



Effective management control systems: A critical review

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Abstract

This paper has demonstrated the need to recognize that every organization is different, and that one model of management control system (MCS) does not suit every company. While the need for goal congruence and goal alignment resonates throughout all types of businesses, profit-seeking and non-profit and government organization (NPGO), the type of data captured and reported, and the ability to influence behavior need to be fine-tuned continuously. The method of feedback and assessment, however, seems to warrant suitability to the employees and the culture they operate in. The findings of the study indicated that all these factors influence the effectiveness of an MCS.

Keywords: management control system, critical review, MCS, non-profit and government organization, NPGO

Introduction

The term control can have various implications in the English language. Control is the course of establishing values, obtaining feedback on the existing performance level, and taking necessary actions to restore the enterprise to its intended condition at any time that the current performance level considerably diverges from its scheduled level (Nielsen and Pontoppidan, 2019) ^[1]. It should be noted that the fundamental objective of control is to ensure the appropriate behavior of the individuals in the institution. These behaviors ought to be following the strategy of the firm. This will, in turn, lead to the achievement of the organization's goals (Silaen, 2009) ^[2].

The planners must follow four different phases namely, plan, do, check, and act to sustain their firms in control. During the 'plan' cycle they build the company's objects, select actions to achieve the intentions, and pick methods to decide on the extent to which targets were reached. Additionally, the policy will be executed during the 'do' stage later. Moreover, the corporation's present degree of performance is observed during the 'check' period, and the actual performance level is compared to the planned level to detect the inconsistencies and take corrective actions. Finally, the managers take the necessary steps to bring the company back to an in-control condition during the 'act' phase. This paper critically scrutinizes the application of an effective Management Control System (MCS) to an institution and concerning the government specifically. While it considers the benefits of MCSs it implies the notion that a particular MCS cannot be successful in all organizations. It provides reasons and encourages the organizations to fine-tune the system to suit their own needs.

Advantages of MCSs

MCS is a valuable tool to achieve organizational objectives (Nguyen, Mia, 2017) ^[3]. Sophisticated MCSs are extensively used to enable businesses to instigate their policies and purposes, and the enterprises are unlikely to meet their targets without effective MCS. A well-organized MCS brings a competitive advantage into the firms and

empowers them to maintain their competitive advantage during the period of high competition. It assists the decision-makers to realize the nature of competition, the strengths, and weaknesses of their institutions in a competitive business setting, and the possible solutions to overcome the current deficiencies. Furthermore, it reduces the uncertainty in strategy development and helps the corporations to handle emerging ideas (Altıntas, Kurtulmusoglu, 2017) ^[4]. Goal congruence, performance evaluation, and autonomy are three useful principles for proposing or assessing a specific MCS with motivation being the mutual strand of the three principles (Hosoda, 2018) ^[5]. An effective MCS highly impacts the motivational level of employees and guides them towards the aims of management and their organization. Also, incentives may be incorporated to stimulate the employees to improve their performance. It should also be noted that managers alone are not able to control the costs of producing a manufactured good. This is indirectly achieved by monitoring the behavior of their staff to minimize the cost of operation. Consequently, effective MCS can also become an active cost reduction tool (Akeem, 2017) ^[6].

The aims and objectives of profit-orientated organizations differ from non-profit and government organizations (NPGOs). For instance, the financial objective of for-profit companies is to augment shareholder value and focus on the financial performance that must be delivered to the stakeholders. However, NPGOs focus on the way that they should handle and assign the funds to maximize their social impact and value. From the customer viewpoint, the goals of profit-focused enterprises are to keep clients, promptly supply products, and present reasonable prices. NPGOs change their perception regarding the customers and recognize who their consumers are different. For example, they determine whether they should count the paying or receiving group as their patron. Financial achievement is not the key purpose of NPGOs. Conversely, social impact, and missions such as decreasing financial distress, school failure percentage, the occurrence or effect of certain sicknesses, or eliminating discrimination are their main priorities. Their purpose is to deliver value to the community they serve and

therefore they are not able to utilize the same MCSs as profit-seeking organizations to achieve their aims (Akeem, 2017) ^[6].

Critical Review

According to (Hosoda, 2018) ^[5] a lack of direction and personal limitations of staff can impact the effectiveness of an MCS. When a lack of direction exists in an organization, individuals do not know what is expected of them. Therefore, the possibility of successful activity occurring is very small, and inappropriate behaviors can be encountered. Knowledge as to what activities or actions are required to achieve the desired outcome is essential. This may be somewhat easily rectified on a production line, however, how do you define the preferred actions in an uncertain environment such as top management? Consequently, controls may need to be modified and utilized differently at various levels in the organizations. In other situations, control can be indirectly achieved via the accumulation of knowledge. One way is by analyzing the outcomes in a particular situation over the period to learn what actions produce the desired ends (Wijethilake, Munir, 2018) ^[7]. Over a period, banks observed which borrowers were expected to pay the requirements of their loan and in doing so they improved a loan approval procedure that was ultimately delegated to lower-level personnel. Alternately, another method of knowledge accumulation is to be informed by others. There is a considerable role achieved by experts who have special knowledge of the preferred acts (Wijethilake, Munir, 2018) ^[7].

The second control issue is personal limitations. Limitations resulting from the lack of intellectual skills, experience, and information about the external environmental responsibilities of the role. This can be overcome by training, formal learning, and working in teams to develop the knowledge base within an organization. It has been demonstrated that no two organizations are the same. Aside from obvious differences in the industry, an organization may operate in, more subtle differences relating to cultural norms between countries in an era of globalization present a compelling case that one MCS does not fit all organizations. Lin (2005) ^[8] review of the China Haier Group highlighted obvious differences in their adoption of an MCS that suited both their organizational needs and goals. Firstly, management adopted a “tough management system with fair rewards and penalty features to help...workers get things done properly” (Lin, 2005, p. 40) ^[8]. This approach was in response to the tendency of Chinese people to ignore rules and not pay enough attention to details. Secondly, guidelines and goals were set by Haier headquarters indicating a top-down approach to target setting. Each division was then required to submit a “divisional action program” on how it would meet all its targets (Lin, 2005, p. 44) ^[8]. Finally, a daily “checkpoint” system via the “3E” card allowed management to instill responsibility in each employee (Lin, 2005, p. 41) ^[8].

Haier management’s approach to changing and controlling the culture of its employees to meet its goals via its three strategies of brand recognition, expansion, and globalization showcases a firm and very dedicated approach. By effecting the change within its culture via a highly diagnostic method, Haier was able to improve the operational effectiveness of its MCS. However, is the focus on the operational effectiveness of an MCS sufficient to compete in today’s

world? Kimura and Mourdoukoutas (2000) ^[9] propose, MCSs “must be expanded to managerial practices that cultivate employee cooperation and creativity” to create and sustain competitive advantages (Kimura and Mourdoukoutas, 2000, p. 43) ^[9]. To do this, a traditional diagnostic management control system containing budgets, targets, and KPIs should be “supplemented by boundary control systems, interactive control systems, and belief systems” (Kimura and Mourdoukoutas, 2000, p. 41) ^[9]. While diagnostic measures can be used to improve operational effectiveness, the other three systems “empower employees to use their judgment and discretion in making decisions...and allow employees to assimilate new information and keep up with...changing market conditions” (Kimura and Mourdoukoutas, 2000, p. 43) ^[9]. The belief system defines the character of the organization and the appropriate behavior that is suitable for attaining targets and goals. Kimura and Mourdoukoutas (2000) ^[9] stipulate that these additional systems are essential to offset the negative impacts on employee creativity that a diagnostic MCS would have.

Building on the concept of creativity, how does an organization measure and control a dream? Moreover, what constitutes an effective MCS about Research and Development (R&D)? A descriptive study on R&D units by Silaen and Williams (2009) ^[10] proposes the use of dimensions (directional, bureaucratic, scientific and financial) and values of representation (external, internal and social) as control tools in R&D (Silaen and Williams, 2009, pp. 267-268) ^[10]. Their study highlights the complexity in adopting an MCS in an R&D organization or business unit given the need to capture meaningful data as to the progress of the R&D (“yardstick” or “direction”) (Silaen and Williams, 2009, p. 269) ^[10]. The sensitivities of maintaining motivation, commitment, and understanding from employees also lend support to the fact that to be effective, an MCS needs to be fine-tuned to the organization’s purpose. The environment of uncertainty within which R&D is conducted suggests that control is implemented informally and with a focus on culture (Silaen and Williams, 2009, p. 271) ^[10]. Nonetheless, there are more simple factors to consider when examining the effectiveness of an MCS. According to Allen and Helms (2001) ^[11], the measurement of organizational performance is a major challenge. Researchers disagree about how performance is to be defined and operationalized. Therefore, it is difficult to apply the system in the same way to different kinds of organizations. Kautz, Eskofier (2017) ^[12] revealed that performance measures describe how the individual task has been achieved. Even though the individual may not be observed, performance measures are used to evaluate and reward individual performance in an organization. This element of an MCS may not suit every organization, but what if it doesn’t even suit every type of employee within an organization?

The research by Petroulas, Brown (2010) ^[13] focusing on the MCS preferences of Baby Boomers, Generation X and Generation Y showed that all three generations had different preferences for “goal setting, performance evaluation, administrative controls and incentives” (Petroulas, Brown, 2010, p. 221) ^[13]. These generational differences have implications for the design of an MCS, particularly in how to “attract, motivate and retain human capital in organizations” as well as an implication on the overall

business performance. A mix of preferences between formal and informal feedback, qualitative and quantitative data capture can have performance implications when designing an MCS. Knowledge of generational preferences can better direct behavior, increase employee satisfaction, and enable “intellectual capital” to be maintained within an organization (Petroulas, Brown, 2010, p. 236) ^[13]. Occasionally, however, the effectiveness of an MCS can be undermined due to the unethical behavior of management. The “creation of budgetary slack and data manipulation” can be a result of the “heavy pressure” that an MCS can place on managers to achieve their objectives (Langevin and Mendoza, 2013, p. 209) ^[14]. An enhancement of MCS “fairness” can help to avoid such behavior through participative target setting, designating responsibility for elements that can be influenced by the manager, quality feedback, and a variety of performance measures (Langevin and Mendoza, 2013, p. 217) ^[14]. Such a situation would most likely be prevalent in profit-seeking organizations given the nature of the creation of the budget and corporate plan. An NPGO can be dependent on government funding or donations or may simply be a cost center and therefore the relationship between receipts (revenue/funding /donations) and payments (expenses) is not real as it is in a commercial sense. Therefore, such unethical behavior is unlikely.

Spano (2009) ^[15] stated that “public sector organizations produce value when they meet the needs of citizens: the higher the level of needs satisfied...the higher the amount of public value created” (Spano, 2009, p. 330) ^[15]. Spano emphasized the importance of goal congruence and the expansion of the MCSs to include institutional and political dimensions i.e., choosing the needs to be satisfied first and how they will be satisfied. Ultimately, “customers and citizens” are placed “at the center of the overall” MCS (Spano, 2009, p. 341) ^[15]. To some extent, this approach can achieve the shift from what the government department plans to do to what it must accomplish, i.e., task versus goal. Without clear goals, the effectiveness of the MCS will be compromised. Another main issue relating to the government sector is the selection and feedback of KPIs and their relevance to achieving the department’s goal. In discharging their accountability to the public via quantitative annual reports, a review of government agencies in the UK showed cases where performance measures included in the annual report were not “easily related to objectives” and “targets...included in the planning documents but were not reported against in annual reports” (Hyndman and Eden, 2002, p. 23) ^[16]. Such findings would indicate a lack of a causal link between goals and KPIs. This ultimately compromises the ability to influence the behavior of employees to achieve the NPGO’s goal(s) given that there must be a link between goals and performance measures in an MCS.

A survey of Italian NPOs demonstrated that MCSs were an essential tool for “leading an organization efficiently towards its general aims” and that “they are significantly different in comparison with MCS commonly used in business firms” (Baraldi, 1998, p. 163) ^[17]. Baraldi (1998) ^[17] stipulated that “soft” variables relating to “perception, acceptance and organizational agreement...are crucial for the effectiveness of MCS” and that the MCS should “integrate a many-sided set of measures” (Baraldi, 1998, p. 163) ^[17]. Incorporating Baraldi (1998) ^[17]’s findings to the

UK example noted previously would improve the relationship between the goals set by the government department and the data captured to monitor the progress towards achieving the goal of the government agency. Using a variety of perspectives to report progress or goal achievement would provide a more holistic and relevant view of the NPGO to its employees and the community it serves. However, is a correlation between goals and measures enough to ensure the effectiveness of an MCS? A review of the modernization of the Greek public sector via the implementation of the performance management and measurement systems (PMMS) by Sotirakou and Zeppou (2006) ^[18] found that it was “prone to cause dysfunctional behavior if it is used as a control tool” (Sotirakou and Zeppou, 2006, p. 1299) ^[18]. Their research deduced that PMMS “must be developed as an internalized continuous process...embedded in the organizational culture and is considered by every member of the organization as a strategic tactic for learning and innovation” (Sotirakou and Zeppou, 2006, p. 1299) ^[18]. This implies highlighting the importance of culture in an organization and how it plays a crucial role in the effectiveness of an MCS.

Culture is not tabled in any formal documentation of an organization, whether it is a profit-seeking or an NPGO is irrelevant. Culture captures the intangible values of the organization and helps to curb unethical behavior. While Gebler (2006) ^[19] noted the seven levels to maintain an ethical organization, the importance of management leadership to promote an ethical culture and to lead by example is fundamental. Performance can be measured and monitored to influence behavior to achieve the organization’s goals, however, if the right culture is not present from the top-down, failure in meeting long-term goals is imminent. Aside from obvious differences stated previously between profit-seeking organizations and NPGOs, another difference worth considering is the concept of discretionary expenditure. Profit-seeking organizations have more of it and traditionally they have rewarded performance with financial incentives under the notion that it can motivate and positively influence employee’s behavior. Yet, there is sufficient skepticism regarding the practice suggesting that it only secures temporary compliance and does not produce any lasting change (Fowler, Van Eenenaam Jr, 2020) ^[20]. Nonetheless, it is still an option available to the profit-seeking organization whereas an NPGO needs to be somewhat more creative in rewarding performance either through promotion or recognition (as examples only).

Conclusion

MCS is a precious instrument to attain organizational objectives. An efficient MCS brings a competitive advantage into the corporations and authorizes them to preserve their competitive advantage throughout the era of intensive rivalry. Moreover, an effectual MCS vastly influences the motivational level of workers and directs them towards the management’s purposes. Additionally, an operative MCS is a successful cost reduction tool. However, the goals of profit-seeking institutions are different from NPGOs, so they are unable to execute the same MCSs as NPGOs. Lack of management and individual restrictions of a workforce can affect the fruitfulness of an MCS. The staff does not know what their duties are whenever there is a lack of direction in the organization. Besides, personal

limitations reduce the efficacy of the workers. Therefore, controls must be altered and employed differently at various levels in the institutions. Apart from evident dissimilarities in the sector a company may operate in, more delicate distinctions about cultural norms among nations in an age of globalization produce a convincing argument that one MCS does not suit all enterprises.

Various generations have dissimilar preferences for goal setting, performance evaluation, and administrative controls and incentives. Moreover, the extent of organizational performance is a key concern in investigating the success of an MCS while its effects can be weakened because of the unethical behavior of management. The notion of discretionary expenditure is another considerable matter too. The significance of goal congruence and the extension of the MCSs to comprise institutional and political dimensions are highlighted by (Spano, 2009) ^[15]. Additionally, the assortment and feedback of KPIs and their importance to accomplishing the department's goal are noteworthy matters. Furthermore, the correlation between objectives and methods are not sufficient to safeguard the effectiveness of an MCS.

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