those ideas into reliable, systematic, and accountable measurements (Freeman et al., 2010). Value creation for stakeholders thus requires managers to develop an accounting and reporting system to collect and communicate information about a range of stakeholder interests (Pruzan, 1998).

The literature shows, however, that the development of an accounting and reporting system that incorporates salient stakeholders requires extensive effort. Its success is dependent upon managers possessing adequate expertise and resources (Ahrens and Chapman, 2004; Henri, 2006; Mouthen and Larsen, 2005; Wouters and Wilderom, 2008). As such, in this study we examine how managers’ attention to salient stakeholders becomes represented in and communicated by a firm’s accounting and reporting system. Specifically, we pose two research questions: How do managers develop an accounting and reporting system to reflect their prioritization of stakeholders? What factors influence managers’ ability to construct an accounting and reporting system to incorporate the voices of salient stakeholders?

To address these research questions, we study the development of ‘Social Return on Investment’ (SROI), an accounting methodology that aims to measure and report on the benefits created for stakeholders by social purpose organizations, such as social enterprises. In each of the two settings we investigate – the United States and the United Kingdom – SROI was developed as an attempt to overcome existing organizational deficiencies by incorporating stakeholders’ voices into the firm’s accounting and reporting system and, crucially, by demonstrating the benefits created by the firm back to its stakeholders. The SROI methodology calculates a ratio of the organization’s costs relative to the monetized benefits gained by different stakeholders from the organization’s activities. Yet, we find that despite similarities in its basic calculative procedure, a comparison of the US and UK cases reveals important differences in how managers’ prioritization of stakeholders was reflected in the formulation of the SROI methodology in each setting, including the range of stakeholder worldviews and expertise incorporated in the SROI calculation and the way those stakeholder interests were represented.

To explain these differences, we develop a theoretical framework to show how the prioritization of stakeholder voices in the development of an accounting and reporting system is shaped by both the epistemic beliefs held by managers, especially their understandings of the type of knowledge that is valid or acceptable, and by the material conditions of the organization, in particular, the amount and type of resources – technical and material – at the managers’ disposal. The findings show that in order for managers to succeed in incorporating stakeholders’ voices and improve value creation, they must develop and implement a relevant accounting and reporting system. Our study of SROI, and the theoretical framework we develop, indicates that understanding stakeholder value creation requires attention not only to how certain stakeholders are recognized as salient to the firm, but also to the changes to accounting and reporting systems that underpin the
process through which stakeholders’ voices are incorporated into managerial practices.

**Theoretical framework: accounting for salient stakeholders**

Limited attention has been given to how managers incorporate the voices of stakeholders into organizational practices (Neville et al., 2011; Parent and Deephouse, 2007). This discrepancy exists even though over-arching ideas about stakeholder engagement cannot be usefully adopted in managerial practice without the development of reliable, systematic ways of translating those ideas into accountable measurements (Freeman et al., 2010). The development of an accounting and reporting system to collect and communicate the social and ethical dimensions of organizational activities is a precondition for effective stakeholder engagement (Pruzan, 1998), manifest in approaches such as social auditing, social accounting, sustainability reporting, and triple bottom-line accounting (Freeman et al., 2010; Greenwood, 2007).

We explore two dimensions where accounting is directly involved in the process of stakeholder management: “listening” to stakeholders and “talking” to stakeholders. First, an accounting and reporting system typically forms a central avenue of communication through which managers in the organization are informed about a variety of stakeholder interests and, ultimately, affects how managers form their views about what needs to be done in the organization (Burchell et al., 1980; Chapman, Cooper and Miller, 2009; Miller and Power, 2013).

Second, an accounting and reporting system is a central means for communicating information about organizational activities “back” to stakeholders, and as such plays a critical role in how stakeholders perceive the organization and its activities, thus increasing the potential to create value for stakeholders (Cooper and Owen, 2007; Freeman et al., 2010; Zadek et al., 2013; Chapman, Cooper and Miller, 2009; Hines, 1988). Scholarship has demonstrated, however, that an accounting and reporting system necessarily reflects managerial decisions about what aspects of the firm and which stakeholders are to be “counted” and which are not (Gray et al., 1997). For example, accounting reports focusing only on the financial activities of the organization may exclude activities that are important to stakeholders, but have little recordable financial footprint (Gray, 2002; Gray et al., 1995), such as changes to air quality, for example, as a result of installing a new filtering system in a chemical plant. As such, we examine the process by which managers develop an accounting and reporting system to include stakeholders’ voices and we delineate the causal factors enabling and constraining managers in that effort. We highlight the importance of the content of managers’ epistemic beliefs and differences in the material conditions in and around the organization in determining how the voices of some stakeholders but not others get incorporated into an accounting and reporting system and, ultimately, into firms’ management of stakeholders for value creation.

**Managers’ epistemic beliefs**

Stakeholder theory has emphasized the critical role of managers’ decisions in how firms select stakeholders for their attention, alongside the objective characteristics of stakeholders’ claims, including their power, urgency and legitimacy (Buysse and Verbeke, 2003; Crilly and Sloan, 2012, 2013; Mitchell et al., 1997). Key determinants of how managers prioritize some stakeholders over others include managers’ cultural frameworks, such as their personal values (Egri and Herman, 2000), their intuition (Harvey and Schaefer, 2001; Henriques and Sadorsky, 1999), managers’ perceptions of the firm’s environment (Crilly and Sloan, 2012), the managers’ role and location in the organization (Parent and Deephouse, 2007), and the effect of the broader organizational culture or the firm’s dominant institutional logic on managers’ decisions regarding stakeholders (Bundy, Shropshire, and Buchholtz, 2013; Mitchell, Agle, Chrisman, and Spence, 2011).

We augment this literature by suggesting that the inclusion of specific stakeholder voices in an organization’s accounting and reporting system is shaped by the specific epistemic beliefs held by its managers. Epistemic beliefs are actors’ assumptions and understandings regarding the source and nature of knowledge and can relate to views on the certainty of knowledge, how it is organized, and the extent of control an individual has over it (Schommer, 1990; Schommer-Aikins and Hutter, 2002). Epistemic beliefs have been shown to influence comprehension and educational processes (Schommer, 1990), as well as playing a role in leadership behaviors, workplace learning and moral reasoning (Bauer et al., 2004; Mintchik and Farmer, 2009; Tickle et al., 2005). Informed by these insights, we focus specifically on how the incorporation of stakeholder voices in an accounting and reporting system is shaped by managers’ epistemic beliefs regarding the type and forms of information they consider valid and appropriate.
The materiality of accounting and reporting systems

Accounting has an inherent material dimension, as to perform accounting it is necessary to create and establish data collection systems, databases, and associated reporting processes (Balogun, Jacobs, Jarzabkowski, Mantere, and Vaara, 2014; Bechky, 2003; Boudreau and Robey, 2005). In particular, accounting research has shown that expanding the set of stakeholder voices reflected in a firm’s accounting and reporting system requires the establishment of new practices to collect information not captured by bookkeeping oriented strictly at financial information (Zadek et al., 2013). We expect, thus, that as managers attempt to include the voices of salient stakeholders in their accounting and reporting system in order to improve the firm’s capacity to create value, they will draw from their particular epistemic beliefs on what information is considered valid and/or credible. At the same time, as managers consider the desirable forms of information collection, aggregation and distribution, they will encounter (or realize they may need to develop) specific material arrangements, such as data systems and reporting formats, which require adequate technical expertise and financial support at the level of the firm and its members. We expect that this process will result in the selection of some salient stakeholders, but not others, for inclusion and representation in the firm’s accounting and reporting system.

Findings

We find that, in the case of the US, the epistemic beliefs of the managers at REDF and the material conditions in which they operated led to a prioritization of funders and government agencies as salient stakeholders in SROI over other potential stakeholders, such as the beneficiaries of social enterprises. In contrast, in the UK, different epistemic beliefs and different material conditions meant SROI was changed to prioritize perceptions of value from multiple stakeholders, including government agencies, beneficiaries, staff, and community members, and thus paid attention to and communicated the value of social enterprises to a wider assortment of stakeholders.

To explain this variation, we trace two organizational processes framing managers’ decisions to alter the existing accounting and reporting system in order to ensure different stakeholder prioritization (see Table 1 for an overview). First, we examine the events in which managers realized the existence of mismatches between the type and quality of information they had collected and reported on to stakeholders and the type and quality of information (and presentation format) they believed would bring about a more responsive engagement with and communication of the firm’s value to stakeholders. Second, following this realization, we examine events whereby managers attempted to develop a new accounting and reporting system for collecting, aggregating, calculating and reporting the necessary information. In this process, managers’ decisions about the new accounting and reporting system, in the form of SROI, were shaped by their epistemic beliefs about what counted as valid and appropriate data to be included in the accounting and reporting system and by the material conditions of their setting, including the nature of managers’ technical knowledge and the firm’s resources.

See appendix, table 1

Discussion

Our study shows that the development of SROI in both the US and UK settings was influenced by managers’ epistemic beliefs – their cognitive understandings of the type of knowledge that is valid or acceptable to use in organizational practices – and the organization’s material conditions – the amount and type of resources, technical and material, at the managers’ disposal. The findings point at two important consequences. First, the process we examine influenced which stakeholder voices were included in the accounting and reporting system (e.g., only direct beneficiaries vs. variety of stakeholders). Second, for those stakeholders included in the accounting and reporting system, it influenced the form and type of data used to represent stakeholder voices (e.g., a set of pre-specified and standardized indicators vs. the organic development of indicators based on stakeholder input). We formalize these findings in the development of two propositions emerging from our analysis:

Proposition 1: The prioritization of stakeholder voices in an accounting and reporting system (such as which stakeholder voices are included and the way those voices are represented and measured), is shaped by managers’ epistemic beliefs (such as what counts as valid and appropriate data).

Proposition 2: The ability of managers to develop an accounting and reporting system, consistent with their epistemic beliefs, is shaped by the organization’s material conditions (such as the nature of existing data collection and
reporting systems, access to financial resources, and access to necessary labour and expertise).

Our study contributes to existing understandings of the roles accounting and reporting systems play in the process of firms’ value creation. The fact that managers sought to adapt the accounting and reporting system in order to better communicate with salient stakeholders resonates with the connection that stakeholder theory identifies between the collection, measurement and communication of information about important dimensions of organizational activity and effective stakeholder engagement (Freeman et al., 2010; Pruzan, 1998). In our case, the managers in both the US and UK settings viewed their engagement with salient stakeholders as deficient because of an unsuitable accounting and reporting system, which hindered their attempts to communicate effectively. It indicates that to understand better the organizational processes through which managers in both for-profit and non-profit firms create value for stakeholders (whether that be economic, social, or environmental value, for example), we should examine how an organization engages with stakeholders through its accounting and reporting system.

Yuval Millo is a Professor of Social Studies of Finance and Management Accounting at the University of Leicester’s School of Management. Yuval’s research focuses on organizational and technological aspects of financial markets and on the valuation of social impact. Yuval holds a PhD from the Science Studies Unit at the University of Edinburgh, and his research has been recognised in fostering the development of the new sociology of finance, also known as Social Studies of Finance. Yuval has also established an academic group and a degree programme dedicated to the social studies of accounting and finance. Yuval’s research examines the conditions that make calculations of value possible and how new calculative practices emerge and influence the formation of new markets and institutions. Yuval published recently in the Journal of Management Studies, Management Accounting Research and the British Accounting Review.

Emily Barman is an associate professor of sociology at Boston University. Her research interests include organizational theory, economic sociology, and nonprofit studies. Her current book, Caring Capitalism: The Meaning and Measure of Social Value is forthcoming with Cambridge University Press. Other publications include the award-winning Contesting Communities: The Transformation of Workplace Charity (Stanford University Press, 2006) and articles in American Journal of Sociology, Journal of Management Studies, Nonprofit and Voluntary Sector Quarterly, Social Science History, and Voluntas, among others.

Matthew Hall is Associate Professor in Accounting at the London School of Economics and Political Science. Matthew’s research interests relate to management accounting, performance measurement and the use of accounting information in public policy debates. His current research is focused primarily on the development and use of performance measurement and risk management techniques in non-governmental organisations (NGOs) through in-depth case studies in Australia, the UK and the US. In particular, Matthew is examining the development of techniques designed to measure social value, and how these become implicated in the operations of NGOs, in impact assessment and in discussions of NGO effectiveness more broadly.

References


Appendix

Table 1

<table>
<thead>
<tr>
<th></th>
<th>REDF</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managers</td>
<td>Managers at philanthropic organization in San Francisco Bay Area using principles of venture capital to fund social enterprises providing employment to homeless persons.</td>
<td>Managers in different parts of the UK working with social enterprises advocating new ways of helping disadvantaged persons.</td>
</tr>
<tr>
<td>Challenge of stakeholder management</td>
<td>Difficulties in communicating the value of social enterprises to stakeholders including funders and government departments.</td>
<td>Difficulties in obtaining relevant information to analyze whether and how social enterprises were creating value for stakeholders.</td>
</tr>
<tr>
<td>Managers’ epistemic beliefs about what counts as valid and appropriate data</td>
<td>Data is valid when it is standardized, collected consistently over time and is comparable across organizations.</td>
<td>Data is valid when it reflects and directly incorporates the (potentially) different experiences of stakeholders.</td>
</tr>
<tr>
<td>Organizations’ material conditions</td>
<td>Extensive financial resources. Hire interns and consultants with expertise in data collection and analysis. Managers also have expertise in data collection and analysis. Resources to develop new data collection systems.</td>
<td>Extremely limited financial resources. No interns or consultants. Managers have limited expertise in data collection and analysis. Lack of resources to develop new data collection systems.</td>
</tr>
</tbody>
</table>