

SYNERGY: ADAPTABILITY CONCEPT IN MANAGERIAL DECISIONS - ACCOUNTANT'S PERSPECTIVE

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Abstract

Purpose: The objective of this paper is to highlight the conceptual terminology of synergy, its meritorious advantage in managerial decision analysis, the challenges in applying synergy ideology to harness its benefits to the advantage of the organizational profitability, the environmental constraints which limit its adaptability to the detriment of organizational performance.

Method/Approach:

An empirical study based on data procurement and historical review of related literature, was adopted. Structural interview questionnaires were prepared to harness the responses of the individual respondents, categorized in order to achieve a representative generalization of ideas. On-line discussion was applied on few selected individuals. A total of 50 (fifty) questionnaires were administered in this respect.

Findings:

Synergy arises when two actions performed jointly produce a greater result than they would, if performed individually or independently. An example is building a restaurant with a motel. The restaurant will make the motel a more convenient place to lodge and motel in the other hand will contribute business to the restaurant. The total business is larger than it would be, if the two units are located some miles away from each other.

Research Limitations/Implications:

- The financial constraint is the major limiting factor which in turn limits the scope of investigation.

- The use of synergy is a challenge for accomplishing organizational change. Challenge is to use synergy to harness its benefits to the advantage of the enterprise. There are four (4) sources of synergy:
- Operating economics of scale which involves the following aspects – management, production and distribution.
- Financial economies.
- Differential management efficiency.

Originality/Value:

Synergy is an important concept for managers because it will reinforce the need to work together in a cooperative manner. Collective bargaining tends to enhance greater performance efficiency and profitability than it would be, if work performed or idea is exhibited individually.

Keywords: Synergy challenges, motel, restaurant, harness, constraint, organizational change, meritorious advantage.

Introduction:

Synergy as a concept has acquired a momentum in management accounting literature. The theme has opened up a new vistas/innovative steps in the direction which will optimize gains of reaping the harvest of benefits of three “E”s namely – Effectiveness, Economy and Efficiency. The challenges of understanding the underlying concept of synergy must be met with full comprehension, efforts must be made to extend its application to management accounting and corporate governance. Hence, topics embracing significant facets of corporate management will virtually benefit from use of synergy. The application can be usefully extended to macro – level and governments can develop, thoughts to refine and redefine their policy framework and use the concept as a strategy to accomplish its cherished goals of accelerated social – economic development for the wide spread prosperity of masses.

Literature Background: (Synergy, management accounting and management). Before defining the concept of “synergy” and identifying areas of application, it is pertinent to state the concept of management accounting and highlight areas where management accounting can be used by management. Practitioners have been in search of a comprehensive definition

of management accounting. The excellent definitions were given by American Accounting Association of USA, chartered institute of management accountants of UK and National Accounting Association (now known as Institute of Management Association) of New Jersey, USA. Their contributions served the world in a befitting manner. However, a comprehensive definition of management accounting was released by the international Federation of Accountants in February 1987 and excerpts from the “Preface of statements on International Management Accounting: Management Accounting is the process of:

- **Identification** – the recognition and valuation of business transactions and other economic events for appropriate accounting action.
- **Management** – the quantifications, including estimates, of business transactions or other economic events that have occurred or may occur.
- **Accumulation** – the disciplined and consistent approach to recording and classifying appropriate business transactions and other economic events.
- **Analysis** – the determination of the reasons for and the relationship of, the reported activity with other economic events and circumstances.
- **Preparation and Interpretation** – the meaningful coordination of accounting and/or planning data to satisfy a need for information presented in a logical format and if appropriate, to include the conclusion drawn from that data.
- **Communication** – the reporting of pertinent information to management and others fro internal and external use.

Use of Management Accounting by Management: A management accountant is one of the best assets for management. His contribution has been growing with passage of time. In this respect, management accountant has varied experiences. His scope is expanding and management of various sectors are benefiting. Exerts from the “preface to statements on “International Management Accounting” issued by the International Federation of Accountants in February 1987, management accounting is used by management to;

- **Plan** – to gain an understanding to expected business transactions and other economic events and their impact on the organization and to use this understanding as a basis for a course of action to be followed by the organization in the future.
- **Evaluate** – to judge the implications of various part and/or future events.
- **Control** – to ensure the integrity of financial information concerning organizations activities or its resources.
- **Assure Accountability** – to implement the system of reporting that is closely aligned to organizational responsibilities and that contributes to the effective measurement of management performance.

Synergy Concept: The ideological scenario is that the whole is greater than the sum of its parts. This is expressed as “ $2 + 2 = 5$ ”. Its application can be extended to industries in which the most efficient plant size should be determined. If the firm is broken into smaller units performing the same function, this would lead to reduced aggregate output and/or increased costs. Synergy represents dynamics that posses the following characteristics:

- The whole eg. Organization would be greater in capability than the sum of its individual parts.
- Individual parts may consist of people and/or units of organization.

Synergy arises when two actions performed jointly produce a greater result than they would, if performed individually or independently. The total business profitability, its resultant effect will be larger than it would be, if the two units are separately exhibited. This is often called the “ $2 + 2 = 5$ ” effect.

Synergy is applied to marketing for measuring overall effectiveness through the coordinated operation of many elements comprising the marketing mix. The Nigerian banking sector is of the view through privatization which involves participation in capital structure, merger and acquisition that promotes “management by Exception”.

It may be noted that not all synergy is positive. The combined negative attitudes and bickering of dissatisfied group members can add up to greater trouble than any one of the members could have caused individually. Negative synergy in action is at times called a panic or a riot.

Quantitatively when $2 + 2 = 3$, it is known as negative synergy.

A large supermarket store achieved prominence by selling high quality distinctive men and women apparel. The new management attempted to capitalize on the firm's reputation by adding a line of medium – priced garments. The prestige of the store fell rapidly and the reduction in profits on the higher margin line more than offset the gain in medium priced garments. The shift in strategy affected the moral of the long – service employees who had taken great pride in the distinctiveness of the stores products and customers.

Sick companies suffer from negative synergy. There is an urgent need for use of technique of synergy to turn sick units/organizations into healthy ones.

Synergy as Part of Management: Management consists of four (4) major functions:

- Planning
- Organizing
- Leading and
- Controlling.

Beside other aspects, organization change is an important constituent of the second function of management ie organization. Chief sources of change include growth and decay, internal and external environments, new personnel, change agents and domino effect.

Growth can be achieved through merger and acquisition and reorganization and reconstruction. Synergy effects are usually sought in a merger. **Synergy** can, therefore, be defined as the fact that the total effect of two organizations coming together is greater than the sum of the effects taken independently.

To illustrate:

Firm 'X' may be strong in finance and Firm 'Y' may be strong in marketing strategy. Both would gain from the synergy effects of merger. Use of synergy is a challenge for accomplishing organizational change. This must be met.

In this respect, it would be pertinent to quote Machiavellian as: "it must be considered that there is nothing more difficult to carry out, nor more doubtful of success, nor more

dangerous to handle, than to initiate a new order of things”. Challenge is to use synergy to harness its benefits to the advantage of the enterprise.

Synergistic Effect of Organization

The output of an organization may differ in quantity or quality from the sum of the inputs. In “ordinary Arithmetic” $2 + 2$ would be equal to 4 (four). However, in the “Organizational Arithmetic”, two units of input plus two more units input may give 3, 4, 9 or 14 units of outputs. In terms of organizational arithmetic, the position is:

X One: If the output is three (3) units, it means an organization losses one unit. This represents an unsuccessful business.

X Two: If the output is four (4) units, it represents break-even or is at point of equilibrium. Accordingly, there is no profit, nor loss.

X Three: If the output is seven (7) units or fourteen (14) units, it represents successful business operation because the output of the organization is greater than the input. This is an example of accelerated positive synergy.

Sources of Synergy: Essentially, there are 4 (four) sources of synergy:

- **Operating Economies of Scale:** through synergy operating economies of scale can be achieved in the following three areas:
 - Management.
 - Production.
 - Distribution
- **Financial Economies:** Financial economies can be secured through synergy in several ways, some of the significant strategies in this respect are:
 - Higher price – earning (PE) ratio.
 - A lower – cost of debt and/or a greater debt capacity.
- **Differential Management Efficiency:** Management of one firm may be relatively inefficient. Therefore, the firm’s profitability can be improved by merger.
- Increased Market power due to reduced competition.

Operating and financial economies are socially desirable as these will increase managerial efficiency.

Opportunities for Synergy: The possible opportunities for synergy are:

- **Optimum Scale of Operations:** At times, some assets or strength of a company is not fully utilized. If an attractive additional opportunity can be discovered which needs this unused capacity then synergy should arise:

Synergy Exercise/Application: J.B, Bros..... manufacturers of all metal garden and porch furniture, present their operating statement as of Dec. 31st 2011..... the result of six (6) months operations as:

	₱	₱
Sales		525,000
Cost of goods sold:		
Variable costs:	₱	
Materials	25,500	
Labor	70,750	
Supervision	21,000	
Heat, light and power	5,250	
Total variable cost		149,500
Fixed costs:		
Supervision	9,000	
Heat, light & power	3,000	
Depreciation	6,000	
Repairs to building	7,500	
Total fixed cost		25,500

Cost of goods sold		175,000
Gross profit.		350,000
S & D Expenses VC:		
Commission	105,000	
Advertising	5,250	
Total VC		
Fixed cost:		110,250
Officers salaries	30,000	
Advertising	30,000	
Office salaries	72,000	
Misc. expenses	30,000	
Total fixed cost		
Total S & D Expenses		162,000
Net Profit		272,250
		77,750

The company has been operating at 60% capacity during the year, but because of increased demand, it tends to operate at 85% capacity.

Tapping the opportunity of unused capacity synergy may be created based on the following guidelines:

- Between labor and sales.
- Between role of supervisors and sales.
- Between advertising and selling.
- Variable relationship between factors having linear relationships.

These are expected to cause the following changes in the cost structure for the next six months period:

- Labor costs may be 15% of sales.
- Variable supervision cost may be 3% of sales.
- Fixed supervision cost may be increased by N8,250.
- The present fixed and variable costs for advertising are adequate for all volume of production up to 60%. For any volume over 60%, the variable cost will be 5% of such increase.
- All other variable costs will keep the same relationship.

Assuming a constant sales price, based on the above plan, new income statement can be drafted:

New Income Statement	₦	₦
Sales		743,750
Cost of goods sold:		
Variable costs:	₦	
Materials	74,375	
Labor	111,563	
Supervision	22,313	
Heat, light and power	7,436	
Total variable cost	215,687	

Fixed costs:			
Supervision	17,25		
Heat, light & power	3,000		
Depreciation	6,000		
Repairs to building	7,500		
Total fixed cost		33,750	
Cost of goods sold			249,437
Gross profit.			494,313
S & D & Admin/Os:			
VC:			
Commission	148,750		
Advertising	10,938		
Total VC		159,688	
Fixed cost:			
Officers salaries	30,000		
Advertising	35,250		
Office salaries	72,000		
Misc. expenses	30,000		
Total fixed cost		167,250	
Total S & D Expenses			326,938
Net Profit			167,373

Accrued Benefits: The benefits achieved due to application of synergy can be quantified as:

- More goods are provided to customers to the tune of N218,750. Economic activity increased accordingly.
- Procurement is made at a higher level and consequently, it paved way for higher productivity use of plant.
- Plant capacity increased and fixed costs per unit decreased. This resulting in cost reduction.
- Financial incentives motivated the workers and supervisors for more productive work.
- Greater use of utilities and therefore, the existing physical infrastructure is put to greater use.
- Services sector ie commission agents and advertising agencies and the related parties also benefited.
- The expected beneficiaries will include shareholders through possible higher dividend declaration, if the directors make a recommendation in this aspect.
- The government will collect more income tax on increased profit earned by the company.
- Healthy trend for employment generation will set in.

All in all, various sectors benefited from the adoption of synergy as a strategy.

Seasonal or Cyclical Stabilization: Synergy occurs when a company that faces large seasonal or cyclical fluctuations succeeds in finding a use for its resources that otherwise would have been idle during the slack period. The growing resort industry may face seasonal peaks. One strategy to be followed could be to cater for training conference which may be held during off-peak period. Cyclical stabilization is much more difficult to achieve. The reason is that fluctuations are much more irregular and difficult to predict than seasonal fluctuations.

One strategy to be used by industrial unit is to look for alternative sources for supply of services.

Expansion: Through expansion, new uses of productive capability and new technology may look after the geographical expansion and new types of customers. Vertical integration may provide economies in marketing, purchasing and production scheduling.

Conclusion

Synergy is the parental hybrid of successful inter-relationship/interplay between the organization and its environmental factors. The underlying concept basically lies on change, change in positive direction. It is a challenge for accomplishing organizational change. It must be met.

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