

Assessing Implementation of Managerial Accounting Practices: Perspective of Pakistani SMEs

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Abstract

With increasing production cost and growing local and international competition, accountants within Small and Medium Enterprises (SMEs) are largely encumbered with the onus of cost control. Through this paper, we empirically examine use and perceived importance of cost management accounting practices within Pakistani manufacturing SMEs. The cross-sectional study is conducted under descriptive research design. Findings from survey questionnaire of 44 manufacturing SMEs indicate that process costing method is widely used and complexity in production process is main difficulty faced by SMEs in product costing. Descriptive analysis indicates that SMEs mainly use product costing information to make pricing decisions of products, profitability calculation and in decision making for new products. SMEs prefer to employ conventional tools like planning and control, budgeting and strategic planning for decision making purposes. Limited sample size under descriptive analysis restricts applicability and generalizability. Our study makes novel contribution in the domain of cost management practices in SMEs since majority of literature is available on cost management practices adopted by only large corporates within Pakistan.

Keywords: *small & medium enterprises; manufacturing; activity based costing; process costing; Job order costing*

Abstrak

Dengan meningkatnya biaya produksi dan meningkatnya persaingan lokal dan internasional, akuntan dalam Usaha Kecil dan Menengah (UKM) sebagian besar dibebani dengan tanggung jawab pengendalian biaya. Melalui penelitian ini, kami menguji secara empiris penggunaan dan pentingnya praktik akuntansi manajemen biaya dalam UKM manufaktur Pakistan. Studi cross-sectional dilakukan di bawah desain penelitian deskriptif. Temuan dari kuesioner survei dari 44 UKM manufaktur menunjukkan bahwa metode penetapan biaya proses banyak digunakan dan kompleksitas dalam proses produksi adalah kesulitan utama yang dihadapi oleh UKM dalam penetapan biaya produk. Analisis deskriptif menunjukkan bahwa UKM terutama menggunakan informasi penetapan harga produk untuk membuat keputusan penetapan harga produk, perhitungan profitabilitas, dan pengambilan keputusan untuk produk baru. UKM lebih suka menggunakan alat konvensional seperti perencanaan dan kontrol, penganggaran dan perencanaan strategis untuk tujuan pengambilan keputusan. Ukuran sampel yang terbatas dalam analisis deskriptif membatasi penerapan dan kemampuan generalisasi. Studi kami membuat kontribusi baru dalam domain praktik manajemen biaya di UKM karena mayoritas literatur tersedia pada praktik manajemen biaya yang diadopsi oleh hanya perusahaan besar di Pakistan.

Kata kunci: *usaha kecil & menengah; manufaktur; penetapan biaya berbasis aktivitas; biaya proses; biaya pesanan pekerjaan*

INTRODUCTION

Decision makers within manufacturing concerns have prime responsibility of allocating organizational resources to suitable, return yielding avenues. This function however is solely possible when adequate information about costs and profits for individual products are clearly outlined. The field of cost accounting takes into account costs of acquiring and utilizing organizational resources and delves into product costing involving computation of total production costs, whereas management accounting uses this tailored information to present financial as well as non-financial information to managers for strategic decision making. Collectively, cost and management accounting practices enables desired planning and control of business operations by focusing on individual products, departments and activities, with an underlying objective of enhancing shareholder's value (Horngren, 2011).

Stakeholders of a firm are legitimately interested to have detailed information about origin and structure of costs and resultant profitability, which is why management needs to be clear while incurring and disclosing costs. Most prioritized area by management of firms is product cost calculation, followed by product pricing strategies (Shotter, 2006). While decision makers covet full information on costs and its drivers, they do realize that it is challenging for them to have complete access over such information. Lack of knowledge about cost of their products often lead decision makers to make unviable strategic decisions about continuation of their products (Kannaiah, 2015). Traditionally, elements of costs have been tracked by accountants through product based costing methods. Even today, several companies opt for this simplistic approach which allocates direct and indirect costs to different product units. On the contrary, activity based costing (ABC), is a more complex method wherein costs are allocated to various activities instead of products. The underlying rationale behind using activities is that products are made through some activities and hence it is the activities which determine costs and not the product itself (Cokins, 2010).

Conventional cost management systems based on volume have been criticized for their inability to reflect modern competitive business environment and provide timely information (Johnson & Kaplan, 1987). Shortcomings are particularly evident when product-based costing techniques are used by companies manufacturing multiple products of varying intricacy. Inefficiencies have been observed in terms of either over or under-costing the elements of costs to individual products when the production process is complicated (Cooper & Kaplan, 1988). Comparatively, ABC works as an efficient methodology which identifies and assigns costs to distinctive activities within departments and work processes (Kannaiah, 2015). When compared to other systems, activity based system provides timely, accurate and reliable information to decision makers (McGowan, 1998). Cost drivers under activity based costing method are factors that lead to a change in the activity's cost (Cokins, 2010). However, existing literature on CMA focuses more on cost management as an interpretation of cost already incurred within the company (Martirosianiene, 2016). The need is hence, to emphasize more on proactive cost control and management.

With increasing production cost and growing local and international competition, accountants within SMEs (Small and Medium Enterprises) are largely encumbered with

the onus of cost control. For emerging economies like Pakistan, economic environment is quite dynamic and challenging, which poses opportunities on one hand but excessive competition on the other for manufacturing SMEs. To sustain competitive advantage, companies must implement techniques of controlling cost and increasing productivity and efficiency and that is where the management accounting system serves most important role (Johnson & Kaplan, 1987). Though this subject paper, we conduct an empirical investigation on management accounting techniques employed by Pakistani small and medium manufacturing enterprises in order to control their manufacturing costs. Our study makes novel contribution in the domain of cost management practices in SMEs since majority of literature is available on cost management practices adopted by large corporates in Pakistan. However, limited sample size under descriptive analysis restricts applicability and generalizability.

The remaining paper continues as follows: Section 2 provides a brief review of existing literature on cost management within manufacturing companies. This is followed by section 3 which details empirical methodology and data set. Section 4 presents the survey findings while section 5 concludes the discussion.

Horngren, et al., (2012) defines cost management as the effective planning and control of various costs within business, keeping into consideration the totality of adopted measures. Major objective of cost and management accounting systems has been to increase firm's profitability and performance through provision of significant information for planning and controlling stages (Johnson & Kaplan, 1987). Walther & Skousen (2009) states that cost and management accounting assist managers within manufacturing firms in internal decision making process by highlighting types of costs allocated to products throughout the value chain process.

Authors such as Atkinson et al. (2012) and Walther & Skousen (2009) suggest various tools for minimizing costs suggesting greater advantages of activity-based costing over conventional manufacturing costing systems. Additionally, Johnson & Kaplan (1987) reports that product performance and production efficiencies needs to be communicated to top management, which makes management accounting system as a communication link between decision makers and accountant. To enhance company performance within emerging economies, study by Nguyen (2018) places great emphasis on two things, accountant's participation in strategic decision making process and use of management accounting systems within firms. Traditional role of management accountants according to Mishra (2011) was to focus on performance and profitability due to which they were mainly engaged in budgeting and cost control. This has changed and accountants are now involved in strategic decision making which requires them to be well versed with operations, technological systems and management (Cooper & Kaplan, 1988). Although plethora of literature has talked upon the altering role of accountants from an administrative one to a strategic one, empirical confirmation on the shift of role is rather scarce.

A comparative field study on the use of CMA practices within SMEs operating in Canada and Australia by Armitage, Webb & Glynn (2015), revealed that costing systems, operating budgets, variance analysis and financial statement analysis was mostly used by SMEs. Their study also found that nature and size of the SME played a major impact on

the company's decision to use a particular CMA technique. Likewise, another developed market comparative study on CMA practices adopted by manufacturing companies in Japan and Australia, was performed by Wijewardena & De Zoysa (1999). Their study concludes that companies in Japan frequently proposed and adopted contemporary CMA practices, as opposed to Australian firms. Also, Japanese companies place more importance on cost control at the stage of product design, whereas Australian companies give more attention to cost control at the manufacturing stage.

An empirical study on the influence of company characteristics on adoption of management accounting practices was conducted by Abdel-Kader & Luther (2008). Based on their study of 148 UK companies within food and beverage industry, conclusion was that in the presence of greater environmental uncertainty and customer power, there is a greater emphasis on the adoption of management accounting systems.

Uyar (2010) conducted a study on 61 manufacturing companies in Istanbul to investigate perceived importance of CMA practices. Job costing was found to be the widely adopted method in companies and most of the firms preferred traditional cost accounting tools over new ones. In a study performed on 30 medium scaled, manufacturing companies in Indonesia, Sunarni (2013) concluded that companies usually choose budgeting as the basic tool in management accounting. The study also found that adoption and use of contemporary management accounting tools was nonexistent in companies.

Meanwhile, study performed by Mbawuni & Anertey (2014) in Ghana's mobile telecom industry indicates that conventional budgeting systems are used within companies. Product profitability is the main driver behind decision making and companies were found to use the departmental overhead rate under costing systems. The findings concluded that companies are motivated to use CMA practices due to increasing costs and global competition. Aligned with this, El-Shishini (2017) studied 37 hotels in Kingdom of Bahrain to examine the influence of competition on the adoption of CMA practices within hotels and found a strong, positive relationship between the two. The study findings led to the following: benchmarking and absorption costing was the top two techniques followed by hotels whereas Activity-based budgeting was found to be the least followed strategy. It was also distinctly observed that conventional CMA techniques are selected by respondents for costing.

An exploratory research was conducted by Moqbel & Al Rjoub (2015) on management accounting practices within 20 Jordanian manufacturing companies. Results of the study indicate that companies consider traditional budgeting tool as the most important and frequently used tool for management accounting. Amongst budgets, the cash flow, operational and financial budget are mostly used for decision making. Legaspi (2014) researched about the management accounting systems followed in Philippines. Data was collected through survey questionnaires from 51 listed, manufacturing companies, about the areas which accountants perceive as important to their company. The study came to the conclusion that customer satisfaction and profitability were main areas. For manufacturing companies, managers placed greater emphasis on pricing and cost calculations related to products and use budgeting for forecasting.

Evolution of management accounting practices as discussed in an empirical study by

Ittner & Larcker (2001) pinpoints to the fact that emphasis of CMA systems has gradually shifted from initial planning and control to quality management and waste reduction to a more recent strategic focus on creating and enhancing firm value. With this approach, a cohesive framework was developed which the authors have named as 'value-based framework'. A systematic literature review on management accounting for small companies by Pelz (2019) indicates that it is very imperative for founders for young and small businesses to select cost management practices keeping into consideration business activities such as product development, sales and financial management.

Naz *et.al* (2016) worked on another aspect of the same topic and studied the influence of internal organizational culture in adoption of a particular CMA system within Pakistani manufacturing companies. Results of this qualitative study from a sample size of 3 companies, shows that modern management accounting systems such as ABC costing, Activity based management (ABM), balanced scorecard are used in organizations having a supportive and innovative orientation. Because their study was focused on ABC, findings revealed that companies dealing with complex products and more variation in the production process are inclined towards implementing ABC.

METHODS

The subject study is a descriptive research and a mono method quantitative approach is applied to examine collected data. Primary data through survey questionnaires has been collected from 44 respondents in a decision making role - owners, accountants or product managers, within manufacturing SMEs. Hence, a cross sectional methodology for data has been applied and unit of analysis are individuals. Out of 150 questionnaires administered individually and by email to randomly selected SMEs from various industries, completed questionnaires with valid responses were received from 44 SMEs, hence, the response rate is 29 percent. From the selected sample, 39 percent of the respondents are small enterprises, whereas remaining 61 percent fall under medium enterprises.

Questionnaire is divided into two main parts; the first part caters to demographic and general information about firm and respondents both, such as number of years in business, ownership structure, sector, number of employees, position of respondent. The second part contains questions on cost and management accounting practices employed within the SME. Multiple choice based questions are focused initially on knowing the product costing method used in the company, followed by reasons prompting their choice of system. In order to ensure content validity, questionnaires on similar subject from previous studies (Brierley *et al.*, 2001; Van Triest & Elshahat, 2007; Uyar, 2010) have been used and adjustments have been made in questions according to research objectives. In addition, questionnaire was also assessed and refined by three internal faculty members with relevant expertise in the field. Empirical data is analyzed through descriptive statistics with the help of SPSS version 21.

RESULT AND DISCUSSION

Table 1. provides details on companies under various industries following a particular product costing method. Out of 44 firms, 23 SMEs (52 percent) follow the process costing method, followed by 11 firms who follow Job order costing (25 percent). SMEs generally work on small economies of scale with a continuous manufacturing process.

Table 1. Product Cocting Method Used

Industry	Job Order Costing	Process Costing	ABC Costing	Others	Total
Automobile & Parts	0	5	0	0	5
Textile	5	4	2	1	12
Paper & Packaging	3	1	1	0	5
Pharmaceuticals	1	0	3	0	4
Chemicals and plastics	0	3	0	0	3
Food	0	7	1	1	9
Others	2	3	1	0	6
Total	11	23	8	2	44

Source: Developed by authors after survey

Hence, process costing is the dominant costing technique when compared to activity based costing, which is deemed as an expensive option due to heavy investment in terms of time and resources. SMEs mainly in the food, automobile and textile sector widely follow process costing and mainly SMEs in textile industry opt for job order costing. However, ABC costing is used by only 3 firms from the pharmaceutical industry. Likewise, SMEs in chemical and plastic industry also use the process costing method. The results are consistent with study conducted by Ahmad (2014) according to which process costing was most widely used amongst Malaysian SMEs, more specifically in chemicals and food/beverages, since it involves processing. In addition, firm's size is a main factor while deciding on adopting advanced costing techniques (Van Triest & Elshahat, 2007). Small sized companies have limited resources which impede implementation of advanced accounting techniques due to which they are unable to gain maximum benefit out of cost management practices, with respect to performance (Lay & Jusoh, 2017).

General demographic information on SMEs and respondents is presented in Table 2. below. The sector classification data shows that majority of the respondents (27 percent) were from the textile sector, followed by food (21 percent) and others (14 percent), which included wooden products, jewelry and leather, etc. 39 percent of firms fall under small enterprises category since they employ less than fifty individuals whereas remaining 61 percent are medium enterprises. In terms of years in business, 61 percent of the SMEs have been in the business for more than five years whereas only 7 percent of the total respondent firms have been operating for less than 2 years. 30 percent of the respondents were owner and general manager, each, whereas 27 percent of respondents were other individuals looking after costing in production and operations.

Table 2. Profile of SME and Respondent

	Frequency	Percent
Sector Classification		
Automobile & Parts	5	11.4
Textile	12	27.3
Paper & Packaging	5	11.4
Pharmaceuticals	4	9.1
Chemicals and plastics	3	6.8
Food	9	20.5
Others	6	13.6
Total	44	100.0
Respondent Position		
Owner	13	29.5
General Manager	13	29.5
Cost Accountant	6	13.6
Other	12	27.3
Total	44	100.0
Number of employees in firm		
<50	17	38.6
50-100	13	29.5
100-200	9	20.5
200-250	5	11.4
Total	44	100.0
Years in Business		
< 2 years	3	6.8
2-5 years	14	31.8
> 5 years	27	61.4
Total	44	100.0

Source: Developed by authors after survey

In the next part of the questionnaire, respondents were asked to highlight problems faced by their firm in product costing. Out of options provided, 28 SMEs (64 percent) pinpointed complexity in their production process as the main difficulty encountered. 23 percent reported unavailability of required information where as 14 percent reported unavailability of specialized software as the main difficulty. Industry wise statistics from Table 3 reveal further that SMEs in textile industry mainly consider production complexity; SMEs within automobile/parts, textile, chemicals/plastics and food consider lack of adequate information and SME in food business consider lack of appropriate software as the main difficulty in product costing.

Table 3. Difficulties Faced in Product Costing

	Complexity in production	Lack of needed information	Lack of necessary software	Total
Automobile & Parts	3	2	0	5
Textile	8	2	2	12
Paper & Packaging	4	1	0	5
Pharmaceuticals	2	1	1	4
Chemicals and Plastics	1	2	0	3
Food	4	2	3	9
Others	6	0	0	6
Total	28	10	6	44

Source: Developed by authors after survey

Allocation of indirect or overhead costs to costs object requires bases for cost allocation which is fundamental for developing costing methodology (Toompua & Pöläjeva, 2014). Hence, as part of questionnaire, respondents were also asked to provide feedback on allocation source for product costing used in their firms (more than one basis for allocation was allowed). Multiple bases for cost allocation are employed by all the respondents. Results (Table 4) indicate that most commonly used allocation bases are machine hours (41 percent), units produced (32 percent) and prime cost (25 percent), whereas direct labour cost is scarcely used by respondents (11 percent). The results support relative size of SMEs as compared to corporates, where production process is labour intensive and overhead costs are likely to be driven by direct labour hours/costs (Horngren et al., 2012). Industry wise analysis for overhead allocation basis was also carried out and the findings reveal that SMEs in textile and food industry mostly select machine hour and units produced whereas SMEs in paper and packaging, automobile/ parts prefer prime cost as the allocation bases.

Table 4. Overhead/Indirect Cost Allocation Bases Applied

Overhead Based	Frequency	Percent
Direct Labour Hour	9	20.5
Direct Labour Cost	5	11.4
Machine Hours	18	40.9
Units Produced	14	31.8
Direct Material Cost	10	22.7
Prime Cost	11	25

Source: Developed by authors after survey

As part of questionnaire, respondents were asked to identify use of costing information on a scale of 1-5 (1=never used, 5=always used). Findings are reported in Table 5 below and it can be seen that product costing information is applied by Pakistani manufacturing SMEs

primarily to make decisions on pricing of their products ($t=6.20$), followed by profitability from customer sales ($t=1.95$), and decision making for new products ($t=1.73$). Uyar (2019) agrees that sales and profitability analysis are important domain areas of SMEs and should not be neglected. These results are in confirmation with study conducted by Van Triest & Elshahat (2007) on Egyptian private companies. Mean value of two other areas, performance measurement and product mix decisions is also greater than test value of 3.5, whereas adding or removing products from product is not considered as an important area for the application of costing information ($t=-0.36$).

Table 5. One-Sample Statistics for the significance of Product Costing information

	Mean	S.D.	t- value	Rank
Making decisions on Pricing	4.3	0.851	6.198**	1
Customer Profitability	3.84	1.16	1.949*	2
Measuring Performance	3.73	1.107	1.361	4
Activity analysis	3.57	1.108	0.408	6
Making decisions on new products	3.8	1.133	1.730*	3
Product mix decisions	3.61	1.243	0.606	5
Adding/removing products	3.43	1.265	-0.358	7

(**) and (*) indicates significance at 1 percent and 5 percent, respectively.

Source: Developed by authors after survey

The respondents were asked to identify what encourages them to employ cost and management account practices, under four specific areas on a Likert scale (1=strongly disagree, 5=strongly agree). Table 6 provides one sample statistics (test value= 3.5), according to which escalating cost of production ($t=4.54$) and competition from other local and international producers ($t=5.80$) were seen significant in encouraging SME firms to employ CMA. Decrease in profits of firms is also a significant reason ($t=2.03$). The mean value of all four reasons is above the test value of 3.5 which indicates that all four are deemed as important factors by Pakistani SMEs. Findings are supported by study of Uyar (2010) since companies operating in emerging markets experience parallel situations.

Table 6. One-Sample Statistic for Importance of Cost Accounting in Firms

	Mean	S.D.	t-value
Decline in Profitability	3.82	1.04	2.029*
Increase in Production costs	4.16	0.963	4.539**
Global/local competition	4.23	0.831	5.802**
Economic Conditions within country	3.52	1.089	0.138

(**) and (*) indicates significance at 1 percent and 5 percent, respectively.

Source: Developed by authors after survey

Table 7 indicates respondent's view on the importance and adoption of CMA practices for their companies. Out of ten different areas identified, six were found to be statistically significant. Responses were taken on the basis of a Likert scale (1 = not important, 5= very important) and a test value of 3.5 was assigned for one sample test. Mean value for each area denotes that respondents do consider ten factors as important. Findings indicate that other than target costing, quality cost reporting, responsible accounting and transfer pricing, others are statistically significant which asserts the fact the SMEs still choose to employ traditional practices of cost and management accounting. Sophisticated cost management control systems have been found to have

Table 7. One-Sample Statistic for Respondents Choice of Techniques under Cost Management

	Mean	S.D.	t-t- value
Budgeting	4.39	0.92	6.388**
Planning & Control	4.41	0.844	7.144**
Cost volume Profit analysis	3.86	0.93	2.594**
Target Costing	3.57	1.021	0.443
Quality Cost reporting	3.7	1.069	1.269
Measuring Performance	3.91	1.074	2.526**
Responsible accounting	3.55	1.21	0.249
Standard costing	3.86	1.133	2.129*
Strategic Planning	4.11	0.895	4.549**
Transfer Pricing	3.41	0.996	-0.606

(**) and (*) indicates significance at 1 percent and 5 percent, respectively.

Source: Developed by authors after survey

positive impact on cost efficiency and organizational performance which is in line with study of Diefenbach, Wald, & Gleich (2018). Planning and control is perceived to be the most important ($t=7.14$), followed by budgeting ($t=6.39$) and strategic planning ($t=4.55$). On the contrary, transfer pricing is considered as the least important practice ($t=-0.60$) for Pakistani manufacturing SMEs. Results from several studies on emerging markets have highlighted that there is a greater adoption of budgeting, planning and performance evaluation in companies (Ahmad, 2014).

Lastly, Table 8 below depicts comparison of findings between small and medium enterprises and results are similar for both. Process costing appeared as the most widely used product costing technique for both small (59%) and medium (48%) enterprises, followed by job order costing. Both small and medium enterprises identified complexity in production process as main difficulty in product costing followed by absence of required information during process. Results were again similar as both small and medium enterprises gave equal weightage to escalating production costs (76% Small; 81% Medium) and cut throat local and global competition (76% Small; 81% Medium) as their main reasons behind adoption of management accounting practices, followed by declining profit margins as their third most important reason for CMA importance.

Findings support Kannaiah's (2015) study which states that SMEs face risk of survival due to pressure on their margins.

Table 8: Comparison of Results: Small Versus Medium Enterprises

		< than 50 (Small Enterprises)	>50<250 (Medium enterprises)
Product Costing Technique Used	Job Oder Costing	4	7
	Process Costing	10	13
	ABC costing	2	6
	Others	1	1
	Total	17	27
Difficulties encountered	Complexity in production	10	18
	Lack of needed information	5	5
	Lack of necessary software	2	4
	Total	17	27
Significance of CMA in Company (Agree & Strongly agree)	Decline in Profitability	12 (71%)	19 (70%)
	Increasing production cost	13 (76%)	22 (81%)
	Global /Local Competition	13 (76%)	22 (81%)
	Economic conditions	10 (59%)	12 (44%)

Source: Developed by authors after survey

CLONCUSIONS

To combat with challenges of global competition from large corporates and technological developments, it is imperative that SMEs move from simplistic procedures for cost determination to innovative cost and management accounting techniques (Mbawuni & Anertey, 2014). This study identifies cost and management accounting practices adopted by 44 manufacturing SMEs in Pakistan. Majority of firms were medium sized industries, with more than five years in business, with respondents in a decision making role. Results show that 52 percent follow process costing method in their manufacturing process and it is preferred technique as compared to ABC costing which is considered to be an expensive option by Pakistani SMEs.

64 percent of SMEs pinpointed complexity in their production process as the main difficulty faced. Industry wise differences were also reported in terms of intricacies involved in production process. In addition, research findings also indicate that most commonly used allocation bases are machine hours, units produced and prime cost whereas direct labour cost is least used as overhead allocation base. SMEs mainly use product costing information to make pricing decisions of products, for profitability calculation and decision making for new products. Escalating cost of production and competition from other local and international producers prompts SMEs to employ efficient cost management practices in their firms. SMEs still favor traditional practices of cost and management accounting as planning and control, budgeting and strategic planning are perceived as important management accounting practices.

The paper provides a descriptive analysis on current adoption practices of CMA in Pakistani manufacturing SMEs, which so far has not been worked upon. Progression of this study will be to include factors (external/internal) which affect firms' choice of cost accounting practices, with increased sample size and inclusion of corporates too.

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